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FINAL FINDINGS

Eurostat EDP dialogue visit to Latvia

7-9 June 2017

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EXECUTIVE SUMMARY

Eurostat carried out an EDP dialogue visit to Latvia on 7-9 June 2017, accompanied by observers from the Directorate General for Economic and Financial Affairs (DG ECFIN) and from the European Central Bank (ECB). Latvia was represented by the Central Statistical Bureau of Latvia (CSB), the Ministry of Finance of Latvia (MoF), the Treasury of Latvia and the Bank of Latvia (the Central Bank). Representatives from the Ministry of Economics, the Ministry of Transport, the Ministry of Environmental Protection and Regional Development, VAS “Latvijas Dzelzcelš” and E&Y Baltics also participated during the relevant sessions. (Please see the list of participants in Annex 1).

Eurostat undertook this EDP dialogue visit in order to discuss the quality framework for the production of EDP statistics, and the audit and internal control arrangements in place, to review data sources for the EDP data compilation and to monitor the implementation of the ESA 2010 methodology and of the provisions of the ESA 2010 Manual on Government Deficit and Debt for the recording of government transactions, the application of the accrual principle and the sector classification of units. The participants agreed on 41 action points.

As regards the institutional responsibilities, the Latvian Statistical Authorities confirmed the publication of Cabinet Regulation No. 756 from 22 December 2015, prescribing the procedures for preparing the EDP notification and identifying reporting responsibilities and deadlines to involved national authorities. At the moment, there is no formal contact for EDP work with the Court of Auditors (CoA), but CSB agreed to invite them to participate to the national EDP Working Group. The Cabinet Regulation No 756 also formalized in writing, the obligations of reporting, the templates and the periodicity of the data to be provided to CSB.

Concerning data sources, Eurostat pointed out that, accrual source data being available, CSB should examine possible ways to *explore* it and use, for instance, the Profit & Loss information on expenditures/revenues, at least, to cross check the flows of payables/receivables reported in EDP tables 2.

As a result of the follow-up of the EDP April 2017 notification data, the Latvian Statistical Authorities agreed with Eurostat the following actions: to provide data for the planned year in the EDP tables 2; to improve structurally the questionnaire table 3, adding a split (under each NACE code) for the B.9 by main companies; in the questionnaire tables 4, to provide the subsector data, and to revise the inclusion of the details in "Receivables/Payables relating to financial instruments" and "Other receivables/Payables relating to non-financial transactions"; and to fill part 3 of the supplementary tables on government support to financial institutions.

A general discussion about the application of the market/non-market test took place. Eurostat enquired on the formula applied for the 50% test and on the chart of accounts codes corresponding to the items used for the calculations. The CSB will clarify to what extent the 50 percent test considers changes in inventories, as well as losses of inventories and of trade receivables.

CSB was asked to reclassify *LatRailNet*, a public corporation classified in NACE O, into the general government sector for the April 2018 notification (unless the NACE code currently attributed is not correct and the activity of this unit is genuinely market).

Before the visit, Eurostat and the CSB had identified three cases which required special attention in the context of the sector classification: Rail Baltica – a rail transport development project, *Tiesu namu aģentūra (TNA) - a public real estate company* and the Deposit Guarantee Fund. Following the discussions about the sector classification, it was concluded that there is still no clear definition of the whole institutional setup and subsequent recording of the flows for Rail Baltica. The CSB will inform Eurostat about developments related to the eventual or tentative setup and business plan of RB Rail, before seeking an advice (ex-ante or ex-post) from Eurostat. In the meantime, CSB will record the expenditure for studies and technical design for RB Rail, currently carried out by the entities, as government expenditure, together with the appropriate matching amount of EU revenue.

Regarding *Tiesu namu aģentūra*, which challenged in court its classification in the Government sector by CSB and had won the ruling at the Administrative Regional Court in 2015, Eurostat expressed its support with the decision of CSB to continue including the company in the government accounts, although removing it from the published administrative list of entities included in S.13. CSB will send to Eurostat the documentation provided to the Court and the Court ruling. Eurostat is examining those cases where the statistical classification of a unit is challenged at a national court in several MS and will, on this basis, provide advice on the sector classification of TNA.

CSB confirmed that the Deposit Guarantee Fund will be reclassified into the general government sector in the October 2017 EDP notification, starting from 2001 onwards. In this context, the CSB will reflect on the appropriate recording of the 2011 rescue operation of *AS Krajbanka* and inform Eurostat (notably considering the possible recording of a financial claim at that time). The CSB will also examine the sectorisation of the Insurance Guarantee Fund, and will notably check whether government is lender of last resort and, if this were the case, will reclassify this fund into the general government sector.

As regards the implementation of the accrual principle for taxes and social contributions, Eurostat reviewed the treatment of the “Subsidised electricity tax” and suggested this tax to be classified as taxes on production (D.29) instead of on product. Furthermore, CSB will consider reclassifying EPT (*Enerģijas publiskais tirgotājs* - Electricity Public Trader), the unit collecting the "Subsidised electricity tax" and redistributing it to energy producers generating electricity from renewable resources or in cogeneration. It will otherwise reroute (recognizing the principal party) the flows (tax on product and subsidy on production) and stocks concerned through government accounts.

CSB mentioned that further tax amnesties may occur in the future in the context of the tax reform expected for 2018. The CSB will provide Eurostat with examples of tax refunds, taking into account that, in Latvia, no payable tax credits exist.

Concerning the recording of interest, Eurostat welcomed the data provided by CSB. The table on interest will be adapted according to the discussion. Furthermore, Eurostat took note that the BOP loans of the Commission to Latvia, issued at a discount, are recorded in the Maastricht debt for the redemption value.

In Latvia, gross fixed capital formation (GFCF) is recorded when the ownership of the fixed asset is transferred to the institutional unit that intends to use them in production, using cash data from Treasury reports, with no accrual adjustments being made. Cash data have been treated as accrual data. The CSB will provide to Eurostat a transition table for GFCF (1) calculated using the cash data adjusted for payable and receivable, (2) using the public account balance sheet and the P&L statement (3), and the investment surveys.

The participants discussed the recording of the winding-down of Reverta by the end of 2017. It was concluded that in 2016 and 2017, after selling the asset portfolio (mostly real estate and loans), only the impact for 2016-2017 will be added through the B.9 of Reverta. CSB will clarify how much cash (to be recorded as D.9), was given to PAREX and whether and for what amount at the time of reclassification a capital transfer was imputed, if any, for the net assets (expected loss). Eurostat takes note that the final loss in excess of the expected loss is to be materialized by a write off of treasury loans benefitting Reverta. Eurostat agrees with the CSB that the appropriate recording should be a capital transfer in 2010, with a revision of the stock of assets reported in the ESA balance sheet.

Eurostat reviewed the recording of the EBRD put option and the *Citadele* sale. CSB will reduce the capital transfer expenditure (88.24 million euro) recorded in 2014 for the amounts of the proceeds collected in 2015 or, if it interprets the put option as a loan at inception, will eliminate the capital transfer completely. The payable of 88M€ corresponds to the activation of the put option, with the EBRD selling back to Government its equity in *Citadele*. The put call will have a deficit impact or not depending on whether an effective claim is acquired, whose value can be reasonably estimated. In this case, it seems there was an effective claim since the equity was sold within few months to investors, and the value can be considered to be the value sold at that time. Under this condition, the recording of a capital transfer should be reduced from 88.24 MEUR to 13.5MEUR.

Eurostat agreed on the current recording of some lump sum payments related to pensions, but questioned if the 2nd pillar transfers of assets of deceased persons, in certain cases, meet the definition of social contributions. CSB will reflect on the appropriate classification of some of these payments, without B.9 impact (D.7/D.91/D.99).

Concerning the reporting of guarantees granted by government, and regarding questionnaire table 9.4, the CSB will review the current recording in order to have an AF.6 liability position together with the B.9 impact. Eurostat will clarify if the amounts in questionnaire table 9.4, as well as the *Citadele* put option, should be excluded from questionnaire table 9.1.

The discussion about capital injections in public corporations focused on the national airline Air Baltic Company (ABC) and SJSC "“*Latvijas Dzelzceļš*” (LDz). The capital injection in Air Baltic might be considered as a financial transaction in F.5, but the recording is still uncertain. CSB should focus on the second part of the test looking into future expected flows and should confirm that there are no specific arrangements that benefit the private investor, such as a buy-back agreement (like a put option). Based on this, Eurostat will confirm the statistical treatment of the capital injection before the next EDP October 2017 notification.

The Latvian authorities requested an ex-ante advice for the correct statistical treatment of a planned equity increase in SJSC “*Latvijas Dzelzcelš*” (LDz) by the government, in order to implement the Latvian railway network electrification project. On the basis of the 2016 financial statements/reports of *SJSC “Latvijas Dzelzcelš” (LDz)*, as well as the main financial results since 2007 that the national authorities will submit, Eurostat will provide a letter of advice on the appropriate recording of the planned capital injection.

Referring to the calculation of the super dividend test applied to the Central Bank, CSB will consider taxes on income in the super dividend test and, as a result, will reduce the dividend revenue originating from the Central Bank for some years (e.g. 2013).

CSB confirmed that they have access to the drafts of PPP projects before they are finalised and signed in order to be able to comment on their statistical treatment. CSB informed that there is still no confirmation of the starting of the *Kekava* PPP project.

Under ESA 2010, flows on derivatives only enter the financial accounts (F.7), with no impact on the deficit. The CSB will clarify whether interest on forex debt under hedge in the working balance is recorded before or after swaps (i.e. interest streams on CCS or forwards are reported within interest payments of the budget rather than separated in another line). The CSB will verify whether the list of derivatives provided to Eurostat is complete, and will add information for 2013 and 2014. Concerning long term forwards used for hedging, the CSB will clarify what exchange rate was used for the valuation (cash value at time of hedge or forward value) and indicate the reduction/increase in Maastricht debt arising at inception from this hedge. The CSB will clarify the recording of lump sums on swap cancellation (unwinding of hedge in 2015) as well as on forward settlements, in the working balance (budget), in public accounts, and in EDP/ESA tables. In relation to QFAGG, the CSB will separate the swap from the debt being hedged and will aim at valuing the bonds at their market values.

Eurostat welcomed the information provided by the Latvian statistical authorities on Emission Trading Scheme (ETS). Eurostat will adapt the template on ETS, so to accommodate cancellation events (as occurred in 2008), and CSB/Ministry will refill the table accordingly. The current compilation of government revenue is acceptable pending some review of the guidance. The CSB will report on the rules followed by public accountants to establish the revenues of these ETS flows.

Regarding UMTS and mobile phone licenses, CSB will update, in accordance with Eurostat's guidance note from February 2017, the recording of the proceeds (revenue) from all mobile phone license contracts from 2017 onwards that should be recorded as rent (D.45), spreading the impact over the license duration, and not as disposal of a non-financial asset with a one-off impact on deficit/surplus at inception.

The participants also discussed the new mandatory electricity procurement scheme, a support system created to facilitate renewable energy and high efficiency cogeneration in Latvia. The increasing burden of the scheme has led government to examine ways to modify the arrangement, notably in order to limit users' contributions or budget grants. The government of Latvia is considering designing a mechanism that would allow the companies receiving support for high efficiency cogeneration to partly waive their right to support, in return for receiving a one-off compensation. The financing of this mechanism is expected to come from a capital withdrawal from JSC "*Latvenergo*". The Latvian authorities presented three different possibilities on how the new scheme could be implemented and asked Eurostat in this context on the possible impact on national accounts data.

Eurostat took note of the project from the Ministry of Economics concerning the subsidized renewable energy scheme and provided information on the recording principles in national accounts (NA). Based on the discussion during the meeting, further exchanges will be necessary. Eurostat stressed that the deficit impact would likely correspond to the reduction in the electricity fees (tax) that the Ministry of Economics aims at achieving.

Eurostat very much appreciated the contribution of the Latvian statistical authorities to the smooth organization of the meeting and the very good co-operation and transparency demonstrated during the meeting, as well as the provision of documents before the visit.

INTRODUCTION

In accordance with Council Regulation (EC) No 479/2009 of 25 May 2009, as amended, on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community, Eurostat carried out an EDP dialogue visit to Latvia on 7-9 June 2017.

The delegation of Eurostat was headed by Mr Eduardo Barredo Capelot (director of directorate D "Government Finance Statistics (GFS) and quality"). Eurostat was also represented by Mr Philippe de Rougemont, Ms Maria Chiara Morandini, Mr Thomas Forster and Ms Anabela Nabais Rodrigues (EDP desk officer for Latvia). Representatives of the Directorate General for Economic and Financial Affairs (DG ECFIN) and theLatvia was represented by the Central Statistical Bureau of Latvia (CSB), the Ministry of Finance of Latvia (MoF), the Treasury of Latvia and the Bank of Latvia (the Central Bank). Representatives from the Ministry of Economics, the Ministry of Transport, the Ministry of Environmental Protection and Regional Development, *VAS "Latvijas Dzelzcelš*" and E&Y Baltics also participated during the relevant sessions.

The previous Eurostat EDP dialogue visit to Latvia took place on 26–27 May 2015.

Eurostat carried out this EDP dialogue visit in order to discuss the quality framework for EDP statistics and the audit and internal control arrangements in place, to review data sources for the EDP data compilation, and to monitor the implementation of the ESA 2010 methodology and of the provisions of the ESA 2010 Manual on Government Deficit and Debt for the recording of government transactions, the application of the accrual principle and the sector classification of units.

The visit focused on the sector classification of specific units (including *Tiesu namu aģentūra*, Rail Baltica II and the Deposit Guarantee Fund), the recording of unexpected gains/losses on Reverta's assets in the context of its winding-down by the end of 2017, the recording of *Citadele* put option with the EBRD, the recording of the capital injection in Air Baltic, the recording of a future capital injection in *SJSC "Latvijas Dzelzceļš" (LDz)*, the new mandatory electricity procurement scheme and the recording of financial derivatives.

