Public Report for 2012

THE TREASURY
OF THE REPUBLIC OF LATVIA

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OF THE REPUBLIC OF LATVIA

Contents

Translation by SIA Skrivanek Baltic

Abbreviations used in the Report

CSA	Credit Support Annex
EIB	European Investment Bank
EAGGF	European Agricultural Guidance and Guarantee Fund
CEB	Council of Europe Development Bank
ERDF	European Regional Development Fund
EBRD	European Bank for Reconstruction and Development
EU	European Union
ESF	European Social Fund
EUROSTAT	Statistical Office of the European Union
GDP	Gross domestic product
ISDA	International Swaps and Derivatives Association
IMF	International Monetary Fund
FIFG	Financial Instrument for Fisheries Guidance

Units of Measurement

EUR	Euro, official currency unit of the EU
LVL	Lats, national currency unit of the Republic of Latvia

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The Treasurer's Statement

The Treasury's strategic course and priorities defined for 2012 were closely tied to the growth of the national economy, as well as the positive government budget performance and the consolidation of Latvia's position in the international financial markets. The main tasks of the Treasury in 2012 included ensuring the financial management and sustainability of the central government budget, improvement of the central government budget implementation process, optimisation of the cost of management of central government debt, development of the government securities market and strengthening of investor confidence.

It should first be stressed that the government policy to address the crisis provided a positive impetus for boosting investor confidence regarding the creditworthiness of the country: the resumption of borrowing in international financial markets provided a stable foundation and an assurance that the international loan programme could be refinanced successfully. Active efforts directed at government securities investors and ratings agencies resulted in Latvia's credit rating being raised by Standard & Poor's and Fitch Ratings, which facilitated a more rapid drop in the cost of debt for Latvia. As a result of these successive steps, USD 1 billion worth of five-year bonds were released in February and, in December, seven-year bonds worth USD 1.25 billion – and it should be added that the December issue took place at an especially advantageous juncture where the securities interest rates were at an all-time low for Latvian borrowing in international financial markets. On the one hand, this enabled the strengthening of Latvia's position as a borrower, but on the other the government was also able to refinance its external debt by repaying the loan received from the International Monetary Fund as part of the international loan programme. This carries an additional symbolic significance, as until then, the country's commitments to the International Monetary Fund could be associated with Latvia's incapability to manage its own finances and a lack of confidence by the international financial market in the country's creditworthiness.

In the medium-term, we intend to borrow more actively in the domestic market, while developing it and offering various maturities for government domestic debt securities. In accordance with the Latvian Central Government Debt Management Strategy, approved by the Minister of Finance, a preferred share of domestic government debt in the overall debt has been specified, and we are currently falling behind this mark. The strategic goal is, accordingly, to borrow as much as possible domestically and as little as possible externally. To this end, the Treasury worked intensively towards implementing the government-supported project of introducing savings bonds to the government debt management, providing the Latvian public with an opportunity to purchase government-issued savings bonds. The completion of the project and the sale of the first bonds are scheduled for the first half of 2013.

In a continued effort to improve the electronic services of the Treasury, we have introduced an online information exchange solution between the Treasury as the holder of such information and the body administering government budget payments as its user. In turn, we have now provided payers with the possibility of verifying whether a payment has been deposited into the government budget. The main priority of the Treasury for 2013 is to achieve the readiness of the Treasury's information systems for operations with the euro in 2014 so as to ensure that the measures to introduce the euro are completed in the areas of remit of the Treasury.

With the period of the Operational Strategy of the Treasury for 2010-2012 coming to a close, we have evaluated the results of its implementation and the degree of attainment of the strategic objectives and tasks and, in view of the regulatory framework and the factors affecting the operations of the Treasury, produced a Treasury Operational Strategy for 2013-2015

A staff that has a full grasp of the Treasury's strategic priorities and professional, focused and cohesive teamwork is an asset developed over the years, without which we would be unable to attain our goals or perform our everyday tasks to a high standard.

Treasurer

Kaspars Āboliņš
Riga, 27 March 2013

The Operational Strategy of the Treasury for 2010-2012

The **ultimate strategic objective of the Treasury** is to be an institution that is dynamic, modern and geared towards perfecting the quality of the services it provides and one that efficiently and securely administers and monitors the processes of public financial management in accordance with the best financial management practices to serve the interests of the State and its residents.

The Operational Strategy of the Treasury for 2010-2012 defines the following **operational directions** for the Treasury:

1) **implementation of the central government budget** that is orientated towards ensuring an effective and economical central government budget implementation process and improving the services provided by the Treasury in accordance with the best practices of financial management;

2) **central government debt management** through securing the necessary financial resources, including those on public capital markets, at the lowest possible cost, to limit financial risks and, to the furthest extent possible, promote the financial interests of the State in the process of issuing state guarantees, with consideration given to factors of state macroeconomic stability and the development of the capital market and financial system, which is aimed at the introduction of the euro currency in the medium term;

3) **cash and state loan management** by implementing effective and safe cash management, limiting and monitoring financial risks, ensuring the necessary liquidity promptly and in the full amount to meet the government's financial commitments, as well as issuing and servicing state loans effectively, taking into account the need to achieve national macroeconomic stability and development targets in the medium term;

4) **performance of the functions of the Paying and Certifying Authority of the EU policy instruments** by organising and standardising the execution of the functions of the Paying and Certifying Authority in a way that ensures that the requirements included in the Latvian legislation are met by the granting authorities and funds are received promptly from the granting authorities, and also minimises the permissible risk for the inclusion of non-compliant expenditure in statements of expenditure and reports.

In pursuing its strategic objectives, the Treasury observes **unified institutional operating principles**:

1) in quality and risk management;
2) in personnel management;
3) in the internal control system;
4) in the application of information technology and information security;
5) in ensuring the lawfulness and legality of procedures;
6) in institutional administration;
7) in institutional communication.

The **principal priorities** of the Strategy are as follows:

1) effective human resource management, whereby employee development and their involvement in the attainment of the Treasury's targets is encouraged at all levels;

2) ensuring high-level access to the services provided by the Treasury in accordance with the developments in information technology and by utilising the opportunities for resource optimisation they afford;

3) effective, economical, responsive and secure administration and monitoring of public financial management processes in accordance with the interests of the State and its residents.

The year 2012 concludes the effective cycle of the Operational Strategy of the Treasury for 2010-2012, which is why **this report provides an evaluation of the implementation of the Strategy**. In 2012, the Treasury produced a **new Operational Strategy of the Treasury for 2013-2015, which was approved by the Minister of Finance on 15 February 2013**.

Legal Status and Structure of the Treasury

The Treasury is a direct administration institution subordinated to the Ministry of Finance. Its operational objective is the effective implementation of public administration functions in the area of public finance management.

The operations of the Treasury are managed by the **Treasurer**. The Treasurer is appointed and dismissed from office by the Minister of Finance.

The Treasury has the following **functions**:

1) organising the implementation and financial accounting of the central government budget;
2) making expenditure allocations and effecting payments from central government budget revenue;
3) management of central government debt;
4) functions of the Paying and Certifying Authority for the EU policy instruments, the European Economic Area Financial Mechanism and the Norwegian Financial Mechanism, and the National Fund functions delegated by the National Authorising Officer;
5) other functions prescribed by laws and regulations.

The legal status, functions, tasks, competence, rights and procedure for ensuring legality are stipulated by Cabinet Regulation No 677 **"Regulation of the Treasury"**, issued on 3 August 2004 pursuant to the Public Administration Structure Law.

The structure and operational organisation of the Treasury is established by the **Rules of Procedure of the Treasury**, issued on 20 February 2012 in accordance with the State Administration Structure Law.

In order to limit the financial risks as far as possible, the **structure** of the Treasury has been created according to the principle of separation of functions (similar to banks and European debt management bodies).

1) client service and financial transactions;
2) financial risk management;
3) accounting and drafting of reports.

To ensure unified decision-making, the following **committees** remained active in 2012:

Audit Committee: to facilitate the effective implementation of the Treasury's internal control system and to improve the internal control system already in place, to ensure the achievement of the Treasury's strategic goals, protection of its resources and establishment and maintenance of effective control measures. The Committee reviews the findings and conclusions of internal and external auditors' reports on the Treasury's operations, the recommendations included in the reports towards operational improvements of the internal control system in place at the Treasury and the comments provided by the audited structural units with respect to the audit findings. The Committee is authorised to decide on the necessary measures for the improvement of the Treasury's internal control system.

Euro Changeover Committee: to develop proposals for the implementation of the euro in the areas of competence of the Treasury and to coordinate the participation of the Treasury's structural units in the measures to introduce the euro.

Committee for the Management of Information System Changes: to implement the coordinated review and execution of requests for changes to the Treasury's information systems.

Credit Committee: to facilitate credit risk management by coordinating the activities of the Treasury's structural units involving the monitoring of state loans, guarantees issued on behalf of the State and counterparty limits.

Quality and Risk Management Committee: to facilitate the constant improvement of the Treasury's operations and the compliance of its services with client needs by implementing effective quality, risk and information security management.

Resource Liquidity Committee: to promote sound cash management in compliance with the tasks defined in the Treasury's Cash Management Strategy for ensuring liquidity management.

Management Committee: to ensure the effective management of the Treasury's staff and financial resources in order to attain the objectives stated in the Operational Strategy of the Treasury.

Central Government Budget Accounting Committee: to arrange the implementation and updating of the Treasury's financial accounting policy of the central government budget and to manage changes to the accounting policy. The task of the Committee is to define the accounting policy and its compliance with accounting standards, to establish accounting policy objectives, to improve and update the accounting policy and to facilitate compliance with the requirements established thereby.

Central Government Debt Management Committee: to facilitate the effective management of central government debt and develop proposals for the improvement and implementation of the Latvian Central Government Debt Management Strategy.

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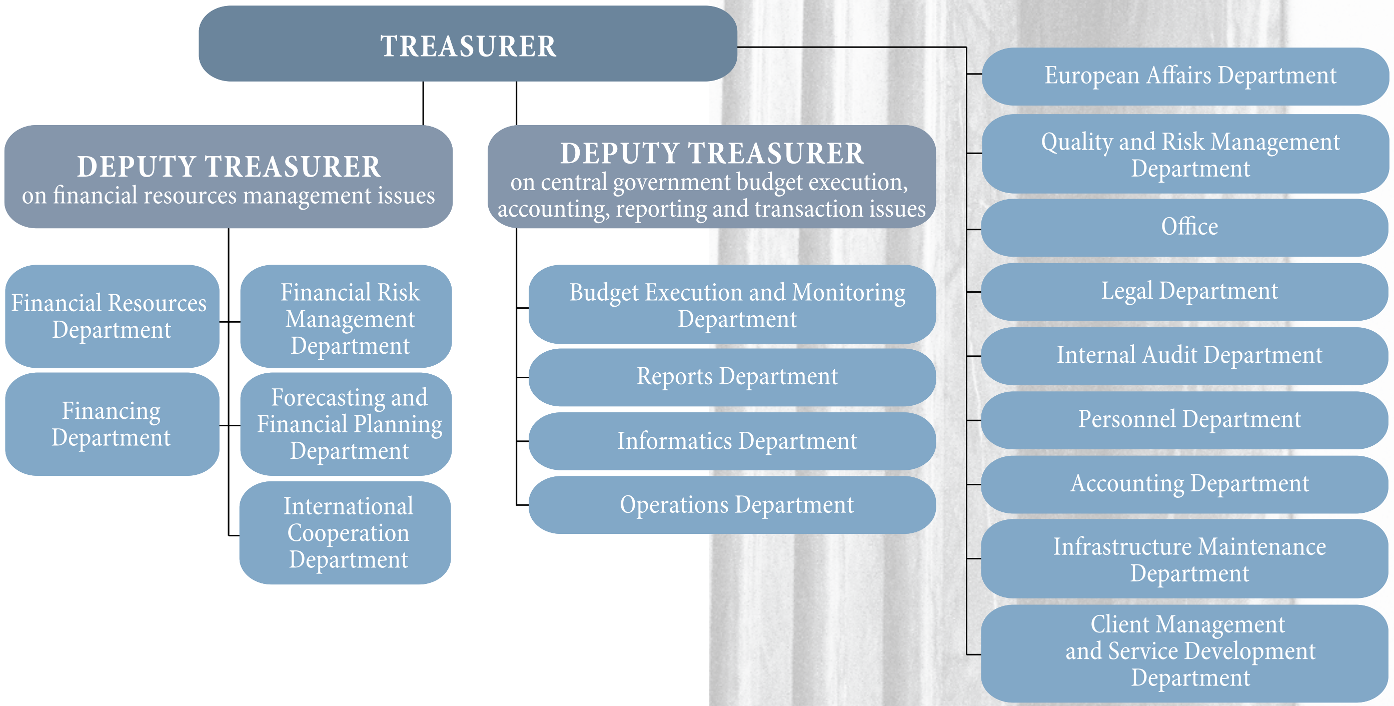
Organisational chart of the Treasury



1. Implementation of the Central Government Budget

1.1. Operational Principles and Areas of Development

In accordance with the Law on Budget and Financial Management, the Treasury, as a direct administration institution subordinate to the Ministry of Finance, has been tasked with organising the implementation and financial accounting of the central government budget and granting expenditure allocations and executing payments[1] within the limits of the appropriations specified in the annual central government budget.

In the implementation of the central government budget, the Treasury maintains a Comprehensive Central Government Budget Planning and Implementation Information System, in which budget accounts for budget implementers are opened; government budget revenues are recorded on the basis of the appropriations in the annual central government budget and financing plans registered with the Treasury; expenditure allocations and grants are issued from the general revenue using eKase, the electronic budget payments system; ensures the processing and execution of payment orders from the Treasury clients; and provides information concerning the taxes and fees paid into the central government budget accounts to the bodies administering government budget payments.

In its efforts to ensure the uniform accounting of public finances, the Treasury drafts legislation concerning accounting at central and local government budget institutions, which involves setting universal accounting principles, methods and a common chart of accounts, as well as a reporting system that is based on financial information classifications approved by the Cabinet of Ministers, which would yield high-quality information regarding the implementation of the central government budget based on both the cash flow accounting principle and accruals principle. The reports submitted by central and local government budget institutions are aggregated in ePārskati ["eReports"], a single budget report system that is used by the Treasury as well as the Ministry of Finance, the State Audit Office, the Bank of Latvia, the Central Statistical Bureau and other public administration authorities.

