

Directorate C: National and European Accounts

Luxembourg, **02-08-2011**
ESTAT/C-3/FL/LA/VK/mg D(2011) 917664

Ms Adriana Ciucea
Head of Department National Accounts
And Statistical Analysis
Romanian National Institute for Statistics
16, Libertatii Avenue
RO-70542 Bucharest

Subject: Recording of restructuring schemes for some public corporations

Ref.: Your letter dated 27 June 2011

Dear Ms Ciucea,

Following your letter of 27 June 2011, I am now in a position to give you our preliminary view on the statistical treatment of the foreseen operations, according to the delay agreed during the EDP dialogue visit in Bucharest on 11-13 July 2011.

The accounting issue for which a clarification is requested

The ex-ante issue, for which an advice is being sought, concerns the recording in national accounts of the foreseen restructuring schemes for some public corporations that have accumulated arrears, notably with government units. Such operations are part of the measures Romania has to implement in the context of the economic programme supported by the International Monetary Fund, the European Union and the World Bank. They have been announced in the Letter of Intent on 9 June 2011.

Documentation provided :

The description of the 3 different schemes is included in the letter mentioned above. No additional information has been requested by Eurostat to the Romanian statistical authorities.

Description of the case

The Romanian government envisaged three kinds of schemes to be implemented in the forthcoming period:

a) Debt-equity swaps (concerning payables to government) for a total amount of 11.2 bn lei relating to the following public companies:

- 4.922 bn lei in C.N. HUILA S.A.
- 2.954 bn lei in S.C. TERMOELECTRICA S.A.
- 2.717 bn lei in CNCF CFR SA (INFRASTRUCTURA)
- 0.595 bn SNTFM CFR MARFA S.A.

Some of these operations will need the approval of the European Commission as they fall under the State Aid Procedure.

b) A loan of 1.882 bn lei to CNCF CFR S.A. (INFRASTRUCTURA) by the State Treasury in order to repay commercial debt to electricity suppliers:

- 59 mn lei to S.C. EON S.A.
- 803 mn lei to S.C. ENEL S.A.
- 320 mn lei to S.C. CEZ S.A.
- 305 mn lei to S.C. ELECTRICA MUNTENIA NORD S.A.
- 56 mn lei to S.C. ELECTRICA TRANSILVANIA NORD S.A.
- 339 mn lei ELECTRICA TRANSILVANIA SUD S.A.

c) A series of funds allocated from the central budget under various forms to the selected public corporations (see below). The funds will be used for repayment of the commercial debt to other companies which will finally repay their fiscal debts against government.

- 669.4 mn lei for subsidies to SNTFC CFR CALATORI S.A. used to pay commercial debt to CNCF CFR S.A. (INFRASTRUCTURA) for 603.1 mn lei and to SCRL Brasov Branch for 66.3 mn lei which will then extinguish payables to government;

- 575 mn lei for increasing equity capital in SNTFM CFR MARFA S.A. used to pay fees (in arrears) to CNCF CRF S.A. (INFRASTRUCTURA) for 500 mn. 75 mn will be used to pay for debt to its branches SC IRV CFR (35) and SCIRL CFR IRLU (40); the three companies mentioned above will then repay their debt to government.

- 130 mn lei for increasing equity capital in CNCF CRF S.A. (INFRASTRUCTURA) will be used to pay ELECTRICA TRANSILVANIA NORD, ELECTRICA TRANSILVANIA SUD and ELECTRICA MUNTENIA NORD; these companies will as a consequence repay their commercial debt to ELECTRICA SERV which will then repay its arrears to government.

-79 mn lei for investment grants to SN NUCLEARELECTRICA S.A. which will consequently pay its supplier RAAN Drobeta Turnu Severin which will then transfer the cash to a coal supplier SNL OLTENIA, the latter finally being in a position to repay its payables to government.

- 329,6 mn lei as subsidies to heating units which will use 138 mn to repay debts to ELECTROCENTRALE (ELCEN) Bucuresti and 191.6 mn to repay debts to SNL Oletia Tg Jiu; both companies will consequently finally extinguish their arrears to government.

In total, in scheme c, the State budget will provide an amount of 1.783 bn lei to the above-mentioned corporations in order to repay an equivalent amount of debt. The subsequent extinction of arrears to government will be of the same amount.

Methodological analysis and clarification by Eurostat

After an examination of the documents provided by the Romanian statistical institute (NSI), Eurostat has reached the following views.

Applicable accounting rules

The Council Regulation 2223/96 incorporates the national accounts concepts and definitions of the European System of Accounts (ESA95) in Community Legislation. The third edition of Manual on Government Deficit and Debt (MGDD) provides further elements for interpreting the accounting rules of ESA95. Notably the parts relating to debt cancellations and capital injections in public corporations are particularly relevant in this case.