With regard to procedural arrangements, the Main Conclusions and Action Points would be sent to Latvia for review in the days following the visit. Then, the Provisional Findings would be sent to Latvia for review. After this, Final Findings will be sent to Latvia and the Economic and Financial Committee (EFC) and published on the website of Eurostat.

Eurostat very much appreciated the contribution of the Latvian statistical authorities to the smooth organization of the meeting and the very good co-operation and transparency demonstrated during the meeting, as well as the provision of documents prior to the visit.

1 Statistical capacity issues

1.1. Review of institutional responsibilities in the framework of the EDP data reporting and government finance statistics compilation

1.1.1. EDP processes and institutional cooperation

Introduction

The Government Finance Statistics Section of CSB is responsible for preparing and submitting the EDP notifications to Eurostat. CSB prepares the non-financial and financial accounts and the Maastricht debt, both annually and quarterly for all the sub-sectors of general government. The EDP tables are compiled by the CSB, except EDP table 1 and table 2A for the planned data, which is compiled by the MoF.

On 22 December 2015, a regulation on the procedures for preparing the notification of General Government Deficit and Debt - Cabinet Regulation No. 756 was adopted. Before the mission, CSB provided to Eurostat the English version of this Regulation.

Eurostat enquired about the cooperation between the institutions involved in EDP and any further changes since the last 2015 EDP visit, in terms of division of responsibilities and organisational structure.

Discussion and methodological analysis

The Latvian statistical authorities confirmed that there had been no changes in the institutional arrangements and the division of responsibilities since the 2015 EDP visit, but there had been new recruitments and the arrangements were formalised with the publication of Cabinet Regulation No. 756 of 22 December 2015. This Regulation covers the procedures for preparing the EDP notification and identifies reporting responsibilities and deadlines for the national authorities involved: MoF, Treasury, the Central Finance and Contracting Agency, the Ministry of Defence and the State Social Insurance Agency. The CBS stressed that the Regulation is detailed enough and additional Memoranda of Understanding are not necessary. Additional institutional arrangements detail the requirements for all institutions providing data to the CSB. Furthermore, the statistical law states that the CSB should always be contacted before changes in the data production or delivery are made, although in some cases this requirement is not fulfilled. Eurostat suggested the CSB to publish the Regulation on its website, for transparency purposes.

CSB provided to Eurostat an update of the flowchart with the EDP statistics production processes, which is the same as the previous flowchart provided in 2015 except for the number of units identified in the "Data compilation & Dissemination process". The biggest changes were in the central and local government units, which decreased from 255 and 872 to 229 and 832, respectively.

CSB organizes regularly working groups and inter-institutional meetings to carry out a comprehensive investigation of methodological issues and data sources, as well as an analysis and assessment of the notification results. The working group meets either every week during the notification periods, or more irregularly, and is in general attended by 2 participants from the Bank of Latvia, 3 from the Ministry of Finance, 3 from the Treasury and the Government finance section from the CSB. There is no written cooperation agreement for the working group and the role of the CSB as chair and final decision maker, if no consensus is reached, is not formalised.

Nevertheless, it is referred in the cabinet regulation nº756 that:

"11. The Bureau (CSB) *shall(...)*
11.2. draw up a work schedule for preparation of the notification and control performance thereof;
11.3. organise meetings of working groups for thorough study of methodological issues and data sources, analysis and assessment of the notification results, inviting the Bank of Latvia in addition to the involved authorities referred to in Paragraph 3 of this Regulation, and, where necessary, other authorities, the competence of which includes compilation and analysis of government financial statistics or associated data;"

CSB informed that, in practice, they have the final word in the discussions and if no consensus is reached, CSB would send a request for advice to Eurostat.

CSB is the entity responsible for the sector delimitation of units and for the definition of the list of entities by subsector of general government for national accounts purposes. This list of entities is published in the website of CSB, together with the lists for other sectors (NPISH, financial sector and corporations classified as households). The sector delimitation as defined by CSB is followed by all institutions. The CSB will send Eurostat a copy of the specific Latvian regulation on sectorisation procedures. For each national classification code there is the link to the corresponding ESA sectorizaction code.

Findings and conclusions

Action point 1 - The Latvian statistical authorities will publish on their website the Cabinet Regulation No 756 recently adopted (by 22 December 2015) on the *Procedures for Preparing the notification of General Government Deficit and Debt*, which provides for the different roles and responsibilities in the context of the EDP reporting.

Deadline: End of June 2017.[1]

Action point 2 – The CSB will provide Eurostat with the Latvian regulation on sectorisation procedures.

Deadline: End of June 2017.[2]

1.1.2. Quality management framework

Introduction

Eurostat enquired on the existence of a quality management framework in CSB, and in particular if something specific existed for EDP.

Discussion and methodological analysis

The Latvian statistical authorities confirmed that there is a CSB quality management framework in place, in accordance with ISO standards, and presented to Eurostat the statistical production model. There is a quality steering group that meets quarterly and which defines, for instance, the quality policy.

[1] On 30.06.2017, CSB informed to have published the regulation in their website in the link: http://www.csb.gov.lv/sites/default/files/dati/Regulations%20No.756.pdf
[2] On 30.06.2017, CSB provided the link to the Latvian regulation on sectorisation procedures: https://likumi.lv/doc.php?id=263203

In general, if a mistake is found, there is an identified procedure that explains what actions are expected and whom to contact, depending on the cases and the type of problem.

The documentation on the quality management framework is not public, but the CSB agreed to send Eurostat a copy of the flowchart presented (not to be disseminated).

The procedures are well documented in the Latvian Inventory of the methods, procedures and sources used for the compilation of deficit and debt data and the underlying government sector accounts according to ESA2010 (EDP inventory).

Findings and conclusions

Action point 3 - The CSB will provide to Eurostat the existing documentation concerning their quality management system for EDP/GFS statistics presented during the meeting.

Deadline: End of June 2017.[3]

1.1.3. Audit and internal control arrangements

Introduction

Eurostat enquired about audit and internal control arrangements on the EDP work.

Discussion and methodological analysis

Some years ago there was an internal audit service, but this was terminated. Usually, the Court of Auditors (CoA) sends their audit reports to the MoF, which informs CSB about issues related to data or accounts and CSB can express an opinion on that.

There is a contact person for the CSB at the CoA, but, at the moment, there is no regular contact and the CoA does not participate in the weekly inter-institutional meetings. The CSB stressed that cooperation can potentially be fostered with the introduction of IPSAS. Eurostat suggested inviting the CoA to participate to the EDP working group.

The result from the CoA's auditing on the implementation of the State budget and concerning the budgets of local governments is publicly available on its website.

In addition, ministries have occasional internal audit exercises, although not on methodological issues.

Findings and conclusions

Action point 4 - Eurostat suggested the CSB inviting the Court of Auditors (CoA) to participate to their EDP Working Group, and informing Eurostat of the developments on this issue.

Deadline: End of June 2017.[4]

[3] On 30.06.2017, CSB provided to Eurostat the documentation concerning their quality management system for EDP/GFS statistics presented during the meeting.

[4] On 30.06.2017, CSB informed Eurostat to have contacted the CoA in the view of their possible participation to the EDP working group meetings. A new contact person from the CoA was nominated and its possible participation is envisaged for end of August.

1.2. Data sources and revision policy, EDP inventory

1.2.1. Structure of the General Government

1.2.2. Availability and use of data sources, revision policy

Introduction

Eurostat asked whether there are different sub sector perimeters, and the CSB stressed that this was the case only for Social Security.

In Latvia, the structure of the general government consolidated budget, in public accounts, includes the central and the local consolidated budgets. The Treasury is the responsible entity for the state budget financial accounting, which is the accrual basis for all government units and public corporations (except for taxes).

Since the last EDP visit, the approval of Cabinet Regulation No 756 in December 2015 on the Procedures for preparing the notification of General Government Deficit and Debt, formalized in written form the obligations of reporting, the templates and the periodicity of the data to provide to CSB.

Discussion and methodological analysis

Eurostat enquired on the financial statements available in the public accounting system and at what level of aggregation those were being produced. In this respect, CSB explained that there is a double accounting system – cash and accrual (business accounting) at all levels, up to the entity level. The balance sheets are produced at the lowest level (unit level) and then are consolidated at the higher level for the central and local government (ministries and districts respectively), except for the reclassified units.

The statements use a national budget classification (not accounting codes) and have a reference for the counterpart sector classification.

Accrual data being available, Eurostat asked why it is not used in the production of the national accounts. At least, the information should be used to cross-check and to correct some of the cash data. For instance, for F.8, the accrual data could be used to correct the cash basis data. Eurostat suggested comparing the current compilation of payables/receivables included in ESA table 2 with the accrual source data.

According to the revision policy, in theory, year (t-4) is finalised. However, if for any reason the data is revised, both GFS and NA tables are also revised. For year (t-5), revisions occur only due to methodological changes or changes in the input/output tables. Conversely, the input/output tables are changed only when significant reclassifications of units take place. CSB clarified that, according to the revision policy in theory, all the time series can be changed.

The next benchmark revision is expected for 2019.

Findings and conclusions

Action point 5 - The CSB will examine possible ways to *explore* the Profit & Loss information on expenditures/revenues maintained by public accountants, which are published by ministries/districts on a consolidated basis, as a way to cross check the flows of payables/receivables reported in EDP tables 2A and 2C. This reconciliation could be presented by main ESA categories (for example P1, P2, P51, etc.). The CSB will inform Eurostat on the developments.

Deadline: end 2017[5].

1.2.3. EDP Inventory

Introduction

The current published version of the Latvian EDP inventory is from October 2015. As agreed during the EDP April 2017 notification, CSB sent an updated version of the EDP inventory, revising sections 3.2.3.4.1 (p.27) and 6.4.4 (p.65), by adding "amortization of" premiums and discounts. Some other small changes were included, such as the updating of the number of units in each subsector of general government.

Discussion and methodological analysis

CSB updates as a general policy their EDP inventory approximately every two years before EDP dialogue visits. The EDP inventory for Latvia is published by Eurostat in their website, but it is not published in the Latvian statistical office website. CSB publishes a more compact version of the inventory.[6] Eurostat suggested that CSB should at least provide in their website the link to the Latvian EDP inventory in Eurostat's webpage.

Findings and conclusions

Action point 6 - After the required adjustments are done, Eurostat will publish the EDP inventory during summer, and will coordinate this publication with the CSB, who will provide a related link on its web site.

Deadline: August 2017.[7]

1.2.4. Compliance with the Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States

The data foreseen by Council Directive 2011/85 are published on the MoF website at: http://www.fm.gov.lv/en/s/fiscal_policy/.

Published cash-based fiscal data are available for general government (gross, partially consolidated) and for all the subsectors of general government, on a monthly basis. The reconciliation table is published in the website, but only in Latvian.

In December 2016 the MoF published data on guarantees, off-balance public-private partnerships (PPP) and non-performing loans (NPLs) for 2010-2015 as a percentage of GDP. Data on liabilities of public corporations is available for years 2012 to 2015 and

[5] On 08/01/2018, CSB sent to Eurostat their analyses on the possible ways to explore the Profit & Loss information and their conclusion was that the final deficit calculation coincides with the results using the current method - where the cash flow deficit is taken as a basis and is adjusted for the amount of changes in debtors/creditors. CSB then thinks that the current method can continue to be used since it has the advantages of simplicity, small efforts, visibility and a clear picture of the economic activities of institutions. Nevertheless, there are differences between the two methods, in the breakdown of the non-financial accounts (P2, D1, P5, D7).

[6] http://www.csb.gov.lv/en/statistikas-temas/notification-general-government-budget-deficit-and-debt-30515.html;

[7] On 30/06/2017, CSB submitted to Eurostat an updated version of the EDP inventory. A revised version of the inventory was published on Eurostat's website on 21/09/2017. On 29/09/2017, Latvia informed to have provided the related link in their website.

data on government participation in the capital of corporations is published for years 2013 to 2015.

2. Follow-up of the previous EDP dialogue visit of 26-27 May 2015

Introduction

The previous EDP dialogue visit to Latvia took place on 26-27 May 2015. All action points resulting from that mission have been completed, except for Action Point 9 regarding Rail Baltica II, which is still in progress. The follow up of this issue was discussed under point 4.1.2. "Sector classification of specific units".

Discussion and methodological analysis

Eurostat recalled the issue under Action Point 2 from the 2015 EDP Dialogue Visit, regarding the "*detailed description on the savings bonds (intended for individuals)",* and asked about the classification of the saving bonds in national accounts. As the government bonds are non-tradable, they are classified in F.2–currency and deposits instead of under F.3-debt securities, as the latter should only include negotiable instruments and just for the amount of the principal, not including capitalized interest. CSB confirmed that the coupons are paid annually.

The treatment of the receivables from the Maintenance Guarantee Fund (MGF) was also reviewed. MGF provides child support in case parents living separately from their children fail to do it. As a consequence, receivables are created in the balance sheet of the Ministry of Justice. The MGF establishes claims against the non-paying parents and collects the claims. However, as the fund was accumulating big volumes of unpaid claims, in the last EDP visit, it was agreed that, in national accounts, the flows related with the MGF would be considered mostly on a cash basis. Consequently, the receivables were reduced by approximately 87%. The remaining 13% of still existing receivables are the amounts considered as still collectable.

3. Analysis of EDP tables and questionnaire – follow up of the April 2017 EDP notification

Introduction

The aim of this agenda item was to review the last notification of EDP data (April 2017).

The Latvian statistical authorities sent the April 2017 EDP notification within the legal deadline and with full internal consistency. All EDP tables were published at the national level on 21 April 2017.