The Treasury has to make timely and complete annual membership contributions on behalf of the Republic of Latvia to international financial organisations and payments into the capital and/or reserves of the international financial institutions where the Republic of Latvia is a holder of capital shares, thus ensuring that the commitments the country has assumed are honoured.

The Treasury follows statutory procedures in making compensation payments to rehabilitated citizens, allocating personal income tax between central and local government budgets, distributing compulsory state social insurance contributions among special budget accounts, and transferring the relevant central government budget grants to local governments.

1.2. Organisation of the Implementation of the Central Government Budget in 2012

Granting and Implementation of Expenditure Allocations

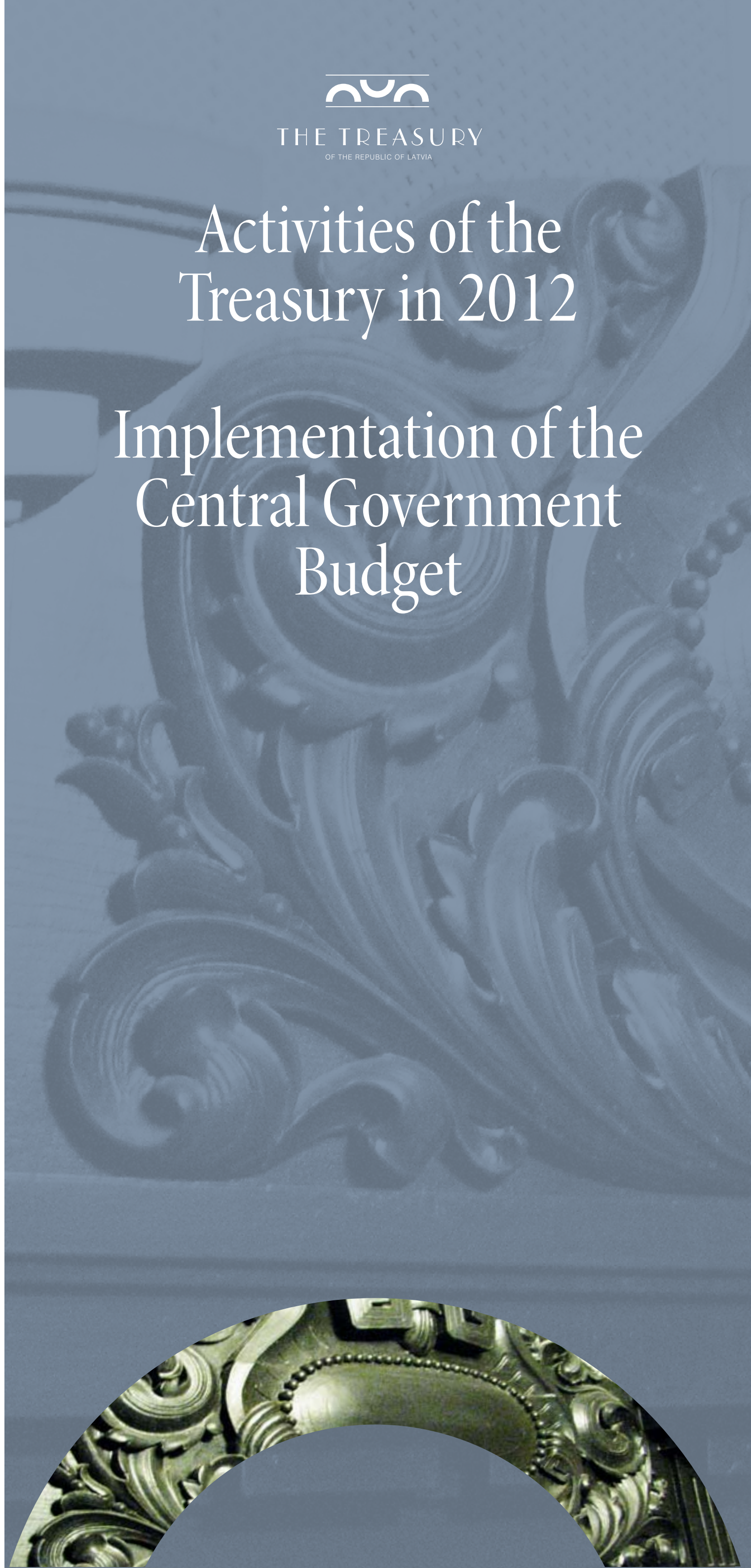
In 2012, the Treasury **allocated expenditures worth LVL 5,109.29 m** towards the implementation of the central government budget, which included **LVL 3,700.38 m** for the general budget and **LVL 1,486.05 m** for the special budget. Allocations were granted to **340 state budget institutions**, including 119 election commissions.

There were 2,031 general budget expenditure accounts in 2012, including 119 accounts for election commissions to ensure the referendum on the draft Law on Amendments to the Constitution of the Republic of Latvia. Compared with 2011, the total number of accounts has decreased by 73. The decrease in the number of accounts was affected by the continuing structural reforms in public administration: the number of budget institutions continued to decline, and so did the number of open expenditure accounts accordingly. Due to the intensive implementation of projects co-financed with EU policy instruments and other foreign aid, the number of operations accounts rose by 1,045 compared to 2011 and reached 7,740. With the decline in the overall volume of gifts and donations, the number of accounts opened by budget institutions to record donated funds dropped and there were 160 such accounts in 2012.

Accounting and Reporting

Pursuant to the regulatory enactments, the Treasury **prepares official daily, monthly and quarterly reports and the Annual Report on the Central Government and Local Government Budget Implementation** (the monthly reports are available on the Treasury's website, the Annual Report on the Central Government and Local Government Budget Implementation is published on the Treasury's website once the opinion of the State Audit Office is received).

[1] *In accordance with Cabinet Regulation "Procedures According to Which the Treasury Provides Payment Services".*



The Treasury **prepares the Annual Report on Central Government and Local Government Budget Implementation by consolidating the information from the annual reports submitted by the ministries, central government institutions and local governments**. The structure and scope of the annual report is prescribed by the Law on Budget and Financial Management and the Cabinet Regulation regarding the procedures for preparing an Annual Report. In 2012 the Annual Report on the performance in 2011 was prepared by **consolidating the consolidated annual reports submitted by 13 ministries, 14 central government institutions and 119 local governments. Ministries and central government institutions include the annual reports of State budget institutions, derived public persons partially financed from the central government budget and institutions not financed from the central government budget in the consolidated central government annual report, while the annual reports of local government budget institutions and joint institutions[2] are included in the local government consolidated annual report**.

The Annual Report audited by the State Audit Office is the most significant and credible source of information on the financial situation of the State at the end of the reporting period and with respect to the results of the implementation of the central government budget in the reporting year. The opinion of the State Audit Office serves as confirmation that the report provides a clear and accurate representation of the completeness and credibility of the information disclosed in the reports. The opinion also corroborates the quality of the information included in the Annual Report and used by the Saeima (the Parliament), the Bank of Latvia, various international institutions (European Commission, EUROSTAT, IMF, international rating agencies) and potential investors who decide on potential investment in the economy of Latvia based on the information in the Annual Report.

In order to include uniform and comparable information in the Annual Report, the Treasury develops and updates the regulatory enactments governing the accounting and reporting of budget institutions.

In ensuring compliance with uniform principles in the financial accounting and reporting of central and local government budget institutions, arrangements for the improvement of budget institution accounting have been carried out, including the development of supplements to the existing regulatory enactments and the provision of detailed explanations to those who compile the reports.

The 2012 amendments to the Cabinet Regulation **specifying the accounting procedures of budget institutions** clarify the regulatory requirements, reducing the room for interpretation in the application of the regulations, the accounting of long-term investments and assessment of depreciation, the accounting of contractual penalties, the classification of liabilities, the accounting of assets received and transferred without compensation, and prescribes the accounting of subsidies, grants and transfers in accordance with the principle of accrual.

In turn, the 2012 amendments to the Cabinet Regulation **on the preparation of annual reports of budget institutions** supplement the requirements for information disclosure on leased assets, the allocation of immovable property tax claims according to due date, clarify the descriptions for the preparation of reports to ensure a better understanding of the drafting provisions, clarifies the provision regarding the electronic submission of reports and the mutual verification of data in accordance with budget classifications. It also excludes the section "Use of Information System 'State Budget and Local Government Budget Reports'" by including it in the Cabinet Regulation "Procedures by Which the Treasury Ensures the Electronic Exchange of Information".

For the purpose of monitoring fiscal discipline by the Fiscal Discipline Supervision Committee, and at the request of the international lenders (the European Commission and IMF) and the most significant users (EUROSTAT, the European Central Bank, international financial institutions, as well as the Saeima, the State Audit Office, the Ministry of Finance, the Bank of Latvia, the Central Statistical Bureau), the Treasury prepared and submitted **additional information on the progress of the implementation of the central government budget and the main financial indicators by summarising the information from the financial statements of the central government and local governments and affiliated and associated companies that was of significance in the drafting of the European Commission and IMF monitoring reports following the conclusion of the international loan programme. An analysis of the risks that are present in the process of the financial management of the budget was performed as well**, whereupon corresponding decisions were adopted on limiting or eliminating them in 2012 and in the medium term.

1.3. Development of the Services and Information Systems of the Treasury

One of the operational priorities set out in the Operational Strategy of the Treasury stipulates that the services provided by the Treasury

[2] *In order to address common tasks, local governments can form joint bodies upon mutual agreement. Such institutions operate on the basis of bylaws approved by the respective local councils. The bylaws prescribe the competence of a joint local government institution, the procedures of financing, monitoring and liquidation thereof, and the procedures by which withdrawal from the institution takes place, as well as other matters pertaining to the operation of the joint local government institution (e.g., construction board, regional municipal police, etc.).*

Implementation of the Central Government Budget

must be available at a high level and in line with the latest developments in information technology, taking advantage of the resource optimisation capabilities this affords. As Latvia prepares for the transition to the euro as its national currency from 1 January 2014, at the end of 2012 the Treasury already began to implement measures to adapt the information systems under its management to the euro.

In 2012 the Treasury maintained and continued the development of the following services and information systems:

Comprehensive Central Government Budget Planning and Implementation Information System

The **Comprehensive Central Government Budget Planning and Implementation Information System** that is maintained by the Treasury ensures the full government budget management cycle: from budget planning to implementation and implementation monitoring:

1) the **central government budget planning functionality** ensures the processing of the central government budget and amendments thereto by gathering data from the ministries and central government budget institutions (this function is performed by the Ministry of Finance);

2) the **central government budget implementation functionality** ensures the processes of the Treasury and central government budget institutions in the system, e.g., the creation of accounts, granting and execution of expenditure allocations, the central government budget revenue process, the process of daily, monthly and annual closing, as well as the local government financial equalisation fund and personal income tax allocation process (this function is implemented by the Treasury).

The **Data Warehouse of the Comprehensive Central Government Budget Planning and Implementation Information System** generates reports on the implementation of the central government budget in accordance with the central government budget structure.

ePārskati, the Budget Reporting Information System of the Ministries, Central Government Institutions and Local Governments

The submitters of the reports of budget institutions file their quarterly and annual reports with the Treasury and sign them digitally using the online Budget Reporting Information System of the Ministries, Central Government Institutions and Local Governments (ePārskati), thus ensuring economies of administrative resources and time on both ends.

In 2012, an expanded capability for the acceptance of reports using the ePārskati system has been established for those institutions that are responsible for accepting reports by law. At this time, this is being successfully done by the Ministries of Culture, Finance and Education and Science.

In 2011, the Treasury supplemented the range of services offered to local governments and in cooperation with them developed a new service: **the possibility for local governments to plan the budget in the ePārskati system**. In 2012, this service was used by 10 local governments, of which four were first-time users.

In 2012, the **integration of the Comprehensive Central Government Budget Planning and Implementation Information System and ePārskati** was commenced so as to ensure that the reconciliation of the data regarding the budget programmes and sub-programmes of the ministries, central government institutions and their subordinate bodies could be carried out in ePārskati, which would further allow for the control of the mutual correspondence of data to be expanded by adding the information provided in the annual report.

As part of the annual stock-taking process, the **capabilities of the reconciliation process have been expanded and the functionality of mutual data reconciliation between general government sector partners has been improved** within ePārskati: mutual data reconciliation may be undertaken before and after the end of the reporting period, the data can be moved from one data reconciliation period to another, and the importing of reconciliation reference data from accounting software and document uploading is possible on the debit side. In order to give a more precise explanation of the data provided in the reconciliation reference, reconciliation has been enabled with respect to revenue decrease and restoration of expenditure, as well as the forwarding of data between subordinate institutions.

ePlāni, the Financing Plan Processing Information System

The financing plan processing information system is used by users at all ministries and central government institutions in order to prepare and submit the approved financing plans to the Treasury.

In 2012, **8,801 general budget and special budget financing plans were registered and processed in the system**.

In late 2012, ePlāni was significantly modified in order to adapt the system to a web-based platform that would ensure and support a faster and higher-quality process of financing plan processing.

eKase, Budget Electronic Payment System

The Treasury renders payment services electronically, using the budget electronic payment system eKase. **Through *eKase* the Treasury enables its clients to execute payment orders, view the results of the execution of payment orders and to receive financial information offered by the Treasury: account status (balance), account turnover statements and a summary of revenues and expenditures or resources to cover expenditures.**

In 2012 the Treasury launched a public electronic service made available under the ERDF-financed project, "Improvement of the Treasury Online Data Exchange System": a verification form of payment data on the Treasury's website, as well as an improved budget electronic payments system, eKase, thus **making a significant contribution towards the development and improvement of electronic services in public administration**. The following e-service enhancement measures were undertaken within the project:

1) an **online data exchange module was introduced in eKase** ensuring automated information exchange between the Treasury as the holder of the information and the body administering government budget payments as the user of the information. The online data exchange module enables requests for payment data, as well as the online loading of payment orders into eKase;

2) a **user interface has been introduced in eKase that allows** the employee of an institution administering government budget payments to request payment data from the Treasury, which includes payment search, and to receive the requested data online using a browser;

3) In the section "Verification of a Payment Made to the Budget" on the Treasury website, a **payment data verification form** has been created where a user, upon entering the payment reference number, can ascertain that a payment made by him or her has been deposited in the government budget (recorded as an entry in a government budget account with the Treasury) and that the user is entitled to receive the requested service.

