EUROPEAN COMMISSION
EUROSTAT

Directorate D: Government Finance Statistics (GFS) and quality

Luxembourg, 24 July 2015
ESTAT/D-3/EBC/LA/MM/ML/eb/D(2015)3451466

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Subject: Sector classification of Irish Water

Ref.: Your letter of 26 March 2015 and further exchange

Dear Ms Banim,

Background

This letter provides Eurostat's ex-ante advice on the appropriate sector classification of Irish Water in national accounts under ESA2010, based on the documentation received to date.

In March 2015, Eurostat received a request from the Irish CSO seeking Eurostat advice on the issue, together with some documentation and a first CSO analysis, concluding with a classification of Irish Water outside government, as a public non-financial corporation. Following discussion between Eurostat and CSO, it was concluded that Irish Water would be classified provisionally within the general government sector for the April 2015 notification, pending the advice from Eurostat.

This note provides for a detailed description of the main aspects of Irish Water constitution and business, followed by an extended accounting analysis, while also addressing and clarifying a number of points raised by the Irish statistical authorities.

Irish Water summary facts

Irish Water was established by the Water Services Act 2013, further complemented by the Water Services (2) Act 2013 and the Water Services Act 2014. The intention of these acts is to restructure and consolidate the previously decentralised water services organisation in place in Ireland into a quasi-unique provider. A large number of so-called "Group Schemes" (around one thousand[1]) as well as of privately owned wells still remain, holding a minority but significant market share (1/4 for water supply, 1/3 for waste water).

[1] These are quasi-mutualist undertakings that group from a few dozen up to a few thousands users, notably in rural areas.

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The restructuring of water organisation in Ireland aims – by regrouping local water authorities (31) into one unique entity – at (1) making tariffs uniform (by starting billing the so-called 'domestic users', i.e. households, supplied by local authorities, from 2015 onwards), (2) increasing the share of costs paid by users[2], (3) boosting efficiency[3], and (4) supporting a large investment programme intended to increase water quality and adherence to best environmental norms[4]. Investments also aim at developing the metering of water devices, so as to charge according to actual consumption. However, billings to domestic users will be capped to the flat access fee otherwise payable, of 260 euro per year for both water and waste water[5]. It is expected that around 70% of Irish Water' clients, whose consumption is metered, will meet or exceed the level of water use at which the fee is capped. The percentage of clients being metered, while low in 2014, is expected to increase rapidly to 72% in 2016.

It can be noticed that the original plan for Irish Water involved no cap but instead a significant free water allowance (30 cubic meters per head). This plan was eventually dropped when survey results indicated that this would lead to a wide dispersion of payments per household, with many (more than a fifth) paying either less than [redacted] euro per annum and others close to [redacted]euro per annum and more. Proportional billings were subsequently no longer considered a feasible option.

Irish Water's consolidation of the activities of the local water authorities is achieved, firstly, by the transfer of the assets (whose net value is estimated by the CSO to be 7 billion euro) of local water authorities to Irish Water.[6] Secondly, Irish Water retains all local authorities' staff in the context of 'service level agreements' (SLA) between Irish Water and local authorities, implying the payment of local authorities' staff as well as of significant 'management fees' to local authorities. The SLAs will be in place for at least 12 years (until 2025). De facto, most staff working for Irish Water is expected to remain employees of local authorities, although transfers of staff to Irish Water may also take place, in case of interruption of SLAs. Irish Water's pension superannuation scheme will not take over the pension liabilities accrued to date of any local government staff entering Irish Water' employment.

Irish Water – which activities are in a transition phase[7] – expects both costs and revenue to be around [redacted] billion euro in 2015. Irish Water supplies both domestic consumers (i.e. households) and non-domestic users (firms and government units). Domestic consumers are to be charged at significantly less than costs. Non-domestic users are, on the contrary, charged (200 million euro per year) at costs, since 2002, reflecting the *"polluter pays and non-cross subsidisation principles"* as laid down in the Water Framework Directive. In this context, billings of government entities as water users are estimated at around 20 million euro a year, or 2% of total costs.

