



Luxembourg,  
ESTAT/D-3/LA/JJ/ANR/PdR/at D (2019)

Ms Aija Žīgure  
President  
Central Statistical Bureau of Latvia  
Lāčplēša Street 1  
Riga 1301  
Latvia

**Subject: Advice letter on the sector classification of 'RĪGAS SATIKSME' pašvaldības SIA**

**Reference:** Discussions held during the EDP April 2019 notification  
Your e-mails from 17/06/2019 and 23/08/2019  
Your formal request for bilateral advice from 19/09/2019

Dear Ms Aija Žīgure,

Following the discussions held during the EDP April 2019 notification and your e-mails from 17/06/2019 and 23/08/2019, culminating in your formal request for bilateral advice from 19/09/2019, Eurostat would like to provide you with its opinion regarding the Sector classification of *Rīgas Satiksme*.

**1. THE ACCOUNTING ISSUE FOR WHICH A CLARIFICATION IS REQUESTED**

A clarification is requested for the correct sector classification of *Rīgas Satiksme*, a municipal limited liability company handling bus and tramway services in Riga. The costs of the company are only marginally covered by transportation ticket sales or parking fees collected from the public. The company has been so far considered a public market producer as the considerable amount of subsidies from the state budget and Riga municipality it receives to compensate for passengers receiving fare discounts are currently predominantly recorded as D.63 – social transfers in kind and booked within sales for the purpose of the 50% test.

**1.1. Background information on *Rīgas Satiksme*<sup>1 2</sup>**

*Rīgas Satiksme* was founded on 20 February 2003. Its legal status is a municipal limited liability company. *Rīgas Satiksme* is a company with share capital of 100% owned by Riga city

---

<sup>1</sup> <https://www.rigassatiksme.lv/en/about-us/>

<sup>2</sup> Note from the Central Statistical Bureau of Latvia (CSB) – e-mail from 17/06/2019 and 19/09/2019.

municipality. *Rīgas satiksme* owns capital shares in the following subsidiaries: SIA “*Rīgas karte*”<sup>3</sup> and SIA “*Rīgas acs*”<sup>4</sup>.

The general strategic goal of *Rīgas Satiksme* operation, entrusted by Riga city, is to provide public transport services within the administrative borders of the city, to administer and manage paid parking in Riga city, and to participate in the maintenance and development of infrastructure of urban transport of Riga.

The company operates four business lines:

- Supervision of the united public transport network;
- Passenger transportation;
- Management of parking lots;
- Transport rent.

The supervision tasks of the company consist in:

- route network planning, route development, which means planning the number/mileage of trips;
- enforcement control: recording of actually executed trips (checking that actual bus trips are on schedule).

*Rīgas Satiksme* provides 8 tram routes, 17 trolleybus and 56 bus routes and manages more than 6000 parking lots in Riga. The company also provides other services: trips in Retro tram during the summer and bicycle parking. The infrastructure (tram lines, track and cableways) is owned by *Rīgas Satiksme*.

There are no other operators in Riga competing for bus lines, except a few high-cost vans which are operated by the private company *Rīgas mikroautobusu satiksme*.

*Rīgas satiksme* calculates the value of one trip according to the Regulation of the Cabinet of Ministers “*The procedure of determination and compensation of losses and expenditures related to delivery of public transport services and determination of tariff for public transport services.*” This value is calculated by dividing the anticipated public transport costs with the anticipated number of passengers and adding VAT in the amount of 12%. The calculation of one trip is submitted by *Rīgas Satiksme* to the Passenger Commercial Transportation Licensing Commission of the Riga City Council for approval. The cost of one trip in 2019 is estimated at 1.43 EUR, but the ticket proceed is 1.15 EUR (before rebates that are reimbursed by Riga municipality), which does not cover all travel costs. The difference between the cost on average and the value of the ticket is also covered by the Riga City Council.

