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FINAL FINDINGS

EDP dialogue visit to Cyprus
7 June 2006

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Provisional findings

Executive summary

The EDP dialogue visit to Cyprus took place on 7 June 2006 with the aim to analyse the Cypriot April 2006 EDP notification and specific transactions undertaken by the Cypriot government. This dialogue visit was the first one after the accession of Cyprus to the EU in 2004.

Firstly, Eurostat examined with the Cypriot statistical authorities the institutional arrangements and source data used for the compilation of government finance statistics.

As far as the analysis of the April 2006 EDP notification is concerned, Eurostat examined in detail all the tables of the EDP reporting and suggested some changes. Most of these were of a presentational nature without impact on the government deficit or debt.

Concerning the delimitation of the government sector, Eurostat discussed the division of responsibilities for sectorizing institutional units inside or outside of government.

In the absence of response to the questionnaire related to EDP tables, Eurostat investigated and analysed the existence of specific transactions undertaken by government. Eurostat took note that the simple time adjusted cash method is used for the recording of taxes and social contributions. Eurostat noted that the recording of EU transactions broadly complies with its decision of 15 February 2005. The recording of the UMTS licences is also in line with the decision of 14 July 2000. Eurostat was informed that no capital injections, no debt assumptions or debt cancellations have been carried out, and no guarantees have been called, over the 2002-2005 period. Eurostat was further informed that the large dividends paid by two companies in 2003 and 2005 did not have a character of superdividends. Eurostat took note that the recording of military expenditure is in line with its decision of 9 March 2006. No securitisation operation has been recently undertaken. The Cypriot authorities informed Eurostat on the PPP projects planned to start from 2007 onwards.

In relation to the ESA95 transmission programme, Eurostat congratulated the Cypriot authorities for the planned delivery of the COFOG 2nd level and for the complete and speedy transmission of quarterly nonfinancial accounts for general government, but requested that efforts be made in relation to annual financial accounts as well as quarterly financial accounts for general government.

Finally, Eurostat appreciated the volume and quality of the documentation provided by the Cypriot authorities during the discussions.

Introduction

In accordance with article 8d of Council regulation (EC) No 2103/2005 of 12 December 2005 amending Council Regulation (EC) No 3605/93 as regards the quality of statistical data in the context of the excessive deficit procedure (hereinafter the Regulation) Eurostat carried out an EDP dialogue visit in Cyprus on 7 June 2006.

The delegation was headed by Mr. Nørlund, director of National and European Accounts. The Directorate General for Economic and Financial Affairs (DG ECFIN) and the European Central Bank (ECB) also participated in the meeting as observers. The Cypriot statistical authorities were represented by the National Statistical Institute (NSI) and the Ministry of Finance (MoF).

Eurostat undertook this visit with the aim of analysing the Cypriot April 2006 EDP notification, as well as discussing several specific transactions carried out by government.

1. Institutional arrangements

Introduction

Eurostat asked about the institutional arrangements for compilation of the government finance statistics.

Discussion

The nonfinancial accounts and EDP Table 2 are compiled by the NSI , while the MoF is in charge of the EDP Table 3. A permanent dialogue between the two institutions exists in order to reconcile the figures. Whilst the Central Bank (CB) has been invited by the NSI to participate more actively to the EDP compilation process, it remains for the time being only within a role of supplier for some of the source data.

Findings and conclusions

Eurostat took note of the good co-operation between the NSI and various departments in the MoF, particularly important in the context of existing staff capacity constraints. Eurostat noted the absence of the CB in the process.

2. Data sources

Introduction

Eurostat enquired about the data sources used for compilation of the government finance statistics.

Discussion

The main source data for central government are, for final data, the *Final Accounts* issued by the Treasury. More recently, the NSI gained access to the internal Treasury database on a

daily basis (FIMAS), useful for provisional statistics of central government and social security funds.

FIMAS does not exist for local government for the moment. Local government as well as social security funds provide financial statements (seemingly on an accrual basis). Extra-budgetary funds provide either financial statements or budget reports. The financial statements are audited either by the Court of Auditors, or by private auditors (local government).

Findings and conclusions

Eurostat took note of the solid source data situation, which seems to also benefit from continuous improvement.

3. Analysis of the April 2006 EDP notifications

Eurostat reviewed all the EDP tables as they were reported in April 2006.

3.1 EDP Table 2A

Introduction

Eurostat discussed each line of Table 2A.

Discussion

The Cypriot authorities used to show two starting lines in Table 2A which was rather confusing for users. Eurostat suggested, for clarity reasons, to retain only one of the existing starting lines. This might be the balance as reported in the annual report of the Treasury (*Final Accounts*), as this seemed the preference of the Cypriot authorities, on the understanding that this balance is *de facto* the main policy balance used nationally (aside from the notified deficit to the EU Commission). The other balance might remain as a memorandum item to the table.