Crucially, government foresees significant funding to Irish Water, in the form of both operational grants and capital funding. Government has calibrated its support of Irish Water at 400 million euro in operational grants in 2015 (480 million euro in 2016), which is explicitly split in (1) a payment to compensate for a 21 m^3 child water allowance (60 million euro), (2) a compensation for the caps (128 million euro), and (3) a water subsidy purely based on the volume of water supplied (210 million euro). Whilst billings to 'domestic users' of local authorities (now Irish Water) will be introduced in 2015, billings to 'non-domestic users' will continue unchanged, pending further decisions. In parallel,

[2] It introduces water charges to domestic users registered with local authorities.
[3] Studies find water supply costs to be high in Ireland, at twice the costs of some comparable producers.
[4] E.g., elimination of areas where water needs to be boiled, elimination of untreated waste water releases, reduction in water leakages (currently above 40% of the total).
[5] Or 160 euro per year when there is only one adult in the dwelling.
[6] Group Schemes will also have the option to join Irish Water by transferring their assets.
[7] Which would make the 2014 results and/or balance sheet as not being particularly relevant.

subsidies to "Group Schemes" appear to have been at the same time reduced, so as to largely equalise the charged water price for domestic users across schemes in Ireland.

Separately, a 100 euro per household and per annum grant is foreseen, apparently to encourage water preservation, although it is not specified in the relevant legislation to what extent the grant will in fact be conditional on water preservation activities. In any case, it will significantly attenuate the net price impacting 'domestic users'. All households will be eligible for this grant, even when not Irish Water customers, by mere administrative registration with Irish Water. In a bid to cut water leakages, it should be noted that whilst pipes within properties belong to landlords, Irish Water will nonetheless offer one-off rehabilitation services free of charge (often involving the complete removal and replacement of pipes) as well as an inspection of the pipes. The metering of properties will be a crucial device to identify large water leakages.

Aside from current payments, government will also to a large extent fund the massive investment programme of Irish Water, foreseen to encompass 5.5 billion euro over 8 years or [redacted] euro a year. Government is expected to provide [redacted] in 'equity/capital contributions' over 8 years, and [redacted] euro in loans. [redacted] euro in 'external debt' is expected to be drawn down for this purpose, the rest stemming from gross savings.

Irish Water is established as a state-owned company within the Ervia Group (the public gas supplier utility, classified in the non-financial corporation sector, previously named Bord Gais Eireann), apparently to benefit from its expertise in network and customer billings. Irish Water has a specific shareholding structure with Ervia having, as of end 2013, one voting A-share, with both the Ministry of Finance and the Ministry for the Environment, Community and Local Government having one non-voting B-share[8]. Shares can only be transferred with the consent of Ministries. In addition, the Ervia A-share holds no economic rights (no dividends and no liquidation value), and Ervia does not consolidate Irish Water accounts when presenting its consolidated financial statements, based, according to Ervia[9], on the IFRS 27 prescriptions to consolidate entities controlled, control being defined as "*the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities*". Privatisation of Irish Water is not envisaged for the future and could only be undertaken through a Resolution from Parliament and a referendum in order to amend the constitution.

While the board of Irish Water is appointed or removed only by Ervia, according to the Articles of Association (article 19.2(a)) – in the context of an unusual general assembly comprising only 3 participants and only one of them voting, the consent of Ministers is however required (article 19.2(c))[10]. The duration of directors' term in office is short, not exceeding one year, which de facto gives significant control to Ministers.

Irish Water is regulated by the Commission for Energy Regulation (CER), which has extended powers, perhaps consistent with its monopolistic character. The CER sets performance standards, examines Irish Water costs and capital plans, and set water prices. It has the powers to produce codes of practice relating to performance standards, customer billings, payment method, information and communication, or customer complaints.

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[8] The article 4.1 of the *Articles of Association* however refers to 100 million shares of 1 cent each, half being A-shares, the other half being B-shares. Article 4.5 seems to allow for the consolidation of all shares held in a certificate, and to allow for limited shareholding (3 shareholders). By and large it remains unclear which entity owns the shares.

[9] 2013 Annual Report of Ervia.

[10] Both the Minister for the Environment, Community, and Local Government and the Minister for Communications, Energy and Natural Resources.

