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EUROSTAT

Directorate C: National and European Accounts

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Mr Todor TODOROV
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Subject: Methodological treatment of the recording of military equipment expenditure

Ref.: Your letter dated 6 March 2007

Dear Mr Todorov,

Following your letter of 6 March 2007, I am in a position to reply to the question you asked on the appropriate statistical classification for the case you have presented.

The accounting issue for which a clarification is requested

The Bulgarian government intends to sign a contract for a delivery of multipurpose corvettes. The possibility of separate delivery of the ship platform and the electronic equipment is being considered by the government.

The issues for which an opinion is being sought, concern the Eurostat's interpretation in relation to two aspects of military equipment expenditure recording, in the context of delivery of ships:

- possible use of cash source data for the purpose of national accounts recording, and
- possible recording of two separate expenditure in the national accounts for the ship platform and for the electronic equipment.

Methodological analysis by Eurostat

After an examination of the provided documentation, Eurostat has reached the following provisional views.

1) Concerning the issue of the use of cash source data, we agree with your reading of the Eurostat's decision on the recording of military expenditure of 9 March 2006. The decision states, that "(...) Member States are obliged to report national accounts data (ESA 95) and the government finance statistics that derive from them, such as government expenditure and government deficit, on an accrual basis." Further, it is specified that "(...) as an interim solution, that government expenditure be recorded on a cash basis, or derived from cash based information, when:

- *the cash data are corrected with observed and accurate data on receivables and payables associated with the contracts in question; or*
- *the cash data are used for small deliveries only, or are corrected for large deliveries; or*
- *the time of payment is close to delivery (within one year of the time of delivery).*

We take note that you expect good level of availability of source data on military expenditure for the delivery of the ships in question, given the good cooperation established with the Ministry of Defence.

2) You indicate that in the presented case of the corvettes, one envisaged option is to separate deliveries of the ship platform and the electronic equipment.

As far as the accounting treatment of such separate deliveries is concerned, we agree with your reading of the above-mentioned Eurostat's decision on the recording of military expenditure. We would like to recall, that in the cases of complex systems, the Eurostat's decision provides for the possibility of recording of government expenditure (...) *"at the time of delivery of individual and operational pieces of equipment that compose the system, and generally not at the time of completion of the contract."*

In this context, we would like to clarify that in the case when the ship platform is not usable without the electronic equipment, a single expenditure entry should be recorded in the national accounts.

Two separate expenditure recordings in the national accounts, in the presented case of the corvettes, could be possible only if two parts, (i.e. the ship platform and the electronic equipment) can be considered to be independent and individually operational elements. It would mean that the electronic equipment in question has a nature of a supplementary element enhancing the operability of the ship.

Conclusion

On the basis of the above considerations, Eurostat confirms your interpretation of two issues presented in your letter:

- the necessity of the accrual based accounting in national accounts of the delivery of the corvettes, and
- the recording of separate expenditure entries for different parts of the military equipment only under the condition that those parts are fully operational independently.

Procedure

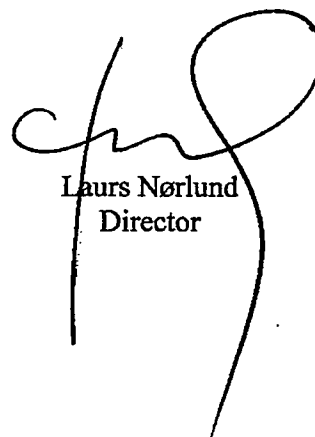
There is no explicit Community legislation which governs a procedure by which Eurostat gives its views on operations which have not yet been enforced. Nevertheless, Eurostat is prepared to give a preliminary view on the statistical classification of such operations provided that it is in possession of 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 Bulgarian 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 3605/93 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 20 June 2007.

Yours sincerely,



Laurs Nørlund
Director

Copy: Ms Paliova, Director of State Treasury Directorate, Ministry of Finance