

Chapter 3 Auditing Institutional and Organisational Arrangements for Public Debt Management

This chapter helps SAIs to identify the elements; recognise the importance of the institutional and organisational arrangements in PDM; and relate the topic with possible audit types, criteria, sources of evidence, and sample audit questions and findings.

3.1 Institutional and Organisational Arrangements in Public Debt Management

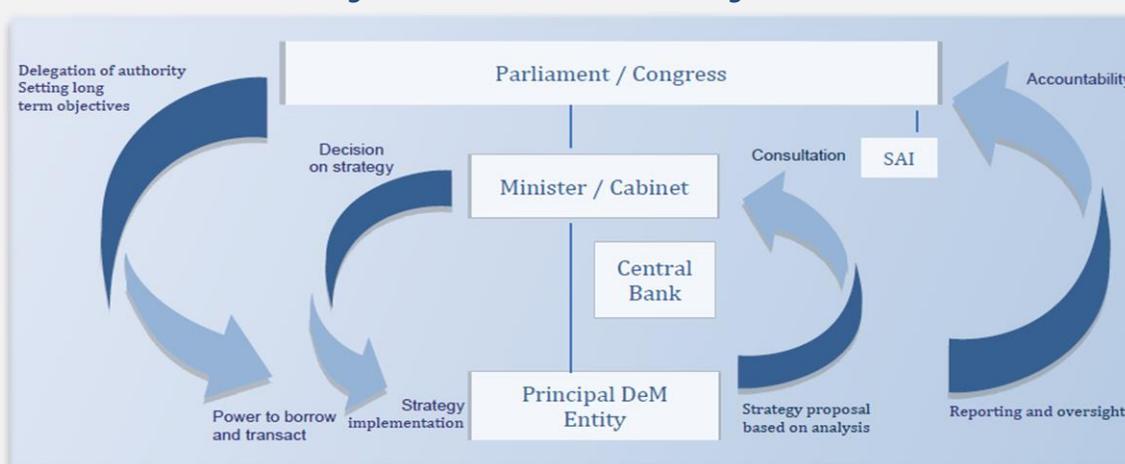
3.1.1 Institutional arrangements

Institutional arrangements are the policies, systems and processes that organisations use to legislate, plan and manage their activities efficiently and to effectively coordinate with others in order to fulfil their mandate.

DeM should be anchored in sound macroeconomic and financial sector policies to ensure that the level and rate of growth in public debt are sustainable. Comprehensive organisational and institutional arrangements should promote public policy elements of DeM, in terms of facilitating coordination with monetary and fiscal policy, the development of the domestic debt market, the control of the possible impact of risky debt structures on the budget and the monitoring of possible contingent liabilities. Debt managers, fiscal and monetary authorities, and financial sector regulators should share an understanding of the objectives of DeM, fiscal, monetary and financial sector policies given the interconnections and interdependencies between their respective policy instruments, as shown in *Figure 4*.

In principle, there should be a separation of DeM policy and monetary policy objectives and accountabilities. Debt managers and fiscal and monetary authorities should share information on the government's current and future cash flow needs. Although the responsibility for ensuring prudent debt levels and conducting DSA lies with fiscal authorities, debt managers should monitor any emerging debt sustainability problems based on portfolio risk analyses and market reactions observed when conducting DeM operations, and inform the government on a timely basis.¹⁶

Figure 4. DeM Institutional Arrangements



Source: *The World Bank Debt Management Performance Assessment (DeMPA Tool)*

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If an institutional arrangement for PDM is to be effective, it needs to be well-specified, with well-articulated mandates and roles, and a robust system of checks and balances in place. A robust system of checks and balances exists, for example, when there is a clear division of the responsibilities at the political level (Parliament and Congress, the president, the cabinet and council of ministers, and the MoF) that sets DeM objectives and strategy and the technical-level (DMO) entities responsible for implementing the DeM strategy.

