

INTOSAI PUBLIC DEBT COMMITTEE

MEMBER STATES QUESTIONNAIRE ON CONTINGENT DEBT

SUMMARY OF RESULTS

Introduction

At its 2003 meeting in Mexico City, the INTOSAI Public Debt Committee recognised that there was a need to take forward its previous work on contingent debt to update its understanding of the particular issues and approaches relevant to Member States and to consider developments in different countries since its previous survey in 2000. This commitment recognised the importance of contingent debt as a potentially significant source of public debt.

The questionnaire on contingent debt was prepared in response to this need. The questionnaire was reviewed in draft by the Committee at its 2004 meeting in Moscow and distributed subsequently to Committee Members for completion.

Responses were received from 15 countries – Argentina, Brazil, Bulgaria, Canada, Fiji, Finland, Lithuania, Mexico, Norway, Portugal, Russian Federation, Republic of Korea, Sweden, United Kingdom and the United States. This paper summarises the results of the responses received.

The paper is organised as follows:

- Part A – provides an executive summary of the key themes and issues arising and identifies possible options for future actions to be considered by Committee Members. A numerical summary of responses is also given.
- Part B – following the structure of the questionnaire, this part of the paper provides a more detailed analysis of the responses received for each question asked.

PART A – EXECUTIVE SUMMARY

Key themes and issues arising

The responses to the questionnaire varied considerably – both in terms of the points made and in the level of information provided. However, although the detail varied, analysis of the responses did reveal common themes and issues – these are summarised briefly below:

- **widespread recognition** – there was widespread recognition of the term “contingent debt” with a general view that it referred to potential liabilities that might arise as a result of future uncertain events. However, precise interpretations varied – for example, as a result of prevailing laws or accounting standards.
- **state guarantees** – the responses indicated that governments and SAIs were generally most active in managing and auditing contingent liabilities arising from guarantees issued by the State.
- **Polackova matrix** – respondents approaches to identifying and classifying contingent debt varied. While many countries focussed on specific types of contingent debt that would reside within the matrix, very few actually used the matrix as part of a comprehensive process to identify and classify contingent debt.
- **contingent debt costs** – the responses indicated that most countries attempted to calculate the expected costs of explicit contingent debt to some degree. Only two countries widened the scope to include consideration of implicit contingent debts. At this stage, further work would be required to undertake a meaningful comparison of contingent debt levels between countries – for example, to ensure that the identification, classification and calculation of costs had been done on a consistent basis. However, even without this analysis, some of the amounts reported by countries were very significant – e.g. in excess of total annual government expenditure and annual GDP.
- **contingent debt disclosure and reporting** – while precise details varied, publicly available disclosures relating to contingent debt were made – often through financial accounts - by the vast majority of respondent countries. Similarly, information on contingent debt was frequently provided to the legislature. Disclosures made and information provided generally focussed on explicit rather than implicit contingent debt.
- **budgeting for contingent debt** – just over half of respondents indicated that the expected costs of contingent debt were recognised in the government’s budget. However, this related only to explicit rather than implicit contingent debt costs.

- **control mechanisms and risk management** – nearly all respondents indicated that control mechanisms were in place to limit/manage contingent debt. In almost all cases this included some form of regulatory framework. Around 50% of respondents stated that there was active management of risks associated with contingent debt and that this was conducted centrally by the Ministry of Finance.
- **audit of contingent debt** – all SAI's stated that they had responsibilities for the oversight/audit of contingent debt and that financial audit work was completed either as part of the wider audit of central government financial statements or as specific assignments to examine government guarantees. A large majority also indicated that performance audit work could address issues relating to contingent debt –although in most cases the amount of work conducted in this area was discretionary. Although numerous examples were provided of positive outcomes achieved through SAI involvement, two thirds of respondents felt there was scope to enhance their role.
- **strengths and weaknesses** - the final part of the questionnaire asked countries to identify strengths and weaknesses that applied to their country's handling of contingent debt. Numerous examples were provided. The main strengths revolved around systems and controls in place for the oversight, limitation and disclosure of information on contingent debt. Areas of weakness identified included - (i) a recognition that controls, monitoring and reporting arrangements often applied only to a limited range of contingent debts - for example, explicit contingent debts and in particular, state guarantees (ii) deficiencies existed in the risk management and centralised oversight of contingent debt (iii) there were weaknesses in linkages to budgetary processes and a consequent lack of focus on sustainability.

Numerical summary of responses

With the exception of questions 1, 20, 24 and 25, all the questions asked in the questionnaire could be given “yes/no” answers. The table below provides a high level numerical summary of the 15 responses received.

Numerical summary of responses		
Question Number	Yes	No (or no answer given)
2. Are procedures in place to identify and classify contingent debt?	10	5
3. Does your country use the “Polackova matrix” to identify and classify debt?	2	13
4. Does your country calculate the expected costs of explicit contingent debt?	11	4
5. Does your country calculate the expected costs of implicit contingent debt?	2	13
6. Does total public debt include any form of contingent debt?	2	13
7. Are disclosures relating to contingent debt required in government financial statements and/or other publications (for example, public debt report, fiscal policy statement)?	12	3
8. Are contingent debts reported to the legislature?	14	1
9. Is the reporting of explicit contingent debt (recognised by law or contract) different from implicit contingent debt (expectations based on moral or social perceptions about the role of government)?	12	3
10. Is the expected cost of explicit contingent debt recognised in the government’s budget?	9	6
11. Is the expected cost of implicit contingent debt recognised in the government’s budget?	0	15
12. Are control mechanisms and/or risk management systems in place to limit/manage contingent debt?	14	1

