

INTOSAI Working Group on Public Debt
Impact of Financial Crises on Public Debt & INTOSAI Initiatives

CONTENTS	Page
Executive Summary	2
Introduction	3
Impact on Public Debt of Financial Crisis	3
New Challenges for Policymakers, Debt Managers and SAIs	6
Governments Face the Risk of Higher Interest Payments	6
Unsustainable Public Debt Levels Could Be Reached Sooner	6
Debt Managers Face Higher Scrutiny from Capital Markets	7
Reporting on Public Debt Has Become More Challenging	9
Acquisition of Financial Assets – Their Impact on Public Debt Reporting	10
Contingencies and Commitments	12
INTOSAI Responses to Financial Crises	13
Individual SAI Initiatives In Response to Financial Crisis	14
Mexico	15
Canada	15
China	15
Russia	16
United Kingdom	16
Austria	17
United States	17
Conclusion	20
Potential Recommendation for XX Congress in South Africa	20

Executive Summary

1. The impact of the global financial crisis on public debt was immediate, severe and with potential long-lasting negative effects due to its housing roots and global reach. Public debt levels have increased to 50-year highs in major advanced countries.
2. Prospects of continuing public debt increases amid an uncertain economic recovery have weakened the capacity to respond effectively to future crises of some governments.
3. Higher interest payments are expected in future years as a result of the combined effect of higher debt levels and higher interest rates.
4. Some governments will face sooner the risk of unsustainable public debt levels due to population ageing and health spending pressures.
5. Markets have concerns about the safety of public debt of some governments, increasing the risk of triggering public debt crises.
6. In response to the global financial crisis, governments took a series of extraordinary actions that create significant reporting and audit challenges for SAIs:
 - Governments received significant amounts of equity and debt securities in distressed firms.
 - Governments purchased risky financial derivatives in distressed markets.
 - Governments expanded government guarantees to private investors, bank depositors and others.
 - Governments must consider how to value and disclose risky financial assets in public debt reports.
 - Governments have significant contingent liabilities and commitments that must be disclosed in reports to policymakers and the public.
7. The current financial crisis demands that SAIs redouble their efforts to provide accountability and lessons learned for their governments, while building the technical capacity of SAIs to carry out their audits of public debt management
 - In order to contribute to efforts to address the financial crisis, the INTOSAI Governing Board established the Task Force on the Global Financial Crisis at its 58th meeting in Vienna in November 2008.
 - The INTOSAI Development Initiative established a *Transregional Program on Public Debt Management Audit*, to train participants from 31 SAIs in AFROSAI, ARABOSAI, ASOSAI, CAROSAI, EUROSAI, and PASAI.

Introduction

Public debt challenges are a major recurring concern across the globe. Today many countries face the prospect of high and unsustainable public debt levels amid a weak economic recovery caused by the global financial crisis that started in 2007. The impact of the crisis on public debt was immediate, severe and with potential long-lasting negative effects due to its housing roots and global reach. According to U.S. Treasury and Federal Reserve officials, the causes of the crisis can be traced to the global surge of unregulated and opaque financial derivatives at a time of significant deterioration of underwriting standards in the U.S. housing sector.¹

The emergence of weakly regulated and highly indebted firms – the “shadow banking sector” – made possible an increase in the level of nontransparent, complex and risky mortgage-backed securities that were widely distributed in the United States and abroad under the seal of approval of rating agencies. When house prices in the United States leveled out and then began to decline, default rates started to rise rapidly, and U.S. and foreign investors suffered losses. The sharp reduction in lending across world financial markets eventually affected real economic activity, as trade and industrial output plunged everywhere as consumers and businesses pulled back from spending, causing public debt levels to rise in many countries.

Impact on Public Debt of Financial Crises

The Great Recession that started in 2007 caused public debt levels to increase to 50-year highs in major advanced countries.² For example, in twelve European countries government debt ratios reached levels higher than the Maastricht-specified ceiling of 60% of GDP at the end of 2010: Greece (142.8%), Italy (119%), Belgium (96.8%), Ireland (96.2%), Portugal (93%), Germany (83.2%), France (81.7%), Hungary (80.2%), the United Kingdom (80%), Austria (72.3%), Malta (68%), the Netherlands (62.7%), Cyprus (60.8) and Spain (60.1) (see table 1 below).

¹ Timothy F. Geithner, *Reducing Systemic Risk in a Dynamic Financial System*, June 9, 2008, www.newyorkfed.org; Donald L. Kohn, *International Perspectives on the Crisis and Response*, October 23, 2009, www.federalreserve.org.

² IMF, *Global Financial Stability Report*, April 2010, available in www.imf.org

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Table 1: General Government Gross Debt, Percent of GDP, end of 2006 and 2010, based on Maastricht Debt Definition

Country: Euro currency countries in bold	2006	2010	Change	Percentage Change
Greece	106.1	142.8	36.7	34.59%
Italy	106.6	119	12.4	11.63%
Belgium	88.1	96.8	8.7	9.88%
Ireland	24.8	96.2	71.4	287.90%
Portugal	63.9	93	29.1	45.54%
Germany	67.6	83.2	15.6	23.08%
France	63.7	81.7	18	28.26%
Hungary	65.7	80.2	14.5	22.07%
United Kingdom	43.4	80	36.6	84.33%
Austria	62.8	72.3	9.5	15.13%
Malta	64.2	68	3.8	5.92%
Netherlands	47.4	62.7	15.3	32.28%
Cyprus	64.6	60.8	-3.8	-5.88%
Spain	39.6	60.1	20.5	51.77%
Poland	47.7	55	7.3	15.30%
Finland	39.7	48.4	8.7	21.91%
Latvia	10.7	44.7	34	317.76%
Denmark	32.1	43.6	11.5	35.83%
Slovakia	30.5	41	10.5	34.43%
Sweden	45	39.8	-5.2	-11.56%
Czech Republic	29.4	38.5	9.1	30.95%
Lithuania	18	38.2	20.2	112.22%
Slovenia	26.4	38	11.6	43.94%
Romania	12.4	30.8	18.4	148.39%
Luxembourg	6.7	18.4	11.7	174.63%
Bulgaria	21.6	16.2	-5.4	-25.00%
Estonia	4.4	6.6	2.2	50.00%