As shown in EDP questionnaire T1.1.2, concerning the deficit, revisions from the October 2016 EDP notification were due to:

- corrections to the co-financing rates in the context of EU agro policies (2013-2015);
- the update of the estimates on the lump sum payments for pension schemes;
- a reclassification in 2013 of a negative capital transfer expenditure to a financial transaction, as a result of super-dividend testing the return of money from the Mortgage and Land Bank (MLB).

Concerning the government debt, the item "Currency and deposits" was revised for 2014 and 2015, respectively by 44MEUR and 53MEUR, due to euro coin adjustments.

Discussion and methodological analysis

Eurostat went through the list of outstanding issues from the EDP April 2017 notification, and recalled the importance of implementing the identified improvements to the EDP tables and related questionnaire in the next October 2017 EDP notification.

During the clarification process for the April 2017 EDP notification Eurostat had encouraged CSB:
- to provide, at least, the main basic entries for the planned year in the EDP tables 2;
- in questionnaire, table 3, on the adjustments for sector delimitation in EDP Tables 2A-D, to add to the current reporting by NACE codes a split (under each code) for the B.9 by main companies. In particular, CSB would report the companies with the largest surpluses for the central government;

- in the questionnaire tables 4, on the breakdown of other accounts receivable/payable (F.8) reported in EDP tables (four sub-tables), to revise the inclusion of the details in "Receivables/Payables relating to financial instruments" and "Other receivables/Payables relating to non-financial transactions". CSB was also encouraged to provide the subsector data on other accounts receivable and payable.
- in questionnaire table 6, on the recording of EU flows, to revise the stocks associated with the flow at line 17.
- concerning the supplementary tables on government support to financial institutions, to fill in Part 3 - transaction in financial assets, actual liabilities of general government and as a way to ensure consistency between part 1 and 2. Eurostat made a quick example in order to fill in the table, and asked CSB to fill the table along this line.

Findings and conclusions

Action point 7 - In the future the CSB will include details for the transition items of table 2A for planned data, provided by MoF, at least for the main categories.

Deadline: EDP October 2017 notification.[8]

Action point 8 - For questionnaire table 3 the CSB will report, under each NACE code, the B.9 of the main units.

Deadline: EDP October 2017 notification.[9]

Action point 9 - The CSB will consider a regular reporting of part 3 of the supplementary table of government interventions to support financial institutions, along the lines of the exercise Eurostat carried out during the meeting. This would help improving consistency and controlling the net asset impact of the financial crisis on government accounts.

Deadline: EDP October 2017 notification.[10]

[8] On 29.09.2017, CSB provided to Eurostat a table with some details for the transition items of table 2A for 2018. Table 2A in itself was filled in for 2017 after the answer to the 1st clarification to the EDP October 2017 notification.

[9] The action was implemented in the questionnaire table 3 in the October 2017 EDP notification.

[10] Not yet implemented.

4. Methodological issues and recording of specific government transactions

4.1. Delimitation of general government, application of 50% rule and qualitative criteria in national accounts

4.1.1. Review of the changes in the list of general government units

4.1.1.1 Government bodies included in table 2A

4.1.1.2 Application of 50% rule and qualitative criteria in national accounts

4.1.1.3 Government controlled entities classified outside general government (public corporations)

Introduction

Prior to the mission, CSB provided to Eurostat an update of annex 1 of the EDP inventory with the list of units belonging to the general government sector for Latvia. During the mission, a review of the changes in the list was undertaken.

Government bodies included in table 2 are, as referred to in the EDP inventory, extra-budgetary accounts (EBA) that record all flows of a non-financial nature which enter the working balance (WB), as reported in the first line of EDP table. Other central government units include: 1) Capital companies controlled and financed by central government (B.9 of units reclassified from S.11 to S.1311); and 2) Derived public persons and entities not financed from budget, which are not included in the WB of central government voted by the parliament, but which are included in the consolidated general government, as for instance, the universities.

Regarding the market/non-market test for the sector classification of units, Eurostat had enquired before the mission on how the test was carried out in Latvia, including the exact formula used for the 50% test based on the chart of accounts. CSB provided a note on the sector classification of units and a table with an example of calculations and formulas.

In Latvia, public hospitals and universities are classified inside general government.

Discussion and methodological analysis

The application of the market/non-market test was discussed. Eurostat enquired on the formula used for the 50% test and on the chart of accounts codes corresponding to the items used for the calculation.

The source data for the information for subsidies is a statistical survey, the same that is used for the calculations of GDP. As CSB mentioned that there are two different surveys filled in by the same entity, Eurostat asked if a cross-check of the information of the two was done and also, when there is a gap between the surveys and the budget, which information is retained. CSB clarified that the survey is only used for the 50% test purpose, not for accounting, mainly because the information from the Treasury is aggregated by ministry and not by entity. Eurostat questioned whether it is possible with this data to distinguish the subsidies on products from those on production. CSB clarified that subsidies on products exist only for agriculture, and that all the other subsidies are decided to be used on production.

Further discussion on the formula of the market/non-market test focused on the approach concerning "changes in inventories" – whether a cost of production approach or a cost of sales approach was used. Although both exist, mostly the production approach is used. Entities can choose between approaches and CSB exploits either one or the other.

It was questioned whether losses on receivables are reported as deduction of invoices (non-collected invoices) or are considered as expenditure, or are reported elsewhere.

Eurostat enquired on the policy for backwards revisions when entities are reclassified. In previous missions, CSB had said that they would reclassify the company since the first year, and this independently of its size. CSB confirmed that, firstly they check the quantitative market/non-market for three years in a row, with production costs below 50% of the sales and then, only after the third year, they reclassify the company. Eurostat mentioned that source data changes constraints should not prevent the company to be reclassified retroactively from inception; maybe a flexible approach could be considered, but only for small units.

CSB becomes aware of the existence of new companies from the register of entities, with the NACE codes. But it takes a year for the company to be registered, and then it is introduced in the statistical system.

Latvia has one public corporation classified in NACE O and outside the general government sector. *LatRailNet* is an infrastructure capacity allocation company and its classification in NACE O (non-market according to ESA 3.84) was questioned by Eurostat during the visit. "*LatRailNet*" is a subsidiary company of the SJSC "*Latvian Railway*". However, the fact that the entity is a subsidiary of a market entity is not a reason not to classify it as a non-market entity. The decision should be based on the 50% test and qualitative criteria.

It was asked why changes in the NACE codes are observed. The CSB explained that this often happens at source level, as businesses can themselves change codes in the register.

Findings and conclusions

Action point 10 - The CSB will provide Eurostat with the two surveys used for the calculation of the 50 percent test. It will provide the exact formula for this calculation using the codes of the surveys (bridge table), as well.

Deadline: August 2017.[11]

Action point 11 - The CSB will clarify to what extent the 50 percent test considers changes in inventories, as well as losses of inventories and of trade receivables.

Deadline: End of June 2017.[12]

Action point 12 - Eurostat took note of the current practice of the CSB to reclassify a unit inside government, when the 50 percent test is not met for three years in a row, without retroactive classification, mostly on the basis of source data considerations. Eurostat does not consider this approach as generally acceptable unless, for practical reasons, the unit is of very minor importance.

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[11] On 31.08.2017 CSB provided to Eurostat an excel file with the two surveys and the exact formula used for the calculation of the 50% test - the sales cost approach and the cost of production approach, illustrating it, for both approaches, with examples of the calculation for some entities.

[12] On 30.06.2017 CSB sent an explanatory note on this issue and it is mentioned that the 50% test includes changes in inventories, as well as losses of inventories and of trade receivables to their fullest amount.

Deadline: EDP October 2017 notification.[13]

Action point 13 - The CSB will reclassify *LatRailNet* into the general government sector for the April 2018 notification, unless the NACE code currently attributed is not correct and the activity of this unit is genuinely market. The CSB will investigate why the NACE code has been changed for the company *LIEPĀJAS SPECIĀLĀS EKONOMISKĀS ZONAS PĀRVALDE* and report to Eurostat.

Deadline: EDP April 2018 notification.

4.1.2. Sector classification of specific units (*Tiesu Namu Aģentūra*, Rail Baltica II, Deposit Guarantee Fund)

Introduction

Eurostat and the CSB had identified before the visit three cases which required special attention in the context of their sector classification: Rail Baltica, *Tiesu Namu Aģentūra* and the Deposit Guarantee Fund.

Rail Baltica II

Latvia, Estonia and Lithuania have engaged in a co-project called “Rail Baltica II”, which is a rail transport development project, registered in Latvia, with the goal to integrate the Baltic States into the European rail network. Rail Baltica II is the second phase of the Rail Baltic project[14] and will be developed by “RB Rail AS”, a special-purpose company established in October 2014 and owned equally by the three Baltic States. Holding equal shares in “RB Rail AS” are SIA “Eiropas dzelzceļa līnijas” in Latvia, UAB “Rail Baltica statyba” in Lithuania and OU “Rail Baltic Estonia” in Estonia.

The railway infrastructure will continue to be owned by the countries in which the respective part of the infrastructure is located. The costs associated with the building of the infrastructure will be allocated according to the same principle – each country will cover only the costs of infrastructures that are located on their territory. According to the current estimates[15] the project will cost approximately 5.8 billion euro altogether, with Latvia investing 2 billion euro. The design part of the project has to be started in 2018, and the construction works are planned to be started in 2020. "*So far, 85% of the project’s funding has come from the European Union (*Structural and Cohesion Funds provided to the EU New Member States)*, and in February this year, the RB Rail partnership submitted a new grant application under the EU’s Connecting Europe Facility for the completion of the design and construction of the railway."*[16]

In order to accomplish the goal, the Latvian Ministry of Transport founded, in October 2014, a limited liability company “*Eiropas dzelzceļa līnijas*” (EDL), which is 100%

[13] On 29.09.2017, CSB sent the EDP notification and informed that they have revised their calculations. In that sequence, *Aviasabiedība Liepája*, was reclassified inside S1313.

[14] *"Rail Baltica is a greenfield rail transport infrastructure project with a goal to integrate the Baltic States in the European rail network. The project includes five European Union countries – Poland, Lithuania, Latvia, Estonia and indirectly also Finland. It will connect Helsinki, Tallinn, Pärnu, Riga, Panevežys, Kaunas, Vilnius, Warsaw. The Baltic part of the Rail Baltica project is referred to as the Global Rail Baltica Project."(* http://www.railbaltica.org/)

"The first phase, known as Rail Baltica I, extends from the Poland-Lithuania border to Kaunas. It was inaugurated on October 16, 2015. Construction of Rail Baltica II, the second phase connecting Kaunas, Riga, and Tallinn, is planned to start construction in 2019. The Tallinn–Riga–Kaunas standard-gauge route is planned to be finished in 2025, and the connection to Warsaw in 2030." (https://en.wikipedia.org/wiki/Rail_Baltica)

[15] http://www.railbaltica.org/cost-benefit-analysis/

[16] http://www.railway-technology.com/features/featurerail-baltica-a-new-corridor-for-the-baltic-states-5777339/; https://ec.europa.eu/eipp/desktop/en/projects/project-54.html

owned by government and holds 1/3 of the equity of RB Rail. The government invested 0.68 MEUR in EDL in 2014, to be followed by similar equity injections in 2016 and in 2017.

In the previous 2015 EDP visit, Eurostat confirmed the classification of the holding company *Eiropas dzelzceļa līnijas* (EDL) in the general government sector, and the joint venture Rail Baltica in the non-financial corporations sector of Latvia as a foreign-controlled non-financial corporation (S.11003).

Discussion and methodological analysis

Two representatives from the Latvian Ministry of Transports (MoT), an expert from the Investment Department and the project manager of Rail Baltica national research project participated in the meeting to present the project and discuss the case.

Eurostat asked, from an accounting point of view, which entity records in their balance sheet the ownership of the infrastructure and who is booking the current and future expenditures, for example studies and technical design for RB Rail. Eurostat also asked which entity was recording the revenue coming from the EU, or from the RB Rail.

The Latvian MoT explained that the EU funds are given to the joint venture RB Rail, which is the financing coordinating entity. Then the Latvian Treasury receives the EU financing from the RB Rail, adds the 15% national financing part and gives it to the MoT. The MoT either pays the service directly to the suppliers or gives it to EDL, which then will pay the suppliers. MoT is convinced that their ministry, which is the entity receiving the grants, is probably the owner of the infrastructure, since the other entities are just implementing parties. Nevertheless, there is still no clear definition on the whole institutional setup of the project and subsequent recording of the flows. A business plan for RB Rail will be prepared by around the end of the year, beginning of 2018, as well as an infrastructure management study. It is still to be decided whether the project will have a joint infrastructure management.

Currently, each country is finishing the technical design part of the project. The expenditure for studies and technical design for RB Rail, currently carried out as government expenditure in Latvia, amounts to 0.680 M euro. This is included in the 290M euro of the grant part for Latvia to be spent until 2020 in studies and technical design.

In terms of recording in national accounts, a large part of the investment (85%) covered by EU funds is neutralized. Even if the ownership of the asset belongs to Government, nonetheless it will not impact the deficit by this 85%. Further advice on the recording to be made in national accounts depends on the setup to be defined for RB Rail. But in cases of international joint ventures, it is possible that the investment expenditure will be divided by the 3 Baltic countries.

The Latvian statistical authorities agreed to provide Eurostat with relevant information about RB Rail (business plan, etc.). Among other issues, the management of EU funds relating to this project should be clarified. Based on this information, Eurostat would then provide its opinion on the future treatment of flows and stocks of RB Rail in national accounts.

Meanwhile, regarding the current expenditure for studies and technical design for RB Rail, the CSB should enquire on the recording of the flows and related stocks in public accounts (Balance Sheet and Profit & Loss). If CSB records the amounts from the working balance at the time the Treasury transfers the funds to the MoT/EDL, there may be a time difference to the moment of the payment to the suppliers. If so, there might be place for a correction. In terms of the nature of the expenditure, it may be P.2 or P.51 expenditure. If the project goes on and the asset is completed, the amounts that should be capitalized need to be identified; if the project is abandoned it should be considered P.2. If there is a doubt, it should be considered work in progress P.52.

