

THE AUDIT OF PUBLIC DEBT – APPLICATION OF INTOSAI AUDITING STANDARDS (1ST DRAFT)

1. INTRODUCTION

Following a meeting of the INTOSAI Development Initiative (IDI) and the INTOSAI Public Debt Committee (PDC) in Ottawa during December 2002, a partnership was formed to develop and deliver a programme in public debt auditing for Supreme Audit Institution (SAI) members of INTOSAI.

The overall goals for the partnership programme between the PDC and IDI are to:

- build Public Debt Auditing (PDA) capacity within INTOSAI members;
- inspire member SAIs in their PDA efforts to strengthen and increase their control initiatives;
- provide member SAIs with trainers within PDA.

This guide addresses primarily the first of the above objectives and aims to provide practical advice on how to approach the audit of public debt. In so doing, the guide may also stimulate progress towards the achievement of the programme's other objectives.

The guide is designed to be relevant and accessible to as wide an audience as possible and avoids the use of complex, technical language. In addition, the guide is not a discourse on how things are done in a particular country, nor is it prescriptive in its tone. Information is presented in generic terms to identify concepts and issues that auditors might consider when examining public debt. In this way the guide will facilitate the development of relevant and effective audit processes by SAI's, taking into account local factors present within national environments.

To ensure proper consideration of the requirements placed on auditors, the guide is organised around INTOSAI Field Standard Requirements. Each Field Standard is considered in turn to provide a structured approach to the complete audit process. Within this format the analysis concentrates on issues specific to public debt - this preserves the document's focus and prevents undue commentary on issues that apply equally to all financial audits.

The document's focus is also maintained by making key assumptions about the guide's coverage and scope. These are as follows:

- the guide addresses the audit of wholesale (not retail) public debt;

- the guide assumes the conduct of a financial audit with the aim of providing an opinion on a set of financial statements (i.e. this is not a performance audit guide).

While there will inevitably be read-across between the different aspects of PDA, there are specific considerations and issues relevant to both retail debt and performance audit that are outside the scope of this present document. Looking ahead, these topics present areas where the partnership programme might develop further guidance.

In addition to INTOSAI Auditing Standards, the guide also draws on the IMF-World Bank Guidelines for Public Debt Management, and previous guidance issued by the PDC.

2. THE FUNDAMENTALS OF PUBLIC DEBT MANAGEMENT

2.1 Introduction

This section of the guide introduces the subject area by addressing certain key questions:

- what is public debt management?
- how do countries facilitate the management of public debt?
- what instruments are used to raise public debt?
- what accountability arrangements exist?

The aim is to provide the reader with a brief introduction to the subject and sufficient context to facilitate a smooth introduction to the audit related sections that follow. The paragraphs that follow utilise information provided in the IMF-World Bank Guidelines for Public Debt Management. A much fuller description of issues relating to public debt management, together with country case studies, can be found in the Guidelines themselves.

2.2 What is public debt management?

Public debt management 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 desired risk and cost levels. It should encompass the main financial obligations over which central government exercises control. Public debt management is important for a number of reasons:

- to ensure that the level and rate of growth of public debt is sustainable in a wide range of circumstances;
- to lower government borrowing costs over the long term, thus reducing the impact of deficit financing and contributing to debt sustainability;
- to avoid economic crises because of poorly structured debt;
- the government debt portfolio is often the largest financial portfolio in the country and can have a far-reaching impact on financial stability – consequently, effective management is essential.

2.3 How is debt management facilitated?

There is a range of measures that governments might introduce to help ensure the effective management of public debt. This includes the development of a legal framework to provide the overall parameters for government debt management activity, for example, in respect of the authority to issue debt and the types of instruments that can be used. The legal framework manifests itself through organisational arrangements. These arrangements should be clear and transparent. The allocation of responsibilities between a country's Finance Ministry, Central Bank, or separate Debt Management Agency, for debt management policy advice, and for undertaking primary debt issues, secondary market operations, depository facilities, and clearing and settlement arrangements for trade in government securities should be publicly disclosed, together with details of debt management objectives and the measures of cost and risk to be adopted.

IMF-World Bank Debt Management Guidelines identify further desirable characteristics of effective debt management:

- **co-ordination with monetary and fiscal policies** – debt managers, fiscal policy advisors, and central bankers should share an understanding of each other's objectives given the interdependencies between their different policy instruments. Where the level of financial development allows, there should be a separation of debt management and monetary policy objectives and accountabilities.
- **availability of information** – the public should have access to information concerning the process for formulating and reporting debt management policies, details on the stock and composition of debt and financial assets – including their currency, maturity and interest rate structure.
- **debt management strategy** – there should be a debt management strategy in place that specifies the objectives of debt management and takes account of inherent risks. This should be complemented by cost-effective cash management policies to enable the authorities to meet with a high degree of certainty their financial obligations as they fall due.
- **risk management framework** – to assess risk, debt managers should regularly conduct stress tests of the debt portfolio on the basis of the economic and financial shocks to which the government – and the country more generally – are potentially exposed. A framework should be developed to enable debt managers to identify and manage the trade offs between expected cost and risk in the government debt portfolio. Debt managers should consider the impact that contingent liabilities have on the government's financial position, including its overall liquidity, when making borrowing decisions.
- **development and maintenance of an efficient market for government securities** – in order to minimise cost and risk over the

medium to long run, debt managers should ensure their policies and operations are consistent with the development of an efficient government securities market. For example, the government should strive to achieve a broad investor base for its domestic and foreign obligations, with due regard to cost and risk, and should treat investors equitably. Debt management operations in the primary market should be transparent and predictable, and governments and central banks should promote the development of resilient secondary markets that can function effectively under a wide range of market conditions.

2.4 How is public debt comprised?

At its broadest level, public debt consists of all borrowings by the public sector, including consideration of the extent of future and contingent liabilities. In the central government sector, public debt is comprised typically from a range of instruments with different characteristics such as maturity and risk profiles. The most common of these instruments are considered briefly below.

Government bonds

Government bonds are debt securities that provide the purchaser with regular income (the “coupon”) and return the principal value on redemption. Government bonds can be issued in a variety of forms of which the most common are: (i) conventional – which entitle the holder to a fixed nominal coupon and (ii) index linked – where the coupon payments and the principle are linked to an official retail price index. Government bonds typically make up a large proportion of the overall debt portfolio and governments issue bonds with a range of different maturities and coupon rates to facilitate effective management of public debt in accordance with the overall strategy and objectives. Bond maturities vary considerably, but usually are for at least one year, while anything over 15 years is considered long term.

Short term instruments

In addition to bonds, governments also issue short term instruments with maturities of less than one year. Usually issued at a discount to their face value and redeemed at par, these instruments – for example Treasury bills in the UK, are essentially used to help governments manage short term cash flows.

