

**DEBT MANAGEMENT AND RISK MITIGATION
PUBLIC FINANCE**

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Introduction

Sovereign 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, achieve its risk and cost objectives, and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities.

A government's debt portfolio is usually the largest financial portfolio in the country. It often contains complex and risky financial structures, and can generate substantial risk to the government's balance sheet and to the country's financial stability. As noted by the Financial Stability Forum's Working Group on Capital Flows, "recent experience has highlighted the need for governments to limit the buildup of liquidity exposures and other risks that make their economies especially vulnerable to external shocks."³ Therefore, sound risk management by the public sector is also essential for risk management by other sectors of the economy "because individual entities within the private sector typically are faced with enormous problems when inadequate sovereign risk management generates vulnerability to a liquidity crisis." Sound debt structures help governments reduce their exposure to interest rate, currency and other risks. Many governments seek to support these structures by establishing, where feasible, portfolio benchmarks related to the desired currency composition, duration, and maturity structure of the debt to guide the future composition of the portfolio. Several debt market crises have highlighted the importance of sound debt management practices and the need for an efficient and sound capital market. Although government debt management policies may not have been the sole or even the main cause of these crises, the maturity structure, and interest rate and currency composition of the government's debt portfolio, together with substantial obligations in respect of contingent liabilities have often contributed to the severity of the crisis. Even in situations where there are sound macroeconomic policy settings, risky debt management practices increase the vulnerability of the economy to economic and financial shocks. Sometimes these risks can be readily addressed by relatively straightforward measures, such as by lengthening the maturities of borrowings and paying the associated higher debt servicing costs (assuming an upward sloping yield curve), by adjusting the amount, maturity, and composition of foreign exchange reserves, and by reviewing criteria and governance arrangements in respect of contingent liabilities.

The high rate of uncertainty in the business operation occasioned by fluctuation in interest rate, exchange rate, failing social economic changes as increased the risk level in business operations. These risks are heightened. When debt is involved and debt being one of the viable sources of financing cannot be avoided, Corporate bodies including (Private and Public) must develop strategies that will help mitigate risk while fully harnessing the full potentials of full debt financing, these brings about the need to evaluate debt management and risk mitigation in public finance. Debt management needs to be linked to a clear macroeconomic framework, under which governments seek to ensure that the level and rate of growth in public debt are sustainable.

Why the need for these topic?

- High rate of uncertainty in business environment.
 - Uncertainties occasioned by fluctuation in interest rate, exchange rate, etc
 - Risk level has increased significantly in recent time.
 - Risk is heightened
 - Where debt is involved.
 - Debt is one viable source of business finance that is unavoidable.
 - Hence, there is need to develop strategies to mitigate risk to harness the full potential of debt financing in Nigeria.
- Hence, this study.

OVERVIEW OF DEBT

Debt can be either short-term, medium-term or long-term. A debt of one year or less is generally considered short-term debt. In contrast, the ones that go for around ten years or longer come under long-term debt. The one that is between these two ranges is the medium-term debt.

Overview Government Debt

- ✓ Government debt is the aggregate of all Government owing's. (Internal and External Debt).
- ✓ Debt includes credit, overdraft, long-term loan, bonds, etc.
- ✓ Debt forms a vital source of financing aside from taxation.
- ✓ Government use debt financing to fund capital projects.
- ✓ Debt are repaid with interest.
- ✓ The enormity of the components of the principal and interest mostly overwhelm the Government.
- ✓ Low scarcity and inadequate income impair Government debt repayment.
- ✓ Internal and External Debt.
- ✓ The government's borrowing within the country is known as internal debt. The government can borrow this debt from sources like banks, individuals, business firms and other internal sources.
- ✓ On the other hand, the government's borrowing from abroad or international is known as external.

Public Debt management mechanism is the measure taken to limit the growth of Nigerian's external debt which include embargo on new loans, directives to States Governments to minimize external borrowings, and the adoption of SAP as well as refinancing, restructuring, and rescheduling of the debt.