Numerical summary of responses		
Question Number	Yes	No (or no answer given)
13. Is there a regulatory framework in place that governs the actions of individual departments/agencies in relation to contingent debt?	13	2
14. Do individual departments/agencies actively manage the risks associated with contingent debts?	7	8
15. Is there centralised risk management of aggregate contingent debt?	6	9
16. Does the SAI for your country have responsibilities for the oversight and/or audit of contingent debt?	15	0
17. Does your budget law or other legislation give the SAI a mandate to audit future consequences of today's budget or other economic decisions made by the government?	12	3
18. Does the SAI undertake financial audit on contingent debt figures disclosed as part of financial statements/reports?	15	0
19. Does the SAI undertake performance audit on issues related to contingent debt?	12	3
21. Are there significant issues arising out of the SAI's work on contingent debt?	12	3
22. Does the SAI report each year on its work in relation to fiscal exposures and in particular, contingent debt?	9	6
23. Is there scope to enhance the SAI's role in relation to contingent debt?	10	5

Previous survey on contingent debt

The Public Debt Committee's publication "Guidance on the Reporting of Public Debt" - published in May 2000 - contained a summary of the results of a survey of SAIs on the levels, type and role of the SAI in the audit of contingent debt. The key findings of the survey included:

- contingent liabilities were generally understood as potential debts which would arise if pre-defined events occurred;
- contingent liabilities were mainly identified and incurred as government guarantees;
- financial statements were the most common channel of reporting contingent liabilities;
- contingent liabilities were significant sources of potential public debt in terms of GDP or public expenditure;
- SAIs were generally encouraging audit programs on contingent liabilities.

These issues are wholly consistent with the findings of the latest survey.

Looking ahead

Having completed the survey and summarised the results, what should the Public Debt Committee do next in respect of contingent debt? A few possible options are set out below:

- publish the survey results – the results of the survey could be published as they stand. This would be relatively straightforward and would provide information highlighting the key issues around contingent debt and how they are addressed in a range of countries.
- extend the survey – the questionnaire could be extended to other INTOSAI member countries. This would ensure greater representation by different areas of the world and may facilitate geographic comparison of issues and practices. However, Committee Members need to consider whether the potential benefits outweigh the additional work involved. How likely is it that an increased number of responses will reveal significant new issues and practices?
- develop good practice guidance in this area – the survey results could form the basis for the development of good practice guidance on contingent public debt. However, this would be a significant undertaking – for example, areas that the guidance might cover include - (i) the development of a common definition of contingent debt (ii) promoting a common framework to facilitate comprehensive identification and

classification of contingent debt (iii) setting out techniques for the quantification of different types of contingent debt (iv) identification of good practice in the area of disclosure and reporting to Parliament (v) consideration of how contingent debt could be linked with the budgetary process (vi) assessment/development of risk management models (vii) the provision of good practice advice on the audit of contingent debt. Many of these issues are probably significant enough to merit individual projects in their own right.

- contribute to the INTOSAI/IDI course on public debt audit – the issues identified through the survey could help inform course materials on contingent public debt and its audit.

PART B – ANALYSIS OF RESPONSES

Section 1 – what is contingent debt?

Question 1 – how would your country’s government define the term contingent debt?

1.1 The bullet points below identify the themes that emerged from the responses received:

- future events – there was a prevailing view that contingent debt referred to potential liabilities that might arise as a result of future, uncertain events.
- no legal definition – several countries noted that the term “contingent debt” was not defined in law and some – Canada, UK and USA - drew on accounting standards as the basis for their interpretation of the term. Mexico was the only country to indicate that contingent debt was defined by statute – in the Mexican Public Debt General Law.
- widespread usage – there was general recognition and usage of the term contingent debt by many countries. However, others noted that they used different terms to express similar concepts. For example, Sweden used the term “economic commitments” to cover “a rather wide area of explicit liabilities of which the major part constitutes guarantees”. Argentina utilised the concept of “indirect debt” which represented “the debt of any natural or legal person, public or private, other than central government itself, which is backed, secured or guaranteed by central government”.
- state guarantees – the significance of state guarantees as a proportion of contingent debt was apparent, with 10 countries making reference to them when answering question 1.

Section 2 – identification and classification of contingent debt

Question 2 – are procedures in place to identify and classify contingent debt?

2.1 Ten out of 15 respondents indicated that they did have procedures in place to identify and classify contingent debt.

Question 3 – does your country use the “Polackova matrix” to identify and classify debt?

2.2 Fiji indicated that they used the Polackova matrix and the USA provided an example of information published by the GAO showing selected fiscal exposures as at 30 September 2003, arranged in a matrix similar to the Polackova matrix. The matrix used by the USA divided liabilities into – (i) explicit liabilities (ii) explicit financial commitments (iii) explicit financial contingent liabilities (iv) exposures implied by current policies or the public’s expectations about the role of government.