Loans and deposits

Governments may borrow funds in the form of loans or cash deposits from a variety of sources, both as part of cash management activities or longer term debt management. Borrowing may be internal, for example from the country’s central bank, or it may be external, for example through a supranational organisation such as the International Monetary Fund.

Sale and repurchase agreements

In recent years, governments have increasingly used sale and repurchase agreements (repos) to facilitate short term secured borrowing. In a repo agreement the government sells securities to a counterparty and at the same time enters into an agreement to buy back the securities at a later date. In substance this represents secured borrowing and it enables the government to borrow money at a better rate than unsecured borrowing.

2.5 What accountability arrangements exist?

Accountability arrangements vary between countries to reflect local circumstances and priorities. In the context of this document, it is worth noting two important aspects of accountability as described below:

- the publication of financial statements – governments may publish financial statements relating to their debt management activities. These activities may be presented in accounts designed specifically to provide information on debt management, or relevant information may be provided on a more piecemeal basis across a range of publications.
- external audit of debt management activities – IMF/World Bank guidelines recognise the important role to be played by external auditors and state that debt management activities should be audited annually by external auditors.

Given the above, the sections that follow are designed to assist external auditors when taking forward the audit of financial statements relating to public debt management activities.

3 - PLANNING

INTOSAI field standard requirement

The auditor should plan the audit in a manner which ensure that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner

- Identify important aspect of the environment in which the audited entity operates
- Develop an understanding of the accountability relationships
- Consider the form, content and users of audit opinions, conclusions or reports
- Specify the audit objectives and the tests necessary to meet them
- Identify key management systems and controls and carry out a preliminary assessment to identify both their strengths and weaknesses
- Determine the materiality of matters to be considered
- Review the internal audit of the audited entity and its work program
- Assess the extent of reliance that might be placed on other auditors, for example, internal audit
- Determine the most effective audit approach
- Provide for a review to determine whether appropriate action has been taken on previously reported audit findings and recommendations
- Provide for appropriate documentation for the audit plan and for the proposed fieldwork

3.1 Introduction

Auditors plan their work so as to perform the audit in an effective manner and to develop and document an overall audit plan, describing the expected scope and conduct of the audit. Auditors develop and document the nature and timing and extent of the planned audit procedures required to implement the overall audit plan. Auditors also review the audit work planned and, if necessary, revise it during the course of the audit.

This section provides auditors with supplementary guidance on the matters to consider when applying the INTOSAI field standard on planning in an audit of public debt activities.

3.2 Identify important aspects of the environment in which the audited entity operates

Auditors identify important aspects of the environment in which the entity operates sufficient to enable them to understand the events, transactions and practices that may have an effect on the way in which public debt activities are conducted and reported.

Understanding the environment in which the entity operates assists auditors in, for example, assessing risks of error, in determining the nature, timing and extent of audit procedures, evaluating audit evidence and in considering the consistency and reliability of the financial statements as a whole when completing the audit.

In the audit of public debt activities this can involve obtaining an understanding of the debt management arrangements within a country, the general economic factors which may influence the debt management practices, and knowledge of the types of financial instruments used in borrowing.

Understanding of the debt management arrangements

The auditor gains sufficient understanding of debt management arrangements to develop an effective audit approach. The auditor regularly reviews this understanding to ensure that the impact of significant changes and developments are reflected properly during the current and future audits.

In obtaining an understanding of the debt management arrangements auditors may consider how debt management activities comply with the Guidelines for Public Debt Management issued by the IMF/World Bank. Assessing the debt management arrangement against the criteria set out within the Guidelines can provide the auditor with a structured view of:

- the objectives and coordination of public debt management;
- the transparency of and accountability for debt management activities;
- the institutional framework for debt management;
- the debt management strategy;
- the risk management framework for debt management activities;
- the role of public debt managers in promoting efficient markets in government securities.

Annex 1 sets out a checklist of issues drawn from the IMF/World Bank Guidelines for Public Debt Management which auditors may wish to consider when developing their understanding of debt management.

General economic factors

The auditor gains sufficient understanding of the general economic factors affecting public debt issuance and management to develop an effective audit approach. General economic factors are likely to have an influence on the nature and extent of public debt activities. For example, when interest rates appear likely to rise, an entity 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.

General economic factors that may be relevant include:

- the general level of domestic economic activity;
- economic conditions in countries in which foreign debt is either held or to which loans have been made;
- the level of interest rates, and availability of financing – (i) may impact on asset and liability valuation (ii) market liquidity may have implications for the type and cost of debt available;
- inflation and currency revaluation – (i) may affect valuation of key balance sheet items (ii) may impact on decisions about the type of debt instruments to be used – for example Fixed or Index-linked Bonds;
- foreign currency rates and controls – (i) may influence the type of debt instrument/currency used (ii) may have material impact on the Profit and Loss Statement (iii) any revaluation of foreign currency assets may impact on the value of assets and liabilities in the post-balance sheet period;
- the characteristics of the markets that are relevant to the instruments used by the entity, including the liquidity or volatility of those markets – (i) condition and credibility of domestic and international capital markets (ii) international derivatives markets;
- government cash flows – (i) ability to meet interest repayments as they fall due (ii) decisions about early redemption of debt (iii) taxation policy and receipts – higher levels of taxation may lead to lower government borrowing, government borrowing itself may be part of a policy to ‘smooth’ taxation over time.

Understanding of transactions and practices

Auditors obtain appropriate skills or knowledge to plan and perform an audit of debt management activities, including an understanding of debt management transactions and practices. Special skills and knowledge include obtaining an understanding of:

- the operating characteristics and risk profile of the financial markets in which the public debt managers operate;

- the financial instruments used by debt managers and their characteristics;
- the entity's information systems. This may require auditors to have special skills or knowledge about computer applications when significant information about financial instruments is transmitted, processed, maintained or accessed electronically;
- the methods of valuation of the financial instrument. This can be particularly important where the entity is using derivative financial instruments as part of its debt management practices; and
- the requirements of relevant legislation, regulations and applicable accounting standards for financial statement assertions related to financial instruments. Derivatives may have complex features that require auditors to have special knowledge to evaluate their measurement, recognition and disclosure. For example, complex pricing structures may increase the complexity of the assumptions used in measuring the value of the instrument.

Members of the audit team may have the necessary skill and knowledge to plan and perform auditing procedures related to financial instruments. Alternatively, auditors may decide to seek the assistance of an expert, with the necessary skills or knowledge to plan and perform the auditing procedures, especially when the derivatives are very complex.