Source: EUROSTAT, General Government Gross Debt – Percent of GDP, <http://epp.eurostat.ec.europa.eu>

Note: ‘Maastricht Debt’ is “the total gross debt at nominal value outstanding at the end of the year of the sector of general government, with the exception of those liabilities the corresponding financial assets of which are held by the sector of general government. Government debt is constituted by the liabilities of the general government in the following categories: currency and deposits, securities other than shares, excluding financial derivatives and loans, as defined in the European System of National Accounts (ESA) 95.” See OECD, *Issues in Measuring Government Debt*, March 2010, available in www.oecd.org.

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In the country at the center of the global financial crisis, U.S. federal debt held by the public increased 80 percent, from \$5.0 trillion in 2007 to \$9.0 trillion in 2010. The U.S. debt-to-GDP ratio increased from 36 percent to 62 percent in the same period.

Due to weaker economic growth prospects, countries with already high debt levels face the specter of continuing increases in public debt, in both nominal and relative to GDP, over the medium-term period. For example, the U.S. debt held by the public is estimated to increase from \$9.0 trillion in 2010 to \$15 trillion in 2016, and the debt-to-GDP ratio is estimated to increase from 62 percent to 76 percent by 2016 (see Table 2).

Table 2: United States Federal Debt Held by the Public, US\$ trillions and as Percent of Gross Domestic Product (GDP), 2004 – 2010 (actual), 2011 to 2016 (estimates)

Year	Debt Held by the Public (US\$ trillions)	Debt Held by the Public / GDP
2004	4.3	36.8
2005	4.6	36.9
2006	4.8	36.5
2007	5.0	36.2
2008	5.8	40.3
2009	7.5	53.5
2010	9.0	62.2
2011 (est)	10.9	72.0
2012 (est)	11.9	75.1
2013 (est)	12.8	76.3
2014 (est)	13.6	76.3
2015 (est)	14.3	76.1
2016 (est)	15.1	76.1

Source: Office of Management and Budget, Budget of the U.S. Government, Analytical Perspectives, Fiscal Year 2012, available in www.budget.gov.

Note: “Federal debt held by the public” is the U.S. federal government’s debt held by all investors outside of the federal government, including individuals, corporations, state or local governments, the U.S. Federal Reserve banking system, and foreign governments. When debt held by the Federal Reserve is excluded, the remaining amount is referred to as “privately held debt”. See GAO, FEDERAL DEBT: Answers to Frequently Asked Questions available in <http://www.gao.gov/special.pubs/longterm/debt/>.

New Challenges for Policymakers, Debt Managers and Supreme Audit Institutions

Record levels of public debt and the prospects of continuing public debt increases amid an uncertain economic recovery have weakened the capacity to respond effectively to future crises of some governments. In coming years, policymakers and debt managers will face the following fiscal and financial challenges.

- Interest payments will take a bigger share of budget resources, leaving fewer funds to meet economic and social priorities.
- Some governments will face sooner the risk of unsustainable public debt levels due to population ageing and health spending pressures.
- The global financial crisis has raised concerns about the safety of public debt of some governments, increasing the risk of triggering of public debt crises.

For SAIs, the extraordinary actions taken by governments and the prospects of weaker budget and financial conditions raise complex issues for auditing and reporting on public debt, fiscal commitments and contingencies.

Governments Face the Risk of Higher Interest Payments

A key budget indicator of the affordability of public debt is the ratio of interest payments to expected government revenues, known as the “interest bite”.³ Higher interest payments are expected in future years as a result of the combined effect of higher debt levels and higher interest rates that are expected with the economic recovery.⁴ For example, the U.S. Congressional Budget Office estimates that the U.S. net interest on public debt as a percentage of total revenues would increase from 9.6 percent in fiscal year 2011 to 20.3 percent in 2021.⁵

Unsustainable Public Debt Levels Could Be Reached Sooner

The global financial crisis has moved closer the point of unsustainable public debt levels in some countries that face spending pressures due to rising health care costs and demographic trends. An unsustainable public debt path is reached if debt grows much faster than the economy over the long run. The most common indicator of public debt sustainability is the ratio of public debt held by the public to the Gross Domestic Product of the country. For example, in its 2011 long-term sustainability report, the U.S. GAO concluded that federal debt held by the public would exceed the post-World War II high of 109 percent of GDP by 2021 and continue to grow thereafter (see textbox 1 below). In order to prevent a vicious cycle of ever-increasing debt that must be issued in order to pay rising interest charges, governments would have to enact sooner a combination of revenue increases and reductions in the costs of health- and aging-related programs.

³ International Standards of Supreme Audit Institutions (ISSAI), *Guidance on Definition and Disclosure of Public Debt*, ISSAI, 5421, in www.issai.org

⁴ International Monetary Fund, *The State of Public Finances Cross-Country Fiscal Monitor*, November 2009

⁵ See US Congressional Budget Office, *An Analysis of the President’s Budgetary Proposals for Fiscal Year 2012*, April 2011, available in www.cbo.gov.