Contrary to what is foreseen, the line Loans granted/Loans repayments in Table 2A of the Cypriot notification did not contain transactions in government assets but in government liabilities. Borrowing and repayments are recorded in the working balance of the Treasury report. Eurostat felt that such figures should therefore be reported under "Other financial transactions" instead of "Loans granted/Loans repayments", because they relate exclusively to transactions in liabilities of government.

The Cypriot authorities explained that the line referring to the difference as shown by a study, between interest paid and interest accrued is reported as 0 due to "negligible amounts" of about 0.1% of GDP. Eurostat noted that amounts of about 0.1% of annual GDP, whilst small, could not be considered as negligible. In addition, further entries for accrual interest adjustments will be considered in relation to recording of bonds issues at premium and discount. See below (Table 3B).

Findings and conclusions

The Cypriot authorities will implement the adjustments suggested by Eurostat in Table 2A. These changes will have no, or only very limited, impact on the level of the reported deficit.

3.2 EDP Table 2C

Introduction

Eurostat reviewed data reported in Table 2C.

Discussion

The working balance of Table 2C does not show the results as reported in the financial statement of local authorities. The current practice to show transactions in liabilities as a transition item, with an adjusted balance for the starting line, will be abandoned.

According to the Cypriot authorities no further adjustments in the table will be necessary because the source data are on an accrual basis. This change has no impact on the level of reported net lending/net borrowing.

Findings and conclusions

The Cypriot authorities agreed to directly show in the working balance of Table 2C the aggregation of accounting results.

3.3 EDP Table 3B

Introduction

Eurostat discussed in details items in Table 3B.

Discussion

Eurostat noted the absence of entries related to premium and discounts on issuance of bonds, and related to accrual adjustments to interest in Table 3B. Given the substantial emission programs of bonds at discount and premium in Cyprus, the current situation was judged not sustainable, and will be addressed before the next notification. The Cypriot authorities provided the mission with estimates for 2005 and agreed to provide, within the following week, estimates on the amounts in question for 2002 and 2004. This might have a limited impact on the measurement of the deficit.

Eurostat noted the absence of payables in Table 3B which was allegedly explained by the practice of immediate settlements of submitted invoices. However Eurostat noted that payments on invoices could be made until the 15th January of the following year, and that the relevant information is available in the annual report of the Treasury. The Cypriot authorities agreed to use this information and start reporting incurrence of other liabilities. The Cypriot authorities will report flows of receivables in Table 3E resulting from the time adjustment method for social contribution and will enquire on the counterpart entry.

The Cypriot authorities indicated that the information on loans (assets) recently reported for 2004 and 2005 would also be reported for 2002 and 2003.

Eurostat understood that all such changes in Table 3B would mainly lead to changes in the item *Currency and deposits* without impact on the item *statistical discrepancies*, owing to the way the former is currently calculated. The item *Currency and deposits* for Central government derives from the Treasury Report and not from money and banking statistics.

The Cypriot authorities indicated that the information deriving from the Treasury statement was by construction balanced, which explains the marginal or inexistent discrepancy. Taking note of the present practice, Eurostat indicated the need to streamline the item currency and deposits, and recommended carrying out systematic comparisons of those data with money and banking statistics.

Findings and conclusions

Additional information will be provided by the following week. The suggested changes will be incorporated into the next EDP notification.

4. Delineation of the government sector

Introduction

Eurostat enquired about the division of responsibilities for the classification of entities in the sector of general government.

Discussion

The Cypriot authorities informed Eurostat that the NSI bears responsibility for classification of units, based on the ESA rules: 1) autonomy of decision criteria and 2) market/nonmarket criteria. Eurostat was further informed that the last exercise of systematic screening of the rule for each public sector unit was carried out in 2003. In addition, a one-off exercise has been undertaken in 2005 in the case of the airway company. Eurostat discussed also the sectorisation of some specific entities (sewage boards, Cypriot airways, Agricultural payments agency, hospitals, schools, semi-government organisations, Civil aviation, and purchasing services).

Findings and conclusions

Eurostat took note of the Cypriot practice in sectorisation.

5. Specific transactions undertaken by government

Eurostat pointed out that Cyprus was the only country not having provided the EDP related questionnaire. This questionnaire helps Eurostat in assessing EDP notifications. The Cypriot authorities explained that this had not been done due to shortage of staff. Eurostat noted that most of the information requested in the questionnaire seemed to exist in the documentation provided.

5.1 Military expenditure

Introduction

On 9 March 2006 Eurostat released a decision on recording military expenditures. Expenditure on purchases of military equipment should be recorded on a delivery basis. The decision clarifies how delivery should be interpreted for some specific long term contracts and lists the appropriate source data.

