THE PUBLIC DEBT AUDIT – AN IMPORTANT FORM OF PUBLIC AUDIT IN THE CURRENT MACROECONOMIC CONTEXT

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Abstract
In the current post-crisis macroeconomic context, the Supreme Audit Institutions (ISA) through their expertise, should become an effective warning to systemic imbalances, a systemic correction initiator, a guarantor of financial order in the system, a tool for creating public confidence, but also a stabilizing force at the macroeconomic level. Both the financial audit, and especially the performance audit, must be reoriented towards new areas, such as auditing the public debt performance. In this respect, after presenting the concept of public debt from the perspective of the audit activity, the paper follows the role of ISA and of the public auditors in the public debt management of the states, as well as concrete aspects regarding the public debt audit activity in our country.

Keywords: management of public debt, audit, Supreme Audit Institutions.

JEL classification: G18, H63.

1. Introduction

The public debt can be, under the conditions of a sound administration, a useful source of funds for financing the economic and social development of a state. Governments often resort to loans in order to cover budget deficits, to build major infrastructure projects, to support the balance of payments, to finance expenditure on goods and services that promote economic growth and welfare, etc. (Melecky, M., 2007). In the wake of a widespread financial crisis on all asset markets, with consequences over the financial markets and implicitly over the public debt instruments, public debt can become a threat to the economic stability of a country.

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A mismanagement of the public debt may lead, in time, to its non-sustainability situation, respectively reaching a level of public debt that will not allow compliance by the government of their obligations regarding the debt service payment. Along with the inability to maintain an acceptable level of economic development, the executive can resort to reducing or rescheduling the public debt, being generated financial crises with a significant negative economic impact and major negative consequences. Given the problems that most countries are facing because of high levels of public debt, we consider that sustainability of public finances should be a major challenge to the level of the public policies of states. (Tăvală, 2017).

2. Brief history of the notion of public debt from the perspective of the audit activity

At the level of the European Union, as claimed by the provisions of Regulation (EC) no. 479/2009 of the Council from 25 May, regarding the application of the Protocol about the excessive deficit applicable procedure annexed to the Treaty of establishing the European Communities, republished, the concept of ***public debt*** is defined as being the "total gross debts due at the end of the year, at their nominal value, in the public administration sector, excluding the liabilities whose financial assets are held by the public administration sector."

From the INTOSAI (International Organization of Supreme Audit Institutions) perspective (INTOSAI, 2000), the public debt is defined as consisting of: " a) debts and other commitments of the central government or federal government, depending on the political organization of the country, of the state, provincial, municipal, regional authorities and other governments and local authorities; of the publicly owned and controlled companies and enterprises as well as of other entities that are considered to be of a public nature and of a similar nature; b) debts and other commitments of a public entity assumed towards private companies or other entities".

In presenting the concept of public debt, the INTOSAI Public Debt Committee has an exhaustive approach to the concept of public debt, meaning that *it includes, in addition to the total debt of the Government, of its organizations, of the state and municipal authorities, and the debt of the national companies with majority state capital, of the state financial system, of the monetary authority and contingent liabilities*. As it is outlined in the Guide to defining and presenting the public debt developed by the Public Debt

Committee, the concept of public debt will change according to the user. For example, the economists want a more comprehensive definition when analyzing the public sector's contribution to the economy. Alternatively, if there is doubt about credibility, the definition of public debt could be limited to the government debt instruments issued by a government entity that has the appropriate authority and responsibility (Romania's Court of Accounts, 2010).

Given the terms of reference established by INTOSAI's management, the Public Debt Committee (PDC) has been assigned the task of publishing guidelines and other information for being used by the Supreme Audit Institutions (SAIs) in order to promote a sound management and to adequately report the public debt. In 1998, INTOSAI has approved the Committee's proposal to merge two studies – one referring to the execution of the public debt management audit and another referring to the internal control - in a single guide, namely one concerning planning and carrying out an internal control audit of the public debt. This guide includes the views of the Congress from the year 1998 and the subsequent comments received from the PDC.

The PDC report drawn up in 1998 towards INTOSAI contained several observations that had an impact over the role of ISA in the public debt audits. The rise in global financial market volatility, the emergence of some complex public debt instruments and practices, the lack of consistency when assessing public debt instruments, and the lack of transparency when reporting the public debt by sovereign entities have posed significant challenges to ISAs. These complicated factors affect the public debt service and call into question the criteria that should be appropriate for assessing the operations and the sustainability of the public debt. At the same time, the legislative bodies have become increasingly worried about the interrelationships which exist between the public debt, tax and economic policies.

