2019

GUID 5250

Guidance on the Audit of Public Debt

DRAFT GUID 5250

INTOSAI WORKING GROUP ON PUBLIC DEBT

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I. BACKGROUND

A. INTRODUCTION

1. Guidance pronouncements or GUIDs are non-mandatory guidelines for the use of the auditor to apply the International Standards of Supreme Audit Institutions (ISSAIs) in all types of audit[1].

    - The Strategic Development Plan (SDP) for the INTOSAI Framework of Professional Pronouncements (IFPP) for 2017-2019 included, under Priority 2, *Project 2.9 Consolidating and Aligning the Audit of Public Debt with ISSAI 100*. This GUID is a consolidated version of 8 earlier ISSAIs related to Public Debt. The category of the ISSAIs related to PD Audit shall no longer be considered an ISSAI (standard), but a Guidance (GUID), specifically classified as "Subject Matter Specific Guidance" (Ref: SDP for the IFPP 2017-2019).

2. The principles of public-sector auditing are enumerated in ISSAI 100. In auditing Public Debt, the auditor should refer to the General Principles and Principles Related to the Audit Process in ISSAI 100.

3. Based on these considerations, an INTOSAI GUID on the audit of PD covering the three audit types, namely, Financial Audit, Performance Audit, and Compliance Audit is now available – labelled and numbered by the INTOSAI IFPP as GUID 5250.

B. OBJECTIVE

4. This GUID aims to serve as guidance for Supreme Audit Institutions (SAIs) in the audit of PD, applying the fundamental auditing principles provided in ISSAI 100 in all phases of the Financial Audit, Performance Audit and Compliance Audit, in order to produce quality audit reports beneficial to sound public debt management (PDM) and good governance.

C. SCOPE

5. This GUID considered the relevant provisions of the following eight (8) earlier ISSAIs on audit of PD in the consolidation and its alignment with ISSAI 100:

ISSAI No.	ISSAI Description
ISSAI 5410	Guidance for Planning and Conducting an Audit of Internal Controls of Public Debt
ISSAI 5411	Debt Indicators
ISSAI 5420	Public Debt Management and Fiscal Vulnerability: Potential Roles for SAIs

[1] Forum for INTOSAI Professional Pronouncements (FIPP) Supplementary guidance to the drafting conventions for the GUIDs.

ISSAI No.	ISSAI Description
ISSAI 5421	Guidance on Definition and Disclosure of Public Debt
ISSAI 5422	An Exercise of Reference Terms to Carry Out Performance Audit of Public Debt
ISSAI 5430	Fiscal Exposures: Implications for Debt Management and the Role for SAIs
ISSAI 5440	Guidance for Conducting a Public Debt Audit – Use of Substantive Tests in Financial Audits
ISSAI 5450	Guidance on Auditing Public Debt Management Information System[2]

6. To a greater extent, the GUID highlights issues specific to PD that would need to be considered when conducting audits of PD.

7. This GUID provides further guidance on how such issues could be addressed by using Financial/Performance/Compliance auditing and does not contain any further requirements for the conducting of the audit.

D. ROLE OF SAIs

8. The UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing states, among others, "An audit institution should conduct independent, objective, professional, timely and periodic audits of their debt portfolios to assess quantitatively and qualitatively the recently incurred obligations. The findings of such audits should be publicised to ensure transparency and accountability in debt management. Audits should also be undertaken at sub-national levels".[3]

9. SAIs have a major role to play in exercising independent external oversight on PD in a country and in publicly reporting on the results of their audits. Through their recommendations, SAIs may encourage improvements in aspects of debt management (DeM), including on the definition and disclosure of PD, strategies, and risk management practices.

10. The possible roles of SAIs in auditing PD and its management may include:

    a. *On the definition and disclosure of PD:*

    - Auditing disclosed debt information: Where the information is part of the general financial statements, audit work is mainly of a financial and compliance nature and most SAIs fulfill this primary role. Other types of disclosed information on PD, including statistical information, may also be audited by SAIs.

    - Commenting on the fiscal and economic implications: SAIs may undertake independent analyses, specifically by means of PAs, based on the quantitative and qualitative information disclosed, to foster better management of the PD and

[2] ISSAI 5450 was moved to GUID 5000 series

[3] UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing (https://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf?user=46)

to improve the understanding of the current and future implications of public commitments and of fiscal sustainability.

- Encouraging improvements in definition and disclosure: While conducting audits, SAIs may find some aspects of the definition and disclosure of PD that could be improved, and may formulate recommendations on the appropriate timing, means, and contents of the disclosure of information on PD and its management. Where disclosure is incomplete, an SAI may identify additional elements of debt or aspects of DeM to be disclosed. Where the disclosed information is not reliable, an SAI may recommend specific improvements in the process of gathering and disclosing the data and other qualitative information. An SAI follows-up the implementation of these recommendations.

b. *On promoting robust PD strategies and sound risk management practices*

- Through financial and performance audits, SAIs may encourage the adoption of sound and robust DeM strategies and proper risk management practices.