Discussion

The Cypriot authorities confirmed that military expenditures recorded in the working balance, which are on a cash basis, are adjusted for imported equipment with information on monthly foreign trade data (delivery basis) that is directly coming from the Ministry of Defence. The Ministry of Defence is subject to the audit by the Court of Auditors.

Findings and conclusions

Eurostat found this recording in line with its decision of 9 March 2006.

5.2 Taxes and social contributions

Introduction

It is recalled that the Regulation 2516/2000 requires taxes and social contributions to be recorded on accrual basis using one of the specified methods – using assessments and declarations or using cash data.

Discussion

The Cypriot authorities explained that they use a simple time adjusted cash basis (or cash basis for those taxes that are to be settled, by law, within the year of assessment).

Findings and conclusions

Eurostat took note of explanations on the method for recording both taxes and social contributions.

5.3 EU transactions

Introduction

The decision of Eurostat published on 15 February 2005 says that transfers from the EU to a Member State should not have impact on the deficit.

Discussion

Eurostat understood that the impact related to expenditures carried out by government on behalf of the EU is broadly neutralised to the extent that the amounts received from the Commission are kept in a dedicated bank account at the Central Bank which is outside the

Treasury account. Receipts from the EU enter the working balance in the Treasury Report (*Final Accounts*) only after the expenditure has been carried out by the beneficiary government unit and the claim for reimbursement checked by the Treasury services, which is judged by the Treasury to entail a limited lag of about 1 to 2 months.

The Cypriot authorities described that the EU own resources payments are adjusted for time lags using detailed monthly information (those items will be moved under receivables in EDP Table 2A).

The Cypriot authorities explained that the Agricultural payment agency is classified outside government. However it was not clear whether all necessary tests were undertaken in order to verify the proper classification of this agency.

In addition, the ESA95 Manual on government deficit and debt specifies the rules for classification of the Market regulatory agencies: "*By convention these units should be classified in the sector general government if their costs incurred in market regulation compared to the total costs are less than 80%, and in the sector non financial corporation if their costs incurred in market regulation compared to the total costs are more than 80%.*"

Findings and conclusions

Eurostat found the compilation practice for transactions with the EU budget to broadly comply with the decision of 15 February 2005. Furthermore, Eurostat suggested checking the classification criteria for sectorisation of this agency with the "80% test".

5.4 UMTS licenses

Introduction

The rules for sales of the UMTS licences are established by the decision of Eurostat of 14 July 2000. Proceeds on the allocation of such licenses "*must be treated as the sale of a non-financial asset (the licence), recorded at the time the licence is allocated*".

Discussion

The UMTS licences were allocated in 2004, to be paid in four instalments. The full amount (10 mio CYP) was recorded in 2004 as the sale of non-financial asset.

Findings and conclusions

Eurostat found the calculation to be in line with its decision of 14 July 2000.

5.5 Other government transactions

Introduction

Eurostat was seeking information on capital injections, debt assumptions/debt cancellations, guarantees and dividends paid to government.

Discussion

The Cypriot authorities indicated that no capital injection, no debt assumption or debt cancellation have been carried out, and that no guarantee had been called over 2002-2005. Eurostat was informed that large dividends paid in 2003 and 2005 by two companies were not in excess of their annual operating profits.

Findings and conclusions

Eurostat took note of the current situation of non existence of such operations.

5.6 Securitisation operations

Introduction

Eurostat asked whether any securitisation operation has taken place or was planned.

Findings and conclusions

The Cypriot authorities indicated that no securitisation has been carried out or was planned.

5.7 Public Private Partnership

Introduction

Eurostat enquired whether such arrangements existed or were planned in future.

Discussion

Eurostat was informed of the various projects in the field of airport, port, roads, desalinisation, energy and marina infrastructures. Whilst one project has been already signed, the investment expenditure and the related accounting impact would only start from 2007 onwards.

Findings and conclusions

The cypriot authorities have not yet finalised their analysis of the accounting treatment of the existing PPP project and will provide further information in autumn 2006.

6. ESA95 Transmission programme

Introduction

Eurostat summarised the Cypriot deliveries of tables within the ESA95 transmission programme.

Discussion

Eurostat congratulated the Cypriot authorities for planning delivery of the 2nd level of COFOG (1998-2004) by the end of 2006, and for the complete and speedy (t+1 month) transmission of quarterly nonfinancial accounts for general government. Whilst understanding the problems for compiling the financial accounts, and appreciating the progress made, Eurostat noted the need to have, in its database, annual financial accounts for general government on a consolidated basis. It was envisaged to establish a capacity to store such dataflows. Alternatively, Eurostat could annualize quarterly data if these were more convenient to provide.

Findings and conclusions

Eurostat noted that it was important to ensure that the Cypriot publication template for government finance statistics is filled and therefore the missing ESA95 tables should be reported, proposing various options to this effect.