Findings and conclusions

Action point 14 - The CSB will inform Eurostat about developments related to the eventual or tentative setup and business plan of RB Rail, before seeking an advice (ex-ante or ex-post) from Eurostat.

Deadline: when available.

Action point 15 - In the meantime, CSB will record the expenditure for studies and technical design for RB Rail, currently carried out by the entities, as government expenditure, together with the appropriate matching amount of EU revenue (around 85 %). Those expenditures are expected to comprise approximately 290 million euro over the next three years. The CSB will reflect on the capitalization of this expenditure, either as GFCF (P.51) or as work in progress (P.52). Furthermore, the CSB will enquire on the recording of the flows and related stocks in public accounts (Balance Sheet and Profit & Loss).

Deadline: April 2018.

<u>Tiesu namu aģentūra</u>

Introduction

Tiesu namu aģentūra (TNA) is a public real estate company in Latvia, 100% owned by the state (by the Ministry of Justice), that rents the state's real estate back to government. The company was reclassified by CSB into the general government sector and the decision was contested by TNA at the national court in 2014.

According to the Latvian statistical authorities "TNA viewed its inclusion to the government sector list as unfounded and non-conforming to legal provisions of ESA 2010. It started proceedings against CSB at the District Administrative Court, which the CSB won. However TNA appealed the ruling at the Administrative Regional Court in 2015 and won. The court thought that there was not enough justification to regard TNA as a non-market public sector institutional unit, arguing that the analysis of differentiation of non-market and market activity was carried out incompletely."

In the last EDP April 2017 notification, CSB continued to include the company in the government accounts, although it removed it from the published list of entities included in S.13. Eurostat supported this pragmatic solution.

The Latvian authorities are waiting for an opinion from Eurostat on the way forward regarding this case.

Discussion and methodological analysis

Eurostat informed that it is examining cases in several countries of contestation in national courts of statistical classification decided by national statistical authorities, and that it intends to address the issue in the next EDPS WG meetings.[17]

CSB referred that the court decision was based on the decision tree, upon which the Court concluded that TNA was a market entity. Eurostat asked CSB to be provided with the decision of the court and with the documentation provided by CSB to the court.

TNA has real estate assets and rents offices, 90% of which to the Ministry of Justice (MJ). Although there are auctions for the rent assignments, the MJ is nearly the only client of TNA. In national accounts, the classification of units is based in the economic structure and not on legal arrangements. The lease and auction procedures need to be clarified, checking price levels against market prices and whether government is prioritised in any way over other market bidders. The MJ created an entity that can only be a market unit if some criteria apply, but TNA looks as an entity providing ancillary services to the MJ.

Eurostat suggested to CSB to read the advice letter provided to the Slovenian statistical authorities on 17 May 2017, published in Eurostat's website, regarding the "Ex ante consultation of the sector classification of the DSU company".

Eurostat will provide an advice letter with an analysis of the TNA sector classification, basing the rational for the reclassification on the applicable ESA paragraphs.

Findings and conclusions

Action point 16 - The CSB will provide Eurostat with information on *Tiesu namu aģentūra* (TNA), based on the questions raised during the meeting (notably on the importance of the 2013 regulation on leasing offices), as well as on additional questions that will be sent by Eurostat following the meeting, with the documentation provided to the Court, and the Court ruling. The CSB will examine Eurostat advice to Slovenia on a similar case recently published on its web site, and provide feedback to Eurostat. On this basis, Eurostat will provide advice on the sector classification of TNA, but – preliminarily – Eurostat confirmed the statistical treatment adopted by CSB.

Deadline: August 2017.[18]

Deposit Guarantee Fund

Introduction

Eurostat has been re-examining the treatment of deposit guarantee schemes in the European context with the aim of ensuring equal treatment of sector classification across Member States. In the 2015 EDP visit, Eurostat had confirmed the classification of the Deposit Guarantee Fund in the financial corporations sector for "the time being", however, in the sequence of the revised text of the MGDD, Eurostat suggested to the

[17] EDPS WG 3-5 July 2017: Item B.3. Statistical classification of units challenged (by units) in Courts; EDPS WG December 2017: Item B.2. Statistical classification of units challenged by units in Courts – follow up.

[18] On 31.08.2017 CSB, sent to Eurostat several translations of the court documentation. CSB acknowledged Eurostat's advice to Slovenia on similar case and agreed with the analysis which could be applied to TNA. On 14.12.2017, CSB answered Eurostat's e-mail from 31.10.2017 and provided further clarifications on TNA. Eurostat is currently preparing the official advice on the sector classification to CSB. In the meantime, the entity will remain classified in S.13.

Latvian authorities during the EDP April 2017 notification that the Deposit Guarantee Fund should not remain classified outside Government.

"EDPS WG has agreed that statutory protection funds organized to meet EU legislation should be classified in S.13 (both Guarantee and Resolution Funds). As a result, we think that it would be in very rare and in very special cases that the protection fund would be classified outside Government. A number of Member States have recently agreed with this view including Italy, which Fund is even legally controlled by the private sector. The Italian authorities have proposed a partitioning of the unit / re-routing of transactions of assets through Government accounts."

CSB agreed to proceed with the reclassification of the Deposit Guarantee Fund inside S.13 in the next EDP October 2017 notification. *"*

Discussion and methodological analysis

According to the relevant Latvian laws regarding the financial supervisor (Financial and Capital Market Commission – FCMC) and the Deposit Guarantee Fund (DGF), the lender of last resort is Government, which indicates that the DGF should be classified inside General Government even under current statistical rules. This reclassification, that should be done since 2001, will improve government B.9 and possibly the public debt. The contributions from the banks are to be considered as a tax. The amounts paid to the banks should be considered as capital transfers and the bank repayments as revenue.

Eurostat recalled the recording treatment of the 2011 rescue operation of *AS Krajbanka.* Due to the bankruptcy of the AS *Krajbanka*, the Deposit Guarantee Fund borrowed (F.4L) 185.5 MLVL (263 MEUR) from the Treasury, in 2011. The last repayment to Government was made in 2014.

CSB referred to the case of another fund in Latvia that would need to be analysed in the light of the new text of the MGDD – the Insurance Guarantee Fund. An important criterion is to understand who pays at the end.

Findings and conclusions

Action point 17 – The CSB confirmed that the Deposit Guarantee Fund will be reclassified into the general government sector in October 2017 starting from 2001 onwards. In this context, the CSB will reflect on the appropriate recording of the 2011 rescue operation of *AS Krajbanka* and inform Eurostat (notably considering the recording of a financial claim at that time). The CSB will also examine the sectorisation of the Insurance Guarantee Fund, and will notably check whether government is lender of last resort and, if this is the case, will reclassify this fund into the general government sector.

Deadline: EDP October 2017 notification.[19]

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[19] For the October 2017 EDP notification CSB reclassified the Deposit Guarantee Fund inside S13 starting, from 2001 onwards. CSB informed that "the rescue operation of AS Krājbanka is recorded in 2011. Concerning the Insurance Guarantee Fund, the insurance and reinsurance law states that in a case of insufficient funds the Insurance Guarantee Fund can borrow from one, or a pool of local or residential financial institutions. It does not propose a last resort bail-out from the government. This is the main point why its sectorisation differs from the Deposit Guarantee Fund."
Eurostat asked to be provided with the analysis of the market character of the Insurance Guarantee Fund.

4.2. Implementation of the accrual principle

4.2.1. Taxes and social contributions

Introduction

The CSB submitted before the visit a document including detailed and comprehensive information about the time adjustment of different types of taxes – VAT; Personal income tax; Social security contributions; Excise tax; Electricity tax; Subsidised electricity tax; and Solidarity tax.

A one month time-adjusted cash method is applied to all main tax categories (VAT, PIT, excise tax, electricity tax) and to social contributions. But for the Subsidized electricity tax, there is a two months adjustment.

Discussion and methodological analysis

Eurostat reviewed the treatment of the Subsidised electricity tax, which CSB is currently recording as D.214 (Taxes on products, except VAT and import taxes) according to the time adjusted method. Taking into account that the tax depends on the production process and not on the quantity of produced electricity, Eurostat suggested the tax to be classified as taxes on production (D.29) rather than on products.

The taxpayers of the subsidised electricity tax are the producers of electricity (including wind power stations) based on their income from selling electricity. According to a national electricity scheme, the electricity producers receive State subsidies, and this tax was introduced to mitigate the "excess of generosity" of the State support. The electricity producers pay the tax which is collected by a subsidiary of a public corporation - *Enerģijas publiskais tirgotājs AS (*EPT, Electricity Public Trader). EPT collects the tax revenue and redistributes it in the form of a Mandatory Procurement Component to energy producers generating electricity from renewable resources or in cogeneration. This issue is further detailed in point 5.2.1. New mandatory electricity procurement scheme.

CSB noted that there are no payable tax credits in Latvia. Eurostat enquired then about the existence and treatment of tax refunds. CSB will check the situation and will provide clarifications and illustrative examples to Eurostat.

Regarding the social contribution figures in questionnaire table 5, Eurostat questioned the systematic decline of the stock of AF.89 – other accounts receivable/payable, excluding trade credits and advances. CSB explained that there were changes, not on the rates but on the proportion of payment from the 2nd pillar contributions. In 2015, it increased from 4% to 5% and in 2016 from 5% to 6%. Nevertheless, this would not explain the pattern of receivables in itself.

Eurostat remarked that if social security collected the contributions and paid later, a payable should have been recorded (a liability). Eurostat enquired on the recording of these payables in the balance sheet and the recording in the financial accounts, and if they explained the decline of assets in questionnaire table 5 (for instance, because there is an increase in the liabilities and the figures are assets netted from liabilities).

CSB mentioned that further tax amnesties may occur in the future in the context of the tax reform expected for 2018. In the past, the amnesty was applied only to tax penalties and fines of the main tax debt and was recorded together with the tax by the actual amounts.

Findings and conclusions

Action point 18 - The CSB will consider reclassifying EPT (Electricity Public Trader), the unit collecting the electricity fees and redistributing them to energy producers generating electricity from renewable resources or in cogeneration. It will otherwise, reroute (recognizing the principal party) the flows (tax on product and subsidy on production) and stocks concerned through government accounts, and inform Eurostat on the approach implemented. The CSB will provide Eurostat with the B.9 and debt impact of those flows.

Deadline: EDP October 2017 notification.[20]

Action point 19 - The CSB will consider changing the classification of the so-called 'subsidized electricity tax' as taxes on production rather than on product, in consideration of its nature.

Deadline: EDP October 2017 notification.[21]

Action point 20 - The CSB will provide Eurostat with examples of tax refunds, taking into account that, in Latvia, no payable tax credits exist. The CSB will also monitor the tax 2018 amnesties and provide information to Eurostat as soon as available.

Deadline: August 2017.[22]

Action point 21 - The CSB will clarify the recording in public accounts (balance sheets) of the payables of Social Security Fund towards the second pillar pension schemes, will report on the amounts of stocks over 2012-2016, and will enquire on the implications for GFS/EDP reporting, which may explain the strange pattern of receivables in questionnaire table 5.

Deadline: EDP October 2017 notification.[23]

4.2.2. Interest

Introduction

The focus of this agenda item was on the data submitted by the CSB before the meeting via the special questionnaire on interest.

The CSB provided, for the EDP April 2017 notification, a document with the recording of interest with data for the period 2013-2016 on the total stock of consolidated debt; the stock of coupons; the stock of discounts (+) / premiums (-); discounts (+) / premiums (-) at issuance; amortisation; discounts (-) / premiums (+) repurchased; revaluation and OCV in discounts and premium; and a memo item on the change in coupons and amortisation of discount/premium.

[20] In the EDP October 2017 notification, EPT (Electricity Public Trader) was reclassified inside S13 from 2014 onwards.

[21] In the October 2017 EDP notification, the subsidized electricity tax was reclassified from D.214 (tax on product) to D.29 (tax on production).

[22] On 31/08/2017 CSB provided an example of the VAT refund to residents. CSB informed Eurostat of a new law on tax amnesties to enter into force on 1st October 2017, and the taxpayers will have the right to apply for the tax amnesty till December 31st 2017.

[23] On 29.09.2017, CSB sent a note on the recording in public accounts (balance sheets) of the payables of Social Security Fund towards the second pillar pension schemes.

Following Eurostat's recommendations during the clarification exercise for the April 2017 notification, CSB revised the EDP inventory in points 3.2.3.4.1 and 6.4.4.

Discussion and methodological analysis

Based on the document submitted by the CSB before the meeting, Eurostat noted that the data filled in the table showed inconsistency between stocks and flows. Amounts in lines 1 and 7 should include the stock of the previous period. Line 15 showed the discount/ premium accrued to date at the time of repurchase (contrary to what is indicated by the side note on the table). Furthermore, Eurostat sought information about the discount on loans (F.4)[24] and according to the Latvian Statistical Authorities, a similar recording of loans as for bonds is applied, with a spreading of the interest.

The loan provided by the EU Commission to Latvia at a discount is being recorded by government just like a bond at nominal value spreading the interests. Eurostat noted that there is an issue of comparability among Member States.

Findings and conclusions

Action point 22 - Eurostat welcomes the data provided by CSB on interest. CSB will adapt the table on interest provided by Eurostat according to the discussion.

Deadline: EDP October 2017 notification.[25]

Point 23 - Eurostat takes note that the BOP loans of the Commission to Latvia, issued at a discount, are recorded in the Maastricht debt for the redemption value.

4.2.3. EU flows

Introduction

The compilation of data for EU flows was discussed in detail in previous EDP visits. The authorities confirmed that the data are compiled by sub-categories, included separately in the programmes.

