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Mr. Laurs Norlund,
Director,
Eurostat,
Batiment Jean Monnet,
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L-2920 Luxembourg-Kirchberg

15th March, 2007

Dear Mr. Norlund,

I refer to previous correspondence concerning the classification of Irish Rail in our National Accounts. In your letter of 1st March 2007 you requested some clarifications regarding the composition of the Sales and Production Costs data used by CSO to assess the market/non-market status of the company. Replies to the specific issues raised are given in Annex 1 and I'm also attaching an EXCEL spreadsheet that sets out the calculations in more detail. The figures are slightly updated but the overall results are as previously indicated.

While the figures still indicate that Revenues account for over 50% of Production Costs, the CSO acknowledges that this case is very borderline and that this ratio could well fall under 50% if the estimates for the 'Consumption of Fixed Capital' could be based on market values.

However, even if Irish Rail was adjudged to be non-market, the CSO still does not think that the entity should be classified within General Government while the holding company (CIE) and its other subsidiaries are classified outside Government as 'Non-financial corporations'. Before it can be classified in the General Government sector, the Government must control a non-market entity. In this instance, we consider that this criterion is not met because the Government does not directly control Irish Rail. The Government does ultimately own Irish Rail, but it does so via the holding company CIE and, in practice, any control it exercises is indirect. The direct control is exercised by CIE, which owns 100% of the share capital of Irish Rail. While the ESA95 does not specifically refer to 'direct' control, we consider that this is the only logical interpretation of the classification rules and that one cannot have a company classified in the General Government sector, if it is 100% owned by a holding corporation classified outside of Government

Of course the holding company has to be genuine and not simply a legal construct or 'shell' operation operating no actual control. In this regard, it is worth recalling that, prior to the reorganisation of CIE in 1986 and the creation of the separate subsidiary companies, the entire CIE Transport Group had operated as a single entity. This is still evidenced, for instance, by the fact that the employees of the Group including

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those working in Irish Rail still belong to the same occupational pension scheme, which is managed by the holding company. In addition, employees of Irish Rail who worked with CIE prior to the 1986 reorganisation, still have an entitlement to return to work for the holding company should they ever wish to do so. Any significant borrowing by the CIE Group can still only be undertaken by the holding company, which then makes the funds available to the subsidiaries. Irish Rail is therefore inextricably linked with the remainder of the Group and to classify it in a different sector to the other entities would, in our opinion, not be consistent with the principles of the ESA95.

We hope that the information we have provided clarifies the issues outstanding and that this will help you to consider again this difficult classification issue. I would appreciate if this correspondence were not made public until a final decision on the classification has been reached.

Yours sincerely

W. Keating

Bill Keating
Assistant Director General
Economic Statistics

Annex 1 – Clarification of some issues concerning the content of 'Sales' and 'Production Costs'

Estimation of 'Consumption of fixed capital'

As we acknowledged in our letter, the depreciation amounts included in the operating cost figures were taken from the company's accounts and were calculated using the historic costs convention. We met with Irish Rail last week to determine whether we could get an estimate of the current market value of their capital assets. Unfortunately, no such valuation exercise has ever been undertaken and it would be a major undertaking to do so.

We have undertaken a cursory examination of the published accounts of Network Rail in the UK, which appears to value its rail infrastructure at market values (the value applied is actually the 'value in use' and is not the depreciated replacement cost. 'Value in use' is calculated, based on the discounted future cash flows from the asset). In Network Rail, the proportion of operating costs accounted for by the depreciation charge is significantly higher than in Irish Rail (23% as against 13%). Even though the two companies are different in nature (Irish Rail also operates the transport service), we acknowledge that if the depreciation estimate for Irish Rail was recalculated using market prices production costs would likely increase with the result that sales would no longer exceed 50% of costs.

Treatment of 'Amortisation of capital grants'

In the Irish Rail accounts, Capital Grants are amortised and credited against depreciation charges. Total 'Operating costs', as reported in the accounts, are therefore reduced by the amortisation amount. However, when calculating the figures for 'Production costs' used in the market/non-market assessment, the CSO adjusted the figure in the annual accounts and added back the amortisation amount deducted.

Treatment of 'Own Work Capitalised'

The estimates of 'Operating Costs' published in the Annual Accounts, excludes the labour and material costs incurred in own capital formation. Our understanding is that this treatment is consistent with the concept of 'Production costs' as defined in ESA95 Paragraph 3.33(b).

Treatment of Grants

The Sales revenues published in the annual accounts and used in the market/non-market assessment excludes both domestic and EU grants. EU grants are all capital in nature and are treated in the Irish Rail accounts as deferred income and amortised against the depreciation costs of the corresponding assets.

Irish Rail has also clarified that the only Government payments included in Sales revenues are the reimbursements received by the company for travel undertaken, free of charge, by designated groups such as old pensioners, under Government sponsored social schemes. All other State grants, including Public Service Obligation payments, are excluded. Some of these payments are the subject of service delivery agreements but the CSO has taken the view that the connection between the payment of the grants and the delivery of the transport output is not direct enough to warrant their inclusion as Sales revenues. We expect that this is also the treatment applied by other Member States in respect of their public transport companies.

Calculation of Sales and Production costs of Irish Rail

		2003 €mill	2004 €mill	2005 €mill
ESA95 'Sales':				
Revenue excl Exceptional items (from P&L Statement)		213	215	222
Total 'Sales'	**A**	**213**	**215**	**222**
ESA95 'Production Costs':				
Operating costs excl Exceptional items (P&L Statement) **		390	389	396
add back 'Amortisation of grants' (Note6)		25	34	38
Exclude '3rd party & employer's liability claims' (Note 4)		8	10	7
Total 'Production costs'	**B**	**407**	**413**	**427**
Sales as % of Production Costs	**A as % of B**	**52%**	**52%**	**52%**