The tasks concerning the method of understanding the interrelationships between the three above-mentioned policies and the method of response to the legislative requirements call for auditing the public debt operations, thus opening new horizons for ISAs. The Committee believes that these tasks require new audit methods and approaches, a more active presence of ISAs and their ability to develop an arsenal of techniques needed to review the sovereign public debt operations. Therefore, the PDC provided in this guide a set of economic, budgetary and financial concepts and indicators that are used in the assessments of these operations. (Romania's Court of Accounts, 2012).

Each ISA will have to exercise its own judgment concerning the appropriate entities and commitments that will be included in the definition of the public debt. The public debt may include the financial obligations assumed by public entities such as a central or federal government, state, province, county, regional, municipal or local entities owned or controlled by the government, and other entities considered public or quasi-public. Each of these institutions has a multitude of commitments that could be considered as public debt. These include securities, bank loans, long-term lease agreements, secured loans, loans from entities that have cash surplus and are subordinated to the government, government securities issues in national currency, operations with savings which resulted from public savings plans, loans from foreign governments and international organizations, rights and obligations regarding pension funds and health insurance of the public employees and other payments.

3. The role of ISA in public debt management

Public debt management (Romania's Court of Accounts, 2012) represents the process of developing and implementing the strategy regarding public debt management and administration in order to contract the necessary loans at cost and minimum risk levels. *The objectives of the public debt management set out in ISSAI 5440 "Realizing the public debt audit - using detail testing in the financial audits"*, are basically the following:

- ensuring a sustainable growth level and rate of the public debt;
- lowering the cost of long-term public lending, which has a significant impact on tax and public debt sustainability;
- ensuring an adequate structure of public debt.

Public debt management can have a major impact over financial stability, as the public debt portfolio is usually the largest financial portfolio in a country. The external public auditor needs to obtain a sufficient understanding of how the public debt management works in order to achieve an effective audit approach. Also, external public auditors should review this understanding on a permanent basis to ensure that the impact of significant developments and evolutions is adequately reflected during the audit. *The key elements* to be considered for understanding and analyzing how public debt management works, are: the law governing the field, the implementing rules and provisions, the procedures, the legislative requirements that are related to the audited field, as well as the reports of the public debt managers. These elements will help the external public auditors to get an insight into: public debt management and objectives; transparency and responsibility of public debt management; the institutional framework for public debt management; the public debt management strategy; the risk management framework for public debt management activities, the role of public debt managers in domestic financial markets. In order to assess the risks associated with management activities, the leading staff must regularly carry out *stress tests* over the public debt portfolio on the basis of some scenarios that address financial and economic shocks, to which the public debt management is exposed. In order for public debt managers to identify, manage and handle the compromises between the risks and expected costs of the public debt portfolio, they would have to develop an adequate risk management framework. If the public debt managers make the decision to contract public debt, they also have to take into account the impact that contingent liabilities may have on the government's financial position, including liquidity on international financial markets.

At the beginning of a public debt audit, Supreme Audit Institution (ISA) must decide which components of the internal controls they will examine, as well as the depth of their analysis, which depend on the legal mandate of the ISA, on the experience of a previous similar audit, and on the resources available for conducting the audit. Some ISAs have a legally restricted mandate for auditing the sovereign public debt. Other ISAs may have a more comprehensive mandate in order to review public debt issues, but they may lack the technical expertise required for reviewing the complex public debt transactions, this having significant links to tax and monetary transactions.

The ISA can define the scope of the debt audits by using the five components of the internal control system: control environment, risk assessment, control activities, information and communication, monitoring. Each component can be seen as a potential audit area. Each component element leads to areas where the audit varies depending on the scope of the audit and on the technical complexity. The first component element - *Control Environment* - leads the auditors to examine the sovereign political debt management behavior, its concerns and actions regarding the controls. This component may be an audit theme for those ISAs that have a clear legal mandate for auditing *the effectiveness of public debt management*. The other four areas of internal control are much closer to the traditional audits of internal controls. For example, risk assessment would lead auditors to identify what events and circumstances affect the ability of the public debt management to record, process and report information concerning public debt (Romania's Court of Accounts, 2012).

Among the components of the control environment, we believe that a particular attention should be paid to the ***computerized public debt information systems***, which have major implications for the audits of sovereign public debt operations. Auditors should have sufficient experience in using the information systems in order to test the internal controls built on information systems that are classified in general and application controls. Many application controls are embedded in the specific IT systems used by the Ministry of Finance and / or the Central Bank for managing the sovereign public debt. Approximately 50 countries (including Romania) have adopted the Debt Management and Financial Analysis System of the Public Debt (DMFAS), an IT system designed by the United Nations Conference on Trade and Development (UNCTAD), and 54 countries have adopted the Commonwealth Secretariat Debt Recording and Management System of the Public Debt (CS-DRMS). DMFAS is a Microsoft Windows-based application that uses the Oracle's Relational Database Management System. CS-DRMS has electronic links with the World Bank debtor reporting system, as well as with the Model concerning the World Bank's Public Debt Sustainability.