3.3 Develop an understanding of the accountability relationships

To be developed

3.4 Consider the form, content and users of audit opinions, conclusions or reports

To be developed

3.5 Specify the audit objectives and the tests necessary to meet them

Auditors obtain competent, relevant and reasonable evidence on which to base their conclusions. In designing the audit programme, auditors specify the objectives they are seeking to address. The assertions that auditors may seek to test in a financial audit of public debt activities are considered in Section 6: Audit Evidence.

3.6 Identify key management systems and controls and carry out a preliminary assessment to identify both their strengths and weaknesses

Auditors obtain and document an understanding of the accounting system and the key management systems and controls sufficient for them to determine their audit approach.

For an audit of debt management activity where there are likely to be complex processes, transactions and accounting issues, the auditor considers key aspects of the internal control system, including:

- **Control Environment:** the control environment is the foundation of internal controls by virtue of its influence on the conduct of public debt personnel. Senior debt managers are responsible for establishing and nurturing a control environment that promotes – (i) ethical values (ii) human resource policies that support public debt objectives (iii) an organisational structure with clear lines of responsibility (iv) communication and computer-based information systems that incorporate adequate security controls.
- **Risk Assessment:** the process of identifying circumstances and events that can prevent senior management from meeting debt management objectives and measuring the probability of their occurrence. Operational risks arise in the normal course of managing debt transactions. Fraud risks arise from intentional misdeeds to gain personal benefit.
- **Control Activities:** the policies and procedures that help ensure that the government's directives are carried out and actions are taken to achieve the government's debt objectives.
- **Information and Communication:** in order to achieve public debt goals, policymakers and public debt managers need to rely on an information system that captures and disseminates relevant and reliable sovereign debt information.
- **Monitoring:** the process through which developments in the external environment, as well as the internal controls over public debt, are monitored to help debt managers respond promptly and effectively to change. This could be facilitated through ongoing debt operations or through separate audits.

The INTOSAI Public Debt Committee has issued more detailed guidance on Planning and Conducting an Audit of Internal Controls of Public Debt (May 2000)

3.7 Determine the materiality of matters to be considered

Auditors consider materiality and its relationship with audit risk when conducting an audit. Auditors also consider materiality when determining the nature, timing and extent of audit procedures.

In auditing public debt activities, auditors should be aware that movements in balance sheet values may not have a direct correlation to those in the revenue statement. Auditors may therefore choose to regard items in the balance sheet and those in the revenue statement as two distinct classes of accounting entries for the purpose of determining appropriate levels of materiality.

The auditor also considers derivatives, guarantees and other 'off balance sheet' items in setting materiality. This requires an understanding of the nature of each off balance sheet item (or class of items) and its impact, or potential impact, on the entity's financial statements.

3.8 Review the internal audit of the audited entity and its work program

Auditors obtain an understanding of internal audit activities to help plan the audit and develop an effective audit approach.

The knowledge and skills required to understand and audit public debt activities can be quite different from those needed to audit other parts of the public sector. Auditors therefore consider the extent to which any internal audit function has the knowledge and skill to cover public debt activities. This can be particularly important where the entity employs complex financial instruments, such as derivatives.

In some entities, internal audit forms an essential part of the risk control function operated by senior management. The work performed by internal audit may assist the auditors in understanding the accounting systems and internal controls and therefore assessing control risk. Areas where the work performed by internal audit may be particularly relevant are:

- reviewing the appropriateness of policies and procedures and management's compliance with them;
- reviewing the effectiveness of control procedures;
- reviewing the accounting systems used to process public debt transactions;
- reviewing other operational systems relevant to debt management activities;
- ensuring that objectives for debt management are fully understood across the entity, particularly where the risk exposures are most likely to arise;
- assessing whether new risks relating to financial instruments are being identified, assessed and managed; and
- conducting regular reviews to provide management with assurance that debt management activities are being properly controlled.

3.9 Assess the extent of reliance that might be placed on other auditors, for example, internal audit

When assessing the internal audit function of the audited entity, and considering the extent of reliance that might be placed on it, the auditor considers: the scope of internal audit activities, the extent to which internal audit activities can be relied upon; the knowledge and skills of internal audit functions, and the role of internal audit within control procedures.

3.10 Determine the most efficient and effective audit approach

Auditors engaged in the examination of debt management activities would determine the audit approach as they would do for any other audit by having regard to the materiality and risk associated with the audit objectives and financial statements in determining the most appropriate audit procedures and sources of assurance.

[0]3.11 Provide for a review to determine whether appropriate action has been taken on previously reported audit findings and recommendations

In determining key audit risks during planning the auditor determines whether appropriate action has been taken on previously reported audit findings and recommendations. This process is identical to that carried out for any audit engagement.

3.12 Provide for appropriate documentation of the audit plan and for the proposed fieldwork

The auditor develops and documents an overall audit plan describing the expected scope and conduct of the audit. The precise form and content of the overall audit plan will vary depending upon the nature and scale of debt management practices in operation. Important matters to consider during the planning stage of the audit include:

- the debt management framework and operating environment;
- consideration of the legal and regulatory framework;
- an assessment of materiality;
- consideration of complex/significant issues;
- an assessment of the scope to place reliance on the work of others – for example internal auditors;
- analytical procedures – using management, economic and market information to form an expectation of what will appear in the accounts;
- documentation of systems and identification of key controls – performance of walkthrough tests;
- identification and assessment of risks and their potential impact on the financial statements – consideration of mitigating controls;

4 - STUDY AND EVALUATION OF INTERNAL CONTROL

INTOSAI field standard requirement

The auditor, in determining the extent and scope of the audit, should study and evaluate the reliability of internal control.

1. Evaluate the risk environment
2. Review and evaluate the entity's information systems
3. Establish the segregation of duties within the entity

4.1 Introduction

Auditor's planning procedures will provide them with an understanding of the institutional framework surrounding debt management activities and within this, knowledge of the key operations. Auditors use this knowledge to evaluate the entity's risk environment and the system of internal control

4.2 Evaluate the risk environment

Auditors evaluate the risk environment WHY? In their evaluation of the risk environment auditors will consider a variety of factors including:

- the legal framework governing debt management activities and any remit laid down by the Finance Ministry for those responsible for debt management operations;
- the institutional framework for establishing operational plans and ensuring effective oversight of debt management activities;
- the experience and knowledge of debt managers and those charged with oversight;
- any unusual pressures faced by debt managers including market pressures which might lead to a breach of borrowing remit
- the complexity of the entity's information systems or changes to those systems,
- the complexity of the debt management portfolio or a decision to employ new types of borrowing instrument.