2.3 The methodologies used to identify and classify contingent debt varied amongst respondents. Some examples are provided below:

- a. Norway – contingent debt is identified by the “appropriate Parliamentary decision authorising the guarantee schemes etc and classified according to which ministry is responsible for the different schemes”. Guarantees to third parties comprise guarantees concerning international development banks and development schemes in other countries; guarantees for local government-bank borrowing and loans; guarantees on exports and investments abroad; and guarantees for loans to environmental, transport and other credit purposes. In addition, there are occasionally some state insurance schemes covering specific purposes.
- b. Mexico - the Mexican Public Debt General Law distinguishes between the following contingent debts – (i) potential liabilities related to banking system and highway infrastructure emergency funding in the 90’s (ii) potential liabilities related to the Long-run Schemes for Productive Infrastructure (PIDIREGAS) (iii) public or development banking’ financial liabilities –in accordance with their organic laws (iv) public agencies’ working liabilities, as recognized in their financial statements.
- c. Sweden - contingent liabilities are identified as “Economic Commitments” and decided on or entered into by Parliament or the Government (or agencies on behalf of the Government). These liabilities become explicit as they are regulated and controlled by Parliament and/or the Government.

Implicit contingent liabilities are also identified – for example, as the result of ongoing analysis and monitoring or as the result of an unexpected occurrence. Sweden provided examples of implicit contingencies that had become explicit and had been exercised - (i) the introduction of flight insurance guarantees following 9/11 (ii) a bailout due to a municipal housing failure (iii) the introduction of a guarantee on bank savings accounts following the early 1990s bank crisis.

Sweden also considered “contingent revenues” on the basis that revenues that are at risk will affect the Government budget and debt if payment is not made. Student loans, non-payment of taxes and loans to corporations are identified as contingent revenues

- d. United Kingdom - the UK was developing accounts for the whole of central government – which would lead to the eventual production of “Whole of Government Accounts” encompassing the whole public sector. These accounts would draw together information presented currently in departmental accounts and Supplementary Statements to the Consolidated Fund and National Loans Fund accounts to provide a high level summary of the government’s provisions, contingencies and commitments.

While the final form of the disclosures was yet to be determined, they were likely to cover issues such as: (i) provisions for nuclear decommissioning, clinical negligence, legal fees and early departure costs (ii) contingent liabilities in relation to Network Rail, clinical negligence and government guarantees and indemnities – including details of unquantifiable contingencies (iii) remote contingent liabilities in relation to UK exporters and notes and coins in circulation – including details of unquantifiable contingencies and (iv) commitments relating to off-balance sheet Private Finance Initiative deals.

- Brazil – contingent debts are classified in accordance with the nature of their origin and divided into six groups - (i) controversies on indexation and control of prices practised in plans of stabilization and the solutions pointed with respect to its compensation (ii) law suits against the social welfare system (iii) law suits against the privatization, liquidation or extinguishing of agencies or public companies and acts that affect the staff administration (iv) debts in recognition (v) state guarantees (vi) other debts.

2.4 The table below draws together the references in the responses to different types of exposures. These have been divided into “explicit” and “implicit” contingencies to provide a broad indicator of where they are most likely to reside on the spectrum of different liability types. However, this can only be indicative as circumstance will vary between and within countries on a case by case basis. Also, items shown in the table can overlap or represent specific elements within a particular broad category such as “central government guarantees”. However, for completeness and practicality, all references have been included and no attempt has been made to construct sub-classifications or groupings.

Summary of contingent debt types
Explicit
1. Central government guarantees:
2. Local government guarantees
3. Guarantees to foreign borrowers
4. Guarantees to national borrowers – e.g. credit guarantees to infrastructure or housing projects
5. Guarantees to state owned companies
6. Guarantees as part of special government programmes
7. Guarantees for international development banks/schemes
8. Guarantees on exports and investments abroad
9. Pending litigations, unadjudicated claims against the state
10. Pension commitments
11. Debt held in government accounts
12. State insurance schemes – e.g. in the USA, the Federal Deposit Insurance Corporation
13. Future social welfare/medical care benefit payments
14. Commitments on future guarantees – i.e. explicit or implicit commitments to enter into future guarantees
Implicit
15. Environmental clean-up costs
16. Future maintenance and operating costs of public assets
17. Unfunded portion of incrementally funded capital projects
18. Disaster relief
19. Nuclear decommissioning and waste disposal costs
20. Potential bailout of public and private institutions – for example, state owned enterprises, banks, municipal authorities, electricity/telecommunications companies
21. Costs associated with exchange rate changes

Section 3 – assessing the expected costs of contingent debt

Question 4 – does your country calculate the expected costs of *explicit* contingent debt?

- 3.1 Eleven respondents stated that their country calculated the expected costs of explicit debt. However, the methods used varied depending on individual circumstances, available information and the breadth of items included within individual interpretations of explicit contingent debt. Some countries did not calculate figures for explicit contingent debt, while others calculated specific contingencies but did not draw these amounts together to present a complete picture. Some countries identified a total figure for contingencies and then analysed this further to estimate the actual costs that were likely to be incurred in the year ahead – this was then used to inform the budgetary process.
- 3.2 While the figures provided by respondents are summarised below, differences in approach make impractical - at this stage - any meaningful comparison of explicit contingent debt figures between countries (for example, gross amounts or expressed as a percentage of annual government expenditure or gross domestic product).