External sources of information can help ISA verify the information provided by the public debt management. The ability to assess external factors and to access the information from a third party source regarding the public debt strengthens the ability of the ISA to assess the probability of non-fulfillment of the sovereign public debt financial obligations. Over the last four decades, the international agencies monitoring the sovereign public debt have reported an increase in the number of cases where the sovereign public debt financial obligations are not met. The total number of cases where the sovereign public debt financial obligations are not met has increased from 18 (in the case of four countries in the period 1956-1965) to 203 (in the case of 65 countries in the period 1986-1994). Most of the public debt rescheduling initiatives have been initiated in recent years under the auspices of the International Monetary Fund (IMF) and the World Bank. External public debt data providers include creditors such as the IMF, the World Bank, international organizations such as the United Nations and the Organization for Economic Co-operation and Development (OECD), lending organizations such as the Paris and London Club and rating agencies. International institutions also provide criteria that can be used in the sovereign public debt audits. For example, rating agencies have identified economic factors and policies that determine a country's ability and capacity to pay its financial liabilities related to public debt (the stability of a country's government, inflation level and rate, exports of goods and services that provide financial reserve currency necessary for the payment of the external public debt service and maintenance of the central bank's foreign exchange reserves for balancing the external balance of payments) (Romania's Court of Accounts, 2012).

4. Aspects concerning the public debt audit in Romania

In our country, according to the provisions of the Romanian Government Decision no. 34/2009, the **Ministry of Public Finances** performs the function of strategy ensuring the *elaboration of the strategy in the field of public debt* and *the function of public debt management and* has the following specific attributions (Romania's Court of Accounts, 2015):

• contracts and reimburses the government public debt and manages the risks associated with the government public debt portfolio;

• draws up the report regarding the public debt of Romania, which it submits to the Government and Parliament on a half-yearly basis;

• contracts and guarantees state loans on the domestic and foreign financial market, within the scope and within the limits of the competences established by law;

• ensures compliance with the commitments made by the agreements concluded with international financial institutions and / or organizations in the field of public debt, including the repayable financial assistance granted by international financial institutions or by the European Union, and shall act as a representative of Romania to international financial institutions, under the conditions of the law.

Because of the appearance of some important fiscal inequalities generated by surplus of public expenditures, the overestimation of the budgetary revenues, the existence of multiple corrections of the budget who increase and reallocated the expenditures, it was adopted the *Law no. 69/2010 of the fiscal-budgetary responsibility*, which provides:

• "ensuring and maintaining fiscal-budgetary discipline, transparency and sustainability in the medium and long term of public finances;

• establishing a framework of principles and rules on the basis of which the Government ensures the implementation of fiscal-budgetary policies leading to a sound financial management of the resources;

• efficient management of public finances in order to serve the public long-term interest, ensuring economic prosperity and anchoring fiscal-budgetary policies in a sustainable context. "

The sustainability of public debt can only be considered in association with the sustainability of public finances. In this context, according to the provisions of the Law no. 69/2010 regarding fiscal and budgetary responsibility, "the sustainability of public finances implies that, in the medium and long term, the Government should be able to manage unforeseen risks or situations without having to make significant adjustments to expenditure, revenue or budget deficit with destabilizing effects from an economic or social point of view."

According to the International Standards of the Supreme Audit Institutions 5410 "Guideline for planning the internal control of the public debt" the *public debt sustainability* is defined such as "the extent to which a government can maintain the existing programs and meet the requirements of creditors without increasing the burden of public debt over the economy". The public debt sustainability analysis aims to provide answers concerning the government's ability to maintain the same expenditure and revenue direction or whether it will need to make an adjustment in order to keep the government public debt steady as a share of GDP.

According to Chapter 7: "The Impact of the Implementation of the 2012-2014 Strategy over the governmental public debt", Subchapter 7.1: "Public debt sustainability analysis" of the Management strategy of the governmental public debt 2012-2014 "the sustainability of public debt is influenced by the volume and dynamics of the public debt stock, of the cost of public debt, and also on the structure of the public debt portfolio (in terms of maturity, exposure to foreign currency risk, the ratio between fixed and floating rate debt, etc). At the same time, the sustainability of public debt is influenced by the general macroeconomic framework as well as by the vulnerabilities present in the private sector, especially with regard to the external debt. For the purpose of assessing public debt sustainability, MFIs regularly carry out analyzes / simulations over the risk factors and their impact on the public debt portfolio. At the same time, the feedback received from the participants in the primary and secondary market of government securities is of great importance when assessing the sustainability of public debt." (Romania's Court of Accounts, 2014).