- SAIs help improve understanding of exposures reported in financial report and could also encourage practices to ensure that fiscal authorities are aware of the impact economic shocks could have on their government's Statement of Financial Position and on PD charges.

- SAIs may encourage sound reporting practices for fiscal exposures, including those not captured by conventional financial and budget reports.

- SAIs may encourage the governments to focus more on monitoring of vulnerabilities, and to give high priority to risk management, production and publication of quality financial information.

- Through Compliance Audit, SAIs may check whether PD transactions have been carried out per existing rules and relevant provisions formulated by the competent authority and reporting on non-compliance thereof.

c. *On encouraging improved data disclosure and best practices approaches*

- SAIs, within the limits of their authority, scope and conduct of audits, encourage their government to produce credible, timely and reliable information relative to the PD and other economic data to assess fiscal vulnerabilities. More specifically, SAIs may encourage governments to publish leading indicators on the size of the external debt, PD structure (maturity, duration, fixed-floating ratio and currency composition) and detailed reporting on reserve assets (including liquidity level and foreign exchange position) and capital movements.

- SAIs may encourage the auditee to adopt best practices for dealing with risks, and for improving the understanding and use of risk assessment techniques, risk mitigation approaches, and risk management approaches.

d. *On promoting the need for a proper regulatory and supervisory framework for the banking industry*

- Through performance audits, SAIs may encourage the auditee to introduce better supervisory and regulatory functions in the financial sector. SAIs could promote the need for national banking regulators and supervisors to carefully consider the adoption of principles, practices and guidelines being developed and to respond positively to compliance assessment reports.

II. PUBLIC DEBT AND PUBLIC DEBT MANAGEMENT

What is Public Debt?

11. A broad definition of debt answers the following questions: *Which entities in a country take on debt? What concepts or instruments constitute debt in a country and how is a country's debt reported?*

12. Generally, PD includes, among others, domestic and foreign liabilities, and other commitments incurred directly by public bodies. These include securities, bank loans, long-term leases, guarantees, issues of national currency, proceeds from public savings schemes, loans from foreign governments and international bodies, pension and health care liabilities, and accounts payable. PD definition also varies from one country to another. It is expected to include all the debt (liabilities) owed by a government.

13. This GUID has not attempted to develop one or more definitions of PD. Rather, the GUID identified various elements of PD which could be considered as well as various types of public bodies whose debt are to be included in a definition of PD. Depending on the purpose for which a report is prepared, an appropriate definition of PD may include the following:
    - Liabilities or other commitments incurred directly by public bodies such as:
        - A central government, or a federal government, depending on the manner of political organisation in the country;
        - State, provincial, municipal, regional and other local governments or authorities;
        - Owned and controlled public corporations and enterprises; and
        - Other entities that are considered to be of a public or quasi-public nature.
    - Liabilities or other commitments incurred by public bodies on behalf of private corporations or other entities, such as debt assumed by a public body following bailouts, defaults or other failures of a private corporation.

14. For the purposes of this GUID, PD shall include all liabilities and obligations incurred by a country, both explicit and implicit.

15. The various elements of liabilities and other obligations may or may not be stated in the financial statements as their liabilities but are reported in documents necessary for budget approval, policy monitoring and formulation, and other purposes.

What is Public Debt Management?

16. PDM is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.

17. According to the definition of PDM, the goals and objectives of government DeM are to:
    - Meet the borrowing requirements of the government;
    - Borrow at the lowest possible cost over the medium to long run;
    - Keep a prudent degree of risk in the debt portfolio; and
    - Meet any other goals the government may have set, such as developing and maintaining an efficient market for government debt securities.

18. The WB/IMF Revised Guidelines for Public Debt Management scoped DeM as the main financial obligations over which the central government exercises control. These obligations typically include both marketable and non-marketable debt, such as concessional financing obtained from bilateral and multilateral official sources and retail debt in some cases. Whether the broader public sector debt is included or excluded from the central government's mandate over DeM will vary from country to country, depending on the nature of the political and institutional frameworks.

19. SAIs carry out Financial, Performance, and Compliance audits on the subject matter of PD. The audits carried out and the reporting procedures depend on the legal mandate and reporting procedures established in the country. The subsequent parts of this GUID discuss 'how' auditors can apply the fundamental auditing principles in ISSAI 100 in the audits of PD.

III. AUDITING PUBLIC DEBT

20. This section of the GUID provides auditors with supplementary guidance on the matters to consider when performing Financial, Performance, and Compliance audits of PD. It is not intended to cover all items necessary to perform an audit of PD. For auditing standards relevant to each type of audit, refer to the following principles and related ISSAIs and GUIDs:

Financial audit	ISSAI 200
Performance audit	ISSAI 300
Compliance audit	ISSAI 400

21. The **Financial Audit** of PD follows the requirements of ISSAI 1805 which is applicable to audits of a single financial statement or a specific element, account, or item of a financial statement.

