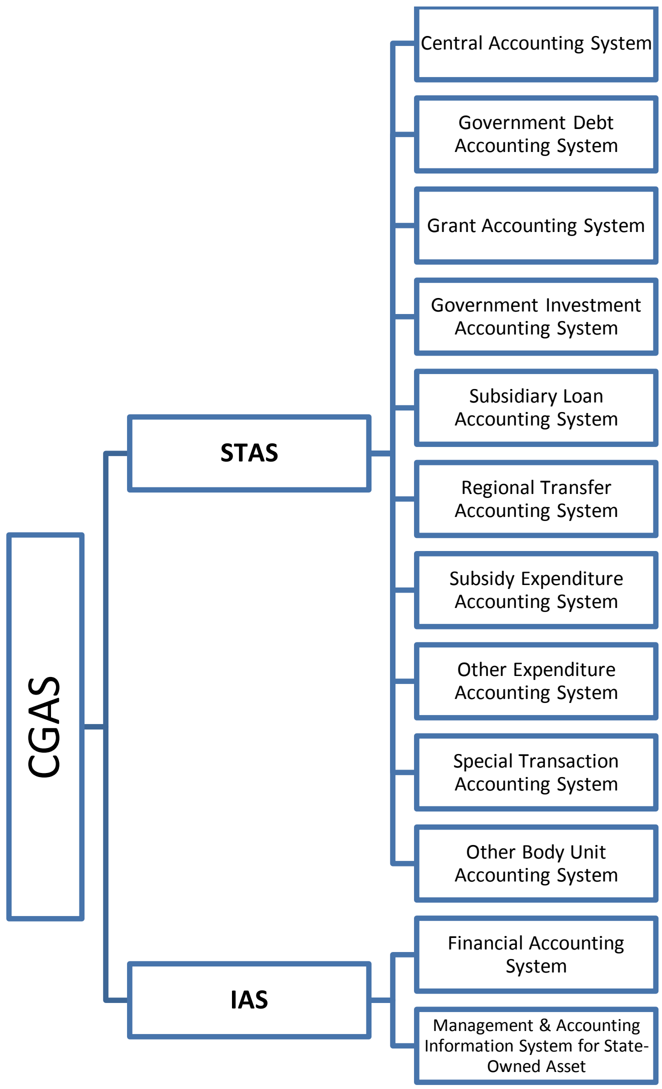
I. Understanding the Public Debt Business Process and Risk Assessment: The Case of Indonesia (para.57 of the GUID)

The preparation of the Indonesian Government Financial Statements is supported by two Accounting Systems: Central Government Accounting System (CGAS) established by the Ministry of Finance, and Local Government Accounting System (LGAS) established by the Ministry of Home Affairs. CGAS consists of two Accounting Systems: The State Treasurer Accounting System (STAS) and Institution Accounting System (IAS). The general picture is as follows:



SAI Indonesia provides an opinion on the Central Government Financial Statements and does not provide an opinion on the financial statements for each unit (management function).

The Objectives of State Debt Management

By looking at the increasingly dominant source of debt financing and the increasing balance of state debt, the government feels the need to manage debt better. In general, the long-term goal of state debt management is to minimize the cost of debt at a controlled level of risk. Specifically, the objectives of state debt management are:

1. ensuring the fulfillment of financing gaps and fiscal sustainability in accordance with the macroeconomic conditions and the lowest cost;
2. to increase prudential principles in debt management, especially to minimize risk, both market risk and refinancing risk; and
3. to develop efforts so that planned loans can be implemented as scheduled and cost estimates.

Achieving those objectives will directly support the implementation of policies to improve fiscal sustainability and fiscal capacity to meet debt sustainability obligations. The scope of debt management involves the procurement, maintenance, and repayment of state debts that directly burden the State Budget, which is currently foreign loan and government bond, managed by the Directorate General of Financing and Risk Management of the Ministry of Finance.