Availability of national accounting analysis

The views of the Romanian authorities are as follows:

- Debt equity swaps have no effect on the net lending/net borrowing of the general government “since the claims on these companies are not shown in financial and non-financial accounts of this institutional sector”.
- The loan to CNCF CFR S.A. (INFRASTRUCTURA) would result only in a change in the composition of liabilities of government sector (reducing AF.7 and increasing AF.4).
- The provision of funds to various public corporations will not affect the government deficit since these operations “will be reflected in non-financial accounts by an increase of expenditures simultaneously with an increase of revenues.”

Analysis

Eurostat based its opinion on the information provided in the letter mentioned above.

It is to be recalled that the national accounts principles (ESA95) imply that the accounting treatment of operations should reflect economic reality (nature of entities and their economic behaviour), and not legal or administrative criteria. In case of potential or apparent conflict between ESA95 provisions, national accounts give priority to substance over form.

It is also recalled that the existence of State aids is not for Eurostat a decisive criterion for the statistical classification of transactions implemented by government units in the context of restructuring.

As a general point, Eurostat would like to point out that, first of all, a number of the public corporations involved in all the schemes have been (re) classified within the government sector (HUILA, TERMOELECTRICA, CFR INFRASTRUCTURA, CFR CALATORI) such that all the envisaged transactions with government would be neutralised through the consolidation process, whereas all the other corporations (public or private) involved in the schemes would benefit from debt cancellations reflected in their business accounts, implying negative impact on the government deficit.

a) Debt-equity swaps

Although the payables of HUILA, TERMOELECTRICA, CFR INFRASTRUCTURA and CFR MARFA, are recorded in business accounts, they have never been recorded in national accounts (since they refer to taxes and social contributions which are recorded using the time adjusted cash method in national accounts) and Eurostat considers that these companies will clearly benefit from the cancellation of their obligations and, thus, after the transaction their financial situation will be improved by a reinforcement of their own funds. Therefore, for Eurostat, a claim should be imputed just before the swap through another change in volume (K10).

As a matter of principle, in line with the provisions on capital injections, the increase in equity could be recorded as a financial transaction only if there is strong evidence of the future market profitability of the corporations, as evidenced by business plans. Otherwise, it should be recorded as a capital transfer from government, with an impact on B9.

For HUILA, TERMOELECTRICA and CFR INFRASTRUCTURA, classified within the general government, all transactions should be neutral through the consolidation process. This however would not be the case for CFR MARFA, which, contrarily to the above-mentioned corporations, is not classified within the government sector. For this reason, Eurostat would appreciate to receive as soon as possible the business plan of CFR MARFA.

b) Loan granted to CFR INFRASTRUCTURA

CFR INFRASTRUCTURA (and therefore the general government) has a liability (commercial debt) to six non-government units under the form of AF7. The funds (loan) received from the state budgets are supposed to be used for repayment of this commercial debt.

Consequently, CFR INFRASTRUCTURA will replace the liability AF7 against other corporations by a liability AF4 owed to the State Treasury. Since the company is classified inside the general government sector, no loan would appear at the level of the consolidated central government sub-sector.

Eurostat agrees that the operation will have no impact on the net lending/net borrowing B9 of the general government sector, as it will give rise only to financial transactions, assuming that the loan will be recoverable. However, the impact on the government deficit will be neutral in any case.

c) Allocation of funds to various corporations

Eurostat understands that there will be actual cash flows from government to corporations which will use the funds to repay their commercial debt against other companies, which will finally repay their fiscal debt to government. It is assumed that in such an arrangement ("circuit"), government, as a whole, will at the end of the process get back the same amount of cash as was originally provided to corporations. In some cases the flows will be consolidated, since some of

those corporations benefiting from this government support are classified in the government sector. It is to be recalled that the fiscal debt of the corporations involved seems to relate to taxes and social contributions and the related claims are not recorded in national accounts (due to the use of time adjusted cash method).

If what is mentioned above is correct, one could consider that the final step of these transactions (extinction of receivables held by government on some corporations) should not be reflected in national accounts as no reciprocal claims/liabilities have been recorded in the past for this purpose and therefore no capital transfer is to be recorded in national accounts. However, Eurostat considers that the nature of the transactions between government and all the corporations must be examined with attention.

First of all, Eurostat considers that no injection of funds should be recorded as an increase in AF5 (equity capital) because none of the transaction meets the criteria stated by Eurostat, i.e. a likely return on investment.

In other terms, where the funds are used for the repayment of debt (and not the acquisition of assets that will provide a market revenue) this must be recorded as a non-financial transaction, under the item "capital transfer" D9.