Credit Cards Tied to Government Accounts

In collaboration with AS Swedbank, the Treasury **provides government budget institutions with the opportunity to use credit cards tied to Treasury accounts for budget expenditures**. Such credit card services are intended to cover **official travel, business travel and expenses** of employees: employees of central government budget institutions are able to make non-cash payments during their business trips while complying with the provision of the Law on Budget and Finance Management which requires that central government budget expenditures are to be charged to accounts opened with the Treasury.

In 2012 the service of credit cards tied to Treasury accounts **was used by 113 state budget institutions, and a total of 958 credit cards were issued to them**.

Acceptance of Payment Cards in the Collection of Government Budget Payments

Because the agreements on the provision of payment card acceptance services entered into in 2008 with AS SEB banka and AS Citadele banka expired on 31 December 2012, in 2012 the Treasury held two procurement tenders for this service. AS SEB banka and AS Citadele banka will continue to provide the payment card acceptance service for the next five years.

The payment card acceptance service **enables those clients of the Treasury that are institutions administering budget payments and collecting budget payments from private individuals to collect such payments using VISA Electron, MasterCard, Maestro or American Express payment cards in a card terminal or in another, alternative system**.

In 2012, **538 payment card terminals were installed** at institutions administering budget payments. In 2012, **500,443 transactions for the total amount of LVL 17,477,242 were performed** with payment cards at institutions administering budget payments. Compared with the data for 2009-2011, it is evident that **a rapid increase in the number of transactions and the amounts collected** continued in 2012, which indicates that the residents approve of the service and are increasingly using payment cards in their payments to the state and enjoy the advantages they afford.

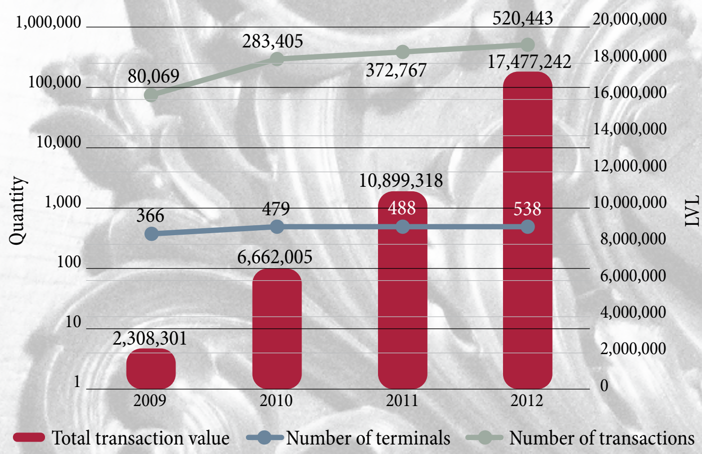


Figure 1.
Dynamics of the service of acceptance of payment cards (VISA, MasterCard and American Express), 2009 to 2012
Source: The Treasury

Centralised Financial Accounting Solution

The Treasury continues to maintain a centralised resource management system, Horizon, **enabling the financial management, accounting and personnel accounting of the Ministry of Finance and the institutions under its supervision (departments of the Ministry of Finance) in a single system**.

To ensure the uniform and effective implementation of the accounting process at the Ministry of Finance and its subordinate institutions, the Treasury continues to maintain the accounting and personnel management processes of the Lotteries and Gambling Supervision Inspectorate. For the purpose of optimising the accounting process within the departments of the Ministry of Finance, the Treasury has maintained the complete accounting records of the Procurement Monitoring Bureau since 2012.

Development of Services for Local Governments

In 2012 a **regulatory framework was established to enable local governments and their capital companies to use all the payment services provided by the Treasury, which, in turn, allows local governments to realise the full budget implementation at the Treasury**: a new Cabinet Regulation, "Procedures According to Which the Treasury Provides Payment Services" has been issued governing all the types of payment services provided and ensured by the Treasury (use of a payment account, conducting of credit transfers, deposits and payouts of cash, payment card payment services, payment card acceptance services) and the procedures for receiving (using) such services, and specifies the entities (including local governments and capital companies in which the central government or a local government holds a stake) to which the Treasury provides certain payment services.

1.4. Performance Indicators of the Operational Targets for Central Government Budget Implementation as Defined in the Operational Strategy of the Treasury

Table 1
Performance indicators of the operational targets for central government budget implementation

			Indicators (numeric values)		
Item No	Operational target	Performance indicators	Last known precise in 2012	Projected for 2012	Implementation measurement (2011)
1.	Optimised results of the central government budget implementation process	1. Proportion of the payments processed through eKase n the total number of payments, %.	99	99	100
		2. Number of institutions using the Treasury online data exchange system, % of the total number of institutions.	2	99	0,8[3]
		3. Decrease in the number of incoming payments that do not conform to the economic classification and the purpose of payment in the central government budget accounts (except tax payments), % of the total number of payments.	-[4]	50	20

[3] The online data exchange module of the government budget electronic payment system, eKase, was commissioned in May 2012, and it was used by 30 clients of the Treasury in 2012.

[4] Since a unified service classifier and a unified supporting document identifier solution were in the process of development and implementation, the target established for 2011 was not achieved..

1.5. Assessment of the Application of the Operational Strategy of the Treasury for 2010-2012 in the Implementation of the Central Government Budget

The strategic objective of the central government budget implementation – ***"Implementation and management of the consolidated budget that is oriented towards ensuring an effective and economical budget implementation process and improving the services provided by the Treasury in accordance with the best practices of financial management"*** – has been achieved to the extent prescribed for 2010-2012 (tasks/performance targets defined).

The attainment of the strategic tasks was facilitated by:

1) restructuring of public administration;
2) fiscal policy, implementation of the state administrative-territorial reform and restructuring of local governments;
3) government support for the introduction of e-government
4) volume of financing available to the Treasury for the development of its electronic services;
5) knowledge, skills and accumulated expertise of the Treasury staff;
6) risk management implemented by the Treasury, the functionality, stability, integrity and security of the information systems and the quality management system in place at the Treasury.

The full achievement of some targets was impeded by:

1) failure of other institutions to implement policy initiatives: e.g., a decrease in the number of incoming payments not in conformity with the economic classification and the stated purpose in the government budget accounts could not be attained because no uniform practice exists for the execution of payments and supporting documents for payments payable to the government budget – i.e., the data to be provided in the purpose of the payment are not standardised, which results in a low standard of quality of payment data;

2) the planned number of users of the Treasury's online data exchange systems could not be reached because a decision was taken during the development of the system not to create a separate system but rather to integrate it into the budget electronic payment system, eKase, as a functional module. Accordingly, the performance indicator only includes the number of those institutions that used the online data exchange module (the server-to-server interface) rather than the system user interface (user-to-server).

Fulfilment of the strategic targets set for the implementation of the central government budget in 2010-2012:

1) the wishes of the clients of the Treasury have been identified and the services provided have been updated accordingly; satisfaction with the service received is not less than 75% of the clients surveyed:

- in order to identify client satisfaction with the services provided, in 2011 the Treasury conducted a major survey across the whole of Latvia: by way of telephone interviews, the opinions of 512 Treasury clients regarding the quality of the services provided were obtained. The results of the polling reveal that 97% of the clients surveyed are satisfied with the fact that the Treasury is introducing e-services more extensively. Of those polled, 79% acknowledged that access to the services throughout Latvia is very important, as it provides significant savings of time, administrative resources and other resources of the institutions. The ESF project "Improvement and Development of the Quality of Treasury Services", which was implemented by the Treasury in 2010-2012, has been included in the information material by the Society Integration Foundation as an example of a successfully implemented ESF project in Latvia, as it provides assurance that the accomplishments and the results achieved were used towards the improvement of public services and the enhancement of their quality;
- On 2 December 2011, the Treasury received the Annual Efficient Management Award granted by the Employers' Confederation of Latvia and the State Chancellery for the implementation of good governance principles at a state administration institution by way of enacting a client-orientated approach, improving financial indicators, reducing the administrative burden, optimising the resources of the Treasury and its clients. The Treasury was presented as a model for other public institutions with respect to simplifying their operations and making it more responsive, comprehensible and more accessible to the public.

2) an affirmative assessment has been received from external auditors and partners regarding the functionality and reliability, fast and responsive accounting, timely and sufficient control, and the quality of report data in the budget implementation process:

- no material deficiencies were detected during the audits performed by the State Audit Office at the Treasury;
- the European Commission has acknowledged that the legislative basis governing accounting and reporting in Latvia conforms to the International Public Sector Accounting Standards by 67%;

- the monitoring and re-certification audits of the quality management system of the Treasury have confirmed that the operations of the Treasury take place in compliance with the requirements of the standard, the quality management system is maintained efficiently and is aimed towards development, and the Treasury actively implements its strategic objectives;

3) **the range of services to be provided to local governments and their institutions has been approved; 10% of Latvian local governments realise the full implementation of their budget at the Treasury in the medium term:**

- the payment services provided by the Treasury to Treasury clients – including local governments – have been approved by a Cabinet Regulation[5];
- seventeen out of 119 local governments, or 14.3%, have applied to use the ePārskati planning tool; the tool is used by 10 local governments (i.e., 8.4%);

4) **expand the electronic circulation of information with clients, achieving a 100% rate in the electronic exchange of routine information with clients:** during the implementation of the strategy, the development of the Treasury's electronic services and information systems aimed at online information exchange continued, taking advantage of the resource optimisation capabilities afforded by technology and achieving the strategic objective of 100% electronic exchange of routine information with clients:

- eKase, the budget electronic payment system, has evolved as the hub of the Treasury's e-services (possibilities to execute payment orders, view the results of the execution of payment orders and to receive financial information offered by the Treasury: account status (balance), account turnover statements and a summary of revenues or resources to cover expenditures and of expenditures), an online data exchange module has been introduced, payers have the ability to verify payments made to the budget, and the full traceability of transactions has been ensured;
- the financing plan processing information system, ePlāni, enables budget institutions to create draft financing plans and file them with the Treasury. On the basis of the submitted financing plans, the Treasury issues expenditure allocations and a grant from the general revenue in accordance with the appropriations prescribed by the State Budget Law for the respective year, and opens budget expenditure accounts for budget institutions;
- ePārskati, the information system for central government and local government budget reporting, enables the management of financial and budget implementation reports and information exchange with the Treasury by central and local government budget institutions, institutions not financed from the budget, ports, free ports and capital companies and other institutions for which the use of reports has been prescribed by law. ePārskati ensures the full budget management cycle: from budget planning to implementation and implementation monitoring;
- with the Cabinet Regulation "Procedures by Which the Treasury Ensures the Electronic Exchange of Information" taking effect, the administrative burden on the client has been reduced as all future applications for and the use of the e-service systems provided by the Treasury are covered by a single Cabinet Regulation, there are uniform application forms for the requesting/cancellation of services, e-service applications are processed in less time (the processing period has been reduced from five to three working days), and the authorisations of the users of the e-services are valid for longer (the term of validity has been extended from one year to three years);

5) **uniform principles for the implementation and accounting of the budget cash flow have been developed and approved:**

- in its efforts to ensure the uniform accounting of public finances, the Treasury drafts legislation concerning accounting at central and local government budget institutions, which involves setting universal accounting principles, methods and a common chart of accounts, as well as a reporting system that is based on financial information classifications approved by the Cabinet of Ministers, which would yield high-quality information regarding the implementation of the central government budget based on both the cash flow accounting principle and accruals principle.
- in accordance with the instructions given by the Cabinet to the Ministry of Finance, for the purpose of the continued improvement of the quality of accounting data and a more successful centralisation process, it is planned that accounting standards for the public sector of Latvia will be produced by 2015 so as to ensure more detailed and comprehensive guidance regarding the application of the best accounting practices;

[5] *Cabinet Regulation "Procedures According to Which the Treasury Provides Payment Services".*

6) the accounting service is provided to 50% of all central government budget institutions:

- an information report has been drafted for the Cabinet, summarising the assessment by the ministries and central government institutions of the prospect of centralising the function of accounting support in accordance with the principle of a single data centre. As the response from the institutions was negligible, no partner has been identified;
- the Treasury maintains a centralised financial accounting service within the departments of the Ministry of Finance, which includes maintaining the accounting and personnel management processes of the Lotteries and Gambling Supervision Inspectorate and accounting records for the Procurement Monitoring Bureau.

The factors driving the attainment of the strategic tasks allow the Treasury to identify the subsequent measures for developing and improving its services, including striving for a 80% client satisfaction rate with respect to the quality of the services provided by the Treasury in the medium term.

With the period of the Treasury Operational Strategy for 2010-2012 coming to a close and having evaluated the results of its implementation and the degree of attainment of the strategic objectives and tasks and, in view of the regulatory framework and the factors affecting the operations of the Treasury, the Treasury has defined a new set of tasks towards the attainment of the strategic objective of the central government budget implementation for the next strategic planning period:

1) apply uniform classifications meeting the requirements of the international financial institutions in the planning and implementation of the consolidated budget and organise an efficient, timely and high-quality process of central government budget implementation;

2) ensure the compliance of financial statements with the fundamental principles of the international accounting standards and the international public sector accounting standards, and execute the government statistical information programme at a high standard of quality;

3) increase remote access to Treasury services, thus reducing the administrative burden of receiving services and the costs related to the administration of services;

4) provide the service of delivery of management accounting information to other budget institutions for the purpose of financial management decision-making;

5) ensure the possibility of the provision of the accounting service to other budget institutions;

6) ensure the adaptation of the Treasury's information systems for the introduction of the euro.

2. Central Government Debt Management

2.1. Operational Principles and Areas of Development

In accordance with the authorisation from the Minister of Finance, the Treasury performs the management of central government debt as well as organises the issuance and monitoring of state guarantees.

The main principles of central government debt management for the medium term are defined in the Latvian Central Government Debt Management Strategy, which is approved by the Minister of Finance. According to the Latvian Central Government Debt Management Strategy, the goal of the management of the central government debt portfolio is to optimise the servicing costs of central government debt in the long term while hedging the financial risks of the government debt portfolio. The management of central government borrowing focuses on ensuring the continuous option of raising resources in the financial markets on optimal terms.