Explicit contingent debt – illustrative figures provided by respondents
<p>Lithuania</p> <p>For the year 2003, explicit contingent debt (state guarantees) amounted to (i) 11% of annual government expenditure (ii) 3% of GDP. For 2003, the actual cost incurred by government was 30 million euros, around 1% of government expenditure.</p>
<p>Bulgaria</p> <p>State guaranteed debt = 336 million euro (ii) 2.19% of GDP</p>
<p>Canada</p> <p>As at 31 March 2004, total federal government liabilities totalled \$CAN 701 billion (of which \$621 billion accounted for interest-bearing debt, and \$80 billion for accounts payable and accrued liabilities). As a percentage of GDP total explicit contingent debt 57.6 %. Of the \$80 billion account payable and accrued liabilities, explicit contingent liability (e.g. litigation, environmental clean-up, and guarantees by the government...) totalled approximately \$20 billion (approximately 11 per cent of government expenditures – note however that these would be expensed only in the year when they are recorded). One could add \$35.8 billion for public debt</p>

Explicit contingent debt – illustrative figures provided by respondents
charges associated to the interest-bearing debt mentioned above, increasing the ratio to 31.5 percent of total government expenditures.
<p>Republic of Korea</p> <p>Explicit contingent debt was 38 trillion won as at end 2003, equivalent to 11.2% of GDP.</p>
<p>USA</p> <p>As at 30 September 2003, explicit contingent liabilities were: unadjudicated claims (\$9 billion); Pension Benefit Guaranty Corporation (\$86 billion); Federal Deposit Insurance Corporation (\$6billion)</p>
<p>Argentina</p> <p>Stock of debt guaranteed by the state to local government authorities = US\$ 14,489.4 million. This figure equated to 70.68% of accrued government expenditure. It was 11.25% at current prices of GDP in 2003.</p>
<p>Norway</p> <p>(i) the total central government guarantee liability at the end of 2003 was approximately 41 bn NOK, which represented a reduction from ca 52.5 bn NOK at the end of 2002. The total central government loss on guarantees was ca 154 mill NOK in 2003.</p> <p>(ii) the guarantee commission for each guarantee scheme is presented in the annual budget proposition to Parliament. Any specific indicators used are presented in the budget proposition and also reported on in the Central Government Financial Statements.</p> <p>(iii) total central government guarantee liabilities was ca 6.9% of total central government expenditure in 2003 (ca 7.1% of expenditure excl. petroleum activities), and ca 2.6% of GDP (ca 3.3% of GDP Mainland Norway).</p>
<p>Brazil</p> <p>Explicit contingent debt = R\$ 142.1 billion = \$49 billion. This was equivalent to 17.96% of annual government expenditure and 9.38% of GDP.</p>
<p>Sweden</p> <p>(i) for state guarantees, commitments on future guarantees, provisions covering expected loss in guarantees and other provisions the total amount was SEK781 billion. The expected cost arising from these contingencies was approximately</p>

Explicit contingent debt – illustrative figures provided by respondents

SEK 13 billion

(ii) for contingent revenues - revenues that will probably not be paid - the expected cost was SEK 72 billion

(iii) a variety of quantitative and qualitative indicators are reported by agencies to Government in annual reports and by the Government to Parliament

(iv) total government expenditure amounts to SEK 708 billion. Consolidated costs (on accrual basis) amount to SEK 867 billion - municipal (non-government) activities are not included in this amount (public transportation, compulsory education, health care, day care, old age care and certain social welfare benefits)

(v) for 2003, contingent debt + contingent revenues = 120% of total government expenditure and 98% of consolidated costs

(vi) in 2003 GDP was SEK 2,439 billion. Contingencies of SEK 781+72=853 billion equated to 35% of GDP.

3.3 Some examples of the approaches adopted by respondents are provided below.

- Lithuania – the potential costs associated with government guarantees are calculated. An assessment is made each year of those guarantees most likely to be called upon and these amounts are budgeted for.
- Russian Federation – for the purposes of assessing the explicit contingent debt costs of the Russian Federation there was a calculation of costs associated with exchange rate changes and government guarantee costs. Methods of forecasting were used to assess the impact of exchange rate changes on the debt costs. Relevant information was contained in explanatory notes to the draft budget and attachments to the draft federal budget for the following budget year.
- Republic of Korea – investment ratings agencies were used to assess the likelihood of the government needing to make payments against explicit contingent debts.
- Norway – Parliament had decided that state guarantee schemes should normally be self financing through the paying of guarantee commission or fees. It was then necessary to calculate the expected costs of each guarantee scheme, but the methods and time horizons used varied between schemes.
- Portugal – calculated the full value of all the guarantees given by the state, but not the amount of payments expected.
- United States – identified three areas of explicit contingent debt and how they were treated – (i) Pension Benefit Guaranty Corporation – used fair value for financial assets and present value estimates for liabilities applying actuarial

estimates of the lifetime of participants (ii) Federal Deposit Insurance Corporation - used historical and institution specific loss data (iii) Unadjudicated claims – amounts were identified in accordance with Statement of Federal Financial Accounting Standards Number 5 “Accounting for Liabilities of the Federal Government”. This states that a contingent liability should be recognised when a past event or exchange transaction has occurred and a future outflow or other sacrifice of resources is probable and measurable.

Question 5 – does your country calculate the expected costs of *implicit* contingent debt?

3.4 Only Brazil and the USA indicated that they calculated the expected costs of implicit contingent debt. The USA provided examples of implicit debts, how they were treated and the amounts involved. For example, actuarial estimates for different scenarios and time horizons are used to calculate the implicit liabilities related to Social Security and Medicare payments. For the financial year 2003, Social Security benefit payments had implicit contingent liabilities of \$3,699 billion, equivalent to 148.8% of the cost of government operations and 33.7% of GDP. Implicit contingent liabilities associated with Medicare (Parts A & B) benefit payments were even larger, with a combined total of \$19,652 billion, equivalent to 790.3% of the cost of government operations and 179% of GDP.

Question 6 – does total public debt include any form of contingent debt?