Second, as a matter of principle, there is clear evidence that all the public corporations will benefit from the "cleaning" of their balance sheets (by way of disappearance of debt, improving de facto their financial situation) by means of a government intervention which, according to national accounts rules, must be considered as government expenditure.

As far as the repayment of cash from these corporations is concerned, Eurostat does not consider that it should be recorded as government revenue. The reason is that, on the basis of the use of the "Time Adjusted Cash" method for recording taxes and social contributions (as mentioned in Regulation 2516/2000), the final transfer of cash cannot be considered as the "normal" payment of the involved compulsory levies and associated penalties.

It must be taken into account that these corporations are part of the public sector and thus they are controlled by government. Therefore, government has evident power to impose to the management of these corporations to meet their tax obligations towards it. This is not the case for private sector, as government must go in this case through legal procedures in order to obtain unpaid taxes. In the present case, government has let the public corporations accumulate a considerable amount of arrears, which must be considered as deliberate indirect support provided to these corporations and which has not been recorded as such in the past in national accounts.

Therefore, the repayment to government of the cash involved in the schemes by the public corporations should be recorded as a financial transaction, with no impact on the government deficit. The counterpart of this transaction is the extinction of the implicit claim/liability existing between government and the public corporations. As this financial relation has presumably not been recorded in the balance sheets, it should be imputed just before the effective transfer of cash, by way of another change of volume (K10).

However, a distinction must be made between the beneficiaries classified inside and outside the government sector. Central government will globally inject 1783 mn lei, of which 799 mn in corporations classified in the government sector (CFR CALATORI for 669 mn and CRF INFRASTRUCTURA for 130 mn) and 984 mn in non government units. In addition, out of the 799 mn lei directly given to the companies classified within the government sector, 196 mn will

be transferred further to non-government units. Due to the consolidation process, all injections in public corporations classified in the government sector that use directly the fund to repay their debt to another public corporation also included in the government sector (which in its turn “repays” a government unit) should have a neutral impact on the deficit in national accounts. This covers only the injection in CALATORI for an amount of 603 mn.

In all other cases, where at the end there would be a benefit for public corporations classified outside the government sector, the transfer of funds will have a negative impact on the government deficit. This concerns both the cases of an injection directly into a non-government unit (CRF MARFA, SN NUCLEARELECTRICA, Heating units, for, respectively, 575 mn, 79 mn and 329.6 mn, i.e. for a total amount of 983.6 mn) or in a corporation classified inside government as a first step for the final repayment of non-government units (CALATORI for 66.3 mn, CFR for 130 mn i.e. a total amount of 196.3 mn).

Under these conditions, taking into account the consolidation effect, the impact on the government deficit should be equal to the capital transfers to the corporations not included in the government sector (1179 mn, about 0.2% GDP).

Conclusion

Based on the information provided by the Romanian authorities and provided that the above-mentioned conditions are fully met, Eurostat concludes that:

- the debt-equity swaps (case a) would have no impact on the government deficit possibly except in the case of the increase in equity in MARFA);
- the loan to CFR INFRASTRUCTURA (case b) would have as such no impact on the government deficit;
- contrarily to the opinion of the Romanian statistical authorities as regards the impact of the scheme based on a “circuit” of cash (case c), a capital transfer should be recorded from government to the public corporations classified outside government, under the conditions described above.

Procedure

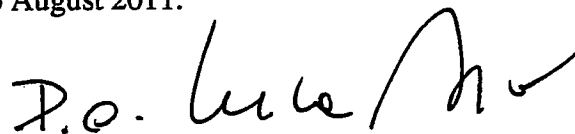
There is no explicit Community legislation which governs a procedure by which Eurostat gives its views on operations which have not yet been enforced. Nevertheless, Eurostat is prepared to give a preliminary view on the statistical classification of such operations provided that it is in possession of all of the necessary background information. The preliminary view is given in accordance with the guidelines for ex-ante advice published on the Eurostat web-site.

This preliminary view of Eurostat is based on the information provided by the country authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view. To this end Eurostat would request to be informed of the final details of the operation (contract and accompanying papers where relevant) when they are available, or (should this be the case) information that the planned operation has been abandoned.

In this context, we would like to remind you that Eurostat is committed to adopting a fully transparent framework for its decisions on debt and deficit matters in line with the amended Council Regulation 479/2009 and the note on ex-ante advice, which has been presented to the

CMFB and cleared by the Commission and the EFC. Eurostat intends, therefore, to publish all future official methodological advice (ex-ante and ex-post) given to Member States, on the Eurostat web site. In case you have objections concerning this specific case, we would appreciate if you let us know. In any case (regardless of whether you have objections or not) we would like to receive an answer from you on the issue no later than 16 August 2011.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'F. Lequiller', with a checkmark at the end.

François Lequiller
Director