State Debt Management Policy

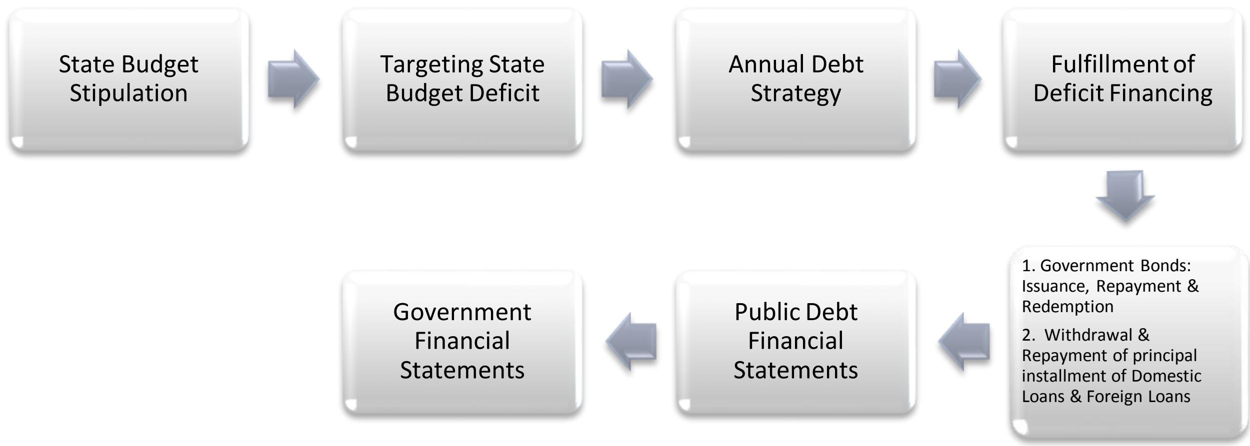
General policy of state debt management is stipulated in various laws and regulations. Regulations related to the state debt management include:
1. Act Number 24 Year 2004 regarding Government Bond; and
2. Act Number 17 Year 2003 regarding State Finances.

Public Debt Accounting System

Number	Component	Description
1.	Public Debt Financing Sources	A. Cash Debt Financing: - Bonds (Domestic & Foreign) - Standby loans / Program Loans (International Financial Institutions) B. Activity/Project Loans - Loans (Domestic & Foreign) - Subsidiary Loans - Government Securities, series: Project Based Sukuk (PBS)
2.	Public Debt Instrument	- Bonds - Loans (Domestic & Foreign)
3.	Parties of Debt Management	neral of Financing and Risk Management of the Ministry of Finance, responsible in managing Public Debt, consists of: - Front Office: responsible for designing policy, standard and procedure of Bonds & Loans; - Middle Office: responsible for designing policy, standard and procedure of public debt’s strategies and portfolios, managing risks, and other liabilities as government supports; - Back Office: responsible for designing policy, standard and procedure of evaluation, accounting and settlements of public debt.
4.	Documentation Sources of Public Debt	A. Bonds: - Bonds Settlements from Stock Exchange Authorities; - Bonds Transaction Review from Book Runners and Lead Managers; - Tender Documents of Government Securities; - Determination of the Winning Bidder; - Notice of Payment; B. Loans: - Withdrawal Application; - Notice of Disbursement from Lenders; - Notice of Payment; - Notice from Fiscal Agency.

5.	System and Information Technology	- Debt Management Financial Analysis System (DMFAS) - Application System: STBS (State Treasury and Budget System) which is system that facilitate the needs of service processes from upstream (budgeting) to downstream (preparation of central government financial reports)

Public Debt Financial Reporting Cycle



Risks of Public Debt Management System at Each Stage

Number	***Activity***	***Risks***
1.	Deficit Financing of State Budget	• Debt financing to cover the state budget deficit exceeds the needs; • The addition of Deficit / Debt of the Republic of Indonesia exceeds 3% of GDP.
2.	Incoming Budget Fund – Loan Financing	• Differences in the value of financing receipt of loan drawdown between Directorate General of Financing and Risk Management listing and lender drawdown data; • Withdrawal of foreign loans is not on schedule so as to incur other costs at the time of withdrawal of foreign loan; • Notice of Disbursement cannot be authorized because of the availability of the ceiling in the Budget Execution Document for the Ministry Expenditure and for Outgoing Budget Fund: Subsidiary Loan.
3.	Outgoing Budget Fund - Loan Financing	• Interest payments & principal installments do not fit the schedule set by the lender.
4.	Incoming Budget Fund – Government Securities	• High yield of Government Bond due to private placement and direct transaction; • Material other costs of Government Bond’s issuance, but they are not capitalized; • Potential yield of Government Bond in the market corner; • Unknown underlying assets of Sukuk.
5.	Outgoing Budget Fund – Government Securities	• Buyback and debt switch transactions do not account for unamortized discount / premium on the series of Government Securities redeemed; • Interest payment & redemption of matured Government Securities are not on schedule.

6.	Preparation of Financial Statements	• Misstatements in debt classification; • Foreign loans due next year are not adjusted as the Current Liabilities; • The debts presented in the Current Liabilities matures more than one year; • Miscalculation in accrued interest (for loans and securities); • Errors in calculation, recognition, and presentation of foreign exchange debt. • Foreign loan presented in the State Treasurer's Statement of Financial Position cannot be specified per Loan ID; • The increasing deficit of State Budget through the addition of debt is not adequately disclosed; • Inadequate disclosure of hedging and underwriting obligations.