Realising that DeM should be treated as a separate public policy, there is today increased consensus that consolidating DeM functions into one DMO is one of the most important steps that can be taken to improve the overall quality of DeM, and pave the way for a more strategic management. In addition to forming a DMO, there is also consensus that DeM should be steered by long-term objectives and a medium-term strategy determined within the political sphere in addition to the analysis of the short-term requirements. This set-up could increase efficiency, transparency and accountability, as well as result in better cost and risk trade-offs in the debt portfolio and a more professional approach to the markets.

In many developing countries, the government can issue debt securities in both the domestic market and foreign markets, as well as negotiate loans offered by multilateral institutions and countries. Because each major funding source would normally have a different set of borrowing instruments, conditionality and procedures, there is an additional requirement to coordinate multiple executive and operating functions to guarantee the effectiveness and efficiency of DeM programmes. For SAIs in these countries, it is important to examine the effectiveness of debt coordination activities amongst the ministry of finance, the central bank, resource mobilisation agencies and loan execution programmes.

3.1.2 Organisational structure

The location and organisational structure of a government DMO will vary amongst countries. Differences in organisational arrangements between developing and developed countries are in part caused by differences in their financing sources. Developed countries borrow mostly from debt markets by issuing marketable debt securities in their local currency. In contrast, developing countries have multiple sources of financing, such as loans from bilateral and multilateral lenders in domestic and foreign currencies, as well as issuances of debt securities in the domestic market—at least in the shorter end of that market—and occasionally also in the international capital markets.

Regarding the structure of the DMO, there are basically two models: The DMO can be established as a separate agency or corporate body outside the MoF (e.g., the DMOs in Germany, Hungary, Nigeria, Portugal and Sweden), or it can be established within the ministry of finance (e.g., the DMOs in Argentina, Brazil, France, Kenya and New Zealand). The experience of advanced Organisation for Economic Co-operation and Development (OECD) countries suggests that transitioning and emerging market economies may have to carry out a very careful analysis of the type of institutional arrangements best suited for their PDM. This is because they tend to have an economic situation in which public policy elements are vital (e.g., development of domestic debt markets, coordination with monetary policy, impact of debt servicing on the budget, control of contingent liabilities) and they lack an independent policy.

A third option is to set up the DMO in the central bank. Amongst countries that have opted for this solution are Denmark and India. The advantage of this arrangement is that retention of knowledge of most aspects of financial markets is centralised within a single authority. The disadvantage is that the central bank's involvement in domestic DeM may generate a market perception that DeM benefits from inside information on the future path of interest rates. This was the main reason why the United Kingdom shifted domestic DeM from the Bank of England to the UK

DMO in 1998, and why India has decided to transfer the federal DeM function from the Reserve Bank of India to a separate Indian DMO. To have the DMO within the central bank might also make it more difficult to separate DeM and monetary policy objectives and accountabilities.

The fourth option is to continue with a fragmented organisational set-up where government borrowing and other DeM functions are spread out amongst different entities, such as MoF, ministry of planning and investments, central bank, treasury, external resources department, accountant general's office, and others. The cases of Bolivia, Ecuador, Vietnam and Indonesia are examples of fragmented structures.

The main disadvantages of a fragmented organisational structure are that it can easily lead to 'turf protection', insufficient and untimely information-sharing between the units, unclear responsibilities and problems with consistently implementing the MTDS. This, in turn, can easily lead to incomplete and unreliable debt information provided to policymakers, which can lead to over-borrowing, causing higher borrowing cost, or under-borrowing, which would make the government vulnerable to a liquidity crisis.

Countries may have to weigh the relative costs and benefits of the different organisational arrangements, and eventually arrive at some kind of trade-off. In order to increase efficiency, create adequate segregation of duties and achieve a basic level of internal control, a DMO is normally organised in separate front-, middle- and back-office functions, as illustrated in *Figure 5*.

Figure 5. Organisation of a DMO



However, in smaller countries with limited staff resources, it is common to find a simpler organisation with only two sections: one combined front- and middle-office section, and one separate back-office section.

The front office obtains the financial resources required to meet the government's financial needs. Its activities include:

- Regular communication and consultation with domestic and external sources of finances;
- Loan negotiation; and
- Issuance of government debt securities and contracting bank debt.