The CER sets a weighted average cost of capital at 5.1%, albeit on a very low "regulated asset base" of [redacted] euro, instead of the [redacted] in net assets calculated by the CSO. Eurostat notes that the consumption of fixed capital is calculated by the CSO to be 220 million euro in 2015 (rightly much higher than the accounting amortisation) on the basis of [redacted] euro.

Revenue collection is also uncertain, with Irish Water estimating that [redacted] of billing amounts will be collected within the year, in 2015, but [redacted] in 2021. Irish Water expects most unpaid amounts to be nonetheless recovered within the following 5 years, and only a small proportion to be written off. Nevertheless, Irish Water plans to provision, as an expense, [redacted] of domestic billings in 2015, a share expected to fall to [redacted] in 2018. In support of this, a flat penalty system of 30 euro or 60 euro per year of late payment is foreseen. It remains that the Irish authorities consider that "*the level of public disquiet around the introduction of water charges may have an impact on the realisation of revenues*".

Analysis of the case

General considerations

The traditional way to classify entities inside or outside government is to go through a decision tree, sequentially, to decide (1) first, if the entity is an institutional unit, that is deemed to have autonomy of decision (and if not who is its parent?), (2) then, if the entity is private or public controlled, (3) and finally if the entity activity is non-market or market (with the crucial notion of economically significant prices, other qualitative criteria and the quantitative 50% test).

However, first, it should be noted that a number of other relevant criteria exist aside that general decision tree, now explicitly spelt out and further developed in the ESA2010 version of the European System of Accounts. Second, in complex cases, there is a need to examine the various criteria either in a different order or using a multi-criteria approach. It would, for instance, not be correct to classify an entity outside government if at each step the answer was largely uncertain. There would be a risk in this respect to end up with clear government undertakings being classified outside general government.

While the public control is not in dispute, the case of Irish Water is complex concerning other aspects such as the autonomy of decision and the market/non-market nature of the entity. In substance, Irish Water merely reorganises an essentially local government non-market service into a national provider, with the same assets and staff, and retaining unchanged billing for non-domestic users. The main change relates to the fact that domestic users will now be charged, aside from a new governance structure. In this context, particularly attention has to be devoted to the fact that the level of charge billed to domestic users was explicitly calibrated so to meet the quantitative 50% criteria ("*a significant component of the strategy to establish Irish Water is that Irish Water will be classified, from inception, as a Market Corporation under Eurostat rules (ESA95/ESA2010)*", as government documentation provided to Eurostat clearly recognises), rather than so to align with best commercial practices. Eurostat notes that the net additional proceeds, arising from the reform, from Irish Water 'domestic' clients, would be a mere [redacted] of revenues.

In this context, the statistical community (Eurostat and the national statistical institute) should be extremely prudent and demanding when examining the case in question. This is all the more so where the case being studied is undertaken in the context of an ex-ante consultation, and where the documentation available is essentially a business plan with its associated uncertainties – and not observed accounting results over a number of years. In itself, this must call for additional prudence.

Furthermore, the intention to fund major investments in public infrastructure via Irish Water may also be an additional relevant consideration to be taken on board to some extent, when assessing the appropriate sector classification.

Finally, a decision on sector classification cannot ignore the likely recording of some important transactions such as the way in which payments by Irish Water to local authorities (SLA) and injections of funds into Irish Water will be accounted.

Autonomy of decision

To determine whether Irish Water is an institutional unit in the meaning of ESA2010, one needs to consider its autonomy of decision according to ESA (ESA 2.12), that is, aside from having complete accounts and having a legal personality: (1) whether it has a capacity to independently hold assets and incur liabilities, and (2) more importantly, whether it has autonomy of action.

To start with, it is important – whether or not Irish Water is considered an institutional unit – to determine which is the parent unit, that is, the controlling institutional unit in which Irish Water accounts would be integrated if Irish Water were not to be found an institutional unit, or, alternatively, the entity owning the equity, if Irish Water were to be found as having the attributes of an institutional unit. It seems, in this respect, that the parent unit would not be Ervia, given that Ervia itself does not consolidate Irish Water in its own accounts. As a consequence, the fact that Irish Water board is a subset of Ervia's board, or possibly that Ervia's board is de facto acting as the true board of Irish Water, would not be instrumental in identifying Ervia as the parent unit, and would thus be interpreted as a merely practical way for government, as owner of both Irish Water and Ervia, for using one of its affiliates' management and technicians expertise for the benefit of another of its affiliates. In that way, were Irish Water to be considered as having autonomy of decision, the capital funding and associated increase in net assets would be accounted as an increase in AF.5 assets of general government. Alternatively, Irish Water would be consolidated within the broader budgetary central government, the main core government unit of central government.

