

Central government debt management

This audit of central government debt management evaluated whether the selected debt management strategy and the implementation model derived from it work as planned.

The selection of central government debt management as an audit topic was based on the financial significance of central government debt management and associated risk. The nominal value of central government debt was about 49.5 billion euros on 31 October 2008. The ratio of debt to gross domestic product has fallen significantly. Although the level of debt has declined, the content of the debt portfolio is subject to constant change. Its structure and properties have been shaped according to set objectives and changing circumstances. Central government debt management is implemented on global financial and capital markets, which can be volatile at times. Large amounts of money are handled in central government debt management both in individual transactions and at the annual level. Reserves and related cash flows are significant from the viewpoint of the state budget economy. The materialisation of even a small risk can result in major financial threats or losses.

The central government debt portfolio fluctuates considerably more than can be directly deduced from net changes in debt. This is mainly due to refinancing and debt management. The principles and strategic objectives of debt management have been outlined in the debt management strategy for the state budget economy.

The debt management strategy is contained in the Ministry of Finance's decision on debt management in the state budget economy. Debt management refers to the procuring of funds in the state budget economy, the investing of the state's cash assets and the managing of risks associated with budget economy debt and invested cash assets and their management. The objective of debt management in the state budget economy is to satisfy financing needs and keep the costs resulting from debt as low as possible over the long term at a risk level that is considered tolerable. Influencing

the interest-rate risk position plays a key role in the debt management strategy. State borrowing is also arranged as cost-efficiently as possible. The debt management strategy, objectives and practical administrative measures focus on the state's net debt.

Central government debt management has been developed in recent years to make it more market-based. It has also been diversified in terms of perspectives and operating possibilities, so that the central government can take advantage of capital markets broadly in debt management. Derivative contracts are used to manage risks associated with debt in the state budget economy.

According to the debt management strategy, objectives fall into two main categories. A general objective is to identify risks associated with debt management or the existing situation. Another objective is to take active measures with the help of risk management to steer debt management in such a way that risks associated with debt are correctly selected and dimensioned. It is also necessary to prepare for the possible effects of risks. These objectives are designed to avoid situations in which, for instance, debt interest costs rise in a way that threatens the state economy or essentially endangers the state's liquidity. The National Audit Office considers that even this model cannot completely avoid the materialisation of general market risks, although their effects can be offset. A broad rise in interest rates always affects debt management costs.

The Finnish state's debt management model covers the procuring of funds, cash management, risk management, the planning of debt management, reporting on debt management, restrictions concerning debt management and the debt management analysis model and theoretical benchmark portfolio.

On the basis of the audit, central government debt management has largely developed in a positive direction in recent years. A strategy based on managing the state's net debt has been created and has been implemented systematically. A strategy based on the use of a benchmark portfolio is quite suitable for developed financial market conditions. The division of labour between the Government (the Ministry of Finance) and the State Treasury has been clarified. Debt management has been organised properly in the Finance Division of the State Treasury.

The debt management model in use has been put to the test by the significant instability of international financial markets. On the

basis of the audit, the selected net debt management model, which avoids risks, has proved its effectiveness in these challenging circumstances.

The audit indicated that, on the basis of the data produced by the debt management information system, it is possible to conclude that the Finance Division of the State Treasury has operated according to approved debt management guidelines and within the risk limits defined in them.

The internal control of central government debt management and risk management have been arranged as a whole at different levels. The National Audit Office considers that this produces true and fair information on debt management. It should be noted, however, that financial markets and debt management needs change constantly. For this reason knowledge and expertise concerning risks associated with fund management situations and fund management tools should be constantly maintained throughout the central government debt management organisation.

In the opinion of the National Audit Office, The Finnish state's debt management strategy and risk management represent best practices internationally. They are well-suited to the needs of a small open economy operating in a large currency zone. Good debt management reduces the country's vulnerability to economic and financial-market disturbances.