Three issues were discussed: the structural funds, the financial instruments and the contribution to the EU budget – amended budgets.

<u>Structural and agricultural funds</u>

Discussion and methodological analysis

In terms of accounting, the inflows (EU revenue) are recorded at the Treasury and outflows at the level of the spending ministries, both at the time the ministries spend the funds. CSB referred that amounts of EU inflows are around 1 billion Euro in total, of which 400 to 500 MEUR were for central government and 150 to 250 MEUR to local government. Around 300 to 400 MEUR concern agricultural funds. The remaining amounts concern current or capital transfers go inside general government. The amounts for central government are booked when the ministries spend the structural funds, as

[24] A discount loan is a loan that does not require the payment of interest or any other charges; rather, a discount loan deducts the interest and/or other charges from the face amount of the loan when it is given out.

[25] CSB re-sent the table on interest recording with the October 2017 EDP notification. On 09/10/2017, in the sequence of the 1st request for clarification, at Eurostat's request LV re-sent the revised table on interest recording. On 13/010/2017, in the sequence of the answer to the 2nd request for clarification, LV re-sent the table on interest recording. The table was discussed is the EDPS WG 6-8 December 2017 under item B.3.c Tables on interest recording (oral).

reflected in the EDP questionnaire table 4. For local government, the data used are not the cash flows but detailed information from their IT system. In addition, some reimbursement from EU funds to local government can transit through central government.

Eurostat clarified that in questionnaire table 4, item 5, line 13 and 13b should be presented at a consolidated level. Also in table 6, lines 2 and 5 are consolidated at general government level.

The current 2014-2020 programme of the EU funding includes all the agricultural flows and other funds. This means that 2016 was the end of the previous program (since there is a 2 years delay) and in that year a drop in the inflows should have been observed. Taking this into account, Eurostat questioned why the stock of receivables of general government against the EU (questionnaire table 6, item 33), increases all the time instead. CSB was aware of this evolution and the explanation provided was that the agricultural funds were paid in advance (one year earlier than the other funds) and, in addition in 2016, 150 MEUR more than in 2015 were handed out, neutralizing the expected fall for 2016. Eurostat asked CSB to document the explanation by providing the amounts of agricultural funds payed out.

Financial instruments

Introduction

CSB provided a document on the treatment of the unused EU funds (JEREMIE). The European Investment Fund (EIF) and government of Latvia launched the JEREMIE programme in 2008 with the aim of providing SMEs with: (1) Equity investment; (2) Development loans; (3) Mezzanine finance; (4) Energy efficiency loans.

"In 2012 government took over this programme from the EIF and the active investment period has ended by now. Eventually the activities under items (3) and (4) did not materialise and the respective funds must be returned to the European Commission. The authorities confirmed that the treatment of unused resources ensures neutrality of impact on government deficit.

(...) In compliance with the Agreement the government of Latvia in 2008 transferred EUR 91 million to the investment fund. The proportions of government and structural fund funding in the Holding Fund are following – 91.02% ERAF funding and 8.98% State budget funding. The introduction of investment fund of the EU structural funds has been assigned to the Ltd 'Latvian Guarantee Agency' (Latvijas Garantiju aģentūra) that has been classified to the sector S12. Nature of government transfer to the Holding Fund is grant. Final beneficiary from national accounts point of view is Holding Fund.
On April 15, 2015, "Latvian Guarantee Agency" (LGA), „Latvian Development Financial Institution Altum" and "Rural Development Fund" (LAF) united in a single body – JSC „Development Finance Institution Altum", which takes over all rights and obligations of ALTUM, LGA un LAF and continues to realize all previous state support programmes of ALTUM, LGA and LAF. According to information from Altum all activities of Jeremie programme have ended and declared to European Commission."

Discussion and methodological analysis

EU flows relating to Jeremie were channeled through the Treasury. The Fund had an account in the Treasury and the money stays there for a couple of years. The expenditure is recorded on the budget of the Ministry of Economy as European structural fund expenditure. At the same time, an entry in the revenue side is also recorded, resulting in a neutral impact in B.9. Eurostat enquired if the revenue entry was recorded in receivables.

In 2013, a stock of payables should be observed, however it is not observable because Latvia nets the receivables and so payables disappear from the system. Eurostat asked CSB to identify the amounts of payables and to reflect on this issue.

Jeremie corresponded to one payment in one year. Eurostat questioned which expenditure was recorded as capital transfer since 2008.

A distinction should be made before and after 2015, when the new instrument Altum was created by merger. The funds were given to Latvia and transferred to the Agency Altum in 2015. Before that, there was the Latvian Guarantee Agency (S.12 at the time, later became S.15). Eurostat asked for information about the stock of payables just before the merger in 2015 and when and how Jeremie impacted the government figures as Maastricht debt or as payables. CSB will collect the information and clarify this to Eurostat. In some countries, amounts were "repaid" to the EU since the purpose of the programmes was changed and the money was cancelled. In Latvia, at the time Jeremie was stopped, the funds were transferred to other activities.

<u>Contribution to the EU budget</u>

Introduction

In 2014, there were revisions to GNI resulting in large own resource contributions to the EU in 2014 (Latvia had to pay 20.0 MEUR by 1st December 2014). Also the Amending Budget (AB) Nº2 to Nº7/2014 was adopted only on 17 December 2014, which was too late for these AB to be integrated into the 2014 call for funds (payment request from the Commission) and the actual impact on payments was in 2015. All the entries are in line with the accrual principle and payments to the EU budget are recorded in the year of the AB establishing the amounts due.

Discussion and methodological analysis

Eurostat took note, in the last April 2017 notification that all the entries are in line with the accrual principle and that B.9 is correct. However, in the questionnaire table 6, item 16/17 Eurostat would have expected, in 2016, an entry of -18.2 MEUR corresponding to -15 MEUR (= -16.5 MEUR+1.5 MEUR) – 3.2 MEUR. Latvia clarified that almost all the amount have already been paid in 2016. Therefore there is no outstanding amount (-18.2 MEUR) of AF.8 (payables/receivables) against EU at the end of 2016. The MoF specified that the receivables and payables in questionnaire table 6 are net.

In table 6, Latvia should record receiving 15 MEUR that were already in the WB and register an entry of -15 MEUR in F.8A. In addition there should also be an entry for the 3.2 MEUR that were not yet paid in 2016.

Findings and conclusions

Action point 24 - The CSB will report to Eurostat on the profile of the stock of EU receivables, and notably: 1) provide a breakdown by category (structural funds, agricultural funds, other); 2) analyse the 2016 pattern of agricultural payments.

Deadline: EDP October 2017 notification.[26]

Action point 25 - Concerning JEREMIE, the CSB will clarify the statistical treatment of those flows since 2008, including how the removal of the payable that should have occurred in 2015 was carried out, and will report to Eurostat.

Deadline: August 2017.[27]

4.2.4. Military expenditure

Introduction

In the last 2015 EDP visit, it was explained that the EDP questionnaire tables 7 were in fact filled by the Ministry of Defence, whereas the CSB lacked access to the more detailed data underlying the figures reported in tables 7. Eurostat encouraged the Latvian statistical authorities to establish a system for receiving detailed information from the Ministry of Defence, in order to be able to record accurately these expenditures in government accounts.

This was put in practice with the publication of the cabinet regulation nº756 from December 2015, that mentions in its point 9 that: *"The Ministry of Defence shall prepare and submit the information referred to in Annex 3 to this Regulation to the Bureau by 1 March of year n (and by 1 September if changes are detected in the previously submitted information)."*

Discussion and methodological analysis

It was confirmed that questionnaire tables 7 are filled by an accountant trained in EDP at the Ministry of Defence.

As some equipment delivery is expected, its recording was discussed. The settlements in kind on the expenditure side should be recorded as P.51 and on the revenue side as gross D.92 – investment grants (D.92 in 2016 amounted to 20 MEUR).

4.2.5. Recording of other flows of receivables and payables

Introduction

The discussion was based on the questionnaire table 4 on the breakdown of other accounts receivable/payable (F.8) reported in EDP tables for the EDP April 2017 notification.

[26] On 29.09.2017, CSB sent the EDP notification and enclosed a note on the EU funds corrections. "We have made deeper analysis of structural funds and other EU policy instruments funds. The calculation is based on the co-funding rate of actual fund's 2010-2016 execution. The use of the planned co-funding rate has led to an impact on the notified deficit in the historical time series which now differs from the recalculated results. Therefore, we have found out that the actual EU co-funding rate has been different from those planned and calculated based on the co-funding rate of actual fund's 2010-2016 execution."

[27] On 29.09.2017, CSB sent the EDP notification and enclosed a note on Jeremie:
"The JEREMIE scheme resources 91.8 MEUR were transferred to EIF (European Investment Fund) S.2. in year 2008. Accordingly to Eurostat decision "The treatment of transfers from the EU budget to Member States" EU flows were recorded in the amount 91.8 MEUR as expenditure on behalf of EU to the final beneficiary outside government. There was no impact on government deficit. In year 2012 the unused resources of JEREMIE in the amount of 32.5 MEUR were repaid back to budget and it was recorded as financial transaction (liabilities to EU F.8L). According to decision of Ministry of Economics (19.10.2011 No.2011) the remaining JEREMIE scheme resources were transferred from EIF to Latvian Guarantee Agency (LGA) S.12 and were spent in sub-activity "Support to enterprises for improvement of competitiveness" (All foreseen amounts are already declared to EU). Statistical treatment was not changed because both institutions were outside general government sector."

Discussion and methodological analysis

As it had been agreed in the request for clarification of the EDP April 2017 notification, for the questionnaire table 4, the CSB was asked to revise some of the details included under "Receivables relating to financial instruments" (line 13), to be placed under "Other receivables relating to non-financial transactions" (line 7). Eurostat argued that, since the WB is used for filling in ESA Table 2, in principle, in the questionnaire table 4, item 7 "Other receivables relating to non-financial transactions (other than in the line 2)" can also be filled in by ESA categories.

Furthermore, CSB agreed to provide the subsector data on other accounts receivable and payable, for the next EDP October 2017 notification.

Future periodic expenditure/revenue and advance payments are distinct. Advance payments occur when making a full or partial payment for goods and services before they are delivered. It is a deferred expense and an asset that represents a prepayment of future expenses that have not yet been incurred.

It can also occur that an expense is not recognized at the same time it is paid. This difference requires either an asset or liability to be recorded, in order to reflect this difference in timing.

Eurostat asked CSB to provide a transition table with the reconciliation of the used cash data corrected by payables and receivables and the accrual data from the financial statements.

This transition table should be done in general for all items, indicating and clarifying from all the payables and receivables in the balance sheet which are used and which are excluded for some reason (e.g., the child support of the MGF that is eliminated because it is considered pure cash basis).

Findings and conclusions

Action point 26 - The CSB will improve the questionnaire table 4 reporting by: 1) reporting subsector information (as already provided for the mission); 2) changing the location of selected items for receivables/payables to non-financial transactions rather than financial instruments; and 3) providing some further breakdown by ESA categories. The CSB will clarify the difference between advance payments and future expenditure/revenue by providing concrete examples.

Deadline: EDP October 2017 notification.[28]

Action point 27 - The CSB will provide a transition table reconciling the payables and receivables reported on the public account balance sheet and the flows reported in the questionnaire tables 4.1/4.2.

Deadline: EDP October 2017 notification.[29]

[28] Questionnaire table 4 was improved at the October 2017 EDP notification.

[29] On 08/01/2018, CSB provided, for the social security fund (2016), a transition table reconciling the payables and receivables reported on the public account balance sheet and the flows reported in the questionnaire tables 4.1/4.2.

4.2.6. Gross Fixed Capital Formation (GFCF)

Introduction

In Latvia, the gross fixed capital formation is recorded when the ownership of the fixed assets is transferred to the institutional unit that intends to use them in production. The EDP inventory indicates that the data source for gross fixed capital formation is cash information from Treasury reports, with no accrual adjustments being made. Cash data have been treated as accrual data.

Discussion and methodological analysis

Eurostat asked why the relevant data for recording of GFCF are not obtained on an accrual basis from the non-financial assets and amortization recorded in the balance sheets and profit and loss statements.

The transition table reconciling the payables and receivables reported on the public account balance sheet and the flows reported in the questionnaire tables 4.1/4.2, mentioned in the previous point, should include also the details of the GFCF items. An exception should be made for intangible assets.

The Latvian authorities referred to an additional investment survey for the Central administration (including the State) with detailed info – more detailed than in the balance sheets. Eurostat asked CSB to make a comparison between the 3 different estimations: 1. cash time adjusted for F.8 (payables/receivables); 2. Variation in the net fixed assets + amortization from the balance sheet; 3. investment surveys. For B.9, and according to the P.51 survey, the difference that exists between cash adjustment by payables/receivables is put in P.2. CSB should also amend the inventory describing the calculation of GFCF and the adjustment to P.2.

Findings and conclusions

Action point 28 - The CSB will provide a transition table for GFCF (1) as calculated using the cash data adjusted for payable and receivable, (2) using the public account balance sheet and the P&L statement (3), and the investment surveys. This exercise will be carried out for selected units or grouping of units, such as the State, or subsectors.

Deadline: December 2017.[30]

Action point 29 - The CSB will adapt the inventory to describe the calculation of GFCF and the adjustment to P.2.

Deadline: End of June 2017.[31]

[30] On 08/01/2018, CSB provided a transition table for GFCF (1) as calculated using the cash data adjusted for payable and receivable, (2) using the public account balance sheet and the P&L statement (3), and the investment surveys. The analysis was carried out for 2 budget institutions (CSB and VVC), 1 ministry (IM) and 2 local governments (VN and VP) consolidated summaries. CSB's conclusion is that data is comparable and the statistical survey data may be replaced by the Treasury data for calculation of P.51. CSB was unable to compare cash data adjusted for payable and receivable, because there is no clear breakdown of payable and receivable for intangible assets and fixed assets.