The nature of the parent being clarified, Eurostat notes the considerable element of controls that government has (through Ministers[11]) in all sorts of decisions. It is first noted that, while Irish Water's directors are appointed and removed by Ervia, their appointment and dismissal must receive the consent of Ministers, with government therefore having a veto right on the issue. Furthermore, directors' tenure tends to be short, for a maximum of one year. This could be seen as providing evidence of government operational control, aside of and in addition to the mere traditional shareholders' control with respect to the strategic orientations (so to derive benefits). The Memorandum of Association, Article 6, sets an impressive list of actions under obligatory Ministerial consent. These include, inter alia, in addition to traditional shareholder prerogatives, such as acquisition, purchases, disposals and winding up of shares, other interest, business or undertaking, the consent on any borrowing as well as on any lending (other than those given in the ordinary course of business, e.g. trade credits) or guaranteeing or pledging, which overall puts a legitimate question mark as to whether Irish Water has genuinely autonomy of decision in its financial decisions.

[11] Four in total: Ministry for Finance, the Minister for the Environment, Community, and Local Government, the Minister for Communications, Energy and Natural Resources, and the Minister for Public Expenditure and Reform.

Aside from this, on the real activity side, various government acts seem to determine some of the most important aspects of the operations of Irish Water: the assets assumed, the employees to employ, the SLA, and the broad pricing parameters – most notably the capping. Additionally, Irish Water's regulator (classified in general government) further determines a large set of operational practices, and above all the actual price charged to consumers.

Although it might be difficult for Eurostat to judge the materiality of the level of autonomy of decision of an entity by merely reading its statute, the specific extended powers that government has in the case of Irish Waters look exceptional.

Finally, Eurostat notes that Local Water authorities' activities will de facto continue, as the large majority of Irish Water staff will continue to be local government employees. Eurostat acknowledges that, as stated by the Irish statistical authorities, this may simply result from the protection of employees under European law (Protection of Employees on Transfer of Undertakings Regulation of 2003). At the same time, it should be recalled that whenever entities split their activities in between two or more legal units – for instance one hosting the assets and the other hosting the employees –, for legal, fiscal, regulatory, management, technical or other reasons, the view of national accountants has always been to recognise only one unique institutional unit (ESA 2.24-2.26 on artificial subsidiaries). This is largely because a producer conducts its activities with both employees and capital, and one would generally not recognise that one of the units would in effect be renting its assets or its workforce to the other unit, this being basically an internal transaction. Upholding the essential principle of substance over form, the canonical national accounts view is that one unit would be ancillary to the other. An important operating criterion in this respect is to what extent the alleged renting of assets or of staff is determined competitively, with various bidders invited, and whether some of the renting is carried out with third parties.

In the case of Irish Water, all local government assets are transferred (with unclear modalities of compensation) and all local staff will continue to be employed and "billed" to Irish Water – outside a competitive bidding procedure. It could be concluded, therefore, that Irish Water would have no control or autonomy of decision over a large part of its workforce.

Related to this, one would need to clarify the true nature of the SLA and the appropriate national accounting of this flow. Doubts persist on whether it should be seen as market output (but in this case based on what "market" and of what type of output (would it be water supply, or provision of labour?)) or whether it should it be a payment for non-market output, or whether the payments should be seen more as intra-government current transfers.

An alternative approach would be to consider that the local water authorities' staff would be part of Irish Water employment, thus defining the institutional unit (or the local KAU) of Irish Water to include some part of local authorities. In this case, however, it would remain to be determined if Irish Water would be classified inside or outside government.