3.5 Canada and Argentina noted that total public debt did include an element of contingent debt. Canada commented – “The public debt includes the explicit portion of the contingent debt as defined by Polakova. If one excludes interest bearing debt, contingent liabilities represent approximately less than 3% of the total gross public debt”. Argentina stated – “the stock of the public debt of the Central Government of Argentina includes all contractual liabilities and therefore, all explicit indirect or contingent debt.”

3.6 Lithuania’s response said that “until 2004, State guarantees were included in total public debt. From 2004, State guarantees were not included in total public debt”.

Section 4 – reporting of contingent debt

Question 7 – are disclosures relating to contingent debt required in government financial statements and/or other publications?

4.1 Of the SAI's surveyed, only Argentina, Fiji and Finland stated that no disclosures were required in respect of contingent debt in government financial statements or other publications.

4.2 In respect of those countries who were required to make such disclosures, the requirements varied somewhat as the examples below illustrate:

- Norway - in the Parliament's Appropriations Regulations, Central Government Financial Statements are required to include a statement of state guarantees. Central Government Financial Management Regulations required agencies administering guarantee schemes to report guarantee liabilities, loss payments, etc. to the responsible Ministry. This reporting was summarized in the Central Government Financial Statements. Ministries were required to report in their budget propositions on guarantee scheme results.
- Sweden - the Government was required to present an annual report to Parliament. This contained a section concerning guarantees. Also, consolidated financial accounts were included. Other information on guarantees and on latent implicit contingencies – e.g. on pensions - was presented in the budgetary process.
- Republic of Korea – a Government Agency made a financial statement on national debt which provided key information on national debt and guarantees. The statement was released to the press.
- United Kingdom - central government bodies were required to disclose details of their contingent debts in their annual financial statements which were audited by the NAO. Details relating to contingent debt were also disclosed in Supplementary Statements to the Consolidated Fund and National Loans Fund, although the particular statements concerned were not audited. From 2003-4, details of contingent debt would be included in Central Government Accounts and these disclosures would be audited by the NAO.
- United States - reporting of contingent liabilities was provided in the following: (i) at the consolidated level - in the 2003 Financial Report of the United States Government (www.fms.treas.gov) (ii) at agency and program level, disclosures were provided in the financial reports of federal agencies.

Question 8 – are contingent debts reported to the legislature?

4.3 With the exception of Finland, all respondents indicated that information on contingent debts was reported to the legislature.

Question 9 – is the reporting of explicit contingent debt (recognised by law or contract) different from implicit contingent debt (expectations based on moral or social perceptions about government)?

4.4 Eleven respondents indicated that different arrangements did exist – the key theme was that reporting arrangements for implicit contingent debt were generally not in place. However, the United States noted that reports relating to implicit liabilities were prepared. These reports were complex and very long – running to hundreds of pages – because of the need to explain the assumptions and calculations used to derive figures.

Section 5 – budgeting for contingent debt

Question 10 – is the expected cost of *explicit* contingent debt recognised in the government's budget?

5.1 Eight respondents indicated that the expected cost of explicit contingent debt was recognised in the government's budget. Of these, most indicated that such costs were met out of general, specific and/or contingency reserves.

Question 11 – is the expected cost of *implicit* contingent debt recognised in the government's budget?

5.2 All respondents indicated that implicit contingent debt costs were not recognised in the government's budget.

Section 6 – control mechanisms and risk management

Question 12 – are control mechanisms and/or risk management systems in place to limit/manage contingent debt?

6.1 With the exception of Argentina, all SAI's stated that there were control mechanisms in place to manage contingent debt.

Question 13 – is there a regulatory framework in place that governs the actions of individual departments/agencies in relation to contingent debt?

6.2 Canada and Brazil were the only respondents to answer “No” to this question – although Canada’s response went on to say that “even though no legislative regulatory framework is in place, risk management practices are in place in each department and agencies/Crown Corporations in regard to the management of explicit contingent debt. Rules and regulations for writing-off debt would also be applied. The Department of Finance and the Treasury Board Secretariat would closely monitor the recording of contingent debt in the government consolidated financial statements.” In substance, Canada’s position did not seem dissimilar to some other respondents who had answered “Yes” to this question. For example, the United Kingdom stated that “Government bodies are required to follow procedures set out in HM Treasury’s publication “Government Accounting”. This provides a detailed analysis of how different types of provision and contingent liability should be disclosed in financial statements and reported to Parliament.”

6.3 Other respondents made reference to a legal framework – (i) Bulgaria referred to “the law on State debt” (ii) Portugal stated “there is a legal framework which requires certain formalities to be met” (iii) Mexico made reference to the “Mexican Public Debt General Law”.

6.4 Argentina’s response noted that - There is a general regulation applicable to the contracting of public debt which lays down that all guarantees must be approved by the competent governing body: the National Office of Public Debt.

Question 14 – do individual departments/agencies actively manage the risks associated with contingent debts?

6.5 Seven respondents indicated that the risks associated with contingent debts were actively managed. Illustrative responses are provided below:

- Canada - responsible for the management of Canada's sovereign debt, the Department of Finance would use sophisticated risk management techniques and apply the Treasury Management Governance Framework for managing the federal government's financial assets and liabilities. Similar risk management regimes would be in place for other government entities managing liabilities and assets (such as Crown corporations/agencies).
- United States – in the context of the Federal Deposit Insurance Corporation, a risk based assessment system was used that charged higher rates to those financial institutions that posed greater risks to the deposit insurance fund. Institutions were placed in one of nine risk categories based on capital ratios and supervisory examination data.
- Sweden – the risk management technique used assessed and monitored the risk/expected cost associated with each contingency type. There was no transfer of risk to private risk/insurance markets. There were no risk sharing provisions. Contingency reserves existed for guarantees and provisions.
- Norway – the main risk management techniques were self financing through the payment of guarantee commission (risk sharing provisions) and the use of contingency reserve funds.
- Republic of Korea – the Public Oversight Committee and the Korea Asset Management Corporation tried to repay as many bonds as possible related to contingent debts so that they would not evolve into national debts.