TEXTBOX – Impact of Financial Crisis on Long-Term Public Debt Prospects in the U.S.

Since 1992, GAO has published long-term fiscal simulations showing federal deficits and debt levels under different sets of assumptions. GAO developed its long-term model in response to a bipartisan request from Members of Congress concerned about the long-term effects of fiscal policy.

There are many ways to describe the federal government’s long-term fiscal challenge. One method for capturing the challenge in a single number is to measure the “fiscal gap.” The fiscal gap represents the difference, or gap, between revenue and non-interest spending in present value terms over a certain period, such as 75 years, that would need to be closed in order to achieve a specified debt level (e.g., today’s debt to GDP ratio) at the end of the period. From the fiscal gap, one can calculate the size of action needed—in terms of tax increases, spending reductions, or, more likely, some combination of the two—to close the gap. That is, one can calculate the size of action needed for debt held by the public as a share of GDP to equal today’s ratio at the end of the period. For example, under our Alternative simulation, the fiscal gap is 9.6 percent of GDP (or nearly \$99.4 trillion in present value dollars). This means that on average over the next 75 years revenue would have to increase by more than 50 percent or non-interest spending would have to be reduced by about 35 percent (or some combination of the two) to keep debt held by the public at the end of the period from exceeding its level at the beginning of 2011 (roughly 62 percent of GDP).

Even more significant changes would be needed to reduce debt to the level it was at just a few years ago or the 40-year historical average. Policymakers could phase in the policy changes over time allowing for the economy to fully recover and for people to adjust to the changes. However, the longer action to deal with the nation’s long-term fiscal outlook is delayed, the greater the risk that the eventual changes will be disruptive and destabilizing. Under our Alternative simulation, waiting even 10 years would increase the fiscal gap to more than 11 percent of GDP—meaning a revenue increase of about 63 percent or a noninterest spending cut of about 40 percent or some combination of the two would be required to bring debt held by the public back to today’s level by 2085. Even more significant changes would be needed to reduce debt to the level it was at just a few years ago or the 40-year historical average.

Source: *The Federal Government’s Long-Term Fiscal Outlook*, January 2011 Update, GAO-11-451SP, available in www.gao.gov. Additional information on GAO simulations is available at www.gao.gov/special.pubs/longterm/index.html.

END OF TEXTBOX

Other countries – Australia, Germany, Korea, Netherlands, New Zealand, Norway, Sweden, Switzerland, and the United Kingdom – also provide information on the long-term fiscal sustainability of social programs in conjunction with their financial statements. In November 2009, the International Public Sector Accounting Standards Board issued a Consultation Paper – *Reporting on the Long-Term Sustainability of Public Finances*, seeking comments on methods of calculating and reporting on the long-term fiscal sustainability of governments. According to the Board, a fiscal sustainability report would help citizens to hold governments accountable and facilitate the process making informed key decisions to change government programs that drive fiscal sustainability.⁶

Debt Managers Face Higher Scrutiny from Capital Markets

The global financial crisis initially led investors to search for the security and liquidity of debt instruments issued by major governments, such as France, Germany and the United States, while avoiding debt instruments of smaller countries with weak financial sectors, such as Ireland. Recently investors have started to assess the solvency risks created by a weak fiscal outlook and the possibility that unsustainable debt trajectories would be reached sooner. Countries that are especially vulnerable to these concerns

⁶ International Public Sector Accounting Standards Board, *Reporting on the Long-Term Sustainability of Public Finances*, Consultation Paper, November 2009, available in www.ifac.org

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depend heavily on foreign investors and have high shares of short-term debt (see table 3 below). In Greece, for example, 61.5 percent of the general government debt is held abroad. According to IMF analysts, “nonresident buyers are naturally more attuned to sovereign risk and inclined to step back from further purchases in times of market stress.”⁷

Table 3: Vulnerability Indicators of Public Debt in Selected Countries Based on Projections for 2011 (as percent of Gross Domestic Product)

Country	Gross General Government Debt, FY'11(p)	Net General Government Debt, FY'11 (p)	Gross general government debt maturing plus budget deficit (2011)	General Government Debt Held Abroad
Australia	24.1	7.8	4.5	43.4
Austria	70.5	50.7	7.8	87.5
Belgium	97.3	82.3	22.4	68.3
Canada	84.2	35.1	18.5	19.6
France	87.6	77.9	20.6	64.4
Germany	80.1	54.7	11.4	52.8
Greece	152.3	N/A	24.0	61.5
Italy	120.3	100.6	22.8	47.0
Japan	229.1	127.8	55.8	6.9
Korea	28.8	27.5	8.9	11.5
Norway	54.3	-157.3	-1.2	44.4
Portugal	90.6	86.3	21.6	56.7
Spain	63.9	52.6	19.3	49.6
Sweden	37.3	-13.8	5.4	45.2
United Kingdom	83.0	75.1	15.7	26.8
United States	99.5	72.4	28.8	31.9

Source: IMF, *Global Financial Stability Report*, April 2011, in www.imf.org

⁷ International Monetary Fund, *Resolving the Crisis Legacy and Meeting New Challenges to Financial Stability*, Chapter 1, page 9, available at www.imf.org/external/pubs/ft/gfsr/2010/01/pdf/chap1.pdf

Reporting on Public Debt Has Become More Challenging

Governments took a series of extraordinary actions to stabilize financial markets and institutions during the global financial crisis that are directly related to the SAIs' responsibilities to audit government reports and ensure policymakers and the public are provided with comprehensive, timely, reliable and clear information on public debt and borrowing actions. Specifically, governments:

- Received significant amounts of equity and debt securities from systemically important institutions in exchange for cash and promises to provide funds in the future as needed. IMF estimates that the average outlay of G-20 countries for this activity was 2.1% of 2008 GDP and the outlay in Austria, Belgium, Ireland, and the U.S. was more than 4% of each country's GDP.⁸
- Purchased risky financial derivatives in distressed markets. For example, the U.S. Treasury purchased \$226 billion in mortgage-backed securities (MBS) from September 2008 to December 31, 2009. In addition, the U.S. Federal Reserve Board purchased \$1 trillion in GSE MBS over the same period.
- Expanded government guarantees to private investors, bank depositors and mutual fund owners. IMF estimates that guarantees provided by G-20 countries were 14.4% of GDP on average. The size of government guarantees, however, was huge for some countries, including Ireland (261%), the U. K. (51.1%), Sweden (47.5%), the Netherlands (33.9%) and the U.S. (31.4%).