A third approach could be to consider that Irish Water is in fact merely providing billing and financial services (or renting of non-financial assets) to local water Authorities, who would in turn continue to be seen as the provider of water services in national accounts. Irish Water receipts would then appear in national accounts as revenue of local governments first, and then further recorded, net of SLA payments, as local government expenditure and Irish Water revenue (largely as income for the renting of assets). In this reading, Irish Water would certainly be classified inside government, as being an ancillary service provider to exclusively government units.

To conclude on this section, Eurostat has significant doubts on the CSO view that it would be straightforward to recognize an institutional unit in the head of Irish Water as currently incorporated, given the considerable control (not only strategic but also operational) held by Ministers, the limited scope for manoeuver within predetermined parameters set either by laws or by regulators, and also in view of the fact that most staff will continue to consist of Local authorities employees. This last point raises the issue of the true perimeter that an Irish Water institutional unit would have, as well as of the actual business of Irish Water: a provider of water to users, or a billing entity ancillary to local water authorities. At the same time, Eurostat considers that if the non-market character of Irish Water were to be established, the issue of autonomy of decision would not need to be clarified, as the entity would be classified in the government sector in any case (as a non-market unit controlled by government).

Market/non-market criteria

It is important therefore to determine if Irish Water is a non-market unit (institutional unit or local KAU), or a market one, that is, assessing whether the 'prices' at which Irish Water 'sells' its output are economically significant or not. The focus here would be on the traditional quantitative criteria (the 50% rule), although qualitative criteria may also be relevant.

Prices are economically significant when they have substantial influence on the amounts of products that producers are willing to supply and on the amounts of products that purchasers wish to acquire (ESA 20.19). Furthermore, ESA further defines the interpretation of economically significant prices, by examining who is the primary purchaser of the output (ESA 20.22-20.28, which include the so called qualitative criteria). Finally, the traditional approach is to apply the economically significant price test product by product (ESA 20.20), and only then apply the 50% market/non-market test (ESA 20.29) at the level of the institutional unit or of the local KAU.

To start with, ESA 20.21 recalls the convention that (for profits) private corporations can be presumed to charge economically significant prices. In contrast, prices of units under public control "*may be established or modified for public policy purposes, which may cause difficulties in determining whether the prices are economically significant. Public corporations are often established by government to provide goods and services that the market would not produce in the quantities or at the prices to meet government policy. For such public units enjoying government support, the sales may cover a large part of their costs, but they will respond to market forces differently from private corporations*". It could be argued that Irish Water meets outright the description above, in so far as the arrangement has not been tested with private operators, which prevents presuming a commercial set-up, while at the same time the implied return on capital in the business plan appears particularly low.

To the extent that Irish Water is seen as a water provider and that government units' consumption is a marginal part of total consumption (2%), ESA 20.23 would apply rather than ESA 20.24-20.28. In this case, an economically significant price would require that the producer has an incentive to adjust supply to make a non-zero (excess) profit on the long-term and consumers are free to choose to consume on the basis of these prices. If Irish Water were to be seen as a billing entity, paragraphs 20.24-20.26 would apply. If the purchaser of the output in the meaning of ESA 2010 were to be interpreted as reflecting the payer instead of the user, paragraphs 20.27-20.28 would apply.

Although Irish Water is not the sole producer in Ireland, as other producers comprise 1/4 to 1/3 of the water supply, it remains that each producer is de facto a local monopoly. Thus Irish Water faces no competition for most of its customer base, which is essentially captive (as most customers already were of local authorities). The situation is a de facto monopoly of water.

The criteria set out in ESA 20.23 that "*Economically significant prices normally result when two major conditions are fulfilled: (1) the producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other production costs, including consumption of fixed capital, by sales; and (2) consumers are free to choose on the basis of the prices charged.*" would be fairly difficult to comply with, in the case of Irish Water.

This is because the massive investment scheme does not seem to have been construed to reflect a good profitability of asset, and a market reaction to lucrative prices, but instead to stem from the need to meet regulatory requirements. Symmetrically, consumer are not free to choose suppliers, facing (local) monopolies, and while some consumers will be metered, most will be at cap, with the effect that the marginal price of their water billings will fall to zero (therefore not reflecting the conditions for being set at economically significant prices).