Question 15 – is there centralised risk management of aggregate contingent debt?

6.6 There were 6 respondents who indicated that there was centralised risk management of aggregate contingent debt. In all cases, this role was undertaken the Ministry of Finance.

Section 7 – the audit of contingent debt

Question 16 – does the SAI for your country have responsibilities for the oversight and/or audit of contingent debt?

7.1 All SAI's stated they had responsibilities for the oversight and/or audit of contingent debt.

Question 17 – does your budget law or other legislation give the SAI a mandate to audit future consequences of today's budget or other economic decisions made by the government?

7.2 Twelve respondents noted that they did have a mandate to audit the future consequences of today's budget or other economic decisions made by the government. Precise responsibilities varied but included scrutiny of government budgets and audit of central government financial statements:

- Lithuania – the SAI must every year issue an opinion on the next year's draft budget. The SAI has the right to select the audit topics related to future consequences of today's budget or other economic decisions made by the government if the SAI regards it as useful.
- Russian Federation – according to the law, the Chamber of Accounts exercises control over the management and servicing of domestic and foreign public debt of the Russian Federation.
- Portugal – the SAI has the possibility, but not the obligation, to audit the future impacts of a given budget or policy decision by Government. However, in most cases the Government is only required to give the present, not the future, financial impact of its policy decisions, and so there is insufficient data for the SAI to audit.
- Mexico – the SAI of Mexico has to evaluate the potential budgetary impact caused by the contingent liabilities.
- Sweden – according to legislation, the SAI has a mandate to undertake value for money audit of the budgetary process which also may include the audit of contingencies.

Question 18 – does the SAI undertake financial audit on contingent debt figures disclosed as part of financial statements/reports?

7.3 All respondents indicated that the SAI audited contingent debt figures disclosed as part of financial statements/reports. For some this work was completed as part of their wider audit of central government financial statements, while others undertook specific assignments to examine government guarantees.

Question 19 – does the SAI undertake performance audit on issues related to contingent debt?

7.4 Eleven respondents stated that they did undertake performance audit on issues related to contingent debt. Most SAIs indicated that they had the powers to undertake performance audit in this area if it was deemed necessary/desirable.

Question 20 – if you have answered “yes” to either question 18 or 19, please provide examples of work that the SAI has completed in this area and their outcome.

7.5 Examples provided in response to this question included the following:

- Lithuania – the SAI had audited contingent liabilities. The main aim was to show that there are many types of contingent liabilities and fiscal exposures which could result in outflows of State funds. These will be registered and a full report prepared. The SAI would also look at the system for issuing and executing guaranties and the recovery from debtors of guaranties paid.
- Republic of Korea – the Board of Audit and Inspection audits public fund management and reports the results to the National Assembly. The Board makes recommendations to government agencies to take steps to enhance the efficiency of the public fund management system.
- Norway - in 1995 the SAI carried out a comprehensive performance audit on the main aspects of central government guarantee schemes. This was reported to Parliament and was an important premise for the provisions on guarantee schemes in the Financial Management Regulations from 1996 onwards.
- Russian Federation - Based on the results of the audit conducted by the Chamber of Accounts of the Russian Federation in 1999-2000 on the status of the former USSR foreign debt settlement, the amount of the said debt was reduced from \$6.5 billion to \$3 billion.
- Sweden - in March 2004 the Riksrevisionen issued a VFM report on the Management of Guarantees (contingent and explicit debt). The purpose of the

audit was to assess whether Parliamentary and Government regulations were complied with, whether requirements necessary to manage guarantees efficiently were in place and whether Parliament and the Government had a comprehensive view of the risks involved.

Question 21 – are there significant issues arising out of the SAI’s work on contingent debt?

7.6 Twelve respondents indicated that significant issues had been identified during the course of their work on contingent debt. Examples of the issues arising are given below:

- Portugal – in recent years the most relevant issues deal with interest rates on loans for which state guarantees have been given. Some recommendations have also been made to Government concerning the follow-up of loans and the recovery of debts from borrowers.
- Bulgaria – (i) transparency of the government's position (ii) improved management of projects financed with state-guaranteed funds (iii) overall risk containment following the audit of individual loans (iv) risk assessments of borrower insolvency and calling the state guarantee.
- Russian Federation - the scope for legislation relating to the granting of government guarantees and their subsequent settlement.
- Republic of Korea - the significant issue for the Board of Audit and Inspection is about judging whether bonds related to contingent debts, mostly public fund debts, are repaid appropriately.
- Norway – (i) operational follow-up of the principle of self-financing guarantees (ii) operational bail provisions on guarantees; and the operational provisions for shared risk on a pro-rata basis between the state and other lenders and guarantors.
- United States – (i) recommended that the US Office of Management and Budget (OMB) reported annually on fiscal exposures and provided a concise list, and cost estimates where possible, of explicit and implicit fiscal risks and commitments (ii) recommended the reinstatement of realistic spending caps and PAYGO rules in order to deal with the near- and medium-term budget deficit, and a fundamental re-examination of existing government programs and activities (iii) where an explicit liability existed with accepted cost-estimation methodologies, GAO suggested that the ultimate objective might be to include the costs directly in the budget when doing so would enhance obligation-based control (iv) recommended that the OMB to take action to ensure that agencies focus on improving cost estimates for fiscal exposures (v) invited Congress to explore options for

improving the information available and the attention given to fiscal exposures in the budget and budget process.