The middle office is responsible for:

- Conducting research and analysis (including input to DSA);
- Providing advice on the DeM strategy with a view to managing risk prudently;
- Developing operational procedures to reduce the operational risks; and
- Ensuring that DeM transactions carried out by the front office are within stipulated risk limits.

The back office centralises all the operations of government debt related to:

- Registration and validation of debt data;
- Settlement of borrowing transactions;
- Monitoring and control of disbursements;¹⁷
- Execution and management of debt service operations; and
- Production of statistical information.

The segregation of duties between the front and back offices is standard in the financial industry. The main advantages with this model are that it will, if properly adhered to, reduce the operational risks and substantially improve the likelihood that the data are always timely and correct. What is important for SAIs to examine is whether there is effective segregation of duties and an effective functioning system of internal control.

3.2 Auditing Institutional and Organisational Arrangements in Public Debt Management

After obtaining the legal information on public debt and organisational arrangements of PDM, SAIs should determine if the arrangements are efficient and create adequate segregation of duties.

In general, the organisational arrangement should provide for the effective and efficient execution of front-, middle- and back-office functions. SAIs should obtain the procedures manual and the specific organisational chart that identifies each of the units and their respective roles and responsibilities. In terms of institutional arrangements, SAIs can assess the coordination mechanisms amongst the DeM units with fiscal and monetary policy-makers with regards to regular

¹⁷ By regularly checking the disbursement schedule against the actual disbursements, the DMO can easily check whether the loans are disbursed as planned and, if not, raise this issue with the project management unit. An added benefit of this communication is that the DMO will get a better grip on any delays in completing the project and consequently on the time for disbursements, which will help the DMO to prepare reasonably reliable forecasts on the total debt service as part of the yearly budget preparation. Project management, however, is not a DeM activity and should not be part of the DMO's mandate.

information sharing of accurate and timely forecasts of central government debt servicing and DSA as well as on current and future debt transactions and the central government's cash flows and other debt-related transactions.

In order to develop criteria to assess specific institutional and organisational arrangements in their respective countries, SAIs may use the ISSAI publications produced by the Working Group on Public Debt, the best practices described in the publications on DeM and the UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing.

At the beginning of an audit of the public debt institutional and organisational arrangements, SAIs must decide which components of internal controls to examine and the depth of analysis of each component.¹⁸ Examples of relevant audits of the institutional and organisational arrangements for PDM that use compliance and performance audit methods are described below.

3.2.1 Compliance audit of institutional and organisational arrangements

A compliance audit of the institutional and organisational arrangements for PDM can examine whether the existing organisational structure and institutional arrangements are in accordance with the legal framework for PDM.

The following are samples of audit objectives that may be used by SAIs in their compliance audit of the organisational arrangements for DeM:

- To determine whether the existing DeM policies, systems and processes conform with those defined in the legal framework; and
- To determine whether the current organisational arrangements of the DMO are in accordance with the existing legal framework and management operational guidelines.

3.2.2 Performance audit of institutional and organisational arrangements

A performance audit of the institutional and organisational arrangements for PDM can examine whether the organisational framework is well articulated, practical, and ensures a fair and transparent PDM and whether the institutional and organisational arrangements for PDM are efficient and promote an effective system of checks and balances.

Examples of audit objectives that SAIs could use in their performance audit of the institutional and organisational arrangements for DeM are:

- To determine whether the mandates, roles and responsibilities of the different DeM units are well articulated;
- To determine whether the division of roles and responsibilities promotes an effective system of checks and balances; for example, is there a clear division of responsibilities amongst the legislature (Parliament), the executive (president or council of ministers) and the technical level (DMO); and
- To determine whether the institutional and organisational arrangements for PDM are efficient and promote an effective system of internal control, with robust checks and balances.

¹⁸ ISSAI 5410, Guidance for Planning and Conducting an Audit of Internal Controls of Public Debt, allows the auditor to define the scope of debt audits by using the five components of a system of internal control: control environment, risk assessment, control activities, information and communication, and monitoring.

3.3 Representative Audit Questions on Institutional and Organisational Arrangements for Public Debt Management

The following are examples of audit questions that could be used to support the audit objectives for performance audits of institutional and organisational arrangements.