It could be acknowledged that economically significant price would not necessarily require strict proportional payments to volume consumed – nor is this a sufficient condition for that matter. Indeed, private producers may find cost effective to bill flat availability fees, particularly when marginal costs are zero – and in practice sometimes do that. But again, private producers are expected to act commercially and thus to price on an economically significant basis. When this practice is entered by a public company, particularly so if it is a monopoly subsidised to a significant extent, the non-proportionality and particularly the capping become distinct problems. There is therefore a clear difficulty in describing the domestic billings as unequivocally market (P.11), and these may alternatively be seen as payments for non-market output (P.131). Although both are to be accounted for in the 50% test (ESA 20.30), there may be other important consequences to this, which are examined further below.

As described above, the operational subsidies of government, of 400 million euro in 2015, are roughly decomposed in: (1) 129 million euro for compensating the cap, (2) 211 million euro for the per unit subsidy, (3) 60 million euro for compensating the child allowance.

Eurostat agrees with the CSO view that the first payment has a nature of subsidy on production (D.39). Eurostat also agree that the second payment has more the nature of a payment to compensate for persistent losses (ESA 4.35c) than of a subsidy on product used domestically (ESA 4.35a). This is important given that ESA 3.33b explicitly excludes the payment under ESA 4.35c from sales in the context of the 50% test. It should be noted that a payment can be a subsidy on products in the meaning of ESA 3.45a only if it is collectable by all producers in Ireland. As regards the third payment, the CSO views this payment as a social benefit (transfer in kind – purchased market production, D.632) to households who in turn use this to purchase volumes from Irish Water, and as such it would enter the 50% test calculation. Although this recording could have some analogies with other circumstances where such a recording would apply, Eurostat has some reservations on this. First, it should be noted that the benefit in question does not depend on the actual consumption by the subsidised party. It would seem more prudent to allow this recording only when there is an actual measure of consumption. Otherwise, applying such provisions unrestrictedly may risk creating incentives towards the multiplication of "allowances" covering various social risks (old age, unemployed, sickness and what not), so to eventually and conveniently cover a large part of actual volumes. Second, it is noted that for such an allowance to be seen as a social benefit, it should be provided to all water users in Ireland fulfilling the same conditions, without exceptions, a point that would need to be clarified. Aside from these two questions, it is explained below why such payments cannot be considered as social transfers in kind – purchased market production.

Another issue to be raised is how to record the expected non-payments. Given the large uncertainty surrounding the actual collection ratios on Irish Water domestic billings, Eurostat had previously suggested to account for this, by recording them cash. This was obviously not due to Eurostat's intention not to apply accrual accounting, as dictated by ESA2010 in general circumstances. Eurostat considered, in this respect, that given the high uncertainty on the proportion of bills which will never be paid, it would be more prudent to record them according to cash (therefore making sure that amounts are booked as revenue of Irish Water only when received) than according to accrual (which would comply with the time of recording rule but at the cost of possible booking as revenue of amounts which will never be received and of revisions later on for non-negligible amounts). All the more so, in a situation where households have never been used to pay for water and in the context of a situation of public disquiet over the water charges, as admitted by the Irish authorities. This seems to be supported by the fact that, according to the figures released by Irish Water on Wednesday the 15th of July, not even 50% of the water charge payments due for the first three months of billing were paid by households and collected by Irish Water.

Eurostat in this respect notes that IFRS/IPSAS prescribes to record as revenue, on a sale of goods or services, the fair value of the consideration provided in exchange, which is not necessarily the nominal or billed value[12]. Firstly, IFRS/IPSAS explicitly prescribes recording a discounted value in case the time lag for the payment is material, which would be the case here for a significant proportion of the billings.[13] Given that users will be billed late fees, perhaps these could be interpreted as property income (with no need for discounting values then). In this respect, it would be useful to clarify where those fees are currently foreseen/recorded in the business plan. Secondly, IFRS prescribes booking at inception the revenue net of expected loss, rather than gross proceeds with a simultaneous expense for the expected non-payments. In contrast, when uncertainty later on arises about the collectability of an amount already booked as revenue, IFRS explicitly prescribes that "*the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognised*"[14]. In this context, it seems reasonable to Eurostat that the domestic sales be reduced by the expected loss, for the evaluation of the 50% test.