## ***1.2. Documentation provided***

The Central Statistical Bureau of Latvia (CSB) provided to Eurostat, by e-mails from 17/06/2019 and 19/09/2019, a document with general information on *Rīgas Satiksme* and their

---

<sup>3</sup> *Rīgas karte* is a joint venture with public (51% owned by *Rīgas satiksme*) and private shareholders (49%) classified in non-financial corporations’ sector. *Rīgas karte* supervises the daily operations of the e-talons sales network, of the money collection, of the controlling equipment on-board the buses/trolleys/trams, of the web sales, of the inspectors’ portable terminals and manages the Ticket Vending Machines and operates the central server for *Rīgas satiksme*.

<sup>4</sup> *Rīgas acs* is a company with share capital 100% owned by *Rīgas satiksme* classified in non-financial corporations’ sector. The company was established with an aim to improve awareness, convenience and safety of passengers in public transport of the capital city. *Rīgas acs* elaborates, implements and manages integrated surveillance, control and coordination system.

methodological analysis on the sector classification of the company. In addition, CSB provided also some figures on:

- Compensations from the Riga City Council and from the State budget for passenger transportation in Riga in 2017
- Financial information, including government financing (D. 632 and D.39) to the company
- The 50% test for 2016-2018

## **2. METHODOLOGICAL ANALYSIS**

### ***2.1. Applicable accounting rules***

- ESA 2010, Chapter 2: in particular, ESA 2.12 dealing with the definition of an institutional unit; ESA 2.24 to 2.26, regarding artificial subsidiaries, as well as, ESA 2.31 to 2.38 concerning institutional sectors and the issue of control of an institutional unit;
- ESA 2010, Chapter 3: ESA 3.12 regarding ancillary activities and ESA 3.19 and ESA 3.26 on economically significant prices and the part *Institutional Units: distinction between market, for own final use and non-market*;
- ESA 2010, Chapter 4: ESA 4.30-4.40 on Subsidies and ESA 4.84 with the list of risks or needs which may give rise to social benefits;
- ESA 2010, Chapter 20 the government accounts: notably the section Market/non-market delineation ESA 20.19 to 20.31; ESA 20.18, ESA 20.309 and 20.310 on public sector control; ESA 20.164 and ESA 1.90 on the issue of reporting “substance over form”;
- In addition to ESA 2010, the Manual on Government Deficit and Debt (MGDD) - 2019 edition, provides a part dedicated to delimitation of the general government sector (Part 1), in particular chapter 1.2 Criteria for classifying units to the general government sector, section 1.2.4 Concept of a market or non-market institutional unit and sub-section 1.2.4.2 Specific cases of producers.

### ***2.2. Availability of national accounting analysis***

The Latvian statistical authorities provided to Eurostat a methodological analysis of the classification of “*Rīgas Satiksme*” based on the general criteria for the sector classification in national accounts: the entity being 1) an institutional unit; 2) a government-controlled institutional unit; 3) a non-market institutional unit.

The CSB conclusions are that *Rīgas Satiksme* must be classified in the sector S.13, taking into account that it is a government - controlled institutional unit, directly controlled by Riga city municipality, which has a monopolistic character in the provision of services without a tender, and that the proceeds received from government exceed 50% of total revenues.

### ***2.3. Methodological analysis and clarification by Eurostat***

#### ***Sector classification general procedure***

In national accounts, the classification of units is based on the economic substance of the organizational arrangements/structures or transactions, and not on the legal design (see ESA 1.90 and 20.164) (“substance over form”).

To help on the allocation of units to sectors, ESA 2010 provides a so-called "decision tree diagram" (diagrams 2.1 and 20.1), with a summary of the main questions to be answered, presented in a hierarchical order.

The Manual on Government Deficit and Debt (MGDD) - 2019 edition provides further details, with a part dedicated to delimitation of the general government sector (Part 1), in particular chapter 1.2 Criteria for classifying units to the general government sector, section 1.2.4 Concept of a market or non-market institutional unit and sub-section 1.2.4.2 Specific cases of producers.

One must first establish if an entity meets the criteria of being an 'institutional unit', by testing if it has 'autonomy of decision'. Second, one must determine if the entity belongs to the public sector or not, i.e., if it is a government-controlled institutional unit or not. Third, the activity of the entity has to be clarified, i.e. one has to identify if the activity of the entity is market or non-market. The market/non-market evaluation comprises both quantitative and qualitative criteria.