22. The **Performance Audit** of PD focuses on whether borrowers and lenders, sovereign debt managers, and other related parties are performing in accordance with the principles of economy, efficiency, and effectiveness, and whether there is room for improvement. Recommendations for improvement may lead to government savings if these result in lower borrowing costs. In conducting audit of PD, performance auditors look at the activities involved in the reporting and management of PD rather than the related financial statements or accounts. The IDI Handbook on Audit of Public Debt Management listed nine major topics of PD which may be subjected to Performance Audit.

23. The **Compliance Audit** of PD focuses on obtaining evidence to assess whether the activities, public credit financial transactions and information comply, in all significant

aspects, with authorities. It provides legislative, supervisory, and governance bodies, and the general public, with an independent and objective evaluation of the administration of government debt.

A. PLANNING AN AUDIT

24. As required under ISSAI 100, the principles related to audit planning include: a) establish the terms of the audit; b) obtain understanding; c) conduct risk assessment or problem analysis; d) identify risk of fraud; and e) develop an audit plan.

ESTABLISHING THE TERMS OF THE AUDIT

25. Auditors agree or establish a common understanding of the terms of the audit engagement with management and, when appropriate, those charged with governance.

26. In the audit of PD, auditors consider the legal mandate, previous audit work done, and what resources are available to perform the audit. Some SAIs have a restricted legal mandate to audit sovereign debt.

27. An important element for carrying out an audit of PD is the existence of a conceptual framework and a broad agreement/understanding of what constitutes PD as this is crucial for determining the scope and objectives for audits of PD.

28. Financial auditors examine PD accounts and schedules supporting the financial statements for the purpose of determining the accuracy and completeness of reported and disclosed debt information.

29. Performance auditors undertake assessment of the management, vulnerability, and sustainability of PD, as well as evaluation of the institutions and personnel responsible for PDM.

30. Compliance auditors assess whether the activities of entities or offices involved in DeM or the Debt Management Office (DMO) are in accordance with the authorities governing these entities or offices.

31. It is also important to have clarity on whether the definition of PD should be limited to marketable debt, or it should include non-marketable debt or other loans, whether the definition should be limited to central government debt or include other government component units. A final consideration is to determine how to treat intra-governmental debt, or debt held by various government accounts.

32. The terms of the audit are usually discussed during initial or entrance conference wherein the audit scope, objective, criteria, materiality level, among others, are communicated or discussed to and agreed with the auditee.

UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

33. Understanding the entities involved in PD, its context, the programs, activities, and functions related to PD, and the circumstances surrounding the audit, enables the auditor to have a

frame of reference for applying professional judgment throughout the audit process, particularly in determining materiality and analysing the risks.

34. Auditors obtain sufficient understanding of the DMO and its environment, including internal control procedures that are relevant to the audit, to be able to develop an effective audit approach.

35. Therefore, auditors identify important aspects of the environment in which the audited entity (Ministry of Finance, DeM agency, or other public entities responsible for managing the PD being audited) operates, sufficient to enable them to understand the events, transactions, and practices that may have an effect on the way PDM activities are conducted and reported.

36. The activities that may be considered under this process are: (a) understanding the legal framework for PD and PDM arrangement (institutional and organisational); (b) understanding the general economic factors including PD markets and financial instruments; (c) understanding the internal control over PD; and (d) conducting risk assessment at the entity level.

37. The extent of understanding the legal framework for PD and PDM arrangements depends on the type of audit. In the case of **Financial Audit**, "matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit should be communicated to those charged with governance, save where the matters are clearly inconsequential. However, the audit mandate, or obligations for public-sector entities arising from legislation, regulation, ministerial directives, government policy requirements or resolutions by the legislature, may result in additional objectives, such as the responsibility to report all instances of non-compliance with authorities, even where clearly inconsequential." (ISSAI 200.124)

38. In the case of **Performance Audit** and **Compliance Audit**, legal framework and PDM arrangements can be potential audit topics or subject matters for audit. Thus, understanding the legal framework and PDM arrangements by performance and compliance auditors may be more extensive than financial auditors.

39. The legal framework and managerial structure for PDM in the context of DeM performance indicators are discussed in the Debt Management Performance Assessment (DeMPA) Methodology of the WB.[4]

40. Legal framework may also impose audit limitations. For instance, some SAIs may not be authorised by law to perform a complete PD audit, or at least, to examine debt data of major government-controlled enterprises that contract loans guaranteed by the government.

41. Assessing the PDM arrangement against the criteria set out in the WB/IMF Revised Guidelines for Public Debt Management can provide the auditor with a structured view of the:
    - Objectives and coordination of PDM;
    - Transparency of and accountability for PDM activities;
    - Institutional framework for PDM;

[4] http://documents.worldbank.org/curated/en/305821468190742099/pdf/96671-WP-DEMPA-2015-Box391446B-PUBLIC.pdf

- PDM strategy;
- Risk management framework for PDM activities; and
- Role of PD managers in promoting efficient markets in PD instruments.