- Argentina - observations reflected instances of failure to comply with legislation - for example, when guarantees were furnished in the absence of any law to support such action, when there was a lack of transparency in accounting or when the parties for whom guarantees had been provided did not receive payment.

Question 22 – does the SAI report each year on its work in relation to fiscal exposures and in particular, contingent debt?

7.7 Nine respondents noted that the results of their work in this area were reported to Parliament – often through an annual reporting process on the work of the SAI. Canada made the following distinction in its response:

- the Office of the Auditor General reports annually on the explicit portion of the Polackova contingent debt in its financial statement opinion of the Public Accounts (but this is done only from an accounting perspective). However, the OAG does not look at the fiscal implication of the contingent debt. For example, the OAG would not report on the sustainability of social program or the long-term fiscal vulnerability of the government.

Question 23 – is there scope to enhance the SAI's role in relation to contingent debt?

7.8 Ten respondents felt that there was scope to increase their role in relation to contingent debt. Some examples of the areas highlighted are given below:

- Lithuania – the SAI is trying to (i) encourage sound reporting practices for fiscal exposures (including contingent debt) (ii) encourage assessment of the expected costs and risks associated with fiscal exposures (including contingent debt) (iii) demonstrate to MPs that there are many types of contingent liabilities and fiscal exposures which can result in significant outflow of State funds (iv) to support the recovery of guaranties paid from debtors (v) to improve the system of issuing and executing guaranties – to protect the interests of the State.
- Russian Federation - increasing the transparency of Government debt policy, stimulating efforts to forecast the emergence and assessment of size of the contingent debt size and to develop mechanisms for its reduction.
- Portugal - the SAI of Portugal expected to expand its verifications, by way of its report on the State Annual Account, to areas of implicit contingent liabilities that had not been dealt with.

- Mexico - to encourage the best governmental practices in relation to the recording, control and assessment of the risks caused by the contingent liabilities.
- Sweden - the first priority would be to encourage sound reporting practices for fiscal exposures. The second priority would be to encourage the use of frameworks to help improve understanding of the scope and nature of the country's exposures.
- Brazil & Fiji – both Brazil and Fiji stated that their priority would be to assess the expected costs and risks associated with specific fiscal exposures.
- Argentina – (i) to quantify the resources that will be required by the pensions system over the next 30 years and the number of people who may not be covered by the system (persons with no formal pension arrangements) and the cost which would be borne by the State if it were to make provision for them (ii) following the conversion of local government debt into national public debt (with central government in a double role as direct issuer with the guarantee of the provinces (local governments) and as indirect debtor) we are currently auditing this conversion operation and evaluating the impact of the possible failure to honour commitments on the part of the local governments, alongside various other default or compliance scenarios.

Section 8 – key strengths and weaknesses

Question 24 – please identify the three most significant strengths and weaknesses that apply to your country’s handling of contingent debt.

8.1 The various responses provided are summarised in the table below.

Respondent	Strengths	Weaknesses
Lithuania	<ul style="list-style-type: none"> (i) system of identification and reporting of State guaranties (ii) regulation of the issuance of State guaranties – these forbid individual departments/ agencies entering into potential liabilities (guaranties) (iii) reductions in the issuance of State guaranties. No new guarantees have been issued in the last two years 	<ul style="list-style-type: none"> (i) incomplete identification and reporting of all fiscal exposures (including contingent debt). (ii) unsatisfactory system of recovery of paid guaranties from debtors. (iii) lack of interest from MPs, Government and the Ministry of Finance in fiscal exposure (including contingent debt)
Bulgaria	<ul style="list-style-type: none"> (i) adequate legal framework in place (ii) sufficient powers to audit and raise public awareness (iii) the size of the contingent debt is kept within reasonable limits set by the annual budget law. 	<ul style="list-style-type: none"> (i) only state guaranteed loans are legally regulated and monitored (ii) the regulation, monitoring and management of municipal guarantees is in a process of development - implicit contingent debts are not monitored (iii) there is scope to improve the links between contingent debt and the budgeting process
Russian Federation	<ul style="list-style-type: none"> (i) the existence of the specialised subcommittee on public debt under the Committee on Finances in the State Duma of the Russian Federation (ii) the existence of specialized public debt units in the central Government, Ministry of Finance and Central Bank. (iii) the existence in the Chamber of Accounts of the 	<ul style="list-style-type: none"> (i) no legally determined term “contingent debt”. (ii) no centralized management of contingent debt (iii) legislative control over contingent debt does not cover all types.