[31] On 30/06/2017 CSB submitted to Eurostat a revised version of the EDP inventory.

4.3 Recording of specific government transactions

4.3.1. Government interventions to support financial institutions

4.3.1.1. Winding-down of Reverta

Introduction

At the end of 2008, *Parex Banka*, the second largest bank in Latvia with total assets of LVL 3.4 billion (4.9 billion EUR), was severely hit by the financial crisis. In November 2008, Latvia notified a package of rescue measures in favour of *Parex*. The plan included a split of *Parex* into a newly established "good" bank, *Citadele banka*, taking over all core and some non-core assets, and a "bad bank" ("Parex", later renamed "Reverta"), which kept the remaining non-core and non-performing assets."[32]

After the split, *Parex banka* (including its subsidiaries) should remain in winding down mode and handle the asset recovery. *Parex banka* would sell and run off all of its assets in order to recover the maximum amount from the assets assigned to it over its lifetime, which for forecasting purposes was assumed to be eight years. *Parex* would concentrate on working out non-performing loans together with already repossessed real estate assets.

Following the split, neither *Parex banka* nor its subsidiaries will engage in new economic activities unless required for its primary task to manage transferred assets and to sell them. In particular, *Parex banka* stopped new loan origination and its banking license was revoked in 2012. However, it can unbundle certain assets into separate subsidiaries for management (sale) purposes.

In 2016 and 2017, after selling the asset portfolio (mostly real estate and loans), only the impact for 2016-2017 through B.9 of Reverta will be added.

Nevertheless, the forecast for repayment of state support shows that recovered amounts potentially might not meet the target set in the restructuring plan, which was the main source for valuing Reverta assets at the moment of its reclassification into the government sector in 2010. Therefore, unless the difference in value could be explicitly related to broad market changes, it seems that government, at the time of reclassification took over (recorded) assets at value that was above prevailing market value.

Discussion and methodological analysis

When a defeasance structure is created and reclassified in S.13, the rule is to record a capital transfer expenditure corresponding to the expected loss, e.g. the net assets recorded at fair value (expected loss). In this sense, Eurostat asked whether a capital transfer for the net asset of *Parex* was recorded in 2010 and for which amount. In case of defeasance structure, the rule is to record the capital transfer at inception, and this is why it is required to know at which value were the assets transferred from *Parex* to the general government: at acquisition value or at face value.

An additional problem is that all capital transfers were made and analysed considering *Parex* outside S.13. But *Parex* was reclassified inside government and now there is a loan inside government. The writing off of the loan should be neutral. In some countries

[32] http://europa.eu/rapid/press-release_IP-14-793_en.htm - State aid: Commission approves public support measures in favour of Latvian banks Reverta (formerly Parex banka) and Citadele.

each time there was a further loss a capital transfer was recorded in the year the loss was realised (increase of B.9 by the expected loss in 2010).

Furthermore, in Latvia, in the balance of payments, loans are still recorded at face value. In the financial crisis table and in table 27, the values for *Parex* are reported at the net value in the BS after provision. So if they have a provision, the stock will decrease and there will be a difference with part 3 of the financial crisis table.

To conclude, CSB could revise the capital transfers at inception. CSB will have to change the *Parex* BS and have a statistical adjustment to reflect the flows over the years. And, to build the stocks over the years, CSB will verify the flows over the years.

According to the findings from the discussion, Eurostat invites the CSB to adapt the recording in part 2 and 3 of the supplementary table and in ESA table 27. This issue is under discussion in the EDPS WG.

Eurostat takes note that the current valuation of the assets of Reverta in ESA Balance Sheets and in the supplementary table of government interventions to support financial institutions uses Reverta own Balance Sheet (i.e. net of allowances for impairment).

Findings and conclusions

Action point 30 - Concerning *Reverta*, the CSB will clarify how much cash to be recorded as D.9 was given to *Parex* and whether and for what amount at time of reclassification a capital transfer was imputed, if any, for the net assets (expected loss). The final loss in excess of the expected loss will be materialized by a write off of treasury loans benefitting Reverta. Eurostat agrees with the CSB that the appropriate recording should be a capital transfer in 2010, with a revision of the stock of assets reported in the ESA balance sheet.

Deadline: December 2017.[33]

Action point 31 - Eurostat takes note that the current valuation of the assets of *Reverta* in ESA Balance Sheets and in the supplementary table of government interventions to support financial institutions uses *Reverta* own Balance Sheet (i.e. net of allowances for impairment). Eurostat invites the CSB to adapt the recording in part 2 and 3 of the supplementary table and in ESA table 27.

Deadline: EDP October 2017 notification.[34]

4.3.1.2. Recording of EBRD put option and the *Citadele* sale

Introduction

This issue was discussed in the 2015 EDP mission and its recording was recalled during the clarifications to the EDP April 2017 notification.

"Citadele bank was registered as a joint stock company on 30 June 2010 and commenced its operations on 1 August 2010. Citadele was established as a result of implementation of an EC restructuring plan, which was approved by the Cabinet of Ministers of the government of Latvia in the spring of 2010 and pursuant to which AS Citadele Banka was to take over from AS Parex Banka certain assets and liabilities and other items, i.e.

[34] On 08/01/2018 and 29/03/2018, CSB provided to Eurostat further information concerning Reverta..

[34] Not yet fully implemented.

an undertaking. The transfer of undertaking took place on 1 August 2010. Citadele, the Latvian Privatisation Agency (LPA) and the European Bank for Reconstruction and Development (EBRD) signed an agreement on 30 July 2010, whereby the EBRD took a shareholding of 25 % of share capital plus 1 voting share. 75% minus 1 share was owned by the LPA. Following a tender process, the Latvian government decided to sell its 75% stake in Citadele to Ripplewood Advisors LLC and an international group of investors. EBRD retained its 25% minus one share stake in Citadele. Privatisation was concluded in April 2015."[35]

LPA and EBRD concluded a put option agreement (embedded in the *Parex Bank* shares purchase contract signed between the mentioned parties) in April 2009, which forms part of the *Parex Bank* shares purchase contract, followed by minor amendments in July 2009, July 2010 and November 2012. With this put option agreement the LPA guaranteed to the EBRD its investment in *Parex Bank*. Eurostat concluded together with the CSB in 2015 that this put option is not a financial derivative instrument in national accounts (i.e., it is not a marketable instrument) and therefore it should be recorded as a guarantee in national accounts. The activation of the put option (i.e. call of the guarantee in national accounts) is related to the privatisation of the *Citadele Bank*, which is the "good bank" after the split of *Parex Bank* in 2010. The privatisation was concluded in 2015.

The provisional amount of 74 MEUR was specified in the equity sale contract, which was subject to change depending on the *Citadele Bank*'s financial result for 2014. There is a payable in the amount of 88.14 MEUR in the 2014 accounts of the LPA, which led to recording a guarantee call (deficit increasing capital transfer) in 2014 (instead of 2015). The recording of the capital transfer of 88.14 MEUR to EBRD had the following formulation: the starting point was the put option price of 114.3 MEUR, which is the amount to be paid by LPA on the historical investment of EBRD (93 MEUR notional + 21.3 MEUR interest). For 1.26 MEUR, the put option was partially settled in 2012, which leaves 112.9 MEUR still to be settled between LPA and EBRD. However, LPA has to pay ERBD only the amount which is not covered by the value of EBRD 25% ownership of *Citadele Bank* (CB) shares, which is calculated as 24.9 MEUR taking into account that the sales price of 75% of PA shares in CB was 74.7 MEUR. Therefore the full amount of impact on B.9 was recorded as 88.14 MEUR = 114.3 -1.26 – 24.9.

Discussion and methodological analysis

Eurostat agrees that 88.14 MEUR corresponds to the government obligation to EBRD, taking into account the original obligation (114.3MEUR) (including interest accrued), minus repayments (1.3 MEUR), minus 25% of the share held by EBRD in *Citadele*. Against this obligation the government acquires 75% of *Citadele* at 74.7 MEUR. As a result the loss is only 13.5MEUR. According to the rules, the capital transfer on a call representing 88.2 MEUR of liabilities against an acquisition on assets of 74.7 MEUR is a capital transfer of 13.5 MEUR. Government sold *Citadele* for 74.7 MEUR after a few months, which provides a good estimate of its value.

Eurostat agrees that there is a payable in the Privatization Agency accounts in 2014 of 88.2 MEUR. But the put call will have a deficit impact or not depending on whether an effective claim is acquired, whose value can be reasonably estimated. In this case, it seems there is an effective claim since the equity was sold within a few months to

[35] *in* https://www.cblgroup.com/en/about-us/history/

investors and the value can be considered to be the value sold at that time (74.7 MEUR). Under this condition, the recording of a capital transfer should be reduced from 88.2 MEUR to 13.5 MEUR.

Another possible way of recording is to consider that at inception it is expected that EBRD will call the put option, and thus, a loan of 93 MEUR from EBRD to the Government would be considered starting in 2010. In this case the put option would be considered as a loan with interest at inception this would eliminate the 2014 capital transfer completely.

Findings and conclusions

Action point 32 - Concerning *Citadele* the CSB will reduce the capital transfer expenditure (88 million euro) recorded in 2014 for the amounts of the proceeds collected in 2015 or, if it interprets the put option as a loan at inception, will eliminate the capital transfer completely.

Deadline: EDP October 2017 notification.[36]

4.3.2. Recording of the lump sum payments provided by the 2nd pillar pension scheme to the State social insurance pension budget

Introduction

This issue was discussed in previous EDP visits and notifications and Eurostat agrees with the CSB approach. At this visit, the recording of the revenue flow as D.9, possibly D.91 (rather than D.6), was discussed.

Discussion and methodological analysis

Eurostat questioned if the 2nd pillar transfers of deceased persons' assets in certain cases meet the definition of social contributions, since in that case there is no holder of the entitlement in the household sector and social contributions are by definition made in expectation of (potential) future benefits. The revenue could be more assimilated to an inheritance tax (D.91a). Amounts are not negligible but this is a classification issue that is B9 neutral.

The State Funded Pension Law provides three kinds of lump sum payments from the 2nd pillar pension scheme asset management companies to the State Social Insurance Pension Budget in Latvia:

- When the 2nd pillar participant has reached the retirement age and choses to add his/her accrued funded pension capital to the non-funded pension capital;

- When the participant, who had family members, supported by him/her, has died prior retirement. In this case the whole funded pension capital, registered by the day of the death of the participant, is included in the State Social Insurance Pension Budget and considered for calculation of the survivor’s pension;

- When the 2nd pillar participant, who does not have any survivors, has died prior retirement. In this case the whole funded pension capital is included in the State Social Insurance Pension Budget and together with other kinds of budget revenues is used to

[36] On 29.09.2017, CSB sent the EDP notification and revised downwards by 74,7M€ the capital transfer expenditure in 2014 (from 88.24M€ to 13.7M€).

finance respective budget`s expenditures in general (i.e. the lump sum payment is not earmarked and not oriented to cover pension expenditures for any specific sub-group of this budget).

Regarding GFS and in terms of recording, there are three different situations that may give rise to the lump sums: retirement age; the person dies and his/her assets are transferred to the heirs; the person dies and there are no heirs. In the last case, the cash acquired is a cash revenue recorded as a D.7 expenditure – current transfer. The question is why it is this not considered a capital tax.

CSB argued that in the social security budget, these amounts are considered non-tax revenue. Moreover the funds are used to cover expenditure. Notwithstanding the fact that this money is transferred as a lump sum payment from the 2nd pillar, it could not be deemed as advance payments for the EDP notification.

As noted above, in accordance with the State Funded Pension Law, the money transferred to the State Social Insurance Pension Budget as a lump sum due to the death of the 2nd pillar participant prior retirement, in the case he/she did not have survivors, is not earmarked for any pension payments related to the 2nd pillar scheme. This money remains in the Pension Budget as revenues and is freely used to cover budget needs.

Eurostat will reflect on the nature of capital tax, keeping in mind that this needs to be treated the same way as when government gets deceased people's assets: it is revenue that comes without a liability.

Findings and conclusions

Action point 33 – Eurostat agreed on the current recording of some lump sum payments related to pensions. Eurostat and CSB will reflect on the appropriate classification on some of these payments, without B.9 impact (D.7/D.91/D.99).

Deadline: EDP October 2017 notification.[37]

4.3.3. Government guarantees and guarantee calls

Introduction

The Latvian statistical authorities provided prior to the meeting a list with the outstanding government guarantees, new guarantees provided, guarantee calls and repayments by individual companies for the period 2015-2016.

Discussion and methodological analysis

Eurostat reviewed the table on stocks and flows of guarantees provided to public and private corporations, which was provided by CSB before the visit. A column with the guarantees called should be added to the table.

Eurostat will reflect on the inclusion of standardized guarantees, as well as the *Citadele* put option, in the questionnaire table 9.1. The CSB will improve the recording of the questionnaire table 9.4 on Standardised guarantees by filling in columns 1 to 6.

Findings and conclusions

[37] To be implemented in the EDP April 2018 notification.

Action point 34 - Regarding questionnaire table 9.4, the CSB will review the current recording in order to have an AF.6 liability position together with the B.9 impact. Eurostat will clarify if the amounts in questionnaire table 9.4, as well as the *Citadele* put option, should be excluded from questionnaire table 9.1.

Deadline: EDP October 2017 notification.[38]

4.3.4. Debt assumptions, government claims, debt cancellations and debt write-offs

CSB submitted before the visit information on debt assumptions and debt write-offs by government for years 2015-2016. The amounts of debt assumptions and debt write-offs are small.