To prevent the risk of government debt refinancing and optimise the cost of government debt management in the medium term as prescribed in the guidelines of the Latvian Central Government Debt Management Strategy, the Treasury implements a medium-term borrowing strategy in line with the following priorities:

1) to implement gradual and timely borrowing in the international financial markets, mainly by organising regular public issues of government debt securities, in order to ensure the refinancing of the government debt obligations undertaken as part of the international loan programme in accordance with the established repayment schedules, on terms that provide more favourable interest rates and repayment periods;

2) to ensure the diversification and expansion of the base of investors in government securities through a regular and constant dialogue and long-term efforts aimed at the investment community and cooperation partners in order to facilitate active participation of investors from different regions of the world in the primary placement of government external debt securities, as well as by ensuring an adequate yield rate to investors, thus limiting financial risks in the long term;

3) to ensure and maintain a group of cooperation partners that are constantly available for financial transactions;

4) in view of Latvia's progress towards joining the eurozone, boost the development of the domestic financial market and ensure adequate investment opportunities to the participants of the domestic financial market;

5) in order to have a favourable impact on the future credit ratings of Latvia, engage in active communication with rating agencies and ensure that a unified and concerted opinion on the situation in Latvia is being presented in the process of establishing ratings.

In accordance with the authorisation by the Ministry of Finance, the Treasury evaluates the projects of the applicants for state guarantees on the basis of proposals from ministries and prepares a list of applicants to be supported and their projects for inclusion in the annual State Budget Law. The Treasury participates in the process of issuing state guarantees by evaluating and monitoring the risks associated with providing such guarantees, by arranging the signature of guarantee agreements and by managing the accounting of the obligations under the guarantees provided in the name of the state, and conducts regular analysis and monitoring of the financial position of the implementers of state-guaranteed projects.

The priorities of the medium-term implementation of a state guarantee policy that conforms with the national interests are as follows:

1) to guarantee the quality of the state guarantee portfolio, which entails reviewing the pool of recipients of state-guaranteed loans and defining the objectives of state guarantees;

2) to implement a process of selection of applicants for state guarantees, granting of guarantees and servicing that is efficient and in line with the best market practices.

In order to implement a focused **investor relations management** and define appropriate measures to be taken, the Treasury regularly informs investors and partners by drawing up an annual Central Government Debt Management Report and quarterly bulletins, and by preparing a digest of relevant weekly developments, as well as engages in other communication measures.

Every year, the Treasury produces an analytical **Central Government Debt Management Report** in Latvian and English covering the preceding year, in order to provide clients and participants of the financial market – including the current and potential partners and investors in government securities – with information on the developments in government debt management, performance indicators and future trends.

The Central Government Debt Management Report is also forwarded to other bodies performing equivalent government debt management functions in the EU (debt management offices) and to the embassies of the Republic of Latvia abroad. Information presented in this form on the latest developments in the management of Latvian government debt has received positive reviews from partners (including banks).

Once every quarter, the Treasury posts a **Quarterly Bulletin on Central Government Debt Management** in Latvian and English on its website, in which it provides the latest data on government budget implementation and central government debt management and current information regarding the credit ratings of Latvia, domestic and external borrowing, management of the debt portfolio, trends and results of government security auctions and local government borrowing.

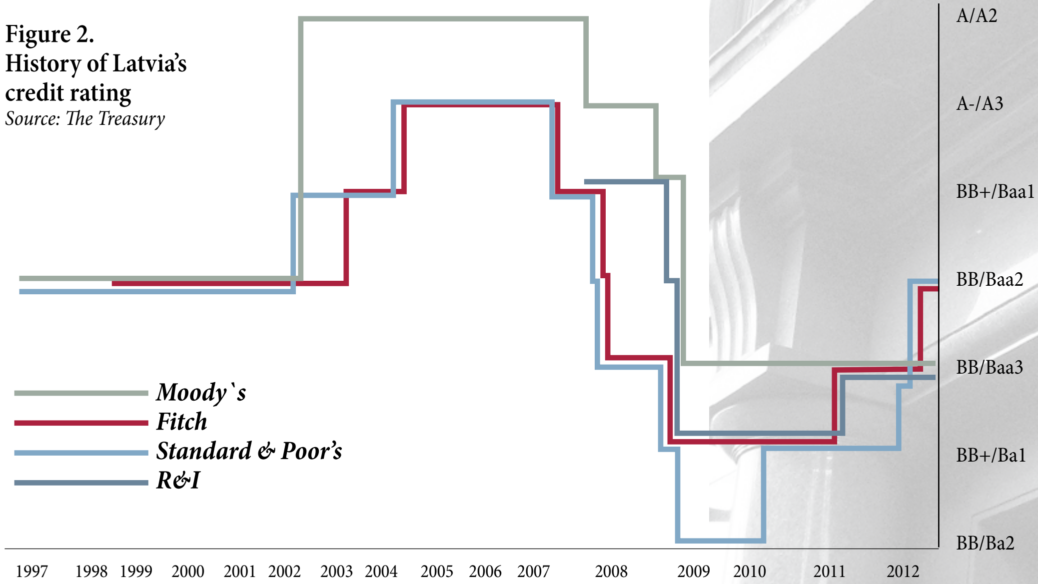
Every week, the Treasury compiles, forwards to investors and posts on its website a **Weekly News Update** in English covering government budget and debt management and news from the Latvian financial sector, economy and politics.

2.2. Credit Rating of the Republic of Latvia

As part of the central government debt management, **for the purpose of establishing the credit rating of the Republic of Latvia**, the Treasury arranges visits by analysts from the three major international rating agencies – **Fitch Ratings, Standard & Poor's** and **Moody's Investors Service** – and the Japanese **R & I** rating agency to Latvia and regularly provides them with information on Latvia. Based on the available information, investors assess the prospects of investing in Latvia (including government securities). Therefore, the credit rating is an essential factor in the availability of financial funds to the state, and it is reflected in the cost of borrowed resources. The rating agencies not only review the credit rating of the Republic of Latvia and its outlook every year, but also assign ratings to government securities. Once a year, an inter-agency working group led by the Treasury informs the Cabinet of Ministers on the national credit rating of Latvia and the factors affecting it, as well as proposals to improve ratings.

In the first half of 2012, R & I and Standard & Poor's raised Latvia's credit rating by one, from BB+ to BBB- with a stable outlook. Thus, after an interval of more than three years, all rating agencies reinstated an investment-grade credit rating for Latvia. In the second half of the year, Fitch Ratings and Standard & Poor's upgraded Latvia's credit rating by another notch, from BBB- to BBB and assigned a positive outlook. Thus, at the end of 2012, **the Latvian credit rating for long-term obligations in foreign currency is BBB- (Moody's Investors Service) with a positive outlook, BBB (Fitch Ratings and Standard & Poor's) with a positive outlook and BBB- (R & I) with a positive outlook. In raising the country's credit rating, the agencies have cited Latvia's rapid economic growth, the fiscal discipline regime established by the government through the reduction of the excessive budget deficit, the well-ordered finances of the country and the decrease in external government debt.**

Figure 2.
History of Latvia's credit rating
Source: The Treasury



2.3. Changes in Central Government Debt

To cover the total financing requirement for 2012 in the amount of LVL 1,076.6 m, including the refinancing of the domestic and external government debt obligations worth LVL 1,104.1 m, borrowing took place in the domestic and international financial market, and the remaining balance of the funding received during the operation of the international loan programme was used.

In 2012, government debt increased by LVL 311.6 m and reached a nominal value of LVL 5,527.8 m, or 36% of the GDP, which did not exceed the end-of-year debt ceiling of LVL 6,200 m prescribed by the annual State Budget Law (see Figure 3).

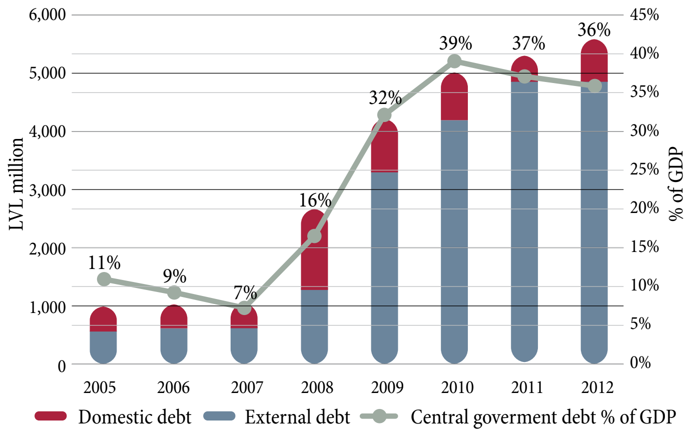


Figure 3.
Central government debt (in nominal value), 2006-2012 (LVL million/% of the GDP)
Source: The Treasury

2.4. Central Government Domestic Debt

The **central government domestic debt** according to nominal value as of 31 December 2012 stood at **LVL 680.6 m**, with debt in lats (domestic debt securities) representing the greatest share, LVL 675.1 m.

In 2012, **domestic debt shrank by LVL 37.3 m** in nominal value, and the percentage ratio of the types of government domestic debt securities in circulation within the domestic debt portfolio has changed. The changes were mainly due to the increased assortment of bonds available (see Figure 4).

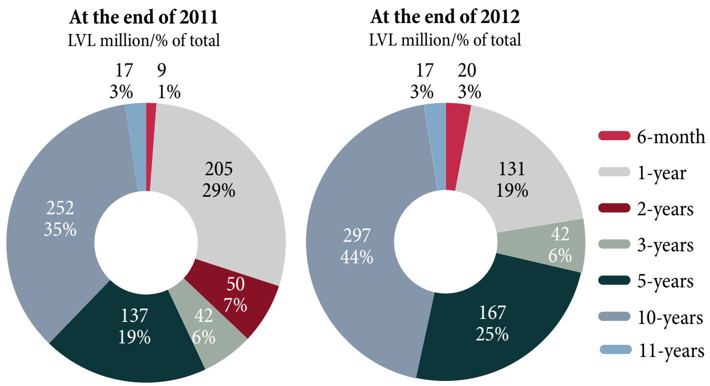


Figure 4.
Government domestic debt securities outstanding at the end of 2011 and 2012
Source: The Treasury

In 2012, the Treasury continued to hold regular government securities auctions. A wide variety of securities ranging from short-term to long-term government securities was offered to investors. The Treasury issued 6- and 12-month T-bills – mainly to ensure relatively low-cost liquidity resources and to maintain activity in the government domestic securities market, as well as to ensure a regular market update of the benchmark for short-term borrowing in lats. In turn, **to ensure investment opportunities in government securities for institutional investors, at the beginning of the year the Treasury offered a new 5-year bond programme and in April, initiated a new 10-year bond programme, which produced good results and demand in auctions.**

Implementation of the Central Government Budget

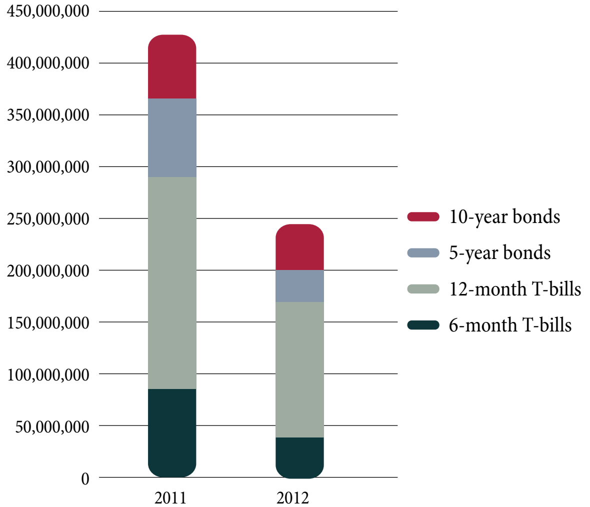


Figure 5.
Government security issues in 2011 and 2012 by maturity
Source: The Treasury

The Treasury sold securities worth LVL 242 m in the primary market. **The total demand for government securities was greater and amounted to LVL 875 m, exceeding supply 3.5 times over**. Demand for government securities was especially high during the auctions organised in March and May, which was due to the confidence of the market participants and positive market data.

In 2012 the Treasury offered 5- and 10- year bonds to investors. Demand for these generally exceeded the supply multiple times over, thus **enabling a gradual reduction of the average yield rates**. Continuing the issue of 10-year bonds proved of essence in meeting the demand by institutional investors.

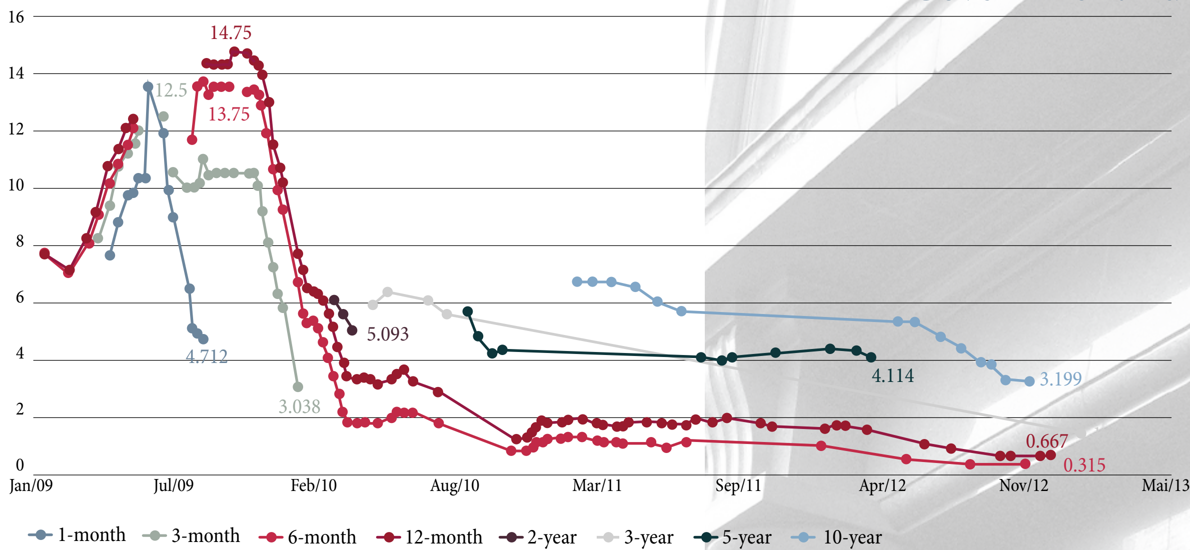
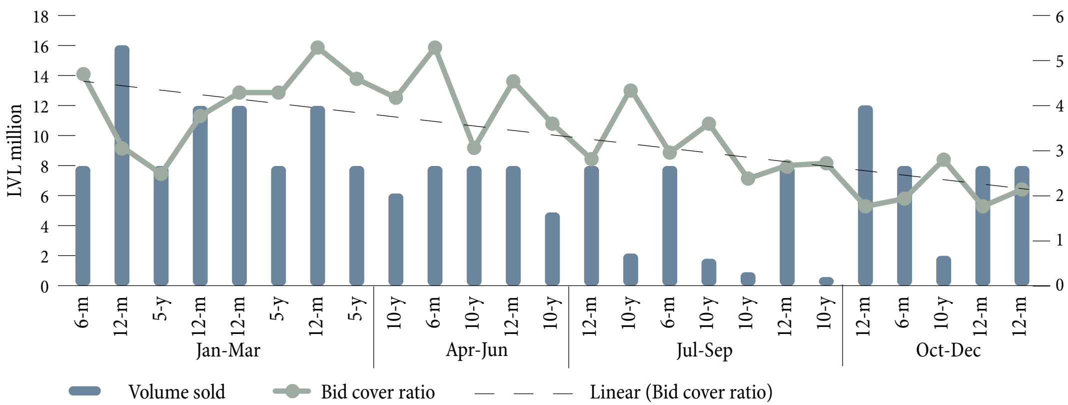


Figure 7.
Average weighted interest rates at the competitive auctions of government domestic securities
Source: The Treasury

Figure 6.
Activity of the primary market for government securities in competitive multi-price auction
Source: The Treasury



Successful issues of 10-year bonds in the primary market caused a decrease in interest rates for long-term government securities in the secondary market, which is used to measure compliance with the Maastricht criterion. **Latvia has met the criterion of the average nominal long-term interest rate since August 2012**.