Respondent	Strengths	Weaknesses
	<p>special division on public debt and the Central Bank. Headed by the auditor – member of the Board of the Accounts Chamber of the Russian Federation.</p>	
Canada	<p>(i) the federal government applies accounting standards to account for explicit contingent debt.</p>	<p>(i) looking beyond accounting issues, it could be argued that the federal contingent debt is only estimated partially and not reported to Parliament fully. Also, an absence of centralised management can make it difficult to monitor, assess, manage and report on total contingent debt.</p> <p>(ii) policy makers and parliamentarians would be more informed through better reporting on the fiscal consequences, long term budgetary position and sustainability of programs. This could be done as part of the annual federal budget or by Canada’s statistical agency.</p> <p>(iii) given numerous levels of government - each managing their own liabilities - assessing and reporting total contingent debt could be very difficult. However, this could be regarded as a challenge rather than a weakness.</p>
Republic of Korea	<p>(i) strict control on repayment bonds related to contingent debt to minimize the national burden.</p> <p>(ii) high professional capability in the management of contingent debt by organizing a special team.</p> <p>(iii) strict control to reduce the occurrence of the contingent debt.</p>	<p>(i) poor management in relation to implicit contingent debt.</p>

Respondent	Strengths	Weaknesses
Norway	<p>(i) there are strict requirements on guarantee limits and on necessary specifications in Parliament's guarantee decisions.</p> <p>(ii) there is a comprehensive regulatory framework for guarantee schemes, which are followed up in the Ministries and agencies concerned.</p> <p>(iii) the principle of self-financing guarantees has an effect on the discipline of the parties concerned, as the costs and consequences come forward.</p>	<p>(i) lack of central risk management could be a weakness if the scope of guarantee schemes becomes considerably larger.</p> <p>(ii) the fact that there is no regulatory framework covering the handling of other types of contingent debt than state guarantees could be a weakness.</p>
Portugal	<p>(i) comprehensive legal framework for some forms of contingent debt and annual budgetary limits to undertaking new liabilities in these forms of debt.</p> <p>(ii) the Ministry of Finance manages all state guarantees.</p> <p>(iii) annual checks carried out by the SAI.</p>	<p>(i) very little attention being given to all other aspects of contingent debt.</p>
Mexico	<p>(i) greater and better information on contingent liabilities. This information highlights the contingent liabilities availability and periodicity.</p> <p>(ii) the civil society and the government are now conscious about the magnitude of the problems that stem from contingent liabilities, especially the labour problems.</p> <p>(iii) since 2002, the Superior Audit Institution of Mexico has audited contingent liabilities.</p>	<p>(i) obsolete legal framework.</p> <p>(ii) there is no specialized unit which, either centralized or individually, looks after the recording, control and assessment of the risks caused by the contingent liabilities</p> <p>(iii) the total federal and provincial governments' working liabilities have not yet been quantified or identified.</p>

Respondent	Strengths	Weaknesses
Sweden	<p>(i) explicit contingent debt and economic commitments are recognized and taken into account in the budgetary process. There is an awareness of the existence and the risk of the commitments for explicit as well as implicit contingencies.</p> <p>(ii) risk assessments within major areas are made on an ongoing basis for explicit as well as implicit contingencies.</p> <p>(iii) measures are being taken, or discussed, in major areas when risks increase e.g. pensions and benefits.</p>	<p>In relation to the management of Guarantees:</p> <p>(i) there are no unified risk assessment procedures, so the Government lacks a comprehensive view of the risks involved.</p> <p>(ii) there are no guidelines for assessing when a guarantee is an effective means for achieving a political goal.</p> <p>(iii) coordination within the Government concerning guarantees could be improved.</p>
Brazil	<p>(i) Budgetary Lines of Direction Law – Fiscal Risks Annex.</p> <p>(ii) information is available in electronic media.</p>	<p>(i) there is no methodology to identify and classify contingent debt.</p> <p>(ii) the information available in electronic media is not organized/systematic.</p>
Fiji	<p>(i) the valuation of guarantees</p> <p>(ii) annual reconciliation between government and entities on guarantees outstanding.</p>	<p>(i) guarantees called upon and paid by government not recovered from the entities concerned.</p> <p>(ii) poor monitoring of guarantees given by government and the Ministry of Finance.</p>
United Kingdom	<p>(i) publication of contingent debt information relating to individual bodies in annual accounts audited by the NAO + aggregation of contingent debt information into Central/Whole of Government Accounts, which will also be audited annually by the NAO.</p> <p>(ii) the accounts referred to in “(i)” above are provided to Parliament each year.</p>	<p>(i) we are not aware of any centralised risk management system currently in place for the management of contingent debt – at face value this appears to be a weakness, although we would need to consult HM Treasury on current arrangements and thinking before reaching any conclusions on this.</p>

Respondent	Strengths	Weaknesses
	<p>(iii) clear criteria exist for the identification and disclosure of contingent liabilities in financial statements and government bodies have to follow published procedures to notify Parliament of new contingent liabilities prior to them being taken on.</p>	
Argentina	<p>(i) statistical and accounting records of contractual indirect debt are kept (ii) provision is made in the budget for the contracting of indirect debt (iii) legal/budgetary procedures are in place for furnishing guarantees.</p>	<p>(i) there is no risk evaluation (estimation of the probability that an event will occur and its financial cost) in relation to indirect contractual debt (ii) there is no risk evaluation in relation to implicit debt arising from the pensions system.</p>

Section 9 – evolution and future of contingent debt

Question 25 – for each key area of interest identified in this questionnaire, what are the key factors or events that have led to contingent debt being handled the way it is now? Are there plans or projects underway to change the way your country handles contingent debt in the future?

9.1 Approaches to the identification, management and control of contingent debt have developed over time in response to economic crisis and/or actual or potential problems being identified. While most respondents did not indicate that significant developments in this area were ongoing or planned, a few relevant comments were made:

- Lithuania – because of the “bad portfolio” of State guarantees, the Government has not issued new guarantees over the past two years and is determined to continue with this approach.
- Bulgaria – risk management and strategic management are the main streams of development at present.
- United Kingdom – the development of “Whole of Government Accounts” should provide a single reference point that draws together in a helpful and meaningful way the provisions, contingent liabilities and commitments across the public sector.