The overall risks of public debt, which may become key audit matters, are as follows:

- Debt financing that exceeds the need to cover the deficit;
- Yield of Government Bonds which is much higher than the neighboring countries having equal country risk;
- Borrowing costs that are not immediately availed (utilized) due to the pending project realization;
- The cumulative value of debt that exceeds the maximum debt limit to GDP; and
- Government obligations and contingent government obligations that are not disclosed in the notes to the financial statements.

SAI Indonesia does not give an opinion on the Financial Statement on Debt Management because it becomes one of the functions of the Central Government Financial Statements. Furthermore, the problems that do not affect the fairness of the Central Government Financial Statements but are significant for the improvement of management are disclosed in audit findings of internal control or noncompliance as part of the audit report of SAI Indonesia.

II. Substantive procedures in FA (para.105 of the GUID)

In **FA**, the objective of substantive tests of detail is to help auditors determine whether the monetary values of PD transactions or balances are stated correctly in the financial statements, reports, schedules, or its equivalent. A sample is shown in Table 1.

Table 1: Substantive Tests of Detail Used in FA

Assertion	Audit Test
Existence and Occurrence	Confirmation with the holder of the public debt instruments, fiscal agent, or custodian/trustee of public debt records
	Inspection of underlying public debt agreements and other supporting documents, confirmations received from creditors, in paper or electronic form, for amounts reported
	Inspection of supporting documents for subsequent realization or settlement after the end of the reporting time period
	Observation of auctions and underwritings
Rights and Obligations	Confirmation with the holder of the public debt instruments, fiscal agent, or custodian/trustee of public debt records
	Inspection of underlying public debt agreements and other supporting documents, confirmations received from creditors, in paper or electronic form, for amounts reported

Assertion	Audit Test
Completeness	Review of all counterparty transactions. When requesting details from the counterparty, consider which part of the organization is responding, and whether this represents all relevant aspects of its dealing with the audited entity
	Review a listing of debt instruments to determine if all types of public debt liabilities included in the accounting records
	Send zero-balance confirmations to potential public debt holders or counterparties
	Review primary dealers' statements for the existence of transactions and holdings of public debt instruments
	Use computer-aided techniques to extract aggregate trading data for agreement with general ledger and financial statement report
	Perform sampling tests of individual trades for counterparty confirmations and after-date receipts
	Review accounting records before and after the year end for unusual transactions
	Review counterparty confirmations received but not matched to transaction records
	Review unresolved reconciliation items in reports
	Inspect public debt agreements for embedded derivatives
	Review minutes of public debt committee and related papers
	Perform calculation for proper accrual and recognition of public debt expense
Valuation and Measurement	Inspection of documents to verify cash receipts from borrowing
	Confirmation of the nominal value of public debt amounts with fiscal agent or trustee
	Re-calculation of mark-to-market calculations for a sample of high value public debt instruments
	Review the basis of valuation as defined by the accounting policies (i.e., market, face, or nominal value) to determine if reasonable and consistently applied
	Check the accuracy of translation of book and market value of public debt instruments denominated in foreign currencies
	Use quoted market prices to verify values disclosed of public debt instruments, money market instruments, and derivatives
	Inspection of documents to verify cash disbursements from repayments
	Inspection of documents to verify cash disbursements from interest payments
Presentation and Disclosure	Verify that accounting principles selected and applied are in accordance with legislation, regulations, and applicable accounting standards, and are appropriate for the public debt management agency
	Verify that the financial statements and related notes provide sufficient disclosures, including the public debt reporting entity, basis of accounting for public debt, types of debt instruments, and types of issuers, and are neither too detailed nor too condensed
	Verify that the financial statements and related notes provide sufficient disclosure that is neither too detailed nor too condensed
	Verify that the financial statements provide information on matters that may affect their use, understanding, and interpretation
	Verify that the financial statements reflect transactions in a manner that present the public debt levels; results of borrowings, repayments, and interest payments; and cash flows within a range of acceptable limits
	Review the classification of public debt instruments to ensure it is in agreement with legislation, regulations, and practices
	Verify that inter-agency debt transactions have been eliminated in consolidation.
	Review the disclosures for related-party transactions, such as debt transactions between the government and the central bank.