The table attached illustrates the various ratios that would result in 2015 and 2016 in case Eurostat would take a different view to the CSO on the issues mentioned above.

[12] IPSAS 9 para 14
[13] IPSAS 9 para 16
[14] IPSAS 9 para 21

million euro	2015	2016
Revenue	**900**	**993**
Total customer revenue	***500***	***514***
Billed non-domestic	229	240
Billed domestic	271	274
Total revenue from government	***400***	***479***
Purchase of water by Government to provide child allowance	60	61
Purchase of water by Government to give effect to caps	129	138
Product subsidy	211	280
Production costs	**1042**	**1068**
Operating costs before CFC	790	774
- Payroll - SLA	[redacted]	
- Payroll - other		
- Intermediate consumption - SLA		
- Intermediate consumption - other		
Consumption of fixed capital	220	238
Net interest expense	32	56
Memo:		
Capital injections	[redacted]	
100 grants on Irish Water's domestic customers		
Cost of capital [redacted]		
All government disbursals		
Implied ratios		
CSO ratio	**0.54**	**0.54**
Alternative ratio 1a - without child allowance	**0.48**	**0.48**
Alternative ratio 1b - without child allowance and with netting of expected nonpayment	0.43	0.43
Alternative ratio 2a - without child allowance and with netting grants	0.36	0.36
Alternative ratio 2a - without child allowance, with netting grants and expected nonpayment	0.30	0.31
Alternative ratio 3b - without child allowance, with netting grants and expected nonpayment, and considering a different cost of capital	0.26	0.27
All government disbursments as a ratio of customer net revenue	1.6	2.1
All government disbursments as a ratio of domestic customer net revenue	4.1	5.5

In addition to this, Eurostat considers that SNA 2008 para 22.29 helps also in understanding the problem at hand when stating: "*These conditions usually mean that prices are economically significant if sales cover the majority of the producer's costs and consumers are free to choose whether to buy and how much to buy on the basis of the prices charged. Although there is no prescriptive numerical relationship between the value of output (excluding both taxes and subsidies on products) and the production costs, one would normally expect the value of goods and services sold (the sales) to average at least half of the production costs over a sustained multiyear period*". This suggests that the 50% criteria can also be used to judge, notably in difficult cases, whether a product is sold at significant price or not. Given that non-domestic billings are sold at cost, one can easily see that domestic billings are well below 50% of costs, even using all the CSO conventions. As such, products consumed by households should be considered as non-market, and payments by households should be considered as payments for non-market output (P.131). While such proceeds would still enter the 50% test, there are two important consequences of this.

The first consequence would be to prevent recording in national accounts the amounts paid out by government to Irish Water in support of domestic billings or deliveries, as subsidies on products

(D.31) and as social benefits regarding government outlays. ESA 4.33 limits D.31 to market output.[15] In addition, the envisaged social transfers in kind treatment D.632 are explicitly referring to "market production purchased by government and NPISH" (ESA 4.38j) and the label of D.632 is indeed "social transfers in kind – purchased market production". As a consequence, none of the 400 million euro would enter the valuation of production at basic prices, and thus the 50% test calculation.

Three further points remain worth examining.

First, the CSO considers that the 100 euro grant should not be considered, because it would be unrelated to water purchases. Indeed, a customer may well have an annual bill to Irish Water below the 100 euro in grant, making him/her a net recipient. However, the situation does not seem to be fully clear. This grant seems part of overall legislations establishing and regulating Irish Water operations. The 100 euro grant seem not conditioned to water-saving spending by households, and instead to be received without any eligibility condition. The fact that Irish water users would need to administratively register with Irish Water could also have accounting consequences, with government investing Irish Water with quasi-agency competences of public service or administration, fairly outside commercial practices. The intention of the grant of 100 euro per year is clearly to partially compensate for the new domestic billings (260 euro per year for most of two-or-more-adults dwellings[16]). In total, Irish Water domestic customers will receive 130 million in grants to compensate for the 270 million of new domestic billings. Eurostat therefore considers that the 100 euro grant should be netted from Irish Waters customers' revenue – at least for the 50% test.[17]

Second, while the costs seem generally prudently measured, notably with respect to consumption of capital (based on the [redacted] euro net fixed assets, rather than on the [redacted] euro in regulatory assets), Eurostat has doubts on the valuation of the cost of capital. It is agreed that ESA2010 20.31 prescribes to use the net interest charge, but ESA 3.33 clearly states that this measure is used "*for the sake of simplicity*". A more realistic 'cost of capital' would clearly push the sales ratio further down, and by itself perhaps below 50% in the CSO own calculation.