For the analysis of the market character of the unit, according to ESA 20.29: *"For other producers that operate under the control of government, an assessment of their activity and resources is necessary. In order to decide if they are market units, and charge economically significant prices, the criteria as set out in paragraphs 20.19 to 20.28 are to be checked. In summary the conditions are as follows:*

*(a) the producer is an institutional unit (a necessary condition; see also the decision tree in paragraph 20.17);*

*(b) the producer is not a dedicated provider of ancillary services;*

*(c) the producer is not the only supplier of goods and services to government, or, where that producer is, it has competitors; and*

*(d) the producer has an incentive to adjust supply to undertake a viable profit-making activity, to be able to operate in market conditions and to meet its financial obligations.*

*The ability to undertake a market activity will be checked notably through the usual quantitative criterion (the 50 % criterion), using the ratio of sales to production costs (as defined in paragraphs 20.30 and 20.31). To be a market producer, the public unit shall cover at least 50 % of its costs by its sales over a sustained multi-year period."*

## ***Rīgas Satiksme***

### **1) Institutional Unit**

ESA 2.12 sets out the rules according to which an entity is to be considered an institutional unit.

Although *Rīgas Satiksme* has some operational autonomy, its autonomy of decision is not straightforward and can be questioned.

Indeed, according to the Law on public transport services – section 5, it is within the jurisdiction of Riga municipality to ensure the organisation of *public transport services in the routes of city significance of the route network*<sup>5</sup>. In the municipality of Riga, this ability to ensure public transport services were granted to *Rīgas Satiksme*.<sup>6</sup>

---

<sup>5</sup> <https://likumi.lv/ta/en/en/id/159858>

<sup>6</sup> The Riga City Council's Resolution decision No. 3989 of 1 March 2005, concerning the conclusion of a delegation agreement with Riga municipal limited liability company "Rīgas satiksme" in respect of public transport, road transport and parking services provision of the City of

In addition, Riga municipality has some powers that may interfere in the autonomy of decision. “*Rīgas Satiksme statutes are approved by Riga city municipality.*

*Accordingly, statutes, for decision taking of such questions, the board of Rīgas Satiksme needs the approval of the participants of the shareholders’ (Riga city municipality) meeting:*

- *approval of the current annual budget and operational strategy of the company;*
- *acquisition, appropriation or encumbering rights of real estate;*
- *conclusion of borrowing and lending agreements;*
- *issuing bills of exchange on behalf of the company, issuing pledge for covering debt liabilities of the company. The company does not issue guarantees and pledges for covering debt liabilities of third persons.”<sup>7</sup>*

The issue is whether these attributions can effectively constrain the autonomy of decision of *Rīgas Satiksme* in its main activity.

More generally, the fact that investment in the bus lines and real estate transactions as well as lending and borrowing agreements would need to be approved by the municipality, may lead to question the genuine autonomy of decision of *Rīgas Satiksme*. In this respect, *Rīgas Satiksme* can be analysed as a borderline case and could be considered either as an artificial subsidiary or an ancillary unit (meaning, not being an institutional unit) and calling for a classification inside government.

It could be defended that *Rīgas Satiksme* is not genuinely engaged in the activity of passenger’s transportation on the market, on a commercial basis, but is a dedicated provider of services to the municipality of Riga. The Law on public transport services<sup>8</sup> corroborates also with this idea when, in its section 8, rules that “*a capital company, which has been granted the right to provide public transport services in accordance with Paragraph three of this Section, has no right to participate in order procedures of public transport services organised by other ordering parties.*” Hence, *Rīgas Satiksme* cannot bid to public transport services in other municipalities. The entity is only due to serve the needs of Riga. According to ESA 2.24 to 2.25, this leads potentially to consider the unit as an artificial subsidiary, to be recorded in the local government sector.

Artificial subsidiaries are entities, wholly owned by a parent company, created in legally separated structures, whereas these various parts of the enterprise in fact constitute a unique whole, from an economic point of view, and should be recognised as one unique institutional unit. The system thus explicitly recognizes that analysing each producer as if it was by definition or convention operating on a market, independently from its creator and main client, would not do justice of the economic reality. Such entities do not satisfy the definition of an institutional unit because they lack the ability to act independently from their parent corporation and may be subject to restrictions on their ability to hold or transact assets held on their balance sheets. In a sense, each entity cannot meaningfully or effectively operate without the others: each entity can be seen as sole (or predominant) client or supplier to the other.