⁸ IMF, *Fiscal Implications of the Global Economic and Financial Crisis*, 2009, in www.imf.org.

Acquisition of Financial Assets – Their Impact on Public Debt Reporting⁹

Because a significant amount of government borrowing during the crisis was invested in risky assets and distressed entities, auditors must consider the proper rules for valuation and reporting them alongside debt figures. Government acquisitions of distressed financial firms occurred during disorderly markets and some were acquired without disbursing cash initially. Purchases of financial assets would normally be based on the market price paid to acquire them. However, if markets were not functioning properly at the time of purchase, the assets can be valued using other methods, such as the discounted value of expected future cash flows or the price at which similar assets trade in open markets. In the textbox below the U.K National Audit Office (UKNAO) describes how the nationalized Northern Rock Bank is reported in HM Treasury accounts at zero cost.

TEXTBOX – REPORTING NORTHERN ROCK IN UK HM TREASURY ACCOUNTS

The HM Treasury led the Government’s response to the current period of instability in the financial markets which began in 2007. The most high profile act has been the Treasury’s acquisition of Northern Rock, which at the time was the UK’s fifth largest mortgage lender. The Government’s decision to take Northern Rock into temporary public ownership on 22 February 2008 had a significant impact on the Treasury’s Resource Account.

Investments – the equity investment in Northern Rock was acquired on 22 February 2008 at zero cost to the Treasury because no payment has yet been made to the previous shareholders. The Treasury, therefore, recognized the investment as zero in the balance sheet.

Provision to refinance the loan – on 28 August 2008, the Treasury replaced the Bank of England loan to Northern Rock with direct funding of £18.8 billion in order to comply with Article 101 of the EC Treaty which restricts monetary financing of government undertakings

Income and expenditures – Northern Rock paid the Treasury £10.9 million in fees in exchange for the support arrangements.

Disclosures – the Accounts featured enhanced disclosures relating to Northern Rock. The various guarantees and indemnities that the Treasury issued as part of its support of Northern Rock are disclosed as contingent liabilities as the liability will only be triggered if certain events occur.

Source: UK NAO, *Performance of HM Treasury 2007-08*, Briefing for the Treasury Select Committee, October 2008, in www.nao.org.uk.

END OF BOX

As shown above in Table 1, **gross** public debt can be a useful indicator to compare public debt levels in different countries, especially when a single regulator has checked the quality and consistency of public debt figures across countries. If a government controls significant amounts of financial assets, **net** public debt could be a better indicator for measuring the effect of government borrowing on capital markets, interest rates and economic growth. As shown in Table 2 above, the gross and net public debt indicators show different results for countries with significant amounts of financial assets, like Norway and Sweden.

⁹ The terms “gross” and “net” public debt can have different meanings across countries. In the U.S., gross debt means debt held by the public plus debt held in government accounts. In other countries gross debt generally means debt held by the public without netting financial assets.

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Whether gross or net public debt would be a better indicator of solvency risk depends on the liquidity and amount of available financial assets to service maturing debt. As a result, governments must decide whether to expand their public debt reports to include financial assets, and how to value and report the assets (see example in textbox below).

TEXTBOX – U.S. Debt Held by the Public Net of Financial Assets and Liabilities

The magnitude and significance of the U.S. Government’s financial assets has increased greatly since the later part of 2008, as a result of the U.S. Government’s actions to address the challenges facing the nation. The next table presents debt held by the public net of the U.S. Government’s financial assets and liabilities, or “net debt”.

Dollar amounts in US \$billions		2010
Gross debt held by the public (as a percent of GDP)		\$9,018.9 (62.2%)
Financial assets:		
Treasury operating cash balance	\$309.8	
Direct loans	\$668.0	
Guaranteed Loan Accounts	-\$32.5	
Troubled Asset Relief Program equity purchases	\$76.9	
U.S. Government-sponsored enterprise preferred stock	\$109.2	
Non-Federal Securities Held by NRRIT	22.8	
Other assets, net of liabilities	-\$29.3	
Total, financial assets net of liabilities	\$1,124.9	
Debt held by the public net of financial assets and liabilities (as percent of GDP)		\$7,894.0 (54.4%)

Source: Office of Management and Budget, Budget of the U.S. Government, Analytical Perspectives, Fiscal Year 2012, available in www.budget.gov

END TEXTBOX

Contingencies and Commitments

As a result of the large increase in guarantees issued by the governments and central banks during the global financial crisis, governments now have significant amounts of contingent liabilities that must be managed and disclosed in their reports to policymakers and the public. For example, the amount of contingent liabilities reported to the European Commission by the 16 euro members increased from zero in 2007 to €773 billion at the end of 2009 (8.6 percent of GDP), excluding the guarantees on bank deposits. For the materially significant contingencies and commitments that governments now confront, SAIs can, within the limits of their legal mandates, examine the information reported to policymakers and the public

The most important unquantified contingency that governments face is the **systemic risk** that can occur when a failure of one or more firms would lead to additional failures in other parts of the economy and jeopardizes the country's economy as a whole. Several SAIs have prepared reports on regulatory reform proposals that highlight the weaknesses of current regulations and identify elements to make regulations more effective. For example, the U.S. GAO has published reports and delivered testimony on a framework to craft and evaluate reform proposals and create a system for monitoring systemwide financial leverage and overseeing systemically important firms, products, or activities.¹⁰ Depending on the extent of their legal mandate, SAIs can provide objective information on the options for reforming the financial regulatory framework, so that countries will not experience another financial crisis that would cause a sharp increase in public debt levels in the future.