42. The organisational models of the DMO are defined by the authorities which may differ from country to country. This could influence the audit scope, objective, and strategy. The most common models are those wherein the DMO is independent of centralised entities (such as the Ministry of Finance); others include it within the scope of the Central Bank or split it over more than one institution. A more detailed discussion of the structure and functions of the DMO can be found in the WB/IMF Revised Guidelines for Public Debt Management.

43. General economic factors are likely to have an influence on the nature and extent of PDM activities. For example, when interest rates appear likely to rise, a debtor may try to fix the effective level of interest rates on its floating rate borrowings through the use of interest rate swaps, forward rate agreements, or caps to cushion the effect of possible increase in government expenditures. The decision to manage the effect of rising interest rates is contained in a PDM strategy.

44. The auditor obtains sufficient understanding of the markets used in borrowing and the types of financial instruments to plan and perform Financial Audit, Performance Audit, or Compliance Audit of PD. This may include:
    - The operating characteristics and risk profile of the financial markets in which the PD managers operate (i.e. condition, reliability, and effectiveness of the primary and secondary markets for PD instruments);
    - The financial instruments used by PD managers and their characteristics;
    - Established policies for debt instruments;and
    - The methods of valuation of the financial instruments. This can be particularly important where the audited entity is using derivatives, which may have complex features.

45. The auditor obtains and documents an understanding of the accounting system and the key management systems and controls sufficient for them to plan the audit. For an audit of PD, where there are likely to be complex processes, transactions, and accounting issues, the auditor considers key aspects of the internal control system, including all five components of internal control — control environment, entity risk assessment, control activities, information and communication, and monitoring.

46. The control environment is the foundation for an internal control system. Senior debt managers establish and maintain an environment throughout the entity that sets a positive attitude toward internal control.

47. The control environment includes:

    - **Integrity and ethical values.** The effectiveness of internal control cannot rise above the integrity and ethical values of the individuals who create, administer, and monitor them. Because senior management can override internal controls, integrity and ethical values of senior PD officials are essential to maintaining effective internal control given their ability to override internal control.

- **Human resource policies and practices**. The increasingly complex nature of PD operations — which may involve multiple currencies, variable interest rates, debt restructuring, and swaps of currency and interest payments — demands increasingly skilled staff to manage PD instruments. The senior debt manager is responsible for obtaining the competence levels necessary to achieve PDM goals and objectives and assigning employees with the appropriate skills to each task.

- **Organisational structure**. Most PD organisations have several operational units with different management functions and reporting responsibilities. Debt managers have two basic functions — a high-level function that involves coordinating debt operations with the government's fiscal and monetary operations, and an operational function that involves managing specific debt transactions.

48. Auditors assess how senior DeM officials demonstrate a commitment to integrity and ethical values, establish human resource policies and practices that support PDM goals and objectives, and establishing an organisational structure to achieve PDM objectives.

49. Debt managers assess the risks facing the country as it seeks to achieve its objectives. Risks encountered in PDM generally include market risks and operational risks. The definitions and detailed descriptions of these risks are shown in *Appendix 1*.

50. Debt managers also assess operational risk in managing PD through governance and control functions. Operational risks arise in the normal course of managing debt transactions. The responsibility for identifying risks and developing plans lies with management. A risk plan would describe procedures to minimise damages caused by the risks. In the course of an audit of internal controls of debt, auditors would examine the risk plan and compare the actual performance of debt managers against the risk plan.

51. The financial auditor considers whether there are events or conditions that may cast significant doubt on whether the audited entity's future resources will be sufficient to sustain public services and to meet obligations as they become due.

52. Auditors evaluate the risk environment of PDM. In their evaluation, they consider a variety of factors including:
    - The legal framework governing PDM activities and any remit laid down by the government for those responsible for PDM operations;
    - The institutional framework for establishing operational plans and ensuring effective oversight of PDM activities;
    - The experience and knowledge of PD managers and those charged with oversight;
    - Any unusual pressures faced by PD managers including market pressures which might lead to a breach of borrowing remit;
    - The complexity of the PDM portfolio or a decision to employ new types of PD instrument.
    - The assessment of internal control which include specific assessment of information systems.

53. For a practical example of SAI Indonesia's undertaking of the PD business process and risk assessment, see *Appendix 2.*

54. Establishing an effective link between DeM objectives and control activities is a critical component of internal control over DeM. Thus, debt managers are required to clearly

establish the DeM objectives in specific areas, such as stability of the debt service, sufficient liquidity to pay current obligations, target average maturity of debt, desired mix of foreign currency debt, and active domestic capital market.

55. In order to achieve DeM objectives, policymakers and debt managers rely on an information system that captures and disseminates relevant and reliable PD information. Management needs access to relevant and reliable communication related to internal as well as external events affecting PD. Relevant and reliable PD information is easier to produce under the following conditions:
   - a uniform system of government accounts is used consistently in budget, cash, and PD operations;
   - an integrated database provides consistent cash, budget, and PD data and facilitates the flow of information between and within operating units;
   - an accounting standards-setting body establishes a uniform accounting framework and form and content reporting requirements; and
   - inter-agency coordinating groups manage the evolution of information systems in an integrated and responsive manner.