---

Riga ([https://www.rigassatiksme.lv/files/lemums\\_par\\_sabiedrisku\\_transporta\\_pasutijuma\\_liguma\\_noslegsanu.pdf](https://www.rigassatiksme.lv/files/lemums_par_sabiedrisku_transporta_pasutijuma_liguma_noslegsanu.pdf)); The Riga City Council's Resolution decision No. 3783 of 18 October 2011, concerning the conclusion of the public transport service contract for the operation of public transport services on the public transport routes of the City of Riga by SIA Rīgas satiksme. ([https://www.rigassatiksme.lv/files/lemums\\_par\\_sabiedrisku\\_transporta\\_pasutijuma\\_liguma\\_noslegsanu.pdf](https://www.rigassatiksme.lv/files/lemums_par_sabiedrisku_transporta_pasutijuma_liguma_noslegsanu.pdf))

<sup>7</sup> Note from CSB – e-mail from 17/06/2019 and 19/09/2019.

<sup>8</sup> <https://likumi.lv/ta/en/en/id/159858>

In addition, ESA 3.12 states: "*An ancillary activity is an activity whose output is intended for use within an enterprise. An ancillary activity is a supporting activity undertaken within an enterprise in order to enable the principal or secondary activities of local KAUs to be carried out. (...)*"

Regarding *Rīgas Satiksme*, even if there are some minority revenues from non-government entities, there is a very high dependence from government as the major financial provider supporting the activity. In addition, there is government ownership of *Rīgas Satiksme* together with a grant of right to ensure the transportation service to *Rīgas Satiksme* without any public tender, which means that government de facto acts on both sides of the transaction. This may contribute further to limiting the autonomy of decision of *Rīgas Satiksme*.

Nonetheless, despite the limitations seen above, given that *Rīgas Satiksme* has operational autonomy and it keeps a complete set of accounts, at this stage, *Rīgas Satiksme* can be deemed to be an institutional unit.

## 2) Public sector unit government-controlled

The concept of public control is defined in ESA 20.18 as the following: Control over an entity is the ability to determine the general policy or programme of that entity. In order to determine the existence of control by government, the criteria used are those used for corporations liable to be public corporations, as set out in ESA 2.32.

As stated in ESA 20.309 the control criteria include the following: "(a) rights to appoint, veto or remove a majority of officers, board of directors etc. [...]", "(b) rights to appoint, veto or remove key personnel. [...]", "(c) rights to appoint, veto or remove a majority of appointments for key committees of the entity. [...]", "(d) ownership of the majority of the voting interest. [...]", "(f) rights to control via contractual agreements. [...]"

*Rīgas Satiksme* is a company with share capital 100% owned by Riga municipality. In accordance with article 14 of the Law on Governance of Capital Shares of a Public Person and Capital Companies, the holder of the capital shares of the company is Riga municipality and the decisions are taken by the mayor of Riga's City Council.

Based on the information provided in a note from CSB and according to ESA 20.309-20.310, *Rīgas Satiksme* can be considered a government - controlled institutional unit being directly controlled by Riga municipality.

## 3) Market character of the unit

As explained in ESA 20.19 and following paragraphs, as well as in the MGDD sub-section 1.2.4.1 - *the concept of "economically significant prices"*, the capacity of producers and consumers to react to economic "signals" is fundamental when assessing market behaviour.

The MGDD subsection 1.2.4.1, point 48 adds: "*Market producers sell their output at economically significant prices. Non-market producers are typically providing their output free of charge or at prices that are not economically significant. A public market producer will act as a business unit subject to market forces such that it might have to close down if it cannot survive at those prices without the permanent support of government or it would be subject to restructuring.*"

Furthermore, ESA 20.27 and 20.28 rule that when the output is sold primarily to Government and the entity is the only supplier of its services, it is presumed to be a market producer only if its sales to non-government units are more than half of its total output or its sales to government fulfils the tendering condition.