4.3.5. Capital injections in public corporations

4.3.5.1. Capital injection in Air Baltic

Introduction

In February 2016, the Latvian government signed an agreement with Ralf-Dieter Montag-Girmes, a German investor to whom 20% of Air Baltic was sold for 52 MEUR. Under the deal, a total of 132 MEUR of new capital to be invested in the Latvian carrier for fleet modernisation and its new Horizon 2021 business plan (52 MEUR by the private investor and 80 MEUR by the Latvian government).

The focus of the discussion was to understand whether the profits of Air Baltic are sustainable in the future and if the government may expect to earn a sufficient rate of return on its investment, mostly in the form of dividends and interest and a higher value of its financial instrument, and as similar conditions as the private investor.

Since 2010, there have been several capital injections in Air Baltic, recorded as capital transfers (D.9) in the government accounts for a total amount of 149 MEUR. The accumulated losses of Air Baltic since 2010 amounted to 165 MEUR and the apportioned losses accruing to government amounted to 111 MEUR. As a result, past losses have been fully covered by capital transfers and therefore, for the capital injection test, CSB should focus now on the second part of the test which is to look into the future and on the expected flows.

Discussion and methodological analysis

In the last EDP April 2017 notification, the capital injection was recorded as a financial transaction, with no impact on government deficit/surplus. The company has been profitable in the last year and past losses have been fully covered by capital transfers. Eurostat asked the statistical authorities to examine closely the future expected results of the company on the basis of the business plan of Air Baltic and to investigate if the private and the public investment were seemingly done on a same basis.

The capital injection in Air Baltic may be considered as a financial transaction in F.5, but the recording is still uncertain and it should be confirmed that there is no specific

[38] For October 2017 EDP notification, table 9.4 was revised. Eurostat had previously clarified that standardised guarantees should not be included in table 9.1.

arrangements that benefit the private investor, e.g. through a buy-back agreement (like a put option).

Findings and conclusions

Action point 35 - The CSB will confirm to Eurostat that there are no specific provisions benefiting the private investor as part of the investment agreement concerning Air Baltic Corporation. Based on this, Eurostat will confirm the statistical treatment of the capital injection before the next notification.

Deadline: August 2017.[39]

4.3.5.2. Capital injection in SJSC "“*Latvijas Dzelzceļš*” (LDz)

Introduction

Just prior to the EDP visit, the Latvian authorities requested an ex-ante advice for the correct treatment of a planned equity increase in SJSC “*Latvijas Dzelzceļš*” (LDz) by government, for the implementation of the Latvian railway network electrification project. CSB provided to Eurostat a detailed excerpt from the Business Plan of LDz and the complete assessment of an independent expert regarding the credibility of assumptions.

Eurostat agreed to discuss the issue and to include it as an agenda point of the EDP visit. For the discussion, Latvia invited two representatives of the Ministry of Transport and the project manager from E&Y.

Discussion and methodological analysis

The representatives of the Latvian Ministry of Transport presented the business plan of LDZ. The project was submitted to the Central Agency for evaluation. There is a period of 2 months to improve the project and the Ministry of Transports would like to have Eurostat's advice by August.

LDz is a state joint stock company and is 100% owned by Latvian State. LDz was founded in September 1991, and has 6 subsidiaries. Each LDz subsidiary (including LDz infrastructure, LDz Cargo etc.) has a functional unbundling, which guarantees independent decisions.

The beneficiary, owner and maintainer of the current railway infrastructure is SJSC LDz.

The Latvian railway network electrification project is divided into two stages. Stage I is planned to be implemented from 2019 to 2023, and Stage II is planned to be implemented from 2023 to 2025. Within the Stage I of the Project, the total investment is planned to be 519 MEUR.[40] The investment would allow not only passengers transportation but an increase of the freight transportation.

The base case scenario assumes no increase in production. The traffic volume is the same with or without electrification. It is a cost efficiency project: the investment has to be

[39] On 31/08/2017 CSB reaffirmed that there are no specific provisions benefiting the private investor as part of the investment agreement concerning Air Baltic Corporation.

[40] SJSC «LATVIJAS DZELZCEĻŠ» Business plan from 18.05.2017.

profitable due to cost savings (in fuel, maintenance and, personnel) stemming from the reduction in the number of trains needed.

The geopolitical situation explains the decrease in rail freight transportation. No grants or subsidies are considered.

Regarding the operating profitability of LDz, the net profit went from 1.2 MEUR in 2014 to 0.6 MEUR in 2015 and then increased to 1.1 MEUR in 2016. To try to understand this evolution, Eurostat asked if it was possible to have the annual report of LDz in English (including the audit report) with the balance sheet and profit & loss statements. Some key statistics from previous years are necessary to see the profile of the results of the company.

The company presents fairly low ROE indicators in recent years. According to the present study the *"project's ROE of 7% is adequate given the industry benchmark for return on equity, drawn from competitors analysis, is 1.8% (3y average)."* However, Eurostat pointed out that because the bond rates have become negative in some countries, this indicator is not so pertinent, and the study should be more demanding on the ROE indicator that needs to meet more than the bond rate.

Eurostat noted that if LDz is a loss making company, even if the project is paying for itself, in national accounts, the government capital injection in LDz would have to be considered a capital transfer, conditioned to the accounts of 2016.

Findings and conclusions

Action point 36 - The CSB will provide Eurostat with the 2016 financial statements/reports of *SJSC "Latvijas Dzelzceļš" (LDz)*, as well as the main financial results since 2007. On this basis, Eurostat will provide a letter of advice on the appropriate recording of the planned capital injection, in principle by the end of August, if all information is available.

Deadline: August 2017.[41]

[41] On 13.06.2017, CSB submitted to Eurostat the LDZ annual report for 2016 (in English) received from Ministry of Transport. On 19.06.2017 and on 30.06.2017, CSB submitted to Eurostat further information, namely, on the main financial indicators provided by LDZ. On 05.10.2017, Eurostat provided a letter of advice on the appropriate recording of the planned capital injection, available on its webpage:
(http://ec.europa.eu/eurostat/documents/1015035/7878213/Advice-2017-LV-Statistical-treatment-of-gov-investm-in-SJSC-Latvijas-Dzelzcels.pdf)
Eurostat concluded that the capital injection is to be recorded as a non-financial transaction expenditure in capital transfers (D.9) – investment grants (D92), with an impact on the government net lending/borrowing (B.9).

4.3.6. Dividends, super dividends

4.3.6.1 Super dividend test to repayments of loans

4.3.6.2 Super dividend test of the Central Bank

Introduction

Prior to the visit, the Latvian statistical authorities sent a list of the dividends paid by companies in 2015-2016, their associated profits and the results of the super dividend test. No super dividends were recorded in 2015 and 2016.

The issue of the super dividends test applied on profits of the Central Bank (*Latvijas Banka*) had been discussed at the previous EDP visits and was again recalled. Prior to the meeting, CSB provided a table illustrating the calculation of the super dividends.

Discussion and methodological analysis

Referring to the calculation of the super dividend test applied to the Central Bank, Eurostat asked whether the operating results used in the calculations were deducted from taxes or not. Taxes, including taxes on income, should be super dividend tested. Upon this change in the calculations of the super dividend test, perhaps the *super-dividend correction* in 2013 may have to be revised and it could be that the results from the test in other years will be different.

Findings and conclusions

Action point 37 - The CSB will consider taxes on income in the super dividend test and, as a result, will reduce the dividend revenue originating from the central bank for some years (e.g. 2013).

Deadline: EDP October 2017 notification.[42]

4.3.7. PPPs, concessions and Energy Performance Contracts (EPC)

Introduction

On 2016 CSB informed Eurostat that the Kekava bypass, a major road PPP project, may be in pipeline.

Concerning the EPC, prior to the meeting CSB sent a note informing that "*According to information provided by the Ministry of Economics, so far in the public sector energy performance contracts have not been concluded. Energy performance contracts have been concluded in the private sector mostly for thermal insulation of apartment buildings.*

Latvian Environmental Protection Fund, in collaboration with the association Passive House Latvia developed methodological guidelines for municipalities and public administration authorities on energy efficiency service procurement for improving energy efficiency of buildings."

Discussion and methodological analysis

[42] On 29.09.2017, CSB sent the EDP notification and revised the results for the super-dividends test from the central bank in 2013 and 2014, with negative impact on the deficit of those years.

CSB informed that there is still no confirmation on the starting of the Kekava project.

Eurostat stressed that the CSB should have access to draft PPP projects before they are finalised and signed in order to be able to comment on their statistical treatment. CSB confirmed to have access to the drafts of the PPP projects before they are finalised and signed in order to carry out a statistical analysis.

4.3.8. Financial derivatives

Introduction

Financial derivatives are used by central and local governments, in particular options (swaptions), cross currency swaps and interest rate swaps. As regards the recording in EDP table 2, cash amounts related to swaps are reported in the working balance and excluded in the 'Other financial transactions, of which: net settlements under swap contracts'.

Before the visit, CSB submitted to Eurostat the structure of the government debt questionnaire.

The CSB also provided previous to the visit: the list of the treasury derivatives in 2015 and 2016 by type, aim and signing and closing contract dates; its classification and impact on B.9; and, the recording in EDP tables 2 and 3.

Discussion and methodological analysis

During the visit CSB provided some contradictory information between foreign-currency debt and hedging.

From the list of treasury derivatives provided by CSB, Eurostat noticed that the existing forwards are mainly long term forwards, with 10 to 15 years of maturity.

CSB will add to the list of treasury derivatives the figures for 2013 and 2014. Following the discussion, it was also noticed that the amounts of forwards are low and that for 2014-2015 the foreign currency debt is only in US dollars.

Under ESA 2010, flows on derivatives only enter the financial accounts (F.7), with no impact on the deficit. Eurostat enquired CSB on their rule to applied for the Maastricht debt in case of hedging. Regarding debt, hedging via derivatives impacts the valuation of face value (in EDP) while it does not change the ESA valuation (market or nominal value) of the underlying instruments. Under ESA, the derivatives enter naturally the BS under the separate category AF.7 – whether the derivative is used for hedging or not.

Eurostat asked CSB to inform on the amount of notional debt covered by forwards and by cross-currency swaps. Furthermore, CSB was also asked to clarify the amounts of forwards.

Eurostat asked about the type of CCS, whether they are normal CCS or off-market swaps. ESA 2010 recognizes, in off-market swaps, a loan component separately from a derivative component – which is to be monitored. Each contract includes interest and principal.

Eurostat questioned whether interest in the WB is recorded after or before swap and debt is recorded before or after swap. Furthermore it is important to clarify whether, when the swap is cancelled and there is a lump sum payment to government, this appears in the WB.

Findings and conclusions

Action point 38 - The CSB will clarify whether interest on forex debt under hedge in the working balance is recorded before or after swaps (i.e. interest streams on CCS or forwards are reported within interest payments of the budget rather than separated in another line). The CSB will verify whether the list of derivatives provided to Eurostat is complete, and will add information for 2013 and 2014. Concerning long term forwards used for hedging, the CSB will clarify what exchange rate was used for the valuation (cash value at time of hedge or forward value) and indicate the reduction/increase in Maastricht debt arising at inception from this hedge. The CSB will clarify the recording of lump sums on swap cancellation (unwinding of hedge in 2015) as well as on forward settlements, in the working balance (budget), in public accounts, and in EDP/ESA tables.

Deadline: August 2017.[43]

Action point 39 - In relation to QFAGG, the CSB will separate the swap from the debt being hedged and will aim at valuing the bonds at their market values.

Deadline: August 2017.[44]

4.3.9. Emission trading permits and Assigned Amount Units (AAU)

Introduction

Prior to the visit, CSB provided a note on the current and future emission trading permits. For this agenda point, a member from the Latvian Ministry of Environment and regional development was invited for the discussion.

Discussion and methodological analysis

The note on the recording of revenues received by government for emission trading permits submitted by the CSB was reviewed in the meeting.

ESA 2010 15.40 prescribes that pollution permits that are sold off should be recorded as taxes on production (pollution tax) for the value of the amounts collected. This is a kind of permit to carry an activity, whose recording is clearly explained in ESA 2010 15.32–15.37.

It was clarified by the Latvian Ministry of Environment that, according to the EU approach and regulation, 5 MEUR per year of emission permits were given for free, the rest was sold. The amount of permits auctioned is also defined on the EU Law.

A producer has permits and may pass them to other countries, and the permits may be surrendered there. But producers may also keep the permits for later years. There was a

[43] On 31/08/2017 CSB provided Eurostat with:
- the clarification that the interest on forex debt under hedge in the WB is recorde before swaps;
- the list of derivatives (with impact of debt instruments) 2013-2016;
- clarified that they use the cash value for the valuation (cash value at time of hedge) and indicated that there is no impact on Maastricht debt arising at inception from this hedge. The amount of debt hedged by forward contracts is small amount of total hedged debt, for example 0.26 % at the end of 2016.
- sent an excel file with the clarification for the recording of lump sums on swap cancellation (unwinding of hedge in 2015) as well as on forward settlements, in the working balance (budget), in public accounts, and in EDP/ESA tables.

[44] On 31/08/2017 CSB informed that QFAGG data would be corrected and included within the next transmission of 2017 Q2 T27.

change of the operating EU rules that implied that before 2008 all the permits that were not used were cancelled.

Selling ETS is done in an open platform on-line. There is a common trading platform and auctions occur but not in Latvia. In general it is difficult to relate this with exports. The permits are sold several times but they are impossible to trace.

Eurostat will modify the template of the table on emission permits and will add a line for the cancelled permits. The table had automatic formulas and, because this line was missing, the results of the table sent previously filled in by Latvia were not correct.

Line 12 of the table refers to the State Revenue Service – everything is cash revenue from the Treasury. And it refers to all the revenues, not only taxes. In 2012, Latvia sold 40 MEUR emission trading permits. In 2013, 28 MEUR was sold in total.