TYPES OF GOVERNMENT DEBT

● Internal and External Debt

The government's borrowing within the country is known as internal debt. The government can borrow this debt from sources like banks, individuals, business firms and other internal sources. On the other hand, the government's borrowing. From abroad or international is known as external debt. These types of debts contribute to the development programs. A few of the sources are bilateral borrowings, multilateral borrowings, loans from the Asian Development Bank, World Bank etc.

▪ **Productive and Unproductive Debt**

If the loan is financed for projects that will bring revenue to the government is known as productive debt. They are self-liquidating in nature—for example, irrigation, power projects, infrastructure, etc.

▪ **Compulsory and Voluntary Debt**

Loans that are raised due to the government's borrowing from the public by using coercive methods are known as compulsory debt—for example, the taxes paid by the public. The members of the public and institutions like commercial banks can subscribe to the securities issued by the government loans, which is known as voluntary debt. For example, the public borrowings.

▪ **Redeemable and Irredeemable Debt**

The debt that the government repays after a fixed period is known as redeemable debt. To sell securities to the public, the government borrows money from them. The interest on this debt is paid irregularly. The debt that has no promised date of repayment by the government is known as irredeemable debt. Therefore, the interest paid may be regular. But such borrowings are not reported by the government.

Debt Management

This represents the action of Government or the Central Bank to influence the composition of debt.

It represents of internal debt, it issues new securities, to replace those maturing or to raise additional

money to the government treasury. It makes use of treasury bills, treasury certificates development

stocks and ways and means, advances as instruments. Internal debt includes trade related debts owned directly to banks, contractors and supplies.

Sovereign debt management

This the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities.

This process also includes meeting any other sovereign debt management goals the government has set. A few of these goals are to maintain and develop an efficient market for government securities. The government should strive to make sure that the rate of growth in their public debt is fundamentally sustainable. This is the public policy that is derived from the broader macroeconomics context.

Public Debt Management Mechanism

Public Debt management mechanism is the measure taken to limit the growth of Nigerian's external debt which include embargo on new loans, directives to States Governments to minimize external borrowings, and the adoption of SAP as well as refinancing, restructuring, and rescheduling of the debt.

This refers to the process of organizing and controlling debt in a way that minimizes financial risk and maximizes the ability to meet financial goals. It involves assessing one's debt situation, creating a plan to repay debts, and implementing strategies to prevent future debts related problems.

What is Risk

- ☐ Risk is a chance of losses,
- ☐ Risk is the possibility of unfortunate occurrence,
- ☐ Unforeseen events, eventualities.
- ☐ Occurrence of economic loss
- ☐ Unpredictability,
- ☐ Probability of some happening that is unwanted and unavoidable

MAJOR TYPE OF RISK

Systematic Risk

Is the market uncertainty of an investment, meaning that it represents external factors that impact all (or many) companies in an industry or group.

Unsystematic Risk

Represents the asset-specific uncertainties that can affect the performance of an investment.

Risk Management

Is an integral component that entails the identification, assessment and mitigation of potential risks associated with lending. These risks could emanate from the potential risks associated with lending. These risks could emanate from the possibility of default by borrowers or a drastic change in market conditions that negatively impact the borrower's ability to repay.

Risk Mitigation in Public Finance

Risk mitigation is a crucial aspect of financial health for any business.

Adequate strategies to mitigate credit risk not only ensure smooth cash flow but also help in maintaining good relationships with clients. There are four common risk mitigation strategies:

- Avoidance
- Reduction
- Transfer and
- Acceptance.

OTHER MEASURES USED FOR RISK MITIGATE

- **Preventative Measures**

Preventative measures are proactive strategies employed to minimize credit risk before it materializes into a tangible threat. These methods revolve around a diligent analysis of potential borrowers and the establishment of well-defined credit policies.

- **Creditworthiness Assessment**

Before extending credit to a borrower, businesses should conduct a thorough evaluation of the client's creditworthiness. This process entails an examination of the borrower's credit history, financial statements, and existing debt obligations. Here, tools like credit scores and ratings can provide valuable insights into a client's ability to meet their credit score and ratings can provide valuable insights into a client's ability to meet their credit commitments.