Debt management is complex and debt managers may not take proper account of all risks and exposures. For example, the choice of

instruments used by debt managers to raise funds will impact on the risks to which the government is exposed. The use of complex derivative instruments is likely to increase exposure to risk of financial loss than the use of plain vanilla instruments such as bonds. For example, debt instruments with embedded put options can increase uncertainty to the issuer, by effectively shortening portfolio duration, and creating greater exposure to market/rollover risk.

The risks that the auditor will also consider when evaluating the risk environment of debt management operations will also include the risks associated with the management of the debt portfolio, such as:

- **credit risk** – the risk that a counterparty of the debt management entity will be unable to meet its obligations. Credit risk can take a number of forms, for example: (i) delivery or settlement risk – where the debt manager settles its side of the transaction but the counterparty fails to deliver (ii) transactions in over the counter derivatives or options – where the counterparty cannot pay what is due when the contract matures;
- **liquidity risk** – the risk that debt managers are unable to generate sufficient interest in government financial products to raise the required levels of borrowing. For example, because of a weak secondary market in government debt;
- **interest rate risk** – the exposure of the debt portfolio entity to adverse movements in interest rates. For example, debt managers may borrow short-term to fund a long-term programme of expenditure in anticipation of a fall in interest rates. If interest rates actually rise, the government faces increased financing costs when the time comes to roll-over its borrowing. Borrowing longer term would introduce greater certainty to financing costs, but would reduce the government’s ability to take advantage of any fall in interest rates;
- **currency risk** – the risk of loss from an adverse movement in exchange rates between the time of purchase and the time of sale of a currency position. For example, the issuance of large amounts of foreign currency denominated debt and foreign exchange indexed debt can leave governments vulnerable to volatile debt service costs;
- **market risk** – the exposure that arises as a consequence of movements in the market price of assets and positions which can be traded in a defined market. Where debt managers are engaged in trading activities or using derivatives for speculative purposes, the value of government assets can be effected significantly by movements in market price;
- **rollover risk** – the risk associated with the redemption and renewal of government debt. This can relate to a number of factors, for example: (i) the maturity profile of debt - where debt managers do not manage prudently the trade off between short term and long term debt costs caused by possible changes in interest rates (ii) the attractiveness of government debt to investors (iii) matching government’s requirement to

redeem debt with the ability to pay, for example through planned cash receipts or through new borrowing;

In evaluating the risk environment the auditor also assesses the mitigating controls employed by public debt managers. Two aspects of internal control that are essential to the proper conduct of debt management activities are controls around IT systems and the segregation of duties. These issues are considered in separate sections below. In addition to these key areas, additional controls that might be in place include:

- management checks to ensure that borrowing instruments have been used in accordance with the agreed policies, guidelines and authority limits;
- recording of decision making processes, to demonstrate that the reasons behind entering into selected transactions are clearly understandable;
- arrangements to identify approved counterparties and set credit limits and to subject these to regular review; and checks to ensure that transactions were undertaken with approved counterparties and within approved limits;
- seeking counterparty confirmations to obtain third party verification of transaction details – matching and reconciling counterparty confirmations received with internal records;
- periodic deal testing by internal audit to confirm transaction details and verify compliance with debt management strategy;
- the existence of delegated authorities and limits for key staff, for example dealers;
- checks to ensure that transactions have been properly recorded and are entered completely and accurately in the accounting records, and correctly processed in any subsidiary ledger through to the financial statements;
- the existence and completion of control checklists to ensure that bond auctions comply with agreed procedures;
- the existence of comprehensive, up to date, procedures manual for key operations – these help to ensure that staff have an authoritative guidance source when required and can help reduce reliance on key staff;
- the performance and documentation of key reconciliations – for example, monthly bank reconciliations, daily reconciliations between dealers’ records and the trading system, and between the trading system and the accounting system;

- periodic testing of disaster recovery arrangements to help ensure the durability of debt management activity in a period of emergency.

4.2 Review and evaluate the entity’s information systems

Auditors review and evaluate and evaluate the 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 complexity of the instruments are important determinants of the necessary level of sophistication of both the entity's information systems (including the accounting system) and control procedures.

As a result of the large number of transactions undertaken, their frequent complexity and the need for swift and accurate information processing and retrieval, debt management systems are invariably computer based. The issues around the audit of debt management computer systems are essentially the same as with the audit of any other computer system. However, there are a number of characteristics associated with debt management that could increase the risk associated with computer systems. These are considered in table 1

Table 1 – IT risks	
Issue	Risk
Transaction volumes are usually large	Users may find it difficult to detect and correct processing errors Programming errors or other systemic errors in hardware or software, while possibly having a small financial effect on each transaction, may impact on a large number of transactions and have a significant financial impact overall Without adequate contingency arrangements a breakdown in systems may be difficult to recover from
Computer processes are often complex	Computer audit trails may be difficult to follow
Assets are often dematerialised into electronic format, and therefore electronic data may have significant intrinsic value	An increased risk of fraud using computer systems

<p>Significant reliance is placed on segregation of duties as a control and system access rights are normally a key aspect of enforcing this.</p>	<p>Weaknesses in the allocation of system access rights, potentially have a greater significance</p>
<p>A large variety of systems are often used for processing different financial products. For example, different systems might be used for recording trading activity, administering bond auctions, undertaking cash management, producing financial statements, and generating management information</p>	<p>Increased possibility of error through system interface problems</p>
<p>Complex computer spreadsheets and models, with less formalised procedures and controls over development and operation, are often used in debt management for pricing, portfolio management and revaluations.</p>	<p>There is a greater potential for program error and in systems developed and operated in this way</p>

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 auditor might consider whether appropriately trained staff are available or should be brought in to undertake this work.

4.3 Establish the segregation of duties within the entity

Adequate separation of duties within debt management operations is essential to minimise the chances of financial losses and damage to the reputation of debt managers through erroneous or fraudulent activity.

It is generally recognised that well-run debt management operations are typified by a recognised pattern of segregation of duties. This is described neatly in the following extract from IMF-World Bank Public Debt Guidelines.

“Operational responsibility for debt management is generally separated into front and back offices with distinct functions and accountabilities, and separate reporting lines. The back office is typically responsible for executing transactions in financial markets, including the management

of auctions and other forms of borrowing, and all other funding operations. It is important to ensure that the individual executing a market transaction and the individual responsible for entering the transaction into the accounting system are different people. The back office handles the settlement of transactions and the maintenance of the financial records. In a number of cases, a separate middle or risk management office has also been established to undertake risk analysis and monitor and report on portfolio-related risks, and to assess the performance of debt managers against any strategic benchmarks. This separation helps to promote the independence of those setting and monitoring the risk management framework from those responsible for executing market transactions. Where debt management services are provided by the central bank (for example, registry and auction services) on behalf of the government's debt managers, the responsibilities and accountabilities of each party and agreement on service standards can be formalised through an agency agreement between the central bank and the government debt managers.”