Regarding Assign Amount Units (AAUs), the Latvian Ministry of Environment explained that AAUs have a different system, different property rights and a different use. AAUs are to be used only by governments that signed the Kyoto protocol, and Latvia is one of them. Some buy AAUs to reach the target of reducing the emission. AAUs started in 2008 and existed until 2012; they do no longer exist. There are some AAU that have zero value and cannot be used and will not be revaluated. The price of these units went down because the US did not ratify the protocol and Canada withdrew as a consequence. From 2021, the Paris Protocol will enter into force and what will legally happen to the second phase of the Kyoto protocol is uncertain.

Findings and conclusions

Action point 40 - Eurostat welcomed the information on Emission Trading Scheme (ETS). Eurostat will adapt the template on ETS, so to accommodate cancellation events (as occurred in 2008). The CSB/Ministry will refill the table accordingly. The current compilation of government revenue is acceptable pending some review of the guidance. The CSB will report on the rules followed by public accountants to establish the revenues of these ETS flows.

4.3.10. UMTS and mobile phone licenses

Introduction

Prior to the visit, the Latvian statistical authorities sent a note on the current and planned operations related to UMTS and mobile phone licenses.

An auction of UMTS[45] licenses was launched in 2002 and its income was recorded in the central government account (S1311) as acquisitions less disposals of non-financial non-produced assets (NP2). It is included in EDP table 2A.

Auctions of mobile phone licences were launched in 2012 and 2013. The revenue from sales was excluded from central government accounts for the years 2012-2014 and the proceeds from sales of licences were recorded as government revenue at the time when the purchasers of a licence can start using the spectrums.

Discussion and methodological analysis

[45] The Universal Mobile Telecommunications System (UMTS) is a third generation mobile cellular system for networks based on the GSM standard.

CSB will update, in accordance with Eurostat's guidance note from February 2017, the recording of the proceeds (revenue) from all mobile phone license contracts awarded from 2017 onwards. It should be recorded as rent (D.45), spreading the impact over the license duration, and not as disposal of a non-financial asset with a one-off impact on deficit/surplus at inception. For the contracts signed in 2016 or before, Member States were given the choice to implement that treatment already now or at a later stage (but no later than the next benchmark revision).

Findings and conclusions

Action point 41 - The CSB will switch to rent recording for UMTS contracts in the October 2017 notification, possibly including older contracts (otherwise, will do so in the next benchmark revision).

Deadline: EDP October 2017 notification.[46]

4.3.11. Others: privatization, sale and leaseback operations, securitisation, etc.

No operations are expected to occur in Latvia in the near future.

5. Any other business (planned future operations, transmission of GFS data etc…)

5.1. ESA 2010 Transmission Programme

5.2. Any other business

5.2.1. New mandatory electricity procurement scheme

Introduction

Prior to the EDP visit, the Latvian statistical authorities, at a request from the Ministry of Economics, asked Eurostat to include an additional agenda point regarding a new mandatory electricity procurement scheme.

To facilitate renewable energy and high efficiency cogeneration in Latvia, a support system has been created, in the form of a subsidy for efficient production paid through a fee collected on users as well as through balancing government grants. The actual costs to end users exceeded 38 EUR/MWh in 2016 and will exceed 40 EUR/MWh in 2020. Support for high efficiency cogeneration is provided to 5 power plants in the form of guaranteed payments. Two of those power plants are operated by 100% state owned JSC "*Latvenergo*" (S.11).

The increasing burden of the scheme has led government to examine ways to modify the arrangement, notably in order to limit users' contributions or budget grants. The government of Latvia is considering designing a mechanism that would allow the companies that receive support for high efficiency cogeneration to partly waive their right of support, in return for receiving a one-off compensation.

The financing of this mechanism is expected to come from a capital withdrawal from JSC "*Latvenergo*". Almost all of the capital withdrawn from JSC "*Latvenergo*" would however go back to the company, notably with a view to allow the company to continue paying significant dividends to the state. The Latvian authorities presented three different

[46] On 29.09.2017, CSB sent the EDP notification and revised the recording of the mobile phone licences, for the contracts made between 2002-2016,.according to the new guidelines published in February 2017.

possibilities on how the new scheme could be implemented and asked Eurostat in this context on the possible impact on national accounts data.

Discussion and methodological analysis

Role and classification of *Enerģijas publiskais tirgotājs*

The current renewable energy support system is mainly based on subsidies to producers paid by *Enerģijas publiskais tirgotājs AS* (EPT), which is a subsidiary of *Latvenergo* (250 MEUR a year). This takes the form of a feed-in tariff that requires EPT to buy electricity generated by renewable energy producers at a tariff which includes a pre-determined premium (determined by law) above or additional to the actual market price for electricity.

EPT is then compensated for the premiums paid to the producers via a fee, so-called mandatory procurement public service obligation fee (MP PSO), paid by end-users in proportion to their electricity consumption (150 MEUR a year). In order to keep the MP PSO fee stable, EPT also receives a government grant (100 MEUR a year), partially financed by the subsidised electricity tax. Furthermore, the government, in its quality of shareholder, has received in the last years dividends from *Latvenergo* AS.

The Latvian authorities explained that the premium paid as well as the MP PSO fee are currently treated as part of the market price to be paid for electric energy without recognising any tax or subsidy. Eurostat expressed its view that the energy support mechanism de facto constituted a tax/subsidy scheme, whereby the premium paid to the producers mainly constitutes a subsidy on production (depending on the production process). The economic substance of the PSO fee is a tax on products. Therefore, Eurostat recommended the NSI to analyse again the whole support scheme and to consider either to classify EPT to the general government sector (since it *de facto* carries out a redistribution activity, it is not a market producer) or to reroute all activities of EPT which are related to the support scheme through the accounts of general government.

Envisaged plan

The Latvian authorities explained in this context that the Cabinet's regulation would establish the possibility for companies to partly waive their rights to receive guaranteed payments, receiving in return a discounted compensation (lump sum payment).

The lump sum will be financed through an equity withdrawal from the government owned *Latvenergo* AS, followed by a subsequent equal cash injection to EPT. EPT then carries out the transfer of the lump sum payment(s) to the parties concerned. The Latvian authorities asked Eurostat about the possible accounting consequences of the intended plan.

The plan considers to provide a lump sum payment either to all producers of renewable energy or only to *Latvenergo* AS.

The support for the renewable energy companies will end in 2028. The present value of the subsidies to be paid to the sole *Latvenergo* AS until this point is around 450 MEUR (equal to the intended lump sum payment). The lump sum payment will presumably be substantially higher if all renewable energy companies will be able to apply for compensation. *Latvenergo* AS would mobilise 250 MEUR from its liquidities and would borrow the remainder.

The Latvian authorities explained that the targeted reduction of the subsidy could reach 75% (70 million a year, assuming a discount rate of 9%).

National account recording

Eurostat explained that the accounting consequences have to be analysed against the background that the energy support scheme is de facto a tax/subsidy scheme, which either results in classifying EPT to the central government or in routing the relevant transactions through the government accounts (see above). Starting from this basic assumption, the expected impact of the amended scheme on government net lending/net borrowing will correspond to the 75% reduction of the MP PSO fee (tax) that the Ministry of Economics wants to achieve, assuming that the funding of the lump sum payment is treated as equity withdrawal.

Second, the scheme proposed may not necessarily change the future surplus of government to the extent that lower subsidies would translate into lower company revenue and profit, and accordingly in lower dividends. Eurostat recalled that any amount distributed exceeding the operating profit is to be recorded as withdrawal of equity according to the super dividend test.

However, this may well depend on the current accounting treatment, in the profit and loss and balance sheet of the electricity producers, of the promised subsidy. A reduction in the subsidies/premium paid to the producers would generally result in the recognition of losses (lower profit) in the P&L accounts of the producers (including *Latvenergo*) over the years, unless the rights to receive guaranteed payments are themselves recorded as an asset on the balance (and would have to be written off their balance sheet with an one-off impact in the P&L).

If the guaranteed payments are recorded as an asset in the accounts of the affected energy companies (including *Latvenergo* AS), it is likely that the EPT mandatory payments are not recorded as revenues in the P&L accounts but directly on the balance sheet (repayment of a claim). If this is the case, the write off of the related asset does not affect the operating profit used for the superdividend test of the concerned companies. When applying the superdividend test, a suitable correction of the operating profit has to be carried out. If, on the contrary, the mandatory payments are recorded as revenues in the P&L, the operating profit and the superdividend test will be indeed affected by the waiver of rights. Eurostat suggested therefore that the Latvian authorities clarify the treatment of the energy support scheme in the financial statements of *Latvenergo* AS and other producers. In the rest of the analysis, it is assumed that the promise of subsidy is not an asset, and that the subsidies are therefore recorded as revenue of the corporation gradually over time.

Third, Eurostat recalled that a decapitalisation of *Latvenergo* AS would be subject to the superdividend test that is mostly recorded as a financial transaction and not as revenue of government. In addition, the reinjection of the funds (even if directly carried out without transiting via the Treasury) in EPT would be capital injection tested. It is most likely that, overall, the transit of funds will be broadly neutral for government accounts.

Overall, the impact on central government net lending/net borrowing can be summarized by the following equation: B.9 = MP PSO fee – Subsidy + *Latvenergo* AS dividends

If the scheme is amended (introduction of a lump sum payment with a corresponding 75% reduction of the subsidy payments), an impact on the central government accounts will occur in subsequent years (less expenditure). However, as shown above, this impact will be, to a large extent, compensated by lower operating profit of *Latvenergo* AS and lead to lower dividends recorded in national accounts (even if actual dividends were to remain, for some reasons, at their current level).

Alternatively, the lump sum paid by EPT upfront to electricity providers may be considered as an advance payment for subsidies which would accrue in the future. The transfer of the lump sum payment back to *Latvenergo* AS and, if applicable, to the other companies is, therefore, balanced at inception by a matching other accounts receivable in the central government accounts (no impact on net lending/net borrowing at the time of the cash transfer). The other accounts receivable is amortized in the form of imputed expenditures for subsidies. This contributes to the gross operating surplus of producers, and *Latvenergo* AS can continue paying a significant dividend.

The lump sum may be recorded as expenditure at inception, rather than in future. The gross operating surplus of producers will fall in the future, and *Latvenergo* AS will have nonetheless to reduce dividends.

An alternative scenario with *Latvenergo* AS simply forfeiting its right without compensation would presumably be treated as an off-balance sheet event, with no entries at inception in national accounts. In subsequent years, the fall in operating surplus would again lead to a reduction in government revenue (dividends).

Findings and conclusions

Action point 42 - Eurostat took note of the project of the Ministry of Economics concerning the subsidized renewable energy scheme and provided information on the recording principles in national accounts. Based on the discussion during the meeting, further exchanges will take place. Eurostat stressed that the deficit impact would likely correspond to the reduction in the electricity fees (tax) that the Ministry of Economics aims at achieving.

Deadline: when available.[47]

[47] On 11/07/2017 Eurostat sent to CSB a draft summary of the discussion regarding the new mandatory electricity procurement scheme in Latvia.

EUROSTAT EDP DIALOGUE VISIT TO LATVIA

7-9 JUNE 2017

AGENDA

1.Statistical capacity issues

1.1. Review of institutional responsibilities in the framework of the EDP data reporting and government finance statistics compilation

1.1.1. EDP processes and institutional cooperation

1.1.2. Quality management framework

1.1.3. Audit and internal control arrangements

1.2. Data sources and revision policy, EDP inventory

1.2.1. Structure of the General Government

1.2.2. Availability and use of data sources, revision policy

1.2.3. EDP Inventory

1.2.4. Compliance with the Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States

2. Follow-up of the previous EDP dialogue visit of 26-27 May 2015

3. Analysis of EDP tables and questionnaire – follow up of the April 2017 EDP notification

4. Methodological issues and recording of specific government transactions

4.1. Delimitation of general government, application of 50% rule and qualitative criteria in national accounts

4.1.1. Review of the changes in the list of general government units

4.1.1.1 Government bodies included in table 2A

4.1.1.2 Application of 50% rule and qualitative criteria in national accounts

4.1.1.3 Government controlled entities classified outside general government (public corporations)

4.1.2. Sector classification of specific units (Tiesu Nama Agentura, Rail Baltica II, Deposit Guarantee Fund)

4.2. Implementation of the accrual principle

4.2.1. Taxes and social contributions

4.2.2. Interest

4.2.3. EU flows

4.2.4. Military expenditure

4.2.5. Recording of other flows of receivables and payables

4.2.6. Gross Fixed Capital Formation (GFCF)

4.3 Recording of specific government transactions

4.3.1. Government interventions to support financial institutions

4.3.1.1. Winding-down of Reverta

4.3.1.2. Recording of EBRD put option and the Citadele sale

4.3.2. Recording of the lump sum payments provided by the 2nd pillar pension scheme to the State social insurance pension budget

4.3.3. Government guarantees and guarantee calls

4.3.4. Debt assumptions, government claims, debt cancellations and debt write-offs

4.3.5. Capital injections in public corporations

4.3.5.1. Capital injection in Air Baltic

4.3.5.2. Capital injection in SJSC "“Latvijas Dzelzceļš” (LDz)

4.3.6. Dividends, super dividends

4.3.6.1 Super dividend test to repayments of loans

4.3.6.2 Super dividend test of the Central Bank

4.3.7. PPPs, concessions and Energy Performance Contracts (EPC)

4.3.8. Financial derivatives

4.3.9. Emission trading permits and Assigned Amount Units (AAU)

4.3.10. UMTS and mobile phone licenses

4.3.11. Others: privatization, sale and leaseback operations, securitisation, etc.

5. Any other business (planned future operations, transmission of GFS data etc…)

5.1. ESA 2010 Transmission Programme

5.2. Any other business

5.2.1. New mandatory electricity procurement scheme

EUROSTAT EDP DIALOGUE VISIT TO LATVIA

7-9 JUNE 2017

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