- **Setting Credit Limits**

Based on the assessment, businesses should establish a credit limit that aligns with the client's ability to repay. Setting a credit limit not only keeps a check on the amount of credit extended but also helps in mitigating potential losses arising from defaults.

- **Regular Monitoring of Account**

Receivable Businesses should regularly monitor their accounts receivable to identify any late payments or defaults at an early stage. This proactive approach allows businesses to take timely actions like following up with the client, renegotiating terms, or in extreme cases, initiating legal procedures.

- **Efficient Collection Tactics**

In the event of delayed payments, businesses need to adopt efficient collection tactics to recover their dues while maintaining a positive relationship with the client. The systematic application of quality management policies, procedures, a practices to the task of assessing, controlling, communicating and reviewing risk.

Importance of Mitigating risks in public debt management

The main objective of public debt management is to ensure that the government financing needs and its payment obligations are met at the lowest possible cost degree over the medium to long run, consistent with a prudent degree risk. Prudent risk management to avoid dangerous debt structures and strategies (including monetary financing of the government's debt) is crucial given the severe macroeconomic consequences of sovereign debt, and the magnitude of the ensuing output losses. These costs include business and banking insolvencies as well as the diminished long-term credibility and capability of the government to mobilize domestic and foreign savings. Government should try to minimize expected debt servicing costs and the cost of holding liquid assets subject to an acceptable level of risk, over a medium- to long-term horizon.

- a. Developing and maintaining an efficient market for government securities.

- b. They must ensure that level and rate of growth in their public debt is fundamentally sustainable and can be serviced under a wide range of circumstances while meeting while meeting cost and risk objectives.
- a. Sovereign debt managers share fiscal and monetary policy advisors' concerns fundamentally sustainable, and can be serviced under a wide range of circumstances remains on a sustainable path and that a credible strategy is in place to reduce excessive levels of debt.

Transparency and Accountability in Debt Management

1. There should be Clarity of Roles, Responsibilities, and Objectives of Financial Agencies Responsible for Debt Management.

As outlined in the Code of Good Practices on Transparency in Monetary and Financial Policies: Declaration of Principles (MFP Transparency Code), the case for transparency in debt management operations is based on two main premises: first, their effectiveness can be strengthened if the goals and instruments of policy are known to the public (financial markets) and if the authorities can make a credible commitment to meeting them; second, transparency can enhance good governance through greater accountability of central banks, finance ministries, and other public institutions involved in debt management.

2. Clarity of Roles, Responsibilities, and Objectives of Financial Agencies Responsible for Debt Management

The allocation of responsibilities among the ministry of finance, the central bank, or a separate debt management agency, for debt management policy advice and for undertaking primary debt issues, secondary market arrangements, depository facilities, and clearing and settlement arrangements for trade in government securities, should be publicly disclosed.⁹ Transparency in the mandates and clear rules and procedures in the operations of the central bank and ministry of finance can help resolve conflicts between monetary and debt management policies and operations. Transparency and simplicity in debt management operations and in the design of debt instruments can also help issuers reduce transaction costs and meet their portfolio objectives. They may also reduce uncertainty among investors, lower their transaction costs, encourage greater investor participation, and over time help governments lower their debt servicing costs.

3. Open Process for Formulating and Reporting of Debt Management Policies

Materially important aspects of debt management operations should be publicly disclosed.

4. Public Availability of Information on Debt Management Policies

The public should be provided with information on the past, current, and Projected budgetary activity, including its financing, and the consolidated Financial position of the government. The government should regularly publish information on the stock and composition of its debt and financial assets, including their currency, maturity, and interest rate structure.

5. Accountability and Assurances of Integrity by Agencies Responsible for debt Management

Debt management activities should be audited annually by external auditors.

Strategies for Risk Mitigation in Public Finance

Risk mitigation is a crucial aspect of financial health for any business. Adequate strategies to mitigate credit risk not only ensure smooth cash flow but also help in maintaining good relationships with clients. The risks inherent in the structure of the government's debt should be carefully monitored and evaluated. These risks should be mitigated to the extent feasible by modifying the debt structure, taking into account the cost of doing so in order to help guide borrowing decisions and reduce the government's risk, debt managers should consider the financial and other risk characteristics of the government's cash flows. Debt managers should carefully assess and manage the risks associated with foreign currency and short-term or floating rate debt.