56. Timely PD reports help prevent irregularities and safeguard assets. Because PD operations are associated with large sums of cash, timely information on cash proceeds and payments associated with PD transactions can discourage fraud perpetrators.

57. A computer-based PDM system is necessary for a large number of PD transactions, which are complex and would require swift and accurate processing and retrieval. There are two primary information systems available to manage PD: (1) the Debt Management and Financial Analysis System (DMFAS), a computer system designed by the UNCTAD, and (2) the Commonwealth Secretariat Debt Recording and Management System (CS¬DRMS). DMFAS is a Microsoft Windows-based application that uses Oracle's Relational Database Management System. CS-DRMS has electronic links with the WB's debtor reporting system as well as with the Debt Sustainability Model of the WB.

58. Auditors review and evaluate the audited entity's information systems, including the accounting system. To achieve this understanding, auditors obtain knowledge of the design of the accounting system, changes to that system and its operation. The relative complexities of the instruments are important determinants of the necessary level of sophistication of both the audited entity's information systems (including the accounting system) and control procedures.

59. The review and evaluation of computer systems is likely to be most effective if performed by audit staff with relevant experience and expertise in this type of work. Before starting the review, the SAI may consider whether appropriately trained staff is available to undertake this work.

60. Debt managers monitor developments in the external environment, as well as the internal controls over PD, to respond promptly and effectively to change. From time to time, senior debt managers may require an independent and detailed assessment of internal controls. This external review ensures the relevance, regularity, and effectiveness of control activities.

61. Debt managers normally depend on periodic reports and communications from inside and outside stakeholders, including institutional creditors, sovereign credit rating agencies, and international organisations, to detect unexpected trends or changes.

62. Internal control monitoring assesses the quality of performance over time and promptly resolves the findings of audits and other reviews. The auditor obtains an understanding of the major activities that the entity uses to monitor internal control over financial reporting, including control activities relevant to PD, and how the entity initiates remedial actions to deficiencies in its controls.

CONDUCTING RISK ASSESSMENT OR PROBLEM ANALYSIS

63. "The auditor should consider and assess the risk of different types of deficiencies, deviations or misstatements that may occur in relation to the subject matter" (ISSAI 100.46), and apply the audit procedures as necessary, throughout the process, in order to keep at an acceptably low level the audit risk of forming incorrect conclusions/opinion.

64. PDM is complex and debt managers may not take proper account of all risks and exposures. Thus, auditors conduct risk assessment to properly identify the high risks areas as potential topics or subject matter for audit.

65. In **Financial Audit**, auditors identify risks throughout the process of obtaining an understanding of the audited entity and its environment, by examining relevant controls that relate to the risks and considering the classes of transactions, account balances and disclosures in the financial statements.

66. In **Performance Audit**, auditors test risk management practices that debt managers perform in order to supervise PD operations. Auditors corroborate that techniques or models in use are effective to detect and monitor contracted debt risks.

67. The compliance auditor's risk assessment starts by identifying significant risks of non-compliance with the regulatory framework governing the entity (laws and regulations).

IDENTIFYING THE RISK OF FRAUD

68. Auditors identify and assess the risks of fraud relevant to the audit objectives and obtain adequate and appropriate audit evidence regarding detected risk, maintaining an attitude of professional skepticism, and being alert to the possibility of fraud throughout the audit process.

69. Financial auditors consider fraudulent financial reporting and misappropriation of assets. In their assessment of the risk of fraud, financial auditors look for "red flags" that have been found in past fraud cases. Examples of risk factors relating to misstatements arising from fraudulent financial reporting and misappropriation of assets can be found in *Appendix 1* of ISA 240.

70. Fraud in **Compliance Audit** relates mainly to the abuse of public authority, but also to fraudulent reporting on compliance issues. Instances of non-compliance with regulations may constitute deliberate misuse of public authority for improper benefit. The execution of public authority includes decisions, non-decisions, preparatory work, advice, information

handling and other acts in the public service. Improper benefits are advantages of a non-economic or economic nature gained by an intentional act by one or more individuals among management, those charged with governance, employees or third parties.

71. Performance auditors, in their assessment of the risk of fraud, obtain an understanding of the relevant internal control systems and examine whether there are signs of irregularities that hamper performance.

72. After conducting risk assessment or problem analysis of the entity/area proposed to be audited, the auditor shall actively manage audit risk to avoid the development of incorrect or incomplete findings, conclusions, and recommendations, providing unbalanced information, or failing to add value. Actively managing audit risk includes anticipating the possible or known risks of the work envisaged, developing audit approaches to address those audit risks during audit planning, and the selection of methods and documenting how those risks will be handled.