Public debt vulnerability represents the extent to which the government becomes dependent on the sources of funding outside its control or influence (ISSAI 5410, "Guide to planning the internal public debt control"). This is influenced by both the level of public debt and its profile. Two types of indicators are used in auditing the performance of public debt sustainability and vulnerability. The first group includes indicators that assess the risk that could arise as a result of the impact of the economic conditions on public debt. The second set of indicators assesses the government's ability to adequately manage public debt taking into account certain expected circumstances (ISSAI 5411 "Public debt indicators").

In 2003, the Department of Foreign Affairs of the International Monetary Fund, through the "Vulnerability Indicators" document, proposed that public debt reported to gross domestic product should be considered as a vulnerability indicator. In the case of emerging countries, the suggested maximum limit of this indicator proposed by the International Monetary Fund is 30%. Given that there is no consensus among the international organizations regarding the acceptable level of this indicator, up until this moment there are only levels suggested by two major international institutions, namely the Debt Relief International and the International Monetary Fund. In this regard, it is possible to mention the ISSAI 5411 audit standard (The International Standards of Supreme Audit Institutions), "Public debt indicators", in which this vulnerability indicator is presented (Romania's Court of Accounts, 2010).

In accordance with the provisions of Law no. 94/1992 regarding the organization and functioning of the Court of Accounts of Romania, republished in 2009, "the Court of Accounts may exercise the performance audit on the management of the general consolidated budget, as well as of any public funds". Also, according to the provisions of this law, the Court of Accounts of Romania has specific attributions over "the formation and management of public debt and the situation of government guarantees for internal and external loans". In accordance with the law, in the field of public debt, the Court of Accounts of Romania has the task of conducting the financial audit on the *"annual general account of the state's public debt"*. By auditing the annual general account of the state's public debt, the Romanian Court of Accounts mainly follows the following (Romania's Court of Accounts, 2012):

a) the accuracy and the reality of the data reported in the financial statements prepared in accordance with the accounting regulations in force;
b) the use of reimbursable financing amounts employed on a contractual basis or guaranteed by the Government through the Ministry of Public Finances and sub-borrowed to the main loan officers as sub-borrowers, according to the destination established in the (framework) loan agreements / financing contracts;
c) the quality of economic and financial management.

The Romanian Court of Accounts carries out the financial audit of the annual general account of the state's public debt in compliance with its own audit standards, which were developed on the basis of:

1) INTOSAI audit standards;

2) the European guidelines for implementing INTOSAI audit standards;

3) the audit standards of the International Federation of Accountants (IFAC) ;

4) best auditing practices in the field.

The overall objective of the public external financial audit of the annual general account of the public debt of the state is to have a guarantee regarding the audited financial declarations, if they are prepared by the entity in accordance with the financial reporting framework applicable in Romania, if it respects the principles of legality and regularity and if it provides a true and fair view of the financial position, of the financial performance and of other information related to the activity developed, on the basis of which the external public auditors may express an opinion.

The specific objectives consisted in collecting sufficient and relevant audit evidence on the basis of which the external public auditors must obtain a reasonable assurance that the audited financial statements are accurate and real, that they are prepared in accordance with the regulations in force applicable to the field and that the public debt instruments are contracted / employed, used and reimbursed in accordance with the legal regulations in force.

5. Conclusions

In the wake of a widespread financial crisis on all asset markets, with consequences over the financial markets and implicitly over the public debt instruments, public debt can become a threat to the economic stability of a country.

In terms of public debt management of the states, ISAs can play an important role by improving the legal regulation in the area of public debt and by providing opinions to public debt managers. Moreover, if the results of the audits were made available to the Parliament as part of the audit, certain public debt issues could be anticipated and resolved before it became unsustainable. Through which there were established to the Ministry of Public Finances.

The external public auditor needs to obtain a sufficient understanding of how the public debt management works in order to achieve an effective audit approach. Also, external public auditors should review this understanding on a permanent basis to ensure that the impact of significant developments and evolutions is adequately reflected during the audit.

Due to the appearance of some significant fiscal imbalances generated by excessive public expenditures, the overestimation of the budgetary revenues, the existence of numerous budgetary corrections having as impact the increase and reallocation of expenditures, in 2010 it was adopted the *Law no. 69 of the fiscal-budgetary responsibility*, through which there were established to the Ministry of Public Finances attributions regarding the fiscal-budgetary strategy of the country for the next three years.

In our country, in accordance with the provisions of Law no. 94/1992 regarding the organization and functioning of the Court of Accounts of Romania, republished in 2009, "the Court of Accounts may exercise the performance audit on the management of the general consolidated budget, as well as of any public funds". Also, according to the provisions of this law, the Court of Accounts of Romania has specific attributions over "the formation and management of public debt and the situation of government guarantees for internal and external loans".

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