A drop in the short-term interest rate for lats could also be observed in 2012. Due to the low interest rates and the high liquidity of credit institutions, the **interest rates for government securities remained close to the all-time lows**.

The Treasury plans to continue to offer a full range of standard maturities for the domestic debt securities – from short-term to long-term – while increasing the borrowing volume conservatively and in keeping with market capacity.

With the development of the domestic government securities market in mind, the Treasury commenced the implementation of a **Primary Dealer System** in Latvia in 2012 (implemented since 11 February 2013). It aims to encourage the development and activity of the government securities market: the emergence of new debt instruments, expansion of the investor base, a more active, liquid and investor-friendly government securities market, and a reduction in the risks associated with the management of central government debt. As part of the Primary Dealer System, credit institutions that have entered into a primary dealer agreement with the Treasury can take part in government security auctions. The following credit institutions have become primary dealers: AS Citadele banka, AS DNB Banka, AS Nordea Bank Finland Plc, AS SEB banka and AS Swedbank. In forming the initial pool of primary dealers, the Treasury evaluated the operations of each credit institution in the government securities market to date and activity in financial transactions with the Treasury with respect to government debt and asset management.

In 2012, the development of a new domestic market instrument – **savings bonds** – was commenced, which aims to attract private individuals as a potential group of investors and expand investment possibilities for residents, broaden their practical experience in making investments, to develop the government securities market on the whole, and to facilitate public confidence in the financial market. The completion of the project and the sale of the first bonds is scheduled for the first half of 2013.

2.5. Central Government External Debt

The **central government external debt** according to nominal value as of 31 December 2012 was **LVL 4,847.2 m**.

The central government external debt **increased by LVL 348.9 m** in 2012, which was due to Latvia's return to the international financial markets in 2011 and the consolidation of its position in those markets in 2012 as a regular borrower.

The major part of the **central government external debt** consists of loans from the European Commission (42%) and Eurobonds issued (42%). Borrowing in the international capital market makes up the remaining external debt obligations (16%) (see Figure 8).

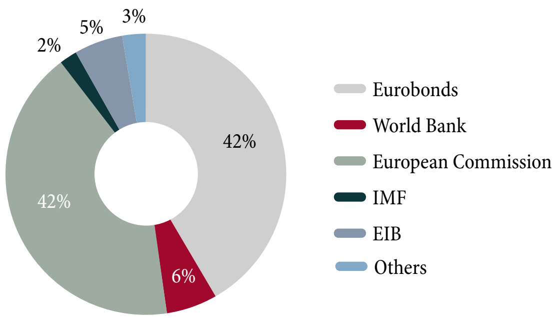


Figure 8.
Structure of the central government external debt as of 31 December 2012 (%)
Source: The Treasury

Borrowing in International Financial Markets

In 2012 Latvia strengthened its position as a regular borrower in the international financial markets with two Eurobond issues. Each issue had a different aim and complied with the government borrowing strategy. The bonds issued at the beginning of the year (in February) ensured the refinancing of the international loan programme, while the December issue took place to take advantage of the favourable financial market conditions for new borrowing.

On 14 February, Latvia successfully issued 5-year bonds in the amount of USD 1 billion with a fixed interest (coupon) rate of 5.25% p.a., while on 5 December, 7-year bonds worth USD 1.25 billion were issued with a fixed interest (coupon) rate of 2.750% p.a., which is historically the lowest securities interest rate since Latvia began borrowing publicly on the international financial markets. It is also the all-time lowest rate for bonds in U.S. dollars for any issuing country from Central or Eastern Europe.

Latvia reached an agreement with the IMF on the early repayment of the full amount of the loan received from the IMF as part of the international loan programme using the resources generated from the latest Eurobond issue. This means that **the early repayment of the IMF loan by the Treasury enabled the refinancing of an expensive short-term loan with a long-term, low-cost loan** (the interest rate on the IMF loan following the partial early repayment made in September decreased from ca. 2.8% to 2%, which could be considered an extremely high interest rate with an average remaining repayment period of 1.5 years, as funds with the same repayment period could be raised in the financial markets at rates below 1%). The refinancing of the IMF loan using long-term resources reduced the short-term refinancing risk of central government debt; as the amount of debt to be repaid over the next few years was reduced, the government's debt repayment profile became more even and, accordingly, less risky.

International loan programme

In 2008-2011, financing in the amount of EUR 7.5 billion was available as part of the international loan programme in order to stabilise the financial system of Latvia, restructure the national economy, raise the country's competitiveness and reduce the effects of economic slow-down risks, thus creating a stable foundation for sustainable economic development. The total amount of borrowing from the international loan programme reached LVL 3.1 billion.

In December 2011, the international loan programme officially concluded; during its operation, it had provided a basis for the sustainable development of the Latvian national economy.

By the end of 2012 (with early repayments made in September and December), the obligations towards the IMF were fully discharged. The loan from the IMF represented the largest share in the central government debt portfolio for the next two years, which is why the early repayment of this loan has a greater positive impact on both the government's debt repayment profile and the interest costs of government debt.

Loans from the European Commission for LVL 2,038 m and from the World Bank, for LVL 281 m (see Figure 9) are still outstanding as part of the international loan programme. The Treasury also considered the option of the early repayment of these loans but concluded that the loan from the European Commission cannot be paid early because the loan made to Latvia was underwritten with funds raised from security issues by the EU in the financial markets and does not provide for an early repayment option. In turn, the early repayment of the World Bank loan is subject to disproportionately large penalties and is therefore financially disadvantageous. Therefore, the option of the early repayment of the remaining loans within the programme is no longer under consideration.

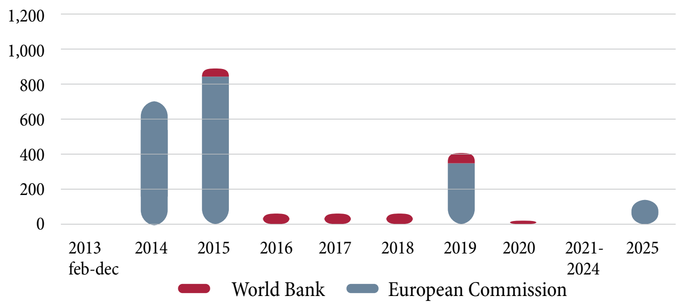


Figure 9.
Repayment schedule of the international loan programme according to nominal value, LVL million
Source: The Treasury

Loans from the EIB and CEB

On 30 October 2008, an agreement was signed with EIB on a loan to ensure central government budget co-financing for EU Structural Fund and Cohesion Fund projects during the 2007-2013 programming period.

On 30 April 2009, Latvia signed an agreement with CEB on the co-financing of projects to improve the field of education and urban and rural infrastructure, totalling EUR 50 m. In June 2012, the Administrative Council of CEB approved the request to extend the draw period of the loan until 30 June 2013.

A spending report for the first tranche of the loan worth EUR 25 m has been submitted to CEB, but inaccuracies were detected in the report data during a monitoring visit, and adjustments are being made.

In October 2012 an amended financial agreement was signed, providing for an extension of the period for submitting a loan draw request until 30 October 2013. In January 2012, EIB approved the allocation of EUR 193.5 m, or 86% of the loan received (EUR 225 m).

2.6. Central Government Debt Portfolio Management

In 2012 all the parameters for the central government debt structure specified in the Latvian Central Government Debt Management Strategy were complied with, while the minimum lats debt share in the debt portfolio remained within the limits of permissible deviation (see Table 2).

Table 2

Compliance of the parameters of the central government debt structure with those established by the Latvian Central Government Debt Management Strategy

Source: The Treasury

PARAMETERS	ACTUAL DEBT STRUCTURE PARAMETERS, 31 DEC 2011		ACTUAL DEBT STRUCTURE PARAMETERS, 31 DEC 2012		DEBT STRUCTURE PARAMETERS DEFINED IN THE STRATEGY	
Share of lats debt	13,7%		12,2%		>= 35%[6]	
Maturity profile	< 1 year 10.0%	< 3 years 43.1%	< 1 year 3.7%[7]	< 3 years 41.4%	< 1year < 25%	< 3 years < 50%
Share of fixed rates	79,5%		95,8%		>= 60%	
Average weighted fixed period of interest rates, years	3,50		4,14		3,4 – 5,0	
Net foreign currency debt composition	EUR 99.74%		EUR 100.53%		EUR 100% (+/- 5%)	

Due to the significant amount of debt repayable in 2014 and 2015, a situation arose in early 2012 where the debt maturity profile of up to three years approached the upper limit set in the Latvian Central Government Debt Management Strategy. To comply with the maturity profile parameter, a number of alternatives were considered, and in 2012 the Treasury adopted a **government debt refinancing reserve approach**. Since the essence of the debt maturity profile parameter is to ensure that the limit for the timely evaluation of refinancing options is not breached, by earmarking resources for repayment-related measures in 2014, the Treasury partially eliminated the refinancing risk – because, if resources have been earmarked, there is no risk with respect to borrowing in the amount of the reserve.

In February and December of 2012, parallel to the issues of USD Eurobonds in the international financial markets, currency swap transactions were made, thereby eliminating the currency risk associated with this borrowing.

Whereas, when repaying the IMF loan early in September and December of 2012, in order to avoid increased currency exposure, it was decided to make an early termination of the currency and interest rate swap transactions entered into for the two Eurobond issues and reverse the fx forward contracts, thereby **creating a positive effect on the performance of currency risk management by the Treasury in the government debt portfolio**.

Given the downward trend in interest rates observed in the financial markets since the fourth quarter of 2011, during a review of the

[6] *The Latvian Central Government Debt Management Strategy states that the share of lats debt in the government debt portfolio must be at least 35%, with the provision that the lats debt share of at least 35% is to be ensured in the medium term, if this corresponds with the development trends of national macroeconomics, capital market and the entire financial system of Latvia and if the weighted average yield of the medium-term and long-term government domestic securities offered at auctions held by the Treasury is less than 100 basis points above the figure for borrowing options in EUR.*

[7] *The maturity profile of the total debt, assuming a government debt refinancing reserve of LVL 100 m.*

applicability of the parameters set in the Latvian Central Government Debt Management Strategy at the beginning of 2012, the permissible duration interval was extended to open up a possibility of fixing historically low interest rates in line with the market situation. This, in turn, would allow optimisation of the cost of servicing of the debt and reduce future risk. New interest rate swap transactions were entered into in 2012. Taking into account the development of the debt crisis in the eurozone and the subsequent downward trend in interest rates in the second half of the year, a further increase in the duration value using interest rate swap transactions was not achieved and rather was attained at the end of 2012 through the issue of Eurobonds and early repayment of the IMF loan.

2.7. State-Issued Guarantees

Having analysed the experience of other countries, the potential recipients of state guarantees and the purpose of such guarantees and having assessed the risk ratios and coverage for the state guarantees, the Treasury has defined the **basic principles for issuing state guarantees** that are used to ensure the effective use of state guarantees as a support instrument, while reducing the impact of this support instrument on the government debt and budget deficit.

In order to improve lending to students by introducing a system of state-provided guarantees and **significantly enhance the efficiency of the granting of study and student loans by reducing the time of provision of a state guarantee**, amendments were made in 2012 to Cabinet Regulation No 501 of 1 June 2010 “Procedure by which Requests for Guarantees to be Issued on Behalf of the State shall be Included in the Draft Annual State Budget Law, and the Procedure for the Issuance and Supervision of the Guarantees”. It provides that, as of 2013, following an auction for the right to issue student loans with a guarantee issued on behalf of the state, a single guarantee and guarantee service agreement for the full amount of the state guarantee shall be entered into by the Ministry of Finance and the participant of the said auction that has acquired the right to provide loans to students with a guarantee issued on behalf of the state. The guarantee agreement provides that the guarantee shall take effect to the extent specified in the summary lists once the Ministry of Education and Science submits summary lists of loan recipients to the Ministry of Finance, which are approved by the Minister of Education and Science. Whereas, at the end of the year, the amount of the state guarantee used shall be adjusted and an additional agreement shall be entered into regarding the amount of the state guarantee used towards study and student loans, to supplement the guarantee and guarantee service agreement concluded at the beginning of the business year.

In order to continue the improvement of the state guarantee policy, **proposals have been drafted and submitted for amendments to the Law on Budget and Financial Management to define the pool of the potential recipients of state guarantees and their aims, with future state guarantees to be issued for projects that do not increase the government debt and budget deficit – which would involve a more limited provision of state guarantees to private companies**.