1. There should be cost-effective cash management policies in place to enable the authorities to meet with a high degree of certainty their financial obligations as they fall due.
2. 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.
3. 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. In order to minimize cost and risk over the medium to long run, debt managers should ensure that their policies and operations are consistent with the development of an efficient government securities market.
4. **Portfolio diversification and Instruments** 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.
5. **Primary Market** Debt management operations in the primary market should be transparent and predictable. To the extent possible, debt issuance should use market-based mechanisms, including competitive auctions and syndications. **Secondary Market** Governments and central banks should promote the development of resilient secondary markets that can function effectively under a wide range of market conditions.
6. The systems used to settle and clear financial market transactions involving government securities should reflect sound practices.

ROLES OF PROFESSIONAL ACCOUNTANTS IN RISK MITIGATION

Professional Accountants play a very vital role in risk mitigation by providing

- Expertise in financial analysis.
- Internal controls
- Compliance and,
- Strategic decision making.
- Risk management should sit at the heart of every organization. Effective risk management requires different parts of an organization and multiple processes to come together to understand collectively how the organization
- To be effective partners and contributors to an organization, professional accountants need to understand the principles of risk management and how they can be implemented to manage opportunities and threats as part of the existing planning and control management cycle.
- Professional Accountants help business identify, assess, and mitigate risks, ensuring financial stability and sustainable growth.
- Professional Accountants role in ERM is not only to mitigate risk but to promote and facilitate effective risk and opportunity management in support of value creation overtime.
- Enterprise risk management (ERM) needs to be part of the professional accountant mind set and makeup.
- Professional accountancy organizations have an opportunity to do more to enable accountants to enhance their contribution to ERM.
- In finance business partnering roles, there is an expectation that accountants in business need managing financial reporting and aptitudes for effective risk management beyond managing financial reporting and compliance risk. Business requires taking risks and seizing opportunities to achieve success.
- The accountant's primary role in ERM is not solely to mitigate risk, but to promote and facilitate effective risk and opportunity management in support of value creation and preservation over time. This involves being focused on the benefits of intelligent risk-taking in addition to the need to mitigate and control risk. ERM requires information and analysis that may indicate success or failure, and support decisions around potential courses of action. Business requires taking risks and seizing opportunities to achieve success. The need for effective ERM has never been greater as organizations navigate

complex and interconnected risks to their business models and operations. Macroeconomic and geopolitical uncertainties digital transformation industries and sectors, cybersecurity, climate change, among other trends present significant uncertainty. The reality is that risk management is

underdeveloped in many organizations a reactive approach to risk management is currently the need for effective ERM has never been greater as organizations navigate complex and interconnected risks to their business models and operations. The reality is that risk management underdeveloped in many organizations; a reactive approach to risk management is currently the norm.

SUMMARY

Debt management is a way to get your debt under control through financial planning and budgeting. The goal of debt management plan is to use these strategies to help you lower your current debt and move toward eliminating it. The overriding message is clear: it is important to better integrate risk management into professional education and training, and to improve the relevance and quality of CPD.

RECOMMENDATION

1. Both incorporation of risk into entry –level accountancy education and continuing professional development (CPD), with lifelong learning on risk management and emerging risk issues.
2. Innovation as to how this education is delivered to accommodate busy work schedule.
3. Interpersonal skills to give finance professionals confidence to apply ERM through the business.
4. A broader mandate from the organization's leadership on managing risk, and greater awareness and understanding of the potential contribution of the finance function to ERM.

CONCLUSION

Effective enterprise risk management (ERM) is built on three essential pillars

- The principle which lays the foundation.
- The framework which determines the structure and
- The process which describes the application.

If any of these three areas are lacking, it can undermine your entire approach. So for efficiency and effectiveness the three areas must be adhere to strictly.

REFERNCE

R. A . Adams (2022) Public Sector Accounting and Finance.

International Federation of Accountant (IFAC) 2015 Enabling the accountant's role in effective enterprise risk management.

Management Advisory Services.

Debt Management Framework

Thanks for listening