¹⁰ GAO, *FINANCIAL REGULATION A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System*, GAO-09-216, and *Financial Crisis Highlights Need to Improve Oversight of Leverage at Financial Institutions and Across System*, GAO-09-739, in www.gao.gov.

INTOSAI Responses to Financial Crises

The current financial crisis presents many challenges to countries around the world and to their SAIs. It demands that SAIs redouble their efforts to help provide accountability and lessons learned for their governments. Although SAIs differ in their legal authorities and mandates, they are generally well positioned to provide independent and objective analyses of these events and can contribute much to efforts to address them.

In keeping with these concerns and considerations, the INTOSAI Governing Board established the Task Force on the Global Financial Crisis at its 58th meeting in Vienna in November 2008. Given the enormous impact of the financial crisis on government finances, the Task Force is coordinating its work with the INTOSAI Public Debt Working Group (PDWG). The INTOSAI chair asked GAO to lead the Task Force, which hosted the kick-off meeting in June 2009 with the participation of 25 countries.¹¹ Four subgroups are examining the origins of the crisis and the potential role of SAIs to avoid future crises. The Task Force has finalized two reports – one on the causes of the global financial crisis and lessons learned, and another on actions taken by governments in response to the financial crisis and management of that response.

In addition to the Financial Crisis Task Force work, two INTOSAI initiatives are supporting SAIs to address new public debt audit challenges.

- The INTOSAI Development Initiative established a *Transregional Program on Public Debt Management Audit*, to train participants from 31 SAIs in AFROSAI, ARABOSAI, ASOSAI, CAROSAI, EUROSAI, and PASAI.¹² The public debt audit plans reported in Table 3 are supported by the IDI Transregional Public Debt Management Audit Initiative.

Table 4: Planned & Ongoing Audits of SAI Participants in IDI-Sponsored Transregional Public Debt Management Audit Program (as of May 2010)

Country	Audit Topic
Albania Fiji Moldova Mongolia Philippines Rwanda Yemen Zambia	Debt Reporting
Bangladesh	Audit of Public Debt Reporting & Monitoring Process
Ethiopia Uganda	Public Debt Information System
Indonesia	Managing the Government Debt Securities
Lithuania	Management of debt securities in domestic market
Vietnam	Issuance, usage and management of the government securities in the period of 2006-2010
Kenya	Management of Loan Guarantees
Ukraine	Audit on the situation of public and publicly guaranteed debt for 2009
Liberia	Legal Framework and Organizational Arrangements for Public Debt Management
Pakistan	Performance Audit of the Implementation of Public Debt Legal Framework & Debt Strategy

¹¹ Countries represented in the first in-person meeting of the INTOSAI Global Financial Crisis Task Force—Challenges to SAIs, held on June 29-July 1, 2009 at the headquarters of the U.S. Government Accountability Office, were Austria, Canada, Chile, China, Cyprus, Denmark, Estonia, Finland, Hungary, Indonesia, Italy, Japan, Korea, Morocco, Netherlands, Poland, Russia, Saudi Arabia, Slovakia, Sweden, United Kingdom, United States, and Venezuela.

¹² See details of IDI’s training activities in www.idi.no.

Country	Audit Topic
Macedonia	Borrowing Activities
Malawi	Debt Servicing Activities
Romania	Management of external loans
Zimbabwe	Debt Management Operations

Source: IDI, Transregional Public Debt Management Audit Program

- INTOSAI’s WGPLD, formerly known as the Public Debt Committee, was set up in 1991 to provide audit guidance to INTOSAI members in this extremely technical area. The WGPLD documents are available at www.wgpd.org.mx, and have been incorporated into the International Standards of Supreme Audit Institutions, available in www.issai.org.

Individual SAI Initiatives In Response to Financial Crisis

For individual SAIs, their audit responsibilities since the onset of the global financial crisis have expanded to the following areas:

1. Ensuring accountability over use of borrowed funds to rescue distressed institutions and allow stabilization of the economy, producing regular, timely, targeted and objective reports on public debt management.
2. Enhancing transparency and accountability by auditing consolidated government financial reports that disclose, in a transparent, complete and timely manner, a full set of public debt obligations, commitments and contingencies, as well as financial and other government-owned assets.
3. Monitoring the government’s borrowing actions to ensure they were carried out efficiently and effectively, while keeping risk exposures at a minimum.
4. Providing insights to reduce the *systemic risk*¹³ caused by highly interconnected entities, such as the largest financial institutions and housing-related government-sponsored enterprises.
5. Providing criteria to deliver fiscal support to distressed sectors and firms, in a manner that is efficient, effective and exposes taxpayers to minimum risk of loss, resolve potential conflicts of interest posed when the government assumes effective control of firms and faces a number of potentially conflicting roles.
6. Identifying options to rebuild the government’s financial capacity, regain the fiscal flexibility and sustainability over the medium- and long-term, in order to meet future crises in an effective manner.