Substantive Analytical Procedures

In addition to substantive tests of detail in **FA,** auditors perform substantive analytical procedures to compare actual and expected values of key financial amounts, such as account balances. The objective of this comparison is to identify and investigate the reason for any unusual or unexpected relationships between the actual and expected values. For example, the relationship between the expected interest expenditures calculated using the interest rates in legal documents and the actual interest expenditures. The auditor develops an expectation or estimate of what the recorded amount should be, based on an analysis and understanding of relationships between the recorded amounts and other data. This estimate is then used to form a conclusion on the recorded amount. A basic premise underlying analytical procedures is that plausible relationships among data may reasonably be expected to prevail unless conditions are known that would change the relationship.

Analytical procedures generally rely on aggregate data rather than unit values, which makes them more effective and efficient than tests of individual transactions. Common analytical procedures involve the use of ratios, trends, and variance analysis. More sophisticated analytical procedures use econometric analysis, including regression, simulations, stress-testing and large-scale economic models. Steps in the application of substantive analytical procedures are shown in Table 2.

Table 2: Steps in the Application of Substantive Analytical Procedures

a.	Determine the amount of the materiality limit. This limit is the amount of difference between the auditor's expectation and the recorded amount that the auditor will accept without investigation. The determination of the limit is a matter of the auditor's judgment.
b.	Identify a plausible, predictable relationship and develop a model to calculate an expectation of the recorded amount. Consider the type of misstatements that could occur and how those misstatements would be detected by the model.
c.	Gather data for developing the expectation, and perform appropriate procedures to establish the reliability of the data. This reliability is subject to the auditor's judgment.
d.	Develop the expectation of the recorded amount using the information obtained during the previous steps. The preciseness of the expectation is subject to the auditor's judgment.
e.	Compare the expectation with the recorded amount, and note the difference.
f.	Obtain explanations for differences that exceed the materiality limit, since they are considered significant.
g.	Corroborate explanations for significant differences.
h.	Determine whether the explanations and corroborating evidence provide sufficient evidence for the desired level of substantive assurance. If unable to obtain a sufficient level of substantive assurance from analytical procedures, perform additional procedures and consider whether the difference represents a misstatement.

Explaining the Difference between Expected and Actual Interest Expense

Suppose the auditor estimates that the interest expense for the current period is $80 million. The auditor obtains this estimate based on a $1 billion public debt average balance times 8 percent, the average annual interest rate. The materiality limit for the substantive analytical procedure is $5 million. The auditor finds that the actual amount of interest expense is $94.5 million. The difference - $14.5 million - exceeds the test materiality by $9.5 million. The auditor asks the public debt managers about the difference and their explanation is that "we borrowed more money and interest rates are higher than last year." The auditor needs to corroborate this explanation. For example, the auditor can find that interest rates first increased during the year and then fell, and were computed to average 9 percent based on a monthly average instead of 8 percent. Additionally, loan statements from lenders indicate that $100 million was borrowed and repaid during the year, and the additional borrowings were outstanding for 6 months. Thus, the average loan balance was actually $50 million higher and the average interest rate was 1 percent higher than the figures used in the auditor's original estimate. Using this new information, the auditor refines its model and recalculates the estimate as $94.5 million ($1,050 million public debt average balance times 9 percent), which equals the actual interest expense.

Substantive Tests of Detail for Derivative Instruments

Debt managers are increasingly using financial derivatives to manage their exposures to risks inherent to some PD instruments, such as interest and foreign currency risks.

Debt managers change the term to maturity and other features of PD by using financial derivatives, known as currency or interest swap agreements to exchange payments with a financial institution according to a pre-arranged formula. In a common swap transaction, a public entity would issue long-term securities and simultaneously agree to swap its fixed-rate, long-term interest payments in exchange for floating (short-term) interest payments. Substantive tests of detail for derivative instruments are shown in Table 3.

Table 3: Substantive Tests of Detail for Derivative Instruments

Assertion	Audit Test
Completeness and Existence	Confirmation of significant terms with the holder of, or counterparty to, the derivative
	Inspection of underlying agreements and other forms of supporting documentation, in paper or electronic form
	Ask holder of or counterparty to the derivative to provide details of all derivatives and transactions with the public debt management agency
	Send zero-balance confirmations to potential holders or counterparties to derivatives
	Review brokers' statements for existence of derivative transactions and positions held
	Review counterparty confirmations received but not matched to transactions records
	Review unresolved reconciliation items
	Inspect agreements, such as loan or equity agreements, for embedded derivatives
Valuation and Measurement	Assess the reasonableness of models, variables, and assumptions used to value derivatives
	Gather market prices to assess valuation that are firm and valid
	Assess the sensitivity of valuation to changes in variables and assumptions
	Inspect supporting documents for settlement of the derivative transactions after end of the reporting period
	Use proprietary models or the public debt management agency's internally developed models to assess valuation when no market prices exist
	Use analytical procedures to evaluate risk management policies, including compliance with credit limits
Presentation and Disclosure	Assess the extent of disclosures of derivatives used as hedges, and extent of compliance with laws and regulations that require disclosure of derivative transactions, including notional and fair value, number and credit quality of counterparties, value at risk, stress test results, etc.