73. Actively managing audit risk also includes considering whether the audit team has sufficient experience and competence to do the audit, has access to accurate, reliable, and relevant good quality information, has considered any new information that is available, and has considered alternative perspectives.

DEVELOPING THE AUDIT PLAN

74. The approach to selecting the audit topics to be included in the audit plan may vary. Some SAIs have a bottom-up approach, where the auditor participates in the selection process. Other SAIs have a top-down approach, where the management selects audit topics and the auditor does not take part in the selection process. Some SAIs have a mix of both approaches. (ISSAI 3200.11)

75. After conducting risks assessment, problem analysis, and considering materiality, auditors can now select the audit area/topic/subject matter. In **Financial Audit**, the auditor proceeds to designing the audit based on the results of the assessment of risks of material misstatement due to error and fraud.

76. In selecting topics for **Performance Audit**, SAIs consider: (a) materiality, including the financial, social, and political aspects of the subject matter; (b) significance, (c) risk, (d) auditability, (e) SAI mandate; and (f) impact. Auditors may develop their own selection criteria and procedures, in line with the requirements of the auditing standards/ISSAIs. The relative importance of each criterion will depend on the unique circumstances in the auditee.

77. In general, SAIs would identify and rank potential audit topics for Performance Audit based on two criteria:
    - Those audits expected to add maximum value in terms of improved accountability, economy, efficiency, and effectiveness; and
    - Audits that ensure an appropriate coverage of sovereign debt operations within the limitations of audit resources available.

78. After selecting and prioritising the audit topic, it is important for performance auditors to have an assurance regarding its auditability prior to commencement of the audit. Assessing auditability is an important requirement in the design process. The auditor considers if

conducting an audit is relevant and cost-effective. Auditors also ensure that they possess the competence to observe actual debt operations, communicate with the DeM staff, and have access to PD reports.

79. Even if the selected topic is consistent with the SAI's strategy, the performance auditor might observe during the design phase that the expected problem is already being handled by the audited entity. Similar studies covering similar objectives may already have been conducted by other institutions, or there are no relevant criteria available and no reasonable basis exists for developing audit criteria. Another reason could be that the information or evidence required is unlikely to be available and cannot be obtained efficiently. In such circumstances, it is important that the auditor informs the management of the SAI of these concerns so that it can decide whether to proceed or not.

80. Where the SAI has discretion to select the coverage of **Compliance Audit**, it performs the procedures necessary to identify significant areas and/or areas with potential risk of non-compliance. In selecting and prioritising topics for Compliance Audit, SAIs consider: (a) public or legislative interests or expectations; (b) impact on citizens; (c) projects with significant public funding; (d) beneficiaries of public funds; (e) significance of certain provisions of the law; (f) principles of good governance; (g) roles of different public sector bodies; (h) rights of citizens and of public sector bodies; (i) potential breaches of applicable laws and other regulations which govern the public entity's activity, or the PD, public deficit and external obligations; (j) non-compliance with internal controls, or the absence of an adequate internal control system; (k) findings identified in previous audits; and (i) risks of non-compliance signalled by third parties.

81. A critical decision is identifying area or topic for examination. Assessment of the benefits of the audit, the interest of the SAI's stakeholders, having sufficient technical resources, and possessing a proper legal mandate are important factors in the SAI's decision to conduct **Performance Audit** and **Compliance Audit**.

82. Given the technical complexity of sovereign debt issues, sufficient technical knowledge and audit experience within the SAI are important factors in the selection of audit topics.

83. Auditors consider materiality throughout the audit process. The assessment of materiality requires professional judgment by the auditor, and is related to the scope of the audit. Materiality judgments are made in light of surrounding circumstances and involve both quantitative and qualitative considerations, such as the various legal and regulatory requirements for the PD, and the visibility and sensitivity of the government's PD. Although the auditor may use a mechanical means to compute materiality, the auditor uses judgment in evaluating whether the computed level is appropriate.

84. Other issues may be considered material or significant in the audit of PD, as follows:
    - Fraud;
    - Breach or commission of unlawful acts of an unintentional nature;
    - Presentation of incorrect or incomplete information to management, the auditor or the legislature (concealment);
    - Refuse to follow-up requests made by management, competent bodies or auditors; and
    - Operations or acts carried out despite the lack of legal basis to do so.

DESIGNING THE AUDIT

85. After the SAI has chosen an audit area/topic/subject matter, the auditor designs the specific audit. The purpose of the design phase is to prepare an audit proposal with a work plan and an audit design/plan. A well thought-out design is indispensable in auditing PD.

86. To define the scope, the auditor identifies which entities/offices are to be included in the audit or which particular programme/subject matter, or aspect of a programme, are to be audited. The auditor also identifies the period of time to be reviewed and, if relevant, the locations to be included. Thus, the scope defines the boundary of the audit. It addresses such things as specific questions to be asked, the type of study to be conducted and the character of the investigation.

87. It is important to define the "Public Debt Scope" for the audit considering the varying definitions of PD among countries.