¹³ Systemic risks may start at an individual or group of firms but multiply to a point where they can jeopardize the stability of the financial system and the country’s economic well-being.

DRAFT – PROGRESS REPORT - FOR DISCUSSION ONLY – 6/7/2011

Specific country responses are detailed below:

MEXICO

A key element of Mexico's crisis in 1994-95 was the financial system's vulnerability due to the state's failure to rule, regulate, and oversee. Two of the most important lessons of that crisis are the need to pay attention to preventive indicators, and to encourage transparency in the disclosure of financial statements. In terms of indicators, trends in areas such as credit and real-estate prices—issues crucial to the onset of the recent crisis in the United States—should be monitored. The Superior Audit Office of Mexico performed over 160 audits from 1996 to 2007 related to Mexico's banking bailout after the financial crisis. Mexico's audit findings include a significant lack of governmental oversight and regulations; a weak legal and regulatory framework; an absence of adequate policies, procedures and operational rules; wide discretion in granting credit to related parties; a major lack of operational transparency; ambiguity in roles and responsibilities; and corruption of bank and government employees. As a result of the audits, the government introduced greater transparency, regulation and oversight; put in place an early alert system; and established stricter bank capital regulation and capital recovery rules.

CANADA

Before the financial crisis, Canada had enjoyed budget surpluses for several years, and its debt management practices have been modified to maintain liquidity of a few benchmark securities at lower levels of issuance. Since the start of the financial crisis, the challenge for debt managers has been to move from an approach oriented to declining market debt to a strategy for dealing with rapidly growing debt. The Office of the Auditor General's audit in 2012 will look at the approach followed by Finance Canada to fund the stimulus package, manage risks and costs, and deal with the long-term impact on public debt.

CHINA

The Chinese National Audit Office (CNAO) audits financial regulatory bodies and financial institutions. Its audits cover 70 percent of total financial assets in China. CNAO has had 3 periods in its development since its inception in 1983. In 1983-98, the objective was to maintain and safeguard national economic industry. In 1999-2007, the objective was to mitigate risk to financial assets, improve management of assets, and audit liabilities and assets. From 2008 until the present, because of crisis, the CNAO changed objectives, and the objective now is to maintain financial security.

These changes in audit objectives were partly due to the outbreak of two financial crises since 1997. There has been a change in scope and methodology due to excessive expansion of credits and loans. The Chinese government identified the reasons and tried to reform Chinese financial institutions and improve internal control. CNAO conducted analyses of the risks faced by financial institutions to have a clear picture of assets and verify their profits and losses. The focus area is authenticity and quality of financial assets, compliance, and internal controls.

In its audits CNAO applies an information technology approach for a more thorough audit of its financial institutions. This approach assists in detection of wrongdoing and the ability to address fraud and enhance the shareholder's reports. The state-owned operations were not gravely affected by the global financial crisis. China's overall audit objectives are enforcement, safeguarding security, and pushing innovation. Since the second half of 2008, CNAO has audited the impact of the global financial crisis on commercial banks and on small and medium enterprises. The government injected four trillion yuan (600 billion USD) as a stimulus to the economy. We were asked to audit the use of these funds. CNAO was also asked to investigate the performance of financial regulatory bodies. Since the second half of 2008, CNAO provided first-hand information to the government in order to make informed decisions in combating the financial crisis. One of the challenges is that public ownership is dominant in the Chinese economy.

RUSSIA

In Russia, the first signs of the crisis showed up in April-June 2008 when the shares of Russian companies started losing their value on world exchanges. The macroeconomic indicators started slowing down in August. In September, the Russian Audit Chamber began audits of companies that use public funds and began work on three levels (audits, monitoring capital flow in the banking system, and monitoring the effectiveness of government measures) to monitor the effective control of crisis measures, keep the government aware of the effects of these measures, and provide the public with the results of government measures.

The Audit Chamber uses the data from the Bank of Russia to conduct monitoring, and the data received allow them to analyze the regulatory system and assess the influence of negative factors. The Chamber does long-term monitoring of the economic situation in Russia and globally. The Russian Audit Chamber also uses information from other sources. This allows assessments of the condition of state regulation. The Chamber is trying to improve informational systems and methodologies. Since December 2008, the results of joint discussions with the Bank of Russia on goals form the basis for the Audit Chamber to enhance the efficiency of the audit response to the crisis. The Audit Chamber is carrying out long-term monitoring of the economic situation and is paying special attention to efficient use of public funds, supporting real economy, and fulfilling social obligations. The Audit Chamber is also updating the president and parliament on a quarterly basis. The Audit Chamber's participation in this task force meeting means that the Chamber is ready to consider sharing information and to use information from other SAIs to enhance the efficiency of crisis response strategies.

UNITED KINGDOM

For UK National Audit Office (NAO), the crisis represented a very complex challenge due to its limited mandate. In UK the Bank of England, the Financial Services Authority (FSA), and the Treasury are responsible for financial regulation. However, NAO's mandate covers only the Treasury and it does not have direct access to the FSA, which is a flaw the SAI has highlighted for many years. If the Treasury decides that the FSA needs to be audited, it will invite the NAO or someone else to look at it. Treasury also gets to decide the scope of the audit--this is an entirely unsatisfactory arrangement. The financial crisis created opportunity for NAO to press its case for audit authority and access, which now enjoys parliamentary support. There are new challenges for auditors on two fronts.