III. Development of Audit Findings Matrix (para. 107 of the GUID)

Table 4: AFM for Cash Management

Audit Objective: Whether cash management (which entails cash flow forecasting, arranging temporary liquidity, maintaining target balance in the Government account, investment of surplus balance over and above the target balance) is done efficiently and effectively**.** (Report No 16 of 2016 "Performance Audit of Management of Public Debt", SAI India)

Researchable question: Whether there was an accurate system of cash forecasts?

Situation	Criterion	Evidence and Analysis	Causes	Effects	Good practices	Recommendation
In at least 40 weeks in each year there were variations between the weekly projected cash balance and the actual cash balance	Projected figures of the Central Bank and the actual cash balance figures of the Government as provided by the Central Bank of the Government	Examination of the relevant documents, records of the Central Bank and the weekly data on cash balance as prepared and made available by the Central Bank	Cash balance projections were made at least 6 months in advance and were impacted by multiple factors including spending by Government departments and units across the country	The mismatches between inflows and outflows in Government account were rough tuned through issuance of cash management instruments, viz., treasury bills and further fine-tuned through Ways and Means advances/ Overdraft by the Central Bank to the Government	Developing better methodology using sophisticated tools for making cash forecasts.	May enable Government to better manage its cash balances and enable prudent investment decisions to be made

IV. Sample audit reports on FA and CA (para. 109 of the GUID)

The case of the audit of the U.S. Federal Debt

The U.S. GAO annually provides a financial audit report to the Secretary of the Treasury on the Bureau of the Fiscal Service's Schedules of Federal Debt. GAO determines whether, in all material respects, the schedules are reliable and Fiscal Service management maintained effective internal control over financial reporting relevant to the Schedule of Federal Debt. Further, GAO tests compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements related to the Schedule of Federal Debt. (FINANCIAL AUDIT

- Bureau of the Fiscal Service's Fiscal Years 2017 and 2016 Schedules of Federal Debt – GAO-18-134)

The case of the audit of the Maldives Public Debt and Government Guarantees

The SAI Maldives conducts an annual audit on the Statement of Public Debt and on the Statement of Government Guarantees. In addition to the financial audit opinion that is provided on truth and fairness of these two statements, a compliance opinion is provided with respect to level of compliance with relevant provisions of the Public Finance Law & Regulations. Other matters addressed in the audit include a financial review of the on-lending of government loans to state-owned enterprises, implementation of debt management strategy, maintenance of debts within the provision of the fiscal responsibility law, and financial review of the debt sustainability ratios.

Reporting Other Matters (Borrowing Limits) – SAI Maldives (Public Debt Financial Audit Report FY 2013)

Ministry of Finance and Treasury (MOFT) and the Central Bank entered into an agency agreement wherein MOFT was granted an Over-Draft Facility (ODF) from the Public Bank Account (PBA). Section 11 of the agency agreement provided that outstanding overdraft amount shall not exceed Maldivian Rufiyaa (MVR) 100,000,000 at the end of any given month, and Section 13 stipulated that any outstanding balance shall be repaid at the end of the financial year and that the Government shall not resort to the ODF as a means for financing the budget deficit. However at financial year end 2013, the PBA was overdrawn by MVR 2,475,000,000. MOFT has represented that during the year the PBA ODF limits were extended with approval from the Central Bank. Furthermore the PBA ODF as of 5 May 2014 amounting to MVR 3,328,000,000 was converted to a short term loan.

Reporting Other Matters (On-lent loans to SOEs) – SAI Maldives (Public Debt Financial Audit Report FY 2013)

MOFT has undertaken to borrow of State-Owned Enterprises (SOEs) for certain development projects and has on-lent the loans to SOEs through a separate agreement signed between MOFT and those SOEs. This on-lending arrangement if successful should result in MOFT being able to repay interest and principal payments to the original lender without resorting to cash flows from the State Budget. However we observed that a large proportion of on-lent loans SOEs were not being repaid to MOFT by the SOEs, resulting in MOFT being ultimately liable to repay the loans from the State Budget. As of the end of the year 2013, the defaulted non-performing on-lent loans to SOEs amounted to MVR 589,000,000.