Audit objective: To determine whether the mandates, roles and responsibilities of the different DeM units are well articulated

- 1) Are institutional and organisational arrangements for PDM properly documented, i.e., is there a comprehensive procedures manual?
- 2) Are the arrangements clearly specified and well-articulated?
- 3) Are the mandates, roles and responsibilities of the different DeM units defined in the primary or secondary legislation?

Audit objective: To determine whether the division of roles and responsibilities promotes an effective system of checks and balances

- 1) Is there a clear division of roles and responsibilities amongst the DeM units at the technical level? Which units perform the functions defined in the 'front', 'middle' and 'back' offices of a DMO?
- 2) Is there a principal DeM unit that ensures proper coordination and exchange of information amongst the various units?

Audit objective: To determine whether the institutional and organisational arrangements for PDM are efficient and promote an effective system of internal control, with robust checks and balances

Organisational (staff capacity and human resource management)

- 1) Does the principal DeM entity (or entities) have professional staff members? How long have the staff members been employed in their current DeM activities? What are the qualifications of staff members?¹⁹
- 2) Do staff members have individual training and development plans? If so, how are these plans formulated, and what are the policies and budget for training?
- 3) Do staff members have code of conduct guidelines, conflict of interest guidelines or both? If so, who is responsible for preparing and monitoring these guidelines? Are staff trained on these guidelines?
- 4) Have previous audits identified instances of non-compliance, fraud, unlawful acts, unethical behaviour, management bias, etc.?

Institutional (coordination with fiscal and monetary policymakers)

- 1) Is there clear separation amongst monetary and fiscal operations and DeM transactions?

¹⁹ DeMPA Methodology, <http://documents1.worldbank.org/curated/en/305821468190742099/pdf/96671-WP-DEMPA-2015-Box391446B-PUBLIC.pdf>.

- 2) Is there a regular and timely exchange of debt-related information (forecasts of debt servicing and DSA) between the fiscal policymakers and the DMO?
- 3) Is there regular information sharing between the DMO and the central bank on monetary policy operations, regarding current and future debt transactions and cash flows?

3.4 Audit Criteria for Auditing Institutional and Organisational Arrangements

In general, institutional and organisational arrangements should establish clear roles and responsibilities to ensure the effective execution of DeM activities, provide well-defined coordinating mechanisms and establish a transparent and accountable system of checks and balances. Lack of coordination in countries with several DeM units is a risk factor that can contribute to the provision of incomplete and unreliable debt information to policymakers. This condition can lead to over-borrowing, causing higher borrowing costs, or to making the government vulnerable to a liquidity crisis.

In terms of organisational arrangements, the DeMPA tool includes two DeM performance indicators (DPIs) that need to be assessed.

- 1) The managerial structure (DPI-2), which has two dimensions to be assessed:
 - a. The effectiveness of the managerial structure for central government borrowings and debt-related transactions and whether it includes a clear division between the political and execution levels; and
 - b. The effectiveness of the managerial structure for preparation and issuance of central government loan guarantees.
- 2) The Segregation of Duties, Staff Capacity, and Business Continuity (DPI-13), which has two dimensions to be assessed:
 - a. Segregation of duties for some key functions, as well as the presence of a risk monitoring and compliance function; and
 - b. Staff capacity and human resource management, to ensure that a sufficient number of DeM staff are employed and adequately trained, and that individual job descriptions have been prepared, amongst others.

In terms of institutional arrangements, the DeMPA tool includes two DPIs that need to be assessed.

- 1) The coordination with fiscal policy (DPI-6), which has two dimensions to be assessed:
 - a. Support of fiscal policymakers through provision of accurate and timely forecasts of central government debt servicing under different scenarios, to ensure that reasonably reliable and timely forecasts of debt servicing are provided during the yearly budget preparation process; and
 - b. Availability of key macro variables, an analysis of debt sustainability and the frequency with which it is undertaken, to ensure that these are shared with the DMO (or the DeM units in a fragmented structure).