An absence of these key divisions of responsibility is likely to raise concern in the auditor's mind about the effectiveness of the control environment. The auditor may conduct further investigations to establish why such segregations of duty are not present or whether the subsequent risks presented are mitigated in some other way. The auditor may decide to raise any residual concerns formally with the debt manager.

5 - COMPLIANCE WITH LAWS AND REGULATIONS

INTOSAI field standard requirement

In conducting regularity (financial) audits, a test should be made of compliance with applicable laws and regulations. The auditor should design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the financial statement amounts or the results of regularity audits. The auditor also should be aware of the possibility of illegal acts that could have an indirect and material effect on the financial statements or results of regularity audits.

In conducting performance audits, an assessment should be made of compliance with applicable laws and regulations when necessary to satisfy the audit objectives. The auditor should design the audit to provide reasonable assurance of detecting illegal acts that could significantly affect audit objectives. The auditor also should be alert to situations or transactions that could be indicative of illegal acts that may have an indirect effect on the audit results.

1. Reviewing compliance with laws and regulations is especially important when auditing government programs
2. Those planning the audit need to be knowledgeable of the compliance requirements that apply to the entity being audited
3. The auditor should be alert to situations or transactions that could be indicative of illegal acts that may indirectly impact the results of the audit

5.1 Reviewing compliance with laws and regulations is especially important when auditing government programs

The audit of public debt management activity is no different from the audit of any other public function in terms of the requirement that external auditors should plan and perform their audit procedures and evaluate and report the results thereof, recognising that non-compliance by the entity with laws or regulations may materially affect the financial statements.

5.2 Those planning the audit need to be knowledgeable of the compliance requirements that apply to the entity being audited

The legal and regulatory framework governing debt management will define the nature and scope of debt management activities. The compliance requirements that apply to the audited entity might take a number of forms:

- legal requirements as set out in primary or secondary legislation;
- regulatory requirements as determined by an external regulator – for example; good practice requirements in respect of anti-money laundering measures, established for the financial services industry;
- supervisory requirements determined by government – for example, the need to comply with an annual debt management remit as agreed annually with the Finance Ministry. Or more generally, the need to operate effective corporate governance and risk management processes in line with requirements for all central government entities.

Within the compliance framework, the specific requirements placed upon the debt management entity will vary but might include:

- restrictions on the type of government debt that can be raised;
- restrictions on the overall level of government debt that can be raised – for example, expressed as a percentage of gross domestic product;
- instructions on the number, size and timing of debt issuance - for example, auctions of government bonds;
- requirements relating to the profile and make up of the government debt portfolio – for example, the maturity of debt instruments, the issue of conventional or index linked bonds.

In addition to domestic requirements, there may also be international considerations that debt managers need to take into account. For example, members of the European Union have limits placed on the extent of government borrowing by the Financial Stability Pact. This requires that borrowing should not exceed 3% of gross domestic product.

5.3 The auditor should be alert to situations or transactions that could be indicative of illegal acts that may indirectly impact the results of the audit

The auditor's ability to be alert to situations or transactions that could be indicative of illegal acts will stem from the extent to which the auditor has a sound understanding of debt management activity - more specifically the legal and regulatory requirements - and the control and governance framework in place.

If the auditor becomes aware of issues or transactions where doubts about compliance exist then these can be taken up with the debt manager where appropriate and further explanations sought. Assurance on such issues can also be obtained from the auditor's review of the debt management control environment and in particular, the existence and operation of an effective compliance function within the debt management entity.

The auditor can target areas where there are heightened risks of illegal activity and target audit work accordingly. For example, the auditor

might conclude that there are particular risks of government debt instruments being used for money laundering purposes. The auditor can then perform focussed audit work to assess the adequacy of controls in this area and verify that particular transactions do not constitute money laundering.

An important area that the auditor can address at an early stage is the relative significance for the audit of potential legal and regulatory issues. For example, the auditor might consider that evidence of government debt instruments being used to facilitate money laundering constitutes a legal breach that warrants a report and qualification of the financial statements. Alternatively, non-compliance with a government imposed remit, might be regarded as a control failure rather than a breach of legislation. In this context the auditor might conclude that inclusion of the issue in the auditor's report to the debt management entity is sufficient. What constitutes an appropriate response by the auditor will depend on the particular circumstances arising and the national context within which the auditor is operating.

6 - AUDIT EVIDENCE

INTOSAI field standard requirement

Competent, relevant and reasonable evidence should be obtained to support the auditor's judgement and conclusions regarding the organisation, program, activity or function under audit.

1. The audit findings, conclusions and recommendations must be based on evidence
2. Auditors should have a sound understanding of techniques and procedures such as inspection, observation, enquiry and confirmation, to collect audit evidence
3. In choosing approaches and procedures, consideration should be given to the quality of evidence

6.1 The audit findings, conclusions and recommendations must be based on evidence

In their audit of public debt activities auditors obtain sufficient competent, relevant and reasonable evidence on which to base their conclusions.

Usually, audit evidence is persuasive rather than conclusive and the auditor seeks audit evidence from different sources or of a different nature to support the same assertion. The auditor's judgement as to what is sufficient, appropriate audit evidence is influenced by such factors as:

- the assessment of the nature and degree of risk of misstatement at both the financial statement level and the account balance or class of transactions level;
- the nature of the accounting and internal control systems, including the control environment;
- the materiality of the item being examined;
- the experience gained during previous audits and the auditor's knowledge of the activity being audited;
- the findings from audit procedures, and from any audit work carried out in the course of preparing the financial statements, including indications of fraud or error;
- the source and reliability of information available.

In evaluating the evidence obtained as part of audit testing, auditors also consider financial statement assertions. Assertions are the representations of those with responsibility for producing debt management financial statements. These representations or assertions may be described in general terms in a number of ways, for example:

- **existence** - an asset or a liability exists at a given date. For example the financial instruments included in the financial statements through measurement or disclosure exist at the date of the balance sheet;
- **rights and obligations** - an asset or a liability pertains to the entity at a given date. For example an entity has the rights and obligations associated with the debt securities, money market instruments or derivatives reported in the financial statements;
- **occurrence** - a transaction or event took place which pertains to the entity during the relevant period. For example the transaction that gave rise to a derivative, or to a profit/(loss) on a disposal of a debt security occurred within the financial reporting period;
- **completeness** - there are no unrecorded assets, liabilities transactions or events, or undisclosed items. For example, all of the entity's debt securities, deposits, money market instruments or derivatives are reported in the financial statements through measurement or disclosure;
- **valuation** - an asset or liability is recorded at an appropriate carrying value. For example, the values of the debt securities or derivatives reported in the financial statements through measurement or disclosure were determined in accordance with relevant legislation, regulations and applicable accounting standards;
- **measurement** - a transaction or event is recorded at the proper amount and revenue or expense is allocated to the proper period. For example interest receipts on financial instruments are properly accrued or recorded, profits/(losses) on sales/maturities are correctly calculated and attributed to the correct accounting period, and were determined in accordance with relevant legislation, regulations and applicable accounting standards; and
- **presentation and disclosure** - an item is disclosed, classified and described in accordance with the applicable reporting framework. (for example, relevant legislation and applicable accounting standards).