Third, while the capital injection of 250 million a year, which is on top of the 400 million in transfers and of the 130 million in grants to customers, will not impact the 50% test, even if these capital injections were reclassified as current transfers, it remains that overall government funds 730 million on the 900 million of Irish Water costs. This constitutes a massive financial support. In this light, SNA 2008 para 22.32 states "*It is likely that corporations receiving substantial government financial support, or that enjoy other risk reducing factors such as government guarantees, will act differently from corporations without such advantages because their budget constraints are softer. A non-market producer is a producer that faces a very soft budget constraint so that the producer is not likely to respond to changes in the economic conditions in the same way as market producers.*" This may in itself be considered sufficient to classify Irish Water as non-market, under a qualitative criteria.

Lastly, given that this advice is on an ex-ante basis, extra care should be taken when discussing not only the market/non-market criteria but also the autonomy of decision criteria. Only the practice will allow statisticians to observe the true nature of the arrangement as well as the realised inflows relevant for analysis. The classification of Irish Water outside government would not be justified on the basis of such a borderline business plan.

[15] ESA 4.36 also restricts subsidies on production for non-market output of non-market producer to cases where such payments depend on general regulations applicable to all producers (market or non-market).

[16] 160 euro per annum for most one-adult dwellings.

[17] At least for those customers having billings above 100 euro, and possibly for the amounts that cover smaller actual billings.

Conclusions

In conclusion, and on the basis of the available information, Eurostat considers that Irish Water is a non-market entity controlled by government and should therefore be classified within the government sector.

Irish Water merely reorganises previously non-market activity carried by local government in a way that currently does not permit to assess whether there is a genuine commercial basis. A large part of the previous arrangement will continue, most prominently the local authorities' staff and the billing of non-domestic users. No competitive bidding has been carried out and the commercial basis is that of a heavily subsidised public monopoly. Whilst the billing of domestic users is a clear change in the set-up, it is unclear whether it is material enough for Irish Water to be considered as a non-financial corporation, given the non-market character of the activity. Eurostat notes that domestic users will only pay [redacted] million euros, when netting with the grants which users will collect. In the meanwhile government support is expected close to 800 million euro a year, in various forms: current transfers, grants to households, or capital injections.

While there might be very good reasons to already classify Irish Water within government on the basis of qualitative criteria, as explained above, Eurostat considers that in any case Irish Water does not meet the 50% test, based on the CSO's own estimates, and should thus be classified in central government in any case. This is because, given that domestic billings do not cover half of their costs, this product is to be considered as non-market (ESA2010 3.19/ SNA 22.29), which causes all payments of government related to these sales to be of a nature other than subsidies on products or than social transfers in kind – purchased market production. As a consequence, none of the payments can enter sales in the 50% test, and the ratio would be at 48% for 2015 and 2016 – rather than 54% as calculated by the CSO.

Aside from this, Eurostat also considers that the CSO should envisage, when calculating the sales for the 50% test, to net household grants as well as the billings expected not to be collected (those provisioned) should the amounts be based on solid estimations, or to record such amounts on a cash basis if in a situation of high uncertainty concerning the total amounts which will be collected (which is to be expected, especially at the beginning of the activity of Irish Water, given that households will be called to pay water fees for the first time ever).

Finally, it is underlined that, in addition, if more realistic or prudent capital costs were considered, the ratio would then fall to 27%, which is a very low ratio and which would reinforce Eurostat's assessment of the appropriate clarification of Irish Water.

Procedure

This view of Eurostat is based on the information provided by the Irish 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. In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC.

Eurostat is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on its website. In case you have objections concerning the publication of this specific case, we would appreciate if you could let us know before 28 July 2015.

Yours sincerely,

(e-Signed)

Eduardo Barredo Capelot
Director