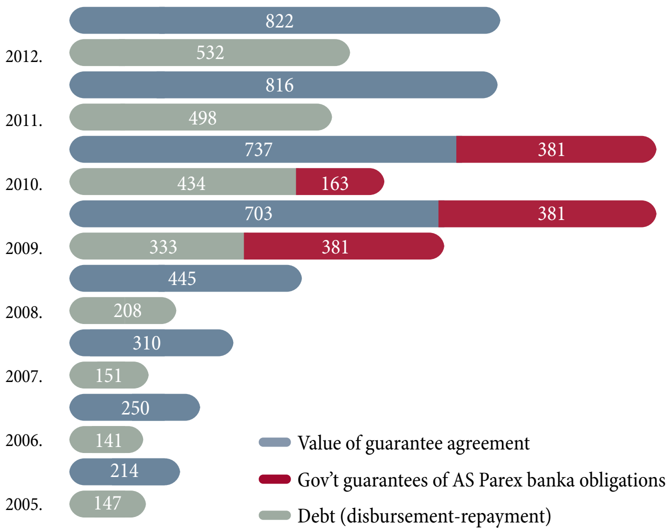


Figure 10.
Remaining balance of state-guaranteed loans (LVL million)
Source: The Treasury

The balance of state-guaranteed loans as at the end of 2012 was LVL 531.9 m (see Figure 10), which when compared with the balance of state-guaranteed loans at the end of 2011 (LVL 498.4 m) constitutes an increase of LVL 33.5 m, or 6.7%.

State-guaranteed loans have been granted to support various sectors: 21% to promote the development of small and medium enterprises, 19% for healthcare, 19% for the manufacturing industry, 18% to education.

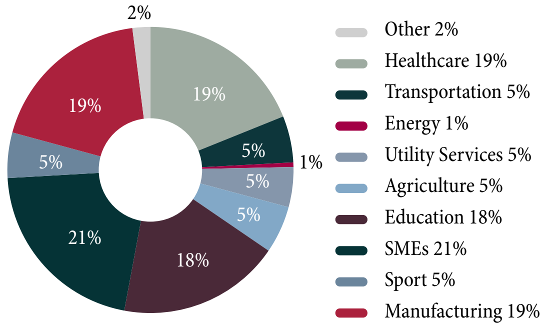


Figure 11.
Use of state-guaranteed loans issued according to general procedure, by sector (%)
Source: The Treasury

In 2012, a total of LVL 11.1 m in state guarantees was issued for study and student loan obligations and LVL 70.3 m to VAS Latvijas Hipotēku un zemes banka [Mortgage and Land Bank of Latvia], as per the annual State Budget Law. A further state guarantee was provided with respect to a loan of LVL 12.3 m to VAS Latvijas Hipotēku un zemes banka from Kreditanstalt für Wiederaufbau to cover liabilities to international creditors.

Pursuant to the State Budget Law for 2013, state guarantees are planned to be issued for study and student loans in the amount of LVL 28.8 million.

2.8. Performance Indicators of the Operational Targets for Central Government Debt Management as Defined in the Operational Strategy of the Treasury

Table 3
Performance indicators of the operational targets for central government debt management
Source: The Treasury

Item No	Operational target	Performance indicators	Indicators (numeric values)		
			Last known precise measurement (2011)	Projected for 2012	Implementation in 2012
1.	Provided financial resources necessary for the financing of the implementation of the central government budget and the refinancing of the central government debt at the lowest possible cost, limiting the financial risks and taking into account the development of the capital market and financial system of Latvia.	Ensured compliance with the approved central government debt portfolio management indicators (%)	100	100	98,6[8]
2.	Performed measures of the investor relations management programme (investor meetings, telephone conferences, video conferences, drafting and distribution of informative materials)	Implemented investor relationship activities prescribed in the Funding Plan (%)	100	100	100
3.	Performed measures aimed at compliance with the Maastricht criteria within the competence of the Treasury.	1. The central government debt at the end of the year does not exceed the criterion for the level of general government debt in the Maastricht Treaty (% of the GDP).	42.2% of the GDP (criterion: 60% of the GDP)	Meets the criterion	Interim assessment: meets the criterion: 41.7%[9]
		2.The long-term interest rate criterion has been met (the rates of the government domestic debt ~10-year bonds may not exceed 2% + the average indicator of three Member States with the lowest inflation)	Meets the criterion	Meets the criterion	Meets the criterion

[8] *At the end of January 2012 the maturity profile indicator for debt up to three years exceeded the permissible limit established in the Latvian Central Government Debt Management Strategy, which was due to the approaching repayment date of the loan from the European Commission (in January 2015). The Latvian Central Government Debt Management Strategy states that "... deviation from the limits of maturity profile, fixed rate share in the debt portfolio and Macaulay Duration is allowable if the deviation does not cause additional financial risk". Thus, the earmarking of resources for debt repayment would partially eliminate the refinancing risk, as the essence of the debt maturity profile parameter is to ensure that the limit for the timely evaluation of refinancing options is not breached. If resources have been earmarked, there is no longer a risk for the amount of funds reserved in relation to the borrowing. The Treasury commenced the preparation process for the issue of Eurobonds in the international financial markets as early as in late 2011, so as to launch the measures for the pre-financing of the international loan programme in accordance with the medium-term borrowing plan. Being aware that the issue would take place imminently and the necessary refinancing reserve for government debt would be ensured, a time of issue was chosen that was the most suitable given the market situation in the assessment at that point, thus creating a slight deviation in the formal fulfilment of the three-year profile indicator. Following the issue and creation of a refinancing reserve, the three-year maturity profile returned to within the limits established by the Latvian Central Government Debt Management Strategy.*

[9] *Data on the amount of the general government debt at the end of 2012 will be available in April 2013.*

2.9. Assessment of the Application of the Operational Strategy of the Treasury for 2010-2012 in the Management of Central Government Debt

The strategic objective for the management of central government debt – ***"To secure the necessary financial resources, including those on public capital markets, at the lowest possible cost, to limit financial risks and, to the furthest extent possible, promote the financial interests of the State in the process of issuing state guarantees, with consideration given to factors of state macroeconomic stability and the development of the capital market and financial system, which is aimed at the introduction of the euro currency in the medium term"*** – has been attained to the degree prescribed for 2010-2012 (in terms of the tasks/ performance targets defined).

The attainment of the strategic tasks was facilitated by:

1) development of the national economy, fiscal policy, measures towards the consolidation of the government budget;
2) accumulated resource liquidity;
3) international macroeconomic situation;
4) improved situation in international financial markets, investor base, country's credit rating;
5) volume of financing available to the Treasury to support its functions;
6) knowledge, skills and accumulated expertise of the Treasury staff;
7) risk management implemented by the Treasury, the quality management system in place at the Treasury.

The full achievement of some targets was impeded due to remuneration that cannot compete with the commercial banking sector: the tasks that need to be completed to implement the functions of the Treasury are equivalent to those performed in commercial bank operations. The absence of competitive pay endangered the effective use of the professional capacity of the staff and the motivation of the most skilled civil servants and staff members to work for the Treasury.

Fulfilment of the strategic targets set for the management of central government debt in 2010-2012:

In central government debt portfolio management

1) **Observance of the approved parameters for the management of the central government debt portfolio and optimisation of the cost of servicing of central government debt have been ensured taking into account borrowing priorities, financial risk management instruments and the availability of transaction partners:**
   - compliance with the central government debt portfolio management parameters specified in the Latvian Central Government Debt Management Strategy was insured, taking into account the criteria laid down;
   - the cost of servicing the government debt was reduced significantly thanks to the activities of the Treasury and measures undertaken in the field of financial risk management, as well as the choice of a borrowing strategy that focuses on the elimination of the refinancing risk of government debt and on flexible borrowing;

2) **calculation methods and portfolio valuation and management instruments in line with international practices ensured in managing the central government debt portfolio:**
   - the methodology for determining the effectiveness of the financial risk management tools used was revised;
   - a mathematical simulation model has been introduced to identify the optimal share of lats debt, which supplements the analysis by the Treasury;
   - with a view to expanding the circle of business partners and the scope of cooperation, the first CSAs (Credit Support Annexes) were entered into envisaging guarantee deposits. The Treasury entered into the first CSA with an international partner in 2012 and continues the coordination of CSA agreements with the remaining partners.

In the management of government borrowing

1) **Timely resources provided to finance the implementation of the central government budget and the refinancing of central government debt**: the implementation of the Latvian Central Government Debt Management Strategy and the regular planning of measures to raise funds for the medium term provided timely resources for the financing of the implementation of the central government budget and the refinancing of central government debt, both in domestic and international financial and capital markets. With the early repayment of the IMF loan in 2012 by the Treasury, an expensive short-term loan was refinanced using a long-term, low-cost loan;

2) **measures implemented towards compliance with the criteria of the Maastricht Treaty regarding government debt and long-term interest rates**: the central government debt at the end of the year did not exceed the criterion for the level of general government debt prescribed in the Maastricht Treaty (60% of the GDP). The Treasury estimate shows that the level of general government debt is in compliance with the Maastricht criterion and well below 60% of the GDP (41.7%[10]). By undertaking timely borrowing measures in

[10] *Data on the amount of the general government debt at the end of 2012 will be available in April 2013.*

accordance with the medium-term borrowing strategy in place, investors in the domestic market were provided with an adequate range of investment instruments. Responsible fiscal policies continued as well. On the whole, this boosted investor confidence with regard to Latvia as a borrower and maintained the high demand for government securities which, in turn, encouraged the downward trend of interest rates. The Maastricht criterion estimate for long-term interest rates at the end of 2012 stood at 5.88%, while the Latvian figure was 4.57%, indicating compliance with the criterion;

3) **the interest of domestic financial market investors and a diversified investor base in the main foreign financial and capital markets has been preserved; measures of the investor relations management programme (investor meetings, telephone conferences, video conferences, drafting and distribution of informative materials) have been performed:**

- given the results of the government securities auctions and statistics on investors holding government domestic debt securities in their portfolios, it has been concluded that credit institutions occupy the leading position in the investor pool, and domestic investors represent the majority among the investors;
- the demand for government securities in 2012 generally exceeded the supply several times over;
- with each new issue of bonds in the international financial and capital markets, Latvia has been able to expand the investor base for securities. Positive trends can also observed in the share of Asian investors in the Latvian Eurobond issues, which reflects greater investor confidence in Latvia;
- investor relations management measures have been undertaken throughout the entire period of implementation of the Strategy: by organising live meetings and providing regular updates regarding developments in the Latvian economy. Latvian representatives have met with the most active investors in the United States, Europe and Asia, thereby providing the investors with the latest information about the situation in Latvia and future plans, and attracting new investors for future borrowing in international financial markets;
- in 2012, Latvia attracted 334 new investors to international issues, who purchased 53% of the total volume sold in international financial markets, thus ensuring a broad diversification of the investor base for Latvia;

4) **borrowing has taken place according to the established benchmarks:** the volume of borrowing and the level of government debt is affected by the overall financing requirements and the availability of a funding reserve. To cover the overall financing requirement, the most suitable financial instruments specified in the medium-term borrowing plan were used. The medium-term borrowing strategy was developed in accordance with the Latvian Central Government Debt Management Strategy, thus providing an optimal balance between the potential cost and financial risks;

5) **new financial instruments introduced, borrowing mechanisms and technology improved:**

- the development of a new domestic financial market instrument – savings bonds – commenced in 2012, and their release to the population is scheduled for 2013;
- in order to develop the government securities market and boost activity in secondary trading, the development of a Primary Dealer System commenced in 2012, which was implemented on 11 February 2013;

6) **regular exchange of information among government institutions ensured and cooperation with rating agencies improved**: Once a year, an inter-agency working group led by the Treasury informs the Cabinet of Ministers on the national credit rating of Latvia and the factors affecting it, as well as proposals to improve ratings. The strategic guidelines in place for improving cooperation with the international rating agencies are followed in the routine activities of the working group.

In the servicing and monitoring of state guarantees

1) A methodologically transparent, responsive and efficient process in line with government interests is in place for the planning, provision and monitoring of state guarantees: the process of planning and granting state guarantees has been revised by developing Cabinet regulations, proposals have been prepared to amend the Law on Budget and Financial Management in order to improve the state guarantee policies;

2) **analysis of state guarantee projects, identification of risk ratios and monitoring of the risk level of the state guarantee portfolio are ensured in line with international practices**: the methodology for establishing the risk ratios of guarantees has been improved, an approach for assessing the accumulation of guarantees issued in non-standard instances has been developed.

With the period of the Treasury Operational Strategy for 2010-2012 coming to a close and having evaluated the results of its implementation and the degree of attainment of the strategic objectives and tasks and, in view of the regulatory framework and factors and the government-approved progress towards the introduction of the euro in 2014, the Treasury has defined a new strategic task of central government debt management for the next strategic planning period – **to provide financial resources to cover the financing requirements at the lowest possible cost, limiting financial risks and taking into account the progression of Latvia's financial markets towards joining the eurozone, as well as to ensure the implementation of a state guarantee policy that is in line with the national interests** – and defined the next set of tasks to achieve it:

1) organise new borrowing in the capital markets of various regions in accordance with the medium-term borrowing strategy;

2) promote the development of the domestic financial market and its integration into the financial market of the eurozone.

3. Cash and State Loan Management

3.1. Operational Principles and Areas of Development

The Treasury Cash Management Strategy, approved by the Minister of Finance, establishes the goals, tasks and responsibility of the Treasury for carrying out financially effective and reliable cash management while observing liquidity requirements and limiting financial risks.

The Treasury places temporarily free cash resources in the Bank of Latvia and Latvian and foreign credit institutions or invests them in fixed-income debt securities, thus limiting the financial risks in accordance with the investment parameters and partnership limits prescribed in the Treasury Cash Management Strategy, which are specified for each business partner depending on the type of financial instrument.

The medium-term priorities for cash management are as follows:

1) to maintain and develop long-term partnerships with the participants of domestic and international financial markets (business partners) to broaden the options for investing cash resources and to secure the information required on both sides to make financial management decisions;

2) to ensure the development of the cash management process in accordance with the best financial market practices and in conformity with the basic principles of financially effective cash placement.

According to the authorisation by the Ministry of Finance, the Treasury organises the government lending process by making financial resources available in the form of state loans in accordance with the loan agreements entered into and by tracking the financial position of the recipients of state loans, which involves the monitoring of the repayment of state loans and, if necessary, engaging in recovery measures.

The priorities for state loan management are as follows::

1) to ensure a transparent and effective state loan management process that is in line with the national interests, while preventing the issuance of high-risk state loans;

2) to ensure the quality of client service and client satisfaction with the government lending process, which includes the conclusion of agreements electronically.