*Rīgas Satiksme* provides public transport services but its costs are only marginally covered by ticket sales or from parking fees collected from the public. The Government financing amounts to more than 60% of the total revenue of the company and only 30-35% comes from the public. The company is the only supplier of these services in Riga and does not compete in the market with other service suppliers. Applying the criteria of ESA 20.27 and 20.28, as more than 50% of the revenues come from government and the provision of the public service transportation was granted by Riga municipality without a tender competition but by a Riga's Council decision, *Rīgas Satiksme* cannot be presumed to be a market producer.

To be a market producer the entity must be selling a product at economically significant prices, i.e., with “*prices that have a substantial effect on the amounts of products that producers are willing to supply and on the amounts of products that purchasers wish to acquire. Such prices arise when both of the following conditions apply:*

*(a) the producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other costs; and*

*(b) consumers have the freedom to purchase or not purchase and make the choice on the basis of the prices charged. (...)*(ESA3.19). Given that the company cannot decide on its own on

investment or on borrowing, the criteria for the price being economically significant as per ESA 3.19 do not seem to be met. A given “price” does not lead to expansion or contraction of *Rīgas Satiksme* supply. In addition, such a price is supposed, according to ESA 3.19, to cover the cost over the long run, which is not the case. On this basis, the main product sold by *Rīgas Satiksme* is non-market and, according to ESA 3.26, the company should be seen as a non-market producer.

However, if *Rīgas Satiksme* is considered a producer of several products, one would need to apply the 50% criterion to the company. Certainly, in the usual quantitative criterion (the 50 % criterion), *Rīgas Satiksme* covers more than 50% of its expenditure with sales. However, this is only because it receives large compensation for transportation of passengers of various social groups either free of charge or at discounted price, through public service operation (PSO) that are recorded as D.63 – social transfers in kind.

To record a D.63 expenditure in government accounts, there needs to be a social risk identified as listed in ESA 4.84. In addition, recognizing a social transfer in kind is conditioned on the use of the service by the customer, i.e., the subsidy is provided on an individual basis and being accounted ticket-by-ticket. We understand this to be the case for *Rīgas Satiksme*.

Nevertheless, and notwithstanding the payments being recorded as D.63, a situation of a public company acting in a de facto monopoly for the provision of public services, and being financed mostly by government, induces to inherently consider it as a non-market producer. This can be confirmed by the last sentence of ESA 20.30 that indeed directs that payments received from government not granted to other producers undertaking the same activity are to be excluded from sales. On this basis, the 50% test carried out after excluding these government payments results in a ratio production to sales below 50%.

### 3. EUROSTAT'S VIEW

On the basis of the above analysis, Eurostat is of the opinion that the classification of *Rīgas Satiksme* inside the general government sector is appropriate. *Rīgas Satiksme* does not seem to be working under market circumstances and with a sufficient market behaviour. Thus, Eurostat supports the Latvian authorities' sector classification proposal of *Rīgas Satiksme* in S.13.

A monopolistic public corporation running infrastructure/public service and receiving a majority of financing, directly or indirectly, from Government, not competing in the market and not selling at economically significant prices, should be classified inside Government. ESA 20.27 and 20.28 point to this when referring that a public producer whose output is sold primarily to Government and is the only supplier of its services, is only presumed to be a market producer if its sales to non-government units are more than half of its total output or its sales to government fulfil the tendering condition of ESA 20.25. In addition, ESA 20.30 requires, for the purpose of the 50% test, excluding from sales the payments made by Government if not granted also to other producers undertaking the same activity.

Furthermore, the fact that real estate/investment decisions, lending and borrowing agreements and the opening of lines need to be approved by the municipality and the fact that *Rīgas Satiksme* cannot operate in other cities, may also question the autonomy of decision. Consequently, *Rīgas Satiksme* could even be analysed as a borderline case in relation to autonomy of decision and could be considered either as an artificial subsidiary or an ancillary unit (meaning, not being an institutional unit), also implying a classification inside government.

#### PROCEDURE

This view of Eurostat is based on the information provided by the Latvian authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on its website.

Yours sincerely,

(e-Signed)

Luca Ascoli  
Director