1. Financial audits – The UK government now has substantial assets and liabilities, and the NAO is responsible for auditing the HM Treasury's accounts. UK's first set of financial statements are to be published this year. One difficult issue is the proposed measures by the government to ensure that banks' toxic assets can be insured by government, which would lead to negotiation over bank losses. These deals are yet to be signed, and there is a significant risk of losses for the taxpayers. The audit of government financial statements is sensitive to how any toxic assets are valued. The calculations are very sensitive to assumptions about where the global economy is going in the next few years. This will present the NAO with substantial audit judgments over the next few years.
2. Performance audits – UK NAO is conducting a number of value-for-money audits. It has already published a report about the nationalization of Northern Rock, which examined the level of preparedness of the UK authorities to face the bank run. NAO discovered significant weaknesses in contingency planning. For example, financial regulation authorities (Bank of England and FSA) had used scenario testing in 2004 to test the banks' ability to deal with difficulty. These tests showed serious weaknesses in financial institution. Legislation was inadequate for winding down weak institutions, but very little happened as a result of these tests. The NAO is looking to obtain greater accountability of public officials and getting UK Treasury to define what "success" is and monitor progress in managing distressed banks. This is particularly important since government is

now majority owner of several banks. In the future NAO may focus on debt management and increasing debt in the coming years (projected next year at 12 percent of GDP).

3. UK National Audit Office's audit work in progress is titled **Government's support to infrastructure projects during the economic crisis**, with an expected publication in summer 2010. On 3 March 2009, the Chief Secretary to the Treasury announced Government action to ensure that some 110 privately financed infrastructure projects would go forward as planned despite difficulties in raising debt finance as a result of the global credit crunch. The strategy also led to the Treasury Infrastructure Funding Unit making a £120m loan to the Greater Manchester Waste project on 8 April, 2009.

Following the crisis, the U.K. Government proposed giving the NAO power to audit the performance of a new prudential regulator, a subsidiary of the Bank of England, and a new consumer regulator for the banking sector following abolition of the Financial Services Authority.

AUSTRIA

In 2009, the Austrian SAI performed a paradigmatic audit of the Austrian Federal Financing Agency, the agency in charge of debt management for the federal government. This audit led to a new law in April 2010 that limits risks and strategies for this agency.

The Austrian SAI is also working on the topic of "contingent debt" together with other SAIs in the INTOSAI Working Group on Public Debt, and plans to perform a contingent debt audit within the next two or three years.

UNITED STATES

GAO's audit responsibilities since the onset of the global financial crisis have expanded to the following areas. The expansion of GAO's legal authority is illustrated in the textbox below.

TEXTBOX – SAI Mandates Related to Global Financial Crisis: The case of GAO

On October 3, 2008, the Congress assigned to GAO important responsibilities in the Stabilization Act related to The Troubled Asset Relief Program (TARP), the \$700 billion program designed to help the nation deal with its serious financial and economic problems. GAO's work monitoring TARP involved examining

- (1) TARP's performance in meeting the purposes of the act,
- (2) TARP's financial condition and internal controls,
- (3) Characteristics of both asset purchases and the disposition of assets acquired,
- (4) TARP's efficiency in using the funds appropriated,
- (5) Its compliance with applicable laws and regulations,
- (6) The efforts to prevent, identify, and minimize conflicts of interest of those involved in TARP's operations, and
- (7) TARP's efficacy of contracting procedures.

GAO is responsible for submitting reports to the Congress at least every 60 days regarding findings in these areas, and by the end of fiscal year 2010, had issued 17 products related to TARP with over 50 recommendations. GAO also was given the responsibility for auditing the annual financial statements of the entity within the Department of Treasury that implements TARP.

In addition to TARP, the Congress created 12 mandates for GAO in the \$787 billion American

DRAFT – PROGRESS REPORT - FOR DISCUSSION ONLY – 6/7/2011

Recovery and Reinvestment Act of 2009, approved in February 2009. GAO is to conduct bimonthly reviews of how selected states and localities are using the Recovery Act funds and to report quarterly on recipient reports on job creation and job retention.

Because of the high level of public interest in the Recovery Act, GAO established a separate page on its external Web site devoted Recovery Act mandates, available in www.gao.gov/recovery.

In January 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which required GAO to, among other things, conduct a one-time audit of all loans and other financial assistance provided by the Board of Governors or a Federal reserve bank under § 13(3) of the Federal Reserve Act.

GAO's FraudNet also put out a special call for the public to report allegations of fraud, waste, abuse, and mismanagement in the use of Recovery Act funds.

Sources: Summary of GAO's Performance and Financial Information Fiscal Year 2009, GAO-10-235SP, available in www.gao.gov, Summary of GAO's Performance and Financial Information Fiscal Year 2010, GAO-11-3SP, available at <http://www.gao.gov/products/GAO-11-3SP>, and the Dodd-Frank Wall Street Reform and Consumer Protection Act, Library of Congress, <http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.4173>:

END OF TEXTBOX

Following reports are available in the US GAO website: www.gao.gov.

Topic: Public Debt Management

DEBT LIMIT Delays Create Debt Management Challenges and Increase Uncertainty in the Treasury Market, GAO-11-203.

DEBT MANAGEMENT Treasury Was Able to Fund Economic Stabilization and Recovery Expenditures in a Short Period of Time, but Debt Management Challenges Remain, GAO-10-498.

DEBT MANAGEMENT Treasury Inflation Protected Securities Should Play a Heightened Role in Addressing Debt Management Challenges, GAO-09-932.

Topic: Financial Audit of Public Debt

FINANCIAL AUDIT Bureau of the Public Debt's Fiscal Years 2010 and 2009 Schedules of Public Debt, Report to the Secretary of the Treasury, GAO-11-52.