Example of audit scope in Financial Audit:

GAO annually audits the consolidated financial statements of the U.S. government. Because of the significance of the federal debt, which is the amount of the federal government's outstanding debt securities, to the government-wide financial statements, GAO audits the Bureau of the Fiscal Service's Schedules of Federal Debt annually to determine whether, in all material respects, (1) the schedules are fairly presented and (2) 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.

Example of audit scope in Performance Audit:

The Performance Audit on public debt management was conducted in order to assess whether Government of India had a clear and explicit legal as well as organisational framework for managing public debt and also to assess whether it had a management strategy to enable minimisation of risk and cost involved.

The Performance Audit covered internal and external debt of the Government. The period of audit coverage was for five years from 2013-14 to 2017-18. Audit was conducted in the offices of Department of Economic Affairs, Ministry of Finance and Central Bank of India during January to March 2018.

Example of audit scope in Compliance Audit:

The Compliance Audit on public debt was conducted to assess the public debt process carried on by the International Finance Unit of the Finance Ministry and the General Treasury of the Republic for debt incurred by the Central Government during the calendar year 2017 to determine if transactions comply with authorities.

88. The audit objective(s) can be thought of as the overall audit question concerning the subject matter to which the auditor seeks an answer. The audit objective therefore needs to be framed in a way that allows a clear and unambiguous conclusion or opinion.

89. In **Financial Audit**, the audit objective is to determine whether, in all material respects, the financial statements, schedules, or accounts are fairly presented.

90. In **Performance Audit**, the audit objectives may focus on the economy, efficiency and/or effectiveness (three Es) of a PDM system, lending and borrowing activities, fiscal policy and other issues which relate to PD. For example, the three Es are defined in the specific context of PD activities, as follows:
    - *In an audit of effectiveness*, SAIs assess whether DeM achieved its objectives and obtained the intended results;
    - *In an audit of efficiency*, SAIs take one step beyond effectiveness to examine the link between resources or inputs used and specific objectives achieved in DeM activities. The main question in an efficiency audit is: are PDM objectives obtained in a cost-effective manner?
    - *In an audit of economy*, SAIs examine whether PD activities are carried out in accordance with sound principles of public administration and follow best DeM practices.

91. In **Compliance Audit**, the audit objective is to enable the SAI to assess whether the activities of public-sector entities are in accordance with the authorities governing those entities. Compliance Audit may be concerned with regularity (adherence to formal criteria such as relevant laws, regulations and agreements) or with propriety (observance of the general principles governing sound financial management and the conduct of public officials).

92. It is good practice for the performance and compliance auditors to create audit questions that address the audit objective(s). It is important for the audit questions to be thematically related, complementary, not overlapping, and collectively exhaustive in addressing the audit objective(s). The aim is to cover all aspects of the audit objective by specific audit questions.

93. Audit criteria may depend on a number of factors, including the objectives and type of audit and may be specific or more general. The auditor needs to establish suitable audit criteria, which correspond to the audit objective(s) and questions.

94. In **Financial Audit**, the audit criteria is the financial reporting framework adopted by the country or as required by the development partners or lending institutions.

95. An important hurdle that SAIs need to overcome in the planning phase for **Performance Audit** is the development of criteria that can be used to determine whether the performance of sovereign DeM meets, exceeds, or falls short of expectations. A suitable criterion is relevant, understandable, complete, reliable, and objective.

96. Most of the authorities are established in the national legislation, but they can be issued at a lower level in the organisational structure of the public sector. The criteria in a **Compliance Audit** for PD can refer to and include laws, rules, regulations, budgetary resolutions, policies, established codes, agreed terms and the general principles that govern the sound financial management of the public sector and the conduct of public officials.

97. An important part of planning the audit is to determine the methods to be used to gather and analyse data. The audit objective(s), audit questions/procedures, audit scope, and the audit criteria are the factors guiding what evidence is needed and the methods most appropriate to obtain that evidence.

98. In order to obtain sufficient and appropriate evidence in the audit of PD, the auditors would perform procedures that may be applicable in all types of audits. Specifically, auditors may carry out the following, among others:

- Make inquiries with the DeM staff. The auditors may ask debt supervisors and staff to explain their DeM duties. Interviewing personnel will help the auditors evaluate whether the staff understand their duties, and perform procedures as described in the debt procedures manuals;
- Examine key debt documents and records in each of the debt activity cycles – planning, negotiating, contracting, issuance, servicing, analysis, and accounting. The required information will be available in previous audit reports, debt reports produced for internal and external monitors, interviews of DeM officials and market experts, laws and regulations on PD, and debt information systems. By examining the documents and records, computer files and debt reports, the auditors can evaluate whether the descriptions presented in the procedures manual and flow charts have been implemented;
- Compare debt statistics presented in reports issued for different users – external monitoring organisations, debt information in government financial reports, debt data presented in Parliamentary hearings;
- Observe control-related activities that do not leave a written audit trail. The auditors performs a walk-through of the main activities in the cycles of PD operations – planning, negotiating, contracting, issuance, servicing, analysis and accounting;
- Re-compute debt calculations to determine whether debt information systems calculations are correct;
- Count the debt documents and records on hand at a given time; and
- Conduct surveys and statistical analysis.