3.2. Cash Management

The aim of liquidity management is to provide cash funds for the fulfilment of financial commitments, both in due time and in the full amount. In order to attain this goal, the Treasury performs the following activities:

1) monitors the stock of liquid resources and compliance with the liquidity limits and the size of the reserve of liquid cash resources;

2) identifies, in a timely manner, situations that may impair the liquidity of cash resources and result in a liquidity crisis;

3) deposits temporarily free funds so as to maintain an adequate stock of liquidity that would ensure the required reserve of liquid resources and compliance with liquidity limits within a specific period.

In managing financial resources, the Treasury observes liquidity requirements, thus preventing the risk of a liquidity crisis.

In 2012, based on the financing requirement and the situation in financial markets, the Treasury ensured the availability of the liquid resources required to meet the financial commitments, as well as deposited temporarily free funds in the Bank of Latvia and Latvian and foreign credit institutions and invested them in fixed-income debt securities. In 2012, liquidity was ensured using the resources available in the Treasury's accounts, funds raised in the domestic and external financial markets and residual funding received during the international loan programme.

With the conclusion of the international loan programme, the Treasury Cash Management Strategy was revised, and an updated Strategy was approved on 17 April 2012, in accordance with which:

1) as of April 2012, **gradual placement of resources in fixed-term deposits outside the Bank of Latvia was commenced**;

2) as of August 2012, **investments in debt securities** were made.

3.3. Issuance and Servicing of State Loans

In 2012, in order to improve the state loan planning process, the Cabinet Regulation **"Procedure by which Ministries and Other Central Government Institutions Include Requests for State Loans in the Annual Draft State Budget Law"** was issued prescribing the procedures according to which ministries and other central government institutions file medium-term state loan requests with the Ministry of Finance for inclusion in the annual draft State Budget Law.

State loans **are intended for the following purposes**:

1) budget and financial management;
2) stabilisation of local government finances;
3) investments;
4) implementation aid programmes to commercial activities;
5) implementation of projects and measures co-financed by the EU;
6) implementation of projects funded through foreign financial aid;
7) ensuring fuel purchases;
8) implementation of the aims specified in Section 81 of the law On Budget and Financial Management.

The **circle of recipients** of state loans is defined in Section 36 of the Law on Budget and Financial Management. **Loan repayments** to the general government budget are planned in accordance with the repayment deadlines and amounts stipulated in the loan agreement.

The Treasury monitors state loans and undertakes debt recovery activities. In cases where local governments have failed to perform the obligations under the agreements, the Treasury is entitled to deduct the outstanding sums from the amount of personal income tax due to the local government or the grant from the local government financial equalisation fund. In cases where commercial companies have failed to perform the obligations under the signed agreements, claims for repayment are brought to the borrowers or complaints are filed with courts regarding the recovery of the debt and an application to secure the claim. If a commercial company has been liquidated and debt recovery is no longer possible, the Treasury writes off the cancelled debt obligations of the liquidated commercial company in accordance with the Cabinet Regulation **"Procedures for the Cancellation of State Loans by the Minister of Finance"**. The debt obligations of commercial companies liquidated in the respective budget year are cancelled in accordance with the amount prescribed in the annual State Budget Law.

The total amount of state loans to be issued in 2012 was set at LVL 314.7 m, which includes the overall increase in state loans stipulated in the annual State Budget Law in the amount of LVL 208 m and the 2012 repayments of state loans issued in the previous years: LVL 106.7 m.

In 2012 the largest share of state loans – LVL 120.4 m, or 81% – was issued to local government bodies (local governments and economic operators managed and financed by local government bodies). The majority of the state loans issued to local governments (85%) was for the implementation of projects co-financed by the EU. In breakdown by sector, the largest volume of state loans, totalling LVL 16.9 m, went to water supply projects, followed by education projects with LVL 14.2 m and energy projects with LVL 12.6 m.

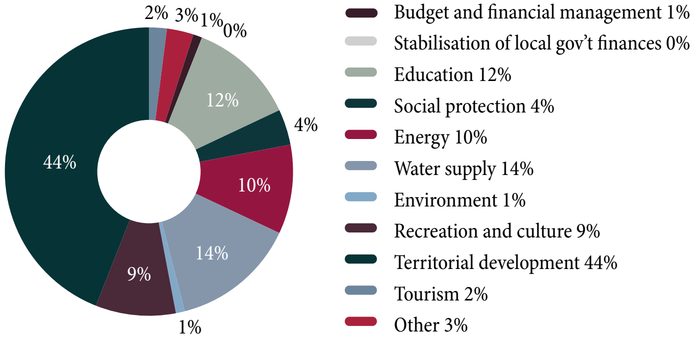


Figure 12.
State loans issued to local governments in 2012, according to purpose (%)
Source: The Treasury

State loans to financial institutions reached LVL 9.9 m, or 7% of the total. A loan of LVL 8.1 m was granted to VAS Latvijas Hipotēku un zemes banka [Mortgage and Land Bank of Latvia] towards loans of working capital for agricultural production, and a LVL 1.8 m loan was issued to VAS Lauku attīstības fonds [Rural Development Fund] towards loans to support agricultural land purchases for agricultural production.

State loans making up LVL 6.1 m, or 4% of the total, were made to a number of non-financial merchants towards the implementation of EU co-financed projects aimed at the reconstruction of water supply and heating systems (e.g., SIA Vinda in Cēsis, State SIA Bulduru Dārzkopības vidusskola [Bulduri Horticulture Secondary School], etc.).

State loans in the amount of LVL 2.6 m, or 2% of the total, were granted to **derived public persons partially financed from the government budget**, such as scientific institutes and higher education institutions that have been granted the status of a derived public person, towards the implementation of EU co-financed projects.

State loans totalling LVL 9.6 m, or 6% of the total, were **issued towards the implementation of the aims specified in Section 8^1, Paragraph one of the Law on Budget and Financial Management**: LVL 9.0 m to AS Air Baltic Corporation to provide the cash flow required for commercial operation; and LVL 0.6 m to the Latvia University of Agriculture to provide operating capital due to the insolvency of AS Latvijas Krājbanka.

Pursuant to the State Budget Law for 2013, the total increase in state loans for 2013 has been set at LVL 208 m, of which LVL 76 m represents the overall increase in borrowing by local governments. In turn, the total permissible amount of state loans to be granted in 2013 has been budgeted in the amount of LVL 275.1 m, which includes LVL 67.1 m in planned 2013 repayments of state loans issued in the previous years.

3.4. Aid Measures to Ensure Liquidity

On 14 February 2012, AS Citadele banka repaid the last fixed-term deposit of state aid (equivalent to LVL 32.75 m), and there is no other liquidity aid provided for by the government.

In early 2012, AS Parex banka was re-registered under a new name, AS Reverta, and its status of a credit institution was abolished. With the changed status of AS Parex banka, all fixed-term deposits of state aid in the bank (equivalent to LVL 427.8 m) were converted into dematerialised closed-issue bonds, while fixed-term deposits of state aid were discontinued. In 2012, AS Reverta paid all interest on the bonds and repaid state aid bonds worth LVL 43 m. The volume of closed emissions by AS Reverta at the end of 2012 stood at LVL 384.8 m, and there were no deposits into the equity capital of AS Reverta in 2012.

In the implementation of the government decisions to transform VAS Latvijas Hipotēku un zemes banka [Mortgage and Land Bank of Latvia] into a development bank, the balance of fixed-term deposits of state aid to ensure liquidity was LVL 25 m at the end of 2012. In 2012, VAS Latvijas Hipotēku un zemes banka repaid LVL 25 m in fixed-term deposits of state aid to ensure liquidity.

3.5. Performance Indicators of the Operational Targets for Cash and State Budget Loan Management as Defined in the Operational Strategy of the Treasury

Table 4
Performance indicators of the operational targets for cash and state budget loan management

		Indicators (numeric values)		
Operational target	Performance indicators	Last known precise	Projected for 2012 measurement (2011)	Implementation in 2012
Efficient and safe cash management.	Ensured income from the investment of central government budget funds in the amount prescribed by the annual State Budget Law (% compliance with the annual plan).	286.4	100	107.3

3.6. Assessment of the Application of the Operational Strategy of the Treasury for 2010-2012 in the Cash and State Loan Management

The strategic objective for cash and state loan management – *"To implement effective and safe cash management by limiting and monitoring financial risks, ensuring the necessary liquidity promptly and in the full amount to meet the government's financial commitments, as well as issuing and servicing state loans effectively, taking into account the need to achieve national macroeconomic stability and development targets in the medium term"* – was achieved to the extent prescribed for 2010-2012 (in terms of the tasks/performance targets defined).

The attainment of the strategic tasks was facilitated by:

1) development of the national economy, fiscal policy, measures towards the consolidation of the government budget;
2) accumulated resource liquidity;
3) international macroeconomic situation and situation in the financial markets;
4) volume of financing available to the Treasury to support its functions;
5) knowledge, skills and accumulated expertise of the Treasury staff;
6) risk management implemented by the Treasury, the quality management system in place at the Treasury.

The full achievement of some targets was impeded due to remuneration that cannot compete with the commercial banking sector: the tasks that need to be completed to implement the functions of the Treasury are equivalent to those performed in commercial bank operations. The absence of competitive pay endangered the effective use of the professional capacity of the staff and the motivation of the most skilled civil servants and staff members to work for the Treasury.

Fulfilment of the strategic targets set for cash and state loan management in 2010-2012:

In cash management

1) **Readiness to embark on cooperation practices that exist between the national central banks of the eurozone members and the bodies administering government financial resources (treasuries, debt management agencies, etc.)**: the practices of eurozone members with respect to the coordination of the activities of the government debt management institutions with the national central banks and the European Central Bank have been studied. It has been concluded that the Latvian practice of cooperation with the central bank in the management of government debt is analogous to that of the majority of eurozone countries, and no substantial changes in the organisation of debt and cash management are to be expected after entering the eurozone;

2) **a conservative approach is in place in the acceptance of deposits, and a regular investment option is maintained based on the fundraising costs of the Treasury:**

- the clients of the Treasury (in accordance with the provisions of the Law on Budget and Financial Management) are provided with an opportunity to invest in the Treasury in accordance with the current financing requirement of the Treasury to ensure the liquidity position;
- the Treasury continued to adhere to the approach where the calculation of compensation for investments made is based on the cost of funds raised by the Treasury;

3) **a constant pool of Treasury business partners is available:**

- the Treasury has allocated temporarily free cash resources to the Bank of Latvia, and the gradual placement of resources in fixed-term deposits outside the Bank of Latvia has commenced;
- since August 2012, investments have been made in securities;
- in 2012, the Treasury entered into a number of new ISDA agreements with new international partners and continued the negotiations in progress regarding several other ISDA agreements. Negotiations have also commenced with new international business partners;

4) **the effectiveness of the placement of cash resources has been evaluated against the established benchmarks, facilitating the achievement of such benchmarks to the furthest extent possible:** cash management was substantially limited during the implementation of the international loan programme, since the recommendation of the IMF and the European Commission was to hold all temporarily free funds in the Bank of Latvia. The Treasury Cash Management Strategy was updated after the conclusion of the international loan programme and approved on 17 April 2012. Following the approval of the Treasury Cash Management Strategy, the temporarily free resources were gradually deposited outside of the Bank of Latvia, which is why the effectiveness of the cash resources was not measured during this period.

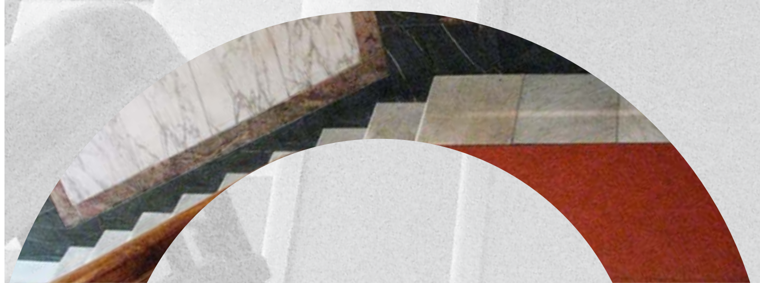
In liquidity management

1) **An approach of a "higher liquidity reserve" implemented:**

- in 2010-2012, the amount of available resources in the Treasury accounts ranged between LVL 740 m to LVL 1,580 m;
- the reserve of financial resources maintained in the Treasury accounts gave investors additional confidence in the creditworthiness of Latvia, as reflected by the consistent decline and stabilisation in borrowing rates;

2) **ensured the observance of the prescribed liquidity indicators and requirements:**

- in order to achieve the aim of liquidity management – to provide cash funds for the fulfilment of financial commitments, both in due time and in the full amount – the Treasury complied with liquidity requirements, thus eliminating the risk of a liquidity crisis occurring;
- based on the financing requirement and the situation in financial markets, the Treasury ensured the availability of the liquid resources required to meet the financial commitments;



3) **evaluated and monitored the adequacy of the prescribed liquidity indicators with respect to the amount of liquid cash resources actually required by facilitating the adoption of optimal liquidity requirements to the furthest extent possible**: an annual evaluation of the liquidity indicators in place was performed to determine their adequacy given the actual amount of liquid cash resources required and, based on the results of the analysis, the procedures for the calculation and setting liquidity targets was optimised and simplified;;

4) **new financial instruments used to increase the effectiveness of liquidity management:** upon the conclusion of the international loan programme, the Treasury Cash Management Strategy was updated (approved on 17 April 2012), stressing the key cash management objectives that focus on ensuring a balance between the available liquidity, limiting financial risks and achieving the maximum yields. Potentially permissible financial instruments for the investment of resources as effectively as possible were evaluated, taking into account financial risk management requirements.