6.2 Auditors should have a sound understanding of techniques and procedures such as inspection, observation, enquiry and confirmation, to collect audit evidence

Auditors can use a variety of sources to obtain the evidence required to provide them with the appropriate assurance. These are considered further below:

- **Inspection** - examining records, documents or tangible assets. Three major categories of evidence are:
 - evidence created and provided to auditors by third parties, including such items as bank statements for cash or custodian statements of debt security holdings;
 - evidence created by third parties and held by the entity, including the results of counterparty circularisations. For example, outstanding balances on repo transactions;
 - evidence created and held by the entity, including the schedules, records and reconciliations underpinning the financial statements.
- **Observation** - looking at processes or procedures performed by others - in particular, those that leave no audit trail. For example, this might include attendance at a debt auction, or at a strategy committee meeting to ensure that all procedures are properly adhered to and monitored.
- **Enquiry** - seeking information from knowledgeable persons inside or outside the entity. Enquiries may range from formal written enquiries to third parties, to informal oral enquiries to persons inside the entity. Responses to enquiries may provide auditors with information not possessed previously or with corroborative audit evidence. Key staff that the auditor may consult within a debt management entity include dealers, compliance, risk management, settlements and IT.
- **Confirmation** - responses to enquiries designed to corroborate information contained in the accounting records. For example, the auditor may seek direct confirmation of debts by communication with debtors or of trading activity through direct communication with counter-parties.

Auditors will draw on the techniques above to obtain evidence to support each of the financial statement assertions. Examples of the substantive procedures auditors might perform are provided at Annex 2.

The auditor's approach to obtaining the required audit evidence will reflect the specialised and complex nature of certain aspects of debt management activities. For example, the auditor may need to review the adequacy of complex accounting estimates used by the debt management agency. This issue is considered further below.

Accounting estimates

Accounting estimates are used for valuation purposes in certain debt management areas, for example, loan loss provisions and derivatives:

- in reviewing the adequacy of loan loss provisions, auditors ascertain that management have properly exercised their judgement following a consistently applied policy in determining the level of provisions;
- for various derivative instruments, an independent fair market valuation may not be readily available. For example, in illiquid markets such as rump stock government debt. In these instances, the debt management entity is likely to use some form of mathematical model to provide a valuation.

When examining the adequacy of mathematical models, the auditor can review the controls, procedures and testing of the model and in particular, the performance of the model in various market conditions. In some cases, the auditor may use their own model to assess the entity's valuations. These procedures involve obtaining an understanding of the assumptions and a review of the estimates involved for reasonableness, consistency and conformity with generally accepted practices. Given the complexities involved with these types of model it is common practice for a specialist to be involved in this area of audit work.

Specific issues the auditor might consider include:

- whether the market variables and assumptions used are reasonable and appropriately supported;
- whether market variables and assumptions are used consistently;
- whether new conditions justify a change in the market variables or assumptions used;
- the sensitivity of the valuation to changes in the variables and assumptions.

6.3 In choosing approaches and procedures, consideration should be given to the quality of evidence.

The reliability of audit evidence is influenced by its source: internal or external, and by its nature: visual, documentary or oral. In general:

- evidence obtained directly by auditors is more reliable than that obtained by or from the entity;
- evidence in the form of documents and written representations is more reliable than oral representations;
- original documents are more reliable than photocopies, telexes or facsimiles.

The following paragraphs consider various types of evidence that might be available.

Evidence from external sources

The auditor can generally place greater reliance on evidence from external sources than evidence produced from the entity's own records. Whilst this applies to any audit, it is particularly important in the audit of public debt. The highly complex nature of accounting systems, transactions, instruments and valuation, as well as the high values involved, makes third party evidence a very efficient and valuable source of assurance. Examples of areas where auditors may seek appropriate external evidence include:

- **asset values** - including published prices and counterparty confirmations. This can also help in the evaluation of any models used by the entity for valuation purposes;
- **cash balances** - including external bank statements and counterparty confirmations;
- **existence and ownership of assets and liabilities** - including third party custodian statements, circularisation and confirmations;
- **occurrence and measurement of transactions** - including counterparty confirmation of deals;
- **exchange rates** – obtained from independently published sources, this information may be used to test the reliability of rates used by the public debt body.

Evidence from the entity's own records

Audit evidence obtained from the entity's records is more reliable when the related accounting and internal control system operates effectively. The auditor's view of the effectiveness of the internal accounting and control system is therefore significant in evaluating the quality of audit evidence generated by client systems and records.

Evidence from experts

Given the complex and technical nature of debt management activity, the SAI will wish to consider whether the audit team has sufficient detailed knowledge to undertake all aspects of the audit.

Areas where specialist advice might be appropriate include:

- the accounting treatment and associated disclosures relating to complex financial instruments, such as derivatives;
- the valuation and pricing models used by debt managers, for example, to derive yield curves;
- the use of IT systems by the debt management entity, for example trading and settlement systems;

- the use of tools to assess risk, for example the expression of market risk through the use of Value at Risk models;
- legal and compliance issues, including for example the quality and effectiveness of contracts used in trading activities.

7 - ANALYSIS OF FINANCIAL STATEMENTS

INTOSAI field standard requirement

In regularity (financial) audit and in other types of audit when applicable, auditors should analyse the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with. Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on financial statements.

1. Financial statements are prepared in accordance with acceptable accounting standards
2. Financial statements are presented with due consideration to the circumstances of the audited entity
3. Sufficient disclosures are presented about various elements of financial statements

7.1 Introduction

Auditors carry out such review of the financial statements as is sufficient, in conjunction with the conclusions drawn from other audit evidence obtained, to give them a reasonable basis for their opinion on the financial statements. Key issues that auditors might address when performing this review are considered below.

7.2 Financial statements are prepared in accordance with acceptable accounting standards

The substantive work performed by the auditor should provide evidence that the financial statements have been prepared in accordance with prevailing accounting standards. This work will be informed by the auditor's professional knowledge of accounting standards and applying this to the debt management activity being audited and the particular disclosures made in the financial statements.