B. CONDUCTING AN AUDIT

99. "Auditors should perform audit procedures that provide sufficient appropriate audit evidence to support the audit report" (ISSAI 100.49).

100. In an audit of PDM activities, auditors obtain sufficient appropriate audit evidence on which to base their conclusions. Greater evidence is ordinarily provided by consistent evidence obtained from different sources, or of a different nature, than by items of evidence considered individually.

101. The auditor's approach to obtaining the required audit evidence will reflect the specialised and complex nature of certain aspects of PDM activities. For example, the auditor may need to review the adequacy of complex accounting estimates used by the entities or offices involved in DeM. Accounting estimates are used for valuation purposes in certain PDM areas, for example, loan loss provisions and derivatives:

- In reviewing the adequacy of loan loss provisions, auditors ascertain that management have properly exercised their judgment following a consistently applied policy in determining the level of provisions; and
- For various derivative instruments, an independent fair market valuation may not be readily available.

102. Substantive procedures help the auditors to obtain competent, relevant, and reasonable evidence in order to support their opinion, or judgment and conclusions. Examples of Substantive Procedures in Financial Audit are shown in *Appendix 2*.

103. SAI has to ensure that the assigned auditors have the necessary skills to undertake all aspects of the work. However, given the complexity and technical nature of DeM activities, expert advice on several areas can be sought, which may include:
   - The accounting treatment and disclosure of information regarding complex PD instruments, such as derivative products;
   - The valuation and pricing models used by PD managers, *e.g.* to derive yield curves;
   - The use of IT systems by agencies involved in DeM, *e.g.* trading and settlement systems;
   - The use of benchmarking techniques and models;
   - The use of risk assessment tools, *e.g.* the expression of market risk through the use of Value at Risk models; and
   - Legal and compliance issues, including the quality and effectiveness of ISAD[5] contracts used in derivative transactions and other contracts used in trading activities, as well as loan agreements the agencies involved in DeM has entered into.

104. The findings and information obtained during the conduct of **Performance Audit** and **Compliance Audit**, as well as the audit conclusions and recommendations are recorded in the Audit Findings Matrix (AFM) or its equivalent. The AFM is a useful tool to support and guide the preparation of the audit report, because it allows gathering the main contents of the report in a structured way. The matrix enables members of the audit team and other stakeholders to have a homogeneous understanding of the findings and their components. A sample AFM for cash management is presented in *Appendix 2*.

C. REPORTING AND FOLLOW-UP

105. Reporting on the results of the audit of PD varies according to the type of audit performed.

106. In the case of **Financial Audit**, "the form of opinion to be expressed by the auditor depends on the applicable financial reporting framework and any applicable laws or regulations."(ISA 805.A8). Sample Audit Reports on **Financial Audit** and **Compliance Audit** of PD are shown in *Appendix 2*.

107. In **Performance Audit**, "auditors are not normally expected to provide an overall opinion, comparable to the opinion on financial statements, on the audited entity's achievement of economy, efficiency, and effectiveness." (ISSAI 300.21)

108. "Performance auditors should specifically describe how their findings have led to a set of conclusions and – if applicable – a single overall conclusion. This means explaining which

[5]General International Standard Archival Description, published by the International Archives Council (IAC) in 1994.

criteria were developed and used and why, and stating that all relevant viewpoints have been taken into account so that a balanced report can be presented." (ISSAI 300.23)

109. In **Compliance Audit**, "the forms of reporting may be defined in law or by the mandate of the SAI. Nonetheless, the audit report normally contains a conclusion based on the audit work performed." (ISSAI 400.59)

110. "SAIs should implement an appropriate system of quality assurance over their audit activities and reporting and subject such system to periodic independent assessment." (Principle 3, ISSAI 20)

111. The attributes of a good audit report can be found in ISSAI 100.51.

112. The auditor needs to report on the results of his follow-up actions appropriately in order to provide feedback to the legislature, executive, stakeholders and the public. Timely and reliable information on the implementation status of recommendations, the impacts of audit and the relevant corrective actions taken, can help demonstrate the value and benefits of the SAIs.

IV. APPENDICES

Appendix 1 – Debt Indicators

Appendix 2 – Practical Examples and SAI Experience/s

LIST OF ABBREVIATIONS

AFM	Audit Findings Matrix
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
DeM	Debt Management
DMFAS	Debt Management and Financial Analysis System
DMO	Debt Management Office
GUID	Guidance
IDI	INTOSAI Development Initiative
IFPP	INTOSAI Framework of Professional Pronouncements
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
ISSAI	International Standards for Supreme Audit Institutions
PD	Public Debt
PDM	Public Debt Management
SAI	Supreme Audit Institution
SDP	Strategic Development Plan
UNCTAD	United Nations Conference on Trade and Development
WB	World Bank