Topic: Long-Term Fiscal Commitments and Debt Sustainability

The Federal Government's Long-Term Fiscal Outlook, January 2011 Update, GAO-11-451SP

Fiscal Year 2010 U.S. GOVERNMENT FINANCIAL STATEMENTS Federal Government Continues to Face Financial Management and Long-Term Fiscal Challenges, Statement of Gene L. Dodaro Comptroller General of the United States, Testimony to Congressional Committees, GAO-11-363T.

FEDERAL DEPOSIT INSURANCE ACT Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision, GAO-10-100.

FINANCIAL MARKETS REGULATION Financial Crisis Highlights Need to Improve Oversight of Leverage at Financial Institutions and Across System, Testimony, GAO-10-555T.

Topic: Enhancing Accountability and Transparency of Financial Support to Distressed Entities

TROUBLED ASSET RELIEF PROGRAM Status of Programs and Implementation of GAO Recommendations, GAO-11-467T.

TROUBLED ASSET RELIEF PROGRAM Third Quarter 2010 Update of Government Assistance Provided to AIG and Description of Recent Execution of Recapitalization Plan GAO-11-46.

DRAFT – PROGRESS REPORT - FOR DISCUSSION ONLY – 6/7/2011

TROUBLED ASSET RELIEF PROGRAM One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges, Report to Congressional Committees, GAO-10-16.

AUTO INDUSTRY A Framework For Considering Financial Assistance, Testimony of Gene L. Dodaro, Acting Comptroller General of the United States, GAO-09-242T.

AUTO INDUSTRY Lessons Learned from Cash for Clunkers Program, Report to Congressional Committees, GAO-10-486.

TROUBLED ASSET RELIEF PROGRAM Automaker Pension Funding and Multiple Federal Roles Pose Challenges for the Future, Report to Congressional Committees, GAO-10-492.

TROUBLED ASSET RELIEF PROGRAM Update of Government Assistance Provided to AIG, Report to Congressional Committees, GAO-10-475.

Topic: Strategies for Managing and Divesting Assets

TARP Treasury's Exit from GM and Chrysler Highlights Competing Goals, and Results of Support to Auto Communities Are Unclear GAO-11-471

FANNIE MAE AND FREDDIE MAC Analysis of Options for Revising the Housing Enterprises' Long-term Structures, Testimony to Congressional Committee, GAO-10-144T

TROUBLED ASSET RELIEF PROGRAM Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM, Report to Congressional Committees, GAO-10-151.

TROUBLED ASSET RELIEF PROGRAM The U.S. Government Role as Shareholder in AIG, Citigroup, Chrysler, and General Motors and Preliminary Views on its Investment Management Activities, Testimony to Congressional Committees, GAO-10-325T.

Topic: Reviews of Funds Provided for Economic Recovery & Stabilization

RECOVERY ACT Opportunities to Improve Management and Strengthen Accountability over States' and Localities' Uses of Funds, GAO-10-999.

RECOVERY ACT Status of States' and Localities' Use of Funds and Efforts to Ensure Accountability, GAO-10-231.

RECOVERY ACT Recipient Reported Jobs Data Provide Some Insight into Use of Recovery Act Funding, but Data Quality and Reporting Issues Need Attention, Testimony of Gene L. Dodaro, Acting Comptroller General of the United States GAO-10-224T.

RECOVERY ACT Funds Continue to Provide Fiscal Relief to States and Localities, While Accountability and Reporting Challenges Need to Be Fully Addressed, GAO-09-1016.

RECOVERY ACT IRS Quickly Implemented Tax Provisions, but Reporting and Enforcement Improvements Are Needed, GAO-10-349

UNEMPLOYMENT INSURANCE TRUST FUNDS Long-Standing State Financing Policies Have Increased Risk of Insolvency, Testimony, GAO-10-692T.

Conclusion

The current financial crisis presents many challenges to countries around the world and to their SAIs. INTOSAI members have taken extraordinary efforts to help provide accountability and lessons learned for their governments. The efforts also support the recommendations of the Congress held in Mexico in November 2007, just before the start of the global financial crisis, where SAIs discussed how to improve the “Management, accountability and audit of public debt”.

The XIX Congress approved seven recommendations on public debt audits and capacity training:

Recommendation 1 - In order to ensure transparency and accountability, SAIs should play a proactive role in auditing public debt and debt management, and providing timely and full reporting to Parliament about the impacts and risks inherent in debt management and the financial system. The extent to which an SAI can do this would depend on its mandate, its responsibilities and the specific circumstances of its country.

Recommendation 2 - Within their national legal framework, SAIs should further develop their audits of public debt by ensuring full disclosure of public debt and public assets.

Recommendation 3 - SAIs should, within their mandate and national legal framework, monitor the development of (long-term) implicit public debt and provide timely information on potential implications of a high or strongly rising implicit public debt level.

Recommendation 4 - SAIs should consider conducting performance audits of public debt and debt management. This could include examining the impacts of budgetary decisions, identifying and assessing risks and reporting on their potential implications.

Recommendation 5 - When auditing public debt, SAIs should ensure that their staff have the requisite skills and expertise, and where appropriate, that SAIs have access to specialized knowledge. SAIs should ensure an adequate adjustment of organizational structures in order to accomplish their objectives.

Recommendation 6 - SAIs should enhance their expertise to assess implications and risks of new financial instruments.

Recommendation 7 - INTOSAI’s Working Group on Public Debt should continue to make significant contributions towards further developing the audit of public debt and its management. The Working Group should adjust its activities continuously in response to any new arising challenges.

Potential Recommendation for XX CONGRESS IN SOUTH AFRICA

SAIs should continue and expand, within their legal mandates, their efforts to provide comprehensive, objective, timely and transparent reporting of the public debt obligations, commitments and contingencies that have been assumed by governments due to the global financial crisis.