While there is a degree of commonality between the audits of most financial statements, the audit of debt management activity may require the auditor to have familiarity with aspects of accounting standards that are not often relevant to the audit of central government functions. For example, the auditor is likely to need expertise in accounting standards relating to derivatives. This may require specialist training to ensure the required degree of expertise.

7.3 Financial statements are presented with due consideration to the circumstances of the audited entity

To ensure that the financial statements are presented with due consideration to the circumstances of the audited entity, the auditor will require a thorough and up to date knowledge of both the debt management entity and the financial markets in general. In this way the auditor can bring an appropriate depth of knowledge to bear when considering the financial statements. This will help the auditor determine whether the financial statements:

- accord with his/her understanding of business activity during the year;
- are consistent with other published information – for example other government reports, or documents produced by the debt management entity;
- reflect properly any significant external developments that have taken place – for example, organisational changes impacting on debt management or large movements in interest rates.

7.4 Sufficient disclosures are presented about various elements of financial statements

In addition to basic checks such as ensuring that the financial statements are numerically correct and internally consistent, the auditor may also want to consider whether additional disclosures relating to debt management activity are sufficient and appropriate. Examples of issues that the auditor's considerations might cover include the following:

- the provision of clear, accessible information about debt management activity and the purpose of the financial statements;
- details about the objectives of the debt management entity;
- details about reporting arrangements;
- a review of activity and performance during the period;
- information on post-balance sheet events;
- information about risk management procedures operated by the debt management entity;
- commentary on specific risks faced by the debt management entity – for example (i) market risk and the use of value at risk and interest rate profile information (ii) derivatives – the operational policies governing their use, and the exposures faced by the debt manager;
- details of accounting policies used to prepare the financial statements – for example relating to accounting conventions, valuation of

securities, repo transactions, gains and losses on trading operations, income recognition;

- the provision of a maturity analysis of debt securities issued and held;
- segmental analysis between different activities – for example between debt management and cash management;
- the disclosure of details about related party transactions.

8 - REPORTING

INTOSAI field standard requirement

At the end of each audit the auditor should prepare a written opinion or report, as appropriate, setting out the findings in an appropriate form; its content should be easy to understand and free from vagueness or ambiguity, include only information which is supported by competent and relevant audit evidence, and be independent, fair and constructive.

With regard to regularity audits, the auditor should prepare a written report, which may either be part of the report on the financial statements or a separate report, on the tests of compliance with applicable laws and regulations. The report should contain a statement of positive assurance on those items tested for compliance and negative assurance on those items not tested.

8.1 The auditor's report on the financial statements

The auditor's reporting requirements in respect of the audit of financial statements relating to debt management activities are likely to be similar to those pertaining to the audit of other central government functions. Consequently, in addition to meeting the requirements of the INTOSAI field audit standard, the auditor might be guided by national auditing standards together with any additional reporting requirements imposed or agreed by government.

8.2 Additional communications

In addition to the auditor's report and opinion on the accounts, the auditor may also prepare other key documents to enhance the audit process and add value to the audited body. For example, at the start of the audit the auditor might prepare a "strategy" document setting out the scope and purpose of the audit, and providing details about how the audit will be conducted and the key issues that the auditor wishes to draw to the attention of the debt management entity.

During the audit, the auditor may feel it appropriate to communicate formally with the debt management body and may prepare letters and reports accordingly. The nature and extent of such interim communications will vary depending on the issues arising. However, at the end of the audit it is common practice for the auditor to provide the debt management body with a letter setting out the key issues encountered and seeking management responses on the points raised and how they will be addressed.

The auditor may have additional rights and duties to report to specified regulators. Where public debt management is overseen by an external regulator, it is likely that the auditor will report to the regulator when information has become available during the performance of the audit and:

- the auditor concludes that the information is relevant to the regulator's functions having regard to such matters as may be specified in statute or any related regulations; and
- in the auditor's opinion there is reasonable cause to believe it is or may be of material significance to the regulator.

With the exception of the formal audit report and opinion on the financial statements, the auditor is likely to have scope to use professional judgement when designing and presenting reports. This allows the auditor to consider the nature of the audience being addressed and the purpose of the document being prepared. For example, the auditor may prepare documents for consideration by the management of the debt management entity or by the audit committee. The differing remit and motivations of these audiences may be reflected by the auditor in the style and content of communications.

Annex 1A: Understanding Debt Management Arrangements: Issues for Auditors to Consider

The types of issues auditors of public debt may wish to consider when obtaining an understanding of the debt management arrangements are set out below.

1. Objectives and Coordination

- | | |
|---|--|
| Objectives | <ul style="list-style-type: none">• Have debt managers defined their key objective?• Is this objective consistent with the IMF/World Bank’s recommendation that it should be, “to ensure that the government’s financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk”? |
| Scope | <ul style="list-style-type: none">• Does debt management activity encompass the ‘main financial obligations’ over which central government exercises control? |
| Coordination with monetary and fiscal policies | <ul style="list-style-type: none">• How far do debt managers, fiscal policy advisers and central bankers share a common understanding of their separate objectives?• Are interdependencies clearly understood• Do debt managers advise fiscal authorities on the costs and risks of government financing requirements and debt levels?• Is there an appropriate separation of debt management and monetary policies objectives and accountabilities?• Do debt, fiscal and monetary authorities share information on the government’s current and future liquidity needs? |

2. Transparency and Accountability

- | | |
|-------------------------|---|
| Clarity of Roles | <ul style="list-style-type: none">• Is there public disclosure of the allocation responsibilities for public debt management between the ministry of finance, the central bank and/(or) a separate debt management agency? This should include such activities as:<ul style="list-style-type: none">▪ The Provision of policy advice▪ Undertaking Issuance of Primary Debt instruments▪ Secondary Market operations▪ Depository Facilities |
|-------------------------|---|

- Clearing/Settlement Arrangements

- Public Disclosure**
- Is there public disclosure of materially important aspects of debt operations?
- Public Availability of Information**
- Is information provided to the public detailing past, current and projected budgetary activity?
 - Does this information disclose the consolidated financial position of the government?
 - Does this information contain detail of the stock and composition of the government's debt and financial instruments, including currency, maturity and interest rate structure?
- Accountability and Integrity**
- Are there formal and/(or) statutory arrangements to ensure annual external audit of debt management activities?

3. Institutional Framework

- Governance**
- Does the legal framework clarify the authority to borrow and to issue new debt, invest, and undertake transactions on the government's behalf?
- Management of Internal Operations**
- Are operational risks and controls properly understood and managed?
 - Are management information systems accurate, comprehensive and properly safeguarded?
 - Are debt management staff governed by code-of-conduct and conflict-of-interest guidelines?
 - Are sound business recovery procedures in place?