- 2) The coordination with monetary policy (DPI-7), which has three dimensions to be assessed:
 - a. Clarity of separation between monetary policy operations and DeM transactions;
 - b. Coordination with the central bank through regular information sharing on current and future debt transactions and the central government's cash flows; and
 - c. Extent of the limit to direct access of financial resources from the central bank (monetary financing of government deficits).

UNCTAD Principle 13 on adequate management and monitoring provides, amongst others, that the establishment of an efficient DMO can address many DeM concerns relating to undisciplined practices with respect to the incurring of debt obligations by sovereign and other public sector borrowers. The DMO should be involved in both the pre- and post-disbursement aspects of any credit for which the State or one of its instruments will be liable. The DMO should have sound processes in place to develop an effective MTDS (including procedures to review the strategy periodically, to monitor emerging risks, to monitor interest costs, to take into account other liabilities that could impact on the government budgetary position, to monitor performance and to report clearly and transparently the outcome of the strategy).

3.5 Sources of Evidence in Auditing Institutional and Organisational Arrangements

SAIs may use the following documents in understanding the institutional and organisational arrangements on PDM. The following documents could be sourced from the DMO, the MoF or the central bank, where appropriate.

- 1) The organisational chart, operations manual and secondary legislation setting out the entities involved in DeM and the preparation and issuance of loan guarantees and their respective roles and responsibilities;
- 2) The agency agreement between the principal DeM entity and the central bank (if such an agreement exists); and
- 3) The documented and approved guarantee framework or government policy.

3.6 Illustrations of Audit Findings on Institutional and Organisational Arrangements

The findings related to institutional arrangements raised by the SAIs that conducted audits during the ALBF programme on this subject matter identified three root causes: (1) lack of segregation of duties, (2) lack of suitably qualified staff and (3) absence of policies and procedure manuals.

1) Lack of segregation of duties

SAIs found a lack of segregation of duties in the recommended front, middle and back office arrangements. This resulted in a lack of transparency in reporting, quality control and efficiency arrangements in the operations of the DMO. The informal nature of the arrangements resulted in lack of accountability in the functioning of the DMO. Specifically, when the DMO is housed internally in the MoF, staff often does DMO functions in addition to their normal responsibilities. This resulted in the SAIs not being able to verify reported

information and required authority for transactions that took place related to debt issue and servicing. On the other hand, the decentralised function of front, middle and back office often vested across a number of entities, resulting in lack of coordination between the DMO functions. Where officers were appointed to various positions, their job description did not speak to DMO functions and vaguely describes their role unrelated to that required to be performed by an officer in the DMO.

2) Lack of suitably qualified staff

In response to some of the findings raised by SAIs, accounting officers and heads of departments cited lack of qualified staff in the DMO as main reasons for findings raised. Specifically, with regards to debt analysis (middle office), recording, accounting (back office) and reporting (back office) were found to have problems of staff capacity. Another department where skills shortages were found was in IT, specifically, skills needed to maintain and administer the software used for the accounting and the reporting of public debt (DMFAS), for which good knowledge of Oracle is needed.

3) Absence of policies and procedures manuals

An absence of policies and procedures manuals was found, resulting in inconsistent practices regarding borrowing and on-lending, resulting in less than optimal conditions for the government. During borrowing negotiations, it was found that no risk assessment policies were in place, the decision regarding optimal borrowing conditions was primarily based on past experiences and the decision vested in one authority. This is due to operational procedures not being documented and standardised, which was further magnified by unclear job descriptions and unclear organigrams, resulting in the objective of DMO not being realised.

On the other hand, in a performance audit on borrowing activities, the preliminary survey revealed that there is a clear delineation of roles and responsibilities in an organisational structure approved by the competent authority. The registration functions are in charge of an area that hierarchically depends on the ministry of finance. Public debt registration is done through a system (e.g., DMFAS 6.1). For this purpose, there is a system coordination which is responsible for maintaining and updating the system. With regard to the personnel who perform the tasks and changes to the system, they were trained in different instances (especially when the change occurred to a more updated version) and the positions of directors and coordinators are occupied by 'career' personnel who were trained and updated in the office itself.