4. Debt Management Strategy

- Risk Monitoring**
- Are risks associated with debt mitigated through modifications to debt structure, with regard to cost?
 - Do debt managers consider the financial and other risk characteristics of the government's cashflows?
 - Are risks associated with foreign-currency and short-term or floating rate debt properly managed?
 - Are cost-effective cash management policies in place to enable the authorities to meet financial obligations as they fall due?

5. Risk Management Framework

- Cost vs Risk**
- A framework should be in place to allow debt managers to stress test the debt portfolio, based on potential economic and financial shocks

Active Management

- Debt managers should display an awareness of the risks of active portfolio management (speculation)

Contingent Liabilities

- Debt managers should actively consider the potential impact of contingent liabilities on government liquidity when making borrowing decisions

6. Efficient Markets

- In order to minimize costs debt managers should ensure that their policies and operations are consistent with the development of an efficient government securities market
- Governments should a strive to achieve a broad investor base for its domestic and foreign obligations, with due regard to cost and risk, and should treat investors equitable.
- Government operations in the primary market should be transparent and predictable. (eg. Through the use of competitive auctions and syndications)
- Governments and central banks should promote the development of resilient secondary markets that can function effectively under a wide range of market conditions (including settlement arrangements)

Annex 1B: Key Features of Effective Public Debt Operation: Issues for Auditors to Consider

The auditor may also wish to consider the following list of common features of international debt management operations. This is also drawn from the IMF/World Bank work on Public Debt Management. It was compiled on the basis of a questionnaire sent to sovereign debt managers in many countries in order to establish what the key features of an effective debt management operation are.¹

Common Institutional Arrangements

- Existence of an annual borrowing authority
- A debt ceiling limit
- Domestic and foreign currency debt programs managed together
- Separate debt agency
- Separate front and back offices
- Separate Risk Management Unit (middle office)
- Formal guidelines for managing market and credit risk
- Annual debt management reports
- Regular external peer reviews of debt management activities
- Annual audits of debt management transactions
- Code-of-Conduct and conflict of interest guidelines for debt management staff
- Business recovery procedures in place

Common Portfolio Management Arrangements

- Stress testing of market risk exposures
- Trading conducted to profit from expected movements in interest or exchange rates
- Government cash balances managed separately from debt
- Foreign currency borrowing integrated with foreign exchange reserves management
- Specialized management information technology in place for risk management

Features of Primary Markets for Government Debt

- Auctions used to issue domestic debt

¹ *Guidelines for Public Debt Management: Accompanying Document* (IMF & World Bank, 2002), p.18.

- Fixed-price syndicates used to issue domestic debt
- Benchmark issues for domestic market
- Pre-announced auction schedule
- Central bank participates in the primary market
- Primary dealer system
- Universal access to auctions
- Limits of foreign participation
- Collective action clause (domestic issues)
- Collective Action Clause, external issues

Features of Secondary Markets for Government Debt

- Over-the-counter (OTC) market
- Exchange-traded market mechanism
- Clearing and settlement systems reflect sound practices
- Limits on foreign participation

Features on Benchmark Portfolios

- Duration
- Term-to-Maturity
- Fixed-Floating Ratio
- Currency Composition
- Public Disclosure of benchmarks
- Use of derivatives

Annex 2: Auditing Public Debt: Substantive Procedures

This annex provides examples of substantive procedures which may be used by the auditor of public debt. The procedures have been grouped for the purposes of illustration – in practice, there will be overlap between procedures and the assertions they address.

Assertion	Audit procedure
Existence & Occurrence	Confirmation with the holder of, or counterparty to, the debt security, money market instrument, deposit or derivative.
	Inspection of underlying agreements and other forms of supporting documentation, including confirmations received by an entity, in paper or electronic form, for amounts reported.
	Inspection of supporting documentation for subsequent realisation or settlement after the end of the reporting period.
	Inquiry and observation.
Rights and Obligations	Confirmation of significant terms with the holder of, or counterparty to, the debt instrument.
	Inspection of underlying agreements and other forms of supporting documentation, in paper or electronic form.
Completeness	Review of all counterparty transactions with the debt management entity – when requesting details from the counterparty, the will consider which part of the counterparty’s organisation is responding, and whether this represents all aspects of its dealings with the debt management entity.
	Sending zero-balance confirmations to potential holders or counterparties to test the completeness of values recorded in the financial records.
	Review of brokers’ statements for the existence of transactions and positions held.

Assertion	Audit procedure
	Use of computer aided audit techniques to extract aggregate trading data for agreement to financial accounting data.
	Sample testing individual trades for counter-party confirmations and after-date receipts.
	Review of counterparty circularisation by the debt management entity to confirm the aggregate of outstanding balances.
	Review of the accounting records before and after the year end for unusual transactions and comparing balances with recent regulatory returns or other ‘average balance’ data.
	Review of counterparty confirmations received but not matched to transaction records.
	Review of exception/breach reports for settlements.
	Re-performance of key year-end reconciliations over assets such as cash balances.
	Review of unresolved reconciliation items.
	Inspection of agreements, such as loan or equity agreements, or sales contracts for embedded derivatives.
	Inspection of documentation for activity subsequent to the end of the reporting period.
	Review of relevant information – for example, minutes of those charged with governance, and related papers and reports on trading activities received by the governance body.
	Testing for proper accrual and recognition of dividend and interest income.
Valuation & Measurement	Inspection of documentation to verify the purchase prices.
	Confirmation of the nominal value of holdings to custodian and counterparty statements.
	Re-performance of mark-to-market calculations for a sample of high value debt instruments.

Assertion	Audit procedure
	Checks on the translation of the book and market values of securities denominated in foreign currencies.
	Review of movements in market prices and exchange rates - particularly in illiquid markets or where the entity has very large positions - to consider whether prices or rates used in period end valuations were appropriate.
	Review of counterparty creditworthiness.
	Review of valuation testing performed by the debt management entity.
	Use of quoted market prices to verify values disclosed for debt securities, money market instruments and derivatives.
Presentation & Disclosure	Confirm that the accounting principles selected and applied are in conformity with relevant legislation, regulations and applicable accounting standards, and are appropriate to the circumstances of the debt management entity.
	Confirm that the financial statements, including the related notes, provide information on matters that may affect their use, understanding, and interpretation.
	Confirm that the information presented in the financial statements is classified and summarised in a reasonable manner that is neither too detailed nor too condensed.
	Confirm that the financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows within a range of acceptable limits.
	Review the classification of securities among the various portfolios, to ensure that it accords with the entity's policy (and authorised remit) and has not been manipulated to enhance performance.