In the issuance and servicing of loans

1) **Ensured a transparent and effective process of the issuance and monitoring of state loans that is line with the national interest:**

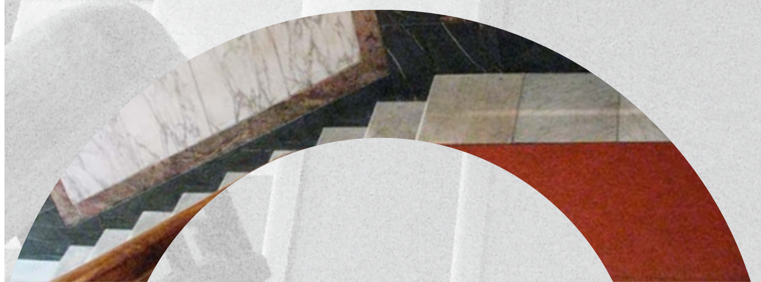
- in order to ensure a high-quality and comprehensive analysis and evaluation of state loan projects while limiting the risks assumed by the government as much as possible, the possibility of issuing a long-term state loan to the social budget of the central government has been created; a new and simplified request form for the disbursement of state loans and a loan disbursement request regarding the authorisation of local government representatives were developed; and the methodology for determining the risk ratios of state loans and for portfolio monitoring was revised to ensure alignment with international practices;
- the process of state loan planning was revised (with respect to the procedures of including state loans in the annual State Budget Law and including the medium-term costs of the loans provided for under the loan agreements in place in the register of long-term liabilities of the central government budget) – the proposals submitted regarding the amendment of the Law on Budget and Financial Management were accepted;
- proposals were developed for amendments to the Law on Budget and Financial Management for improving the state lending policy;

2) **monitoring of the risk level of the state loan portfolio has been ensured in line with international practices:** the methodology for establishing the risk ratios of loans has been improved, an approach for assessing the accumulation of loans issued in non-standard instances has been developed.

With the period of the Treasury Operational Strategy for 2010-2012 coming to a close and having evaluated the results of its implementation and the degree of attainment of the strategic objectives and tasks and, in view of the regulatory framework and factors, and the government-approved progress towards the introduction of the euro in 2014, the Treasury has defined a new strategic task of cash and state loan management for the next strategic planning period – **to ensure the financially effective and reliable management of cash resources by limiting and monitoring financial risks, providing timely and full availability of cash resources to meet the government's financial commitments, as well as to implement a government lending policy in line with the national interest** – and formulated the next set of tasks towards its achievement:

1) to ensure the development of the cash management process in accordance with the best market practices and in conformity with the basic principles of financially effective cash placement;

2) to ensure that the planning, issuance and servicing process of state loans takes place in accordance with the best market practices and the principles of effective service provision while taking into account the national interest and developments in the financial markets.



4. Implementation of the Functions of the Paying and Certifying Authority for European Union Policy Instruments

4.1. Operational Principles and Areas of Development

In accordance with the provisions of regulatory enactments, the Treasury performs the functions of the Paying and Certifying Authority for the EU policy instruments, the European Economic Area Financial Mechanism and the Norwegian Financial Mechanism, and the Latvian-Swiss Cooperation Programme.

Pursuant to the Law on the Management of European Union Structural Funds and the Cohesion Fund, the Treasury acts as the Certifying Authority and Paying Authority for ERDF, ESF and the Cohesion Fund in the 2007-2013 programming period. As the Certifying Authority, the Treasury prepares and submits statements of expenditure and payment requests to the European Commission and certifies that the declared expenditure complies with the applicable Community and Member State regulations. In turn, as the Paying Authority, it ensures the accounting of the EU Fund financing received from the European Commission and spent and makes payments to the EU Fund beneficiaries within the shortest possible time frame.

In order to ensure the functions of the Paying Authority of the Latvian-Swiss Cooperation Programme, the Treasury opens and services co-financing accounts for the Programme, verifies the compliance of the payment requests received with the requirements of the framework agreement and the relevant regulatory enactments, confirms and submits them to the competent authorities of Switzerland, makes payments once co-financing funds are received from the Swiss Confederation and arranges refunds of unused resources or non-compliant expenditure to the Swiss Confederation.

In implementing its functions as the Certifying Authority of the European Economic Area Financial Mechanism and the Norwegian Financial Mechanism for 2009-2014, the Treasury submits approved interim financial statements, final programme reports and forecasts to the Financial Mechanism Office, as well as monitors the refunding of resources not absorbed or non-compliant expenditure.

4.2. Function of the Paying Authority in the 2004-2006 Programming Period

The final statements of expenditure of the EU Structural Funds (statements requesting the outstanding portion of EU financing from the European Commission with respect to the declared eligible expenditure) for each of the Funds were submitted in 2010, and with the submission of the final documents to the European Commission, **the closure process of the 2004-2006 programming period of the EU Structural Funds was commenced.** Full final payments were received from the European Commission in 2011 as part of the EAGGF and ESF. In turn, in 2012 final payments were received from the European Commission under the ERDF and FIFG, and thereby Latvia has received all the final payments – which is to be viewed positively, as other Member States have not yet received the final payments.

The final statements of expenditure for the projects co-financed from the Cohesion Fund were submitted to the European Commission in 2011, whereas in 2012 an adjusted statement of expenditure was submitted for one project, based on the deficiencies noted in the final inspection report of an independent entity. In 2012, funds amounting to EUR 23.2 m were received from the European Commission for the submitted final statements of expenditure. At the end of 2012, the Treasury has not received final payments in 13 projects, as the European Commission continues the evaluation of the final documentation.

4.3. Functions of the Paying Authority for the European Economic Area Financial Mechanism and the Norwegian Financial Instrument

As part of the European Economic Area Financial Mechanism and the Norwegian Financial Mechanism (the 2004-2009 programming period), individual projects, programmes (integration of environmental policy in Latvia, facilitation of public and private partnerships, cross-border cooperation) and grant schemes

(strengthening of civil society and social integration, academic research, a non-governmental organisation fund, a scholarship grant scheme, a project preparation fund, a short-term expert fund) for the total amount of EUR 45.5 m were implemented. The submission of final reports to the Financial Mechanism Office began as early as 2010 and 2011, and the verification and submission of the remaining final reports to the Financial Mechanism Office continued in 2012: 31 final project reports and interim reports for three projects, because the implementation period of these periods was extended. Payments worth EUR 1.1 m were received in 2012 for all the reports submitted in 2012 (both interim and final reports).

The implementation of the EEA and Norwegian Financial Mechanisms in the 2009-2014 programming period will mainly take the form of programmes[11], thus ensuring a more effective deployment of these financial instruments. By the end of 2012, the donor states approved all the programmes presented by Latvia. In 2012, the implementation of one project – "Technical assistance to the Beneficiary State and Fund for bilateral relations at national level" – commenced, and three payment requests were submitted to the Financial Mechanism Office, for which funds in the amount of EUR 0.2 m were received.

4.4. Functions of the Paying Authority within the Latvian-Swiss Cooperation Programme

By the end of 2011, the competent authorities of Switzerland had approved the majority of the projects, grant schemes and programmes, and the last project agreement, as part of the Latvian-Swiss Cooperation Programme, was concluded in early 2012. Overall, obligations to the tune of 100% of the total available financing have been assumed, which constitutes CHF 54.9 m (excluding the Scholarship Fund grant).

In 2012, the Paying Authority **verified and submitted one final and 19 interim refund requests to the competent authorities of Switzerland** in the amount of CHF 7.4 m as part of the Latvian-Swiss Cooperation Programme, receiving CHF 6.9 m for the submitted refund requests. One of the requests for funds submitted in 2012 was paid for by the Swiss competent authorities in 2013.

[11] *"Technical assistance to the Beneficiary State and Fund for bilateral relations at national level" will be implemented as a project.*

4.5. Functions of the Certifying and Payment Authority in the 2007-2013 Programming Period

At the beginning of 2012, the European Commission suspended payments to Latvia, as deficiencies had been identified in the management and control system in place for the 2007-2013 programming period of the EU Structural Funds and the Cohesion Fund, set up by the Treasury as the Certifying Authority and the Ministry of Finance as the Managing Authority. In order to eliminate these deficiencies, the Treasury and the Ministry of Finance drew up an action plan for the rectification of the deficiencies noted in the report, which included comprehensive measures towards improving the performance of verifications (providing for checks with respect to procurement, double financing and compliance with state aid rules) and the revaluation of previously declared expenditure, in order to provide the European Commission with assurance that flaws within the system have not affected the eligibility of the declared expenditure. By the end of March 2012, the Treasury had implemented the majority of the improvements specified in the action plan, which was also verified by the Audit Authority in a follow-up audit of the implementation of the recommendations. The **European Commission** evaluated the results of the follow-up audit conducted by the Audit Authority and **resumed payments in June and July of 2012**[12].

In 2012, within the framework of the EU Funds of the 2007-2013 planning period, the **Paying Authority verified and paid out on 8,333 payment orders, including 571 advance payments**. The Paying Authority reimbursed beneficiaries for LVL 426,190 (EUR 611,267) from the EU Funds. Advance payments of LVL 55,686 were made as part of EU Fund projects.

In 2011, the Treasury and the Ministry of Finance undertook measures to simplify the process of administering resources from the EU Structural Funds and the Cohesion Fund. The functionality of the management information system of the EU Structural Funds and the Cohesion Fund was enhanced, which means that as of 2012 the liaison bodies and responsible authorities no longer file statements of expenditure with the Certifying Authority, but instead the Certifying Authority creates them within the system. In 2012, the Certifying Authority prepared, verified and submitted 30 statements of expenditure to the European Commission within the period prescribed in the regulatory enactments.

[12] *The Directorate-General for Regional Policy did so in late June, whereas the Directorate-General for Employment, Social Affairs and Inclusion, in early July.*

Table 5

Expenditure certified for the European Commission and refunds received in 2012, compared with 2011, EUR thousand

Source: The Treasury

EU policy instrument	Eligible expenditure declared		Amount requested		Amount received[13]	
	2011	2012	2011	2012	2011	2012
Operational programme 1 (ESF)	152,004	123,680	129,090	110,033	123,459	112,275
Operational Programme 2 (ERDF)	82,192	134,139	34,516	70,885	26,000	79,401
Operational Programme 3	492,672	573,651	409,595	475,476	362,571	522,500
incl. ERDF	*307,579*	*325,552*	*262,709*	*277,152*	*231,871*	*307,990*
incl. the Cohesion Fund	*185,093*	*248,099*	*146,886*	*198,324*	*130,700*	*214,510*
Total	**726,868**	**831,470**	**573,201**	**656,394**	**512,030**	**714,176**

4.6. Performance Indicators of the Operational Targets Defined in the Operational Strategy of the Treasury for the Implementation of the Functions of the Paying and Certifying Authority of the EU Policy Instruments

Table 6

Performance indicators of the operational targets for the implementation of the functions of the Paying and Certifying Authority of the EU policy instruments

Source: The Treasury

Operational target	Performance indicators	Indicators (numeric values)[14]		
		Last known precise	Projected for 2012 measurement (2011)	Implementation in 2012
Certified expenditures paid in full.	Expenditure received from the European Commission, as % of the expenditure requested from the European Commission.	100	100	100

4.7. Assessment of the Implementation of the Operational Strategy of the Treasury for 2010-2012 with respect to the Execution of the Functions of the Paying and Certifying Authority of the EU Policy Instruments

The strategic objective for the implementation of the functions of the Paying and Certifying Authority for the European Union policy instruments – ***"To organise and standardise the execution of the functions of the Paying and Certifying Authority in a way that ensures that the requirements included in the Latvian legislation are met by the granting authorities and funds are received promptly from the granting authorities, and also minimises the permissible risk of the inclusion of non-compliant expenditure in statements of expenditure and reports"*** – was achieved to the extent prescribed for 2010-2012 (in terms of the tasks/performance targets defined).

The attainment of the strategic tasks was facilitated by:

1) European Commission guidelines;
2) knowledge, skills and accumulated expertise of the Treasury staff;
3) risk management implemented by the Treasury and the quality management system in place at the Treasury.

[13] Including payments claimed in 2011 but withheld by the Commission.
[14] Instances where the European Commission has applied financial corrections or withheld debtors' claims not paid in time by another authority were disregarded.

The full achievement of some targets was impeded by the suspension of all payments under the operational programmes of the EU funds by the European Commission in early 2012. Despite the fact that, following its inspection, the Audit Authority concluded that the management and control systems of the Certifying Authority were functioning effectively though some improvements were needed, the European Commission considered the deficiencies identified as material for payments to be stopped. The Commission stipulated that the previously declared expenditure was to be revalued and the management and control system was to be improved. Thanks to the timely improvements in the management and control systems of both the Certifying Authority and the Managing Authority and the implementation of the measures included in the action plan that was approved by the Commission, in the second half of 2012, payments to Latvia resumed, and Latvia could receive the withheld payments, as well as the payments submitted subsequently.

The factors referred to above and the audits performed to ensure certified expenditure allow the Treasury to define the next set of tasks for development in accordance with the requirements of the granting authorities and by arranging the payment system in a way that eliminates non-compliant expenditure and prevents attempts at fraud.

Achievement of the strategic targets established for the implementation of the functions of the Paying and Certifying Authority for European Union policy instruments in 2010-2012

1) **certified expenditure paid in full**: the management and control system of the Certifying Authority was improved by providing for additional checks and data analysis and evaluation in the regulatory documentation of the quality management system, as a result of which greater assurance was provided regarding the compliance of the certified expenditure with the regulatory enactments and the risk of declaration of non-compliant expenditure to the European Commission was reduced;

2) **the payment system is organised in a way to eliminate non-compliant expenditure and prevent attempts at fraud**: in accordance with the requirements laid down by the regulatory enactments, documents governing the quality management system have been drawn up in order to realise the execution of the functions of the Paying Authority by ensuring the adequate functioning of the payment system;

3) **document processing takes place within periods that are shorter than those prescribed by the regulatory enactments**: documents governing the quality management system have been developed to ensure the timely processing of payment documents in accordance with the provisions of the regulatory enactment, and to enable the processing of payment documents within a shorter span of time than prescribed by the regulatory enactments, provided that the received payment documents meet the specified quality criteria. In processing payment documents, reasons for delays are identified and, to the furthest extent possible, risks are reduced to prevent instances where the processing of payment documents is not completed within the prescribed period;

4) **an affirmative assessment has been received from external auditors and partners regarding the functionality and reliability of the system, fast and responsive payments and accounting, timely and sufficient control, and quality reporting**: in October 2012, European Commission auditors audited the improvements implemented by the Certifying Authority in the management and control system. The results of the audit have not yet been received, but during the final meeting the auditors noted that no deficiencies had been identified in the measures implemented by the Certifying Authority. Assurance was gained during the European Commission audit about the accounting of recoverable and recovered non-compliant expenditure by the Certifying Authority and reporting thereof to the European Commission. The results indicate that, even though minor improvements are needed, the system works well. At the end of 2012, the system audit performed at the Certifying Authority by the Audit Authority also provides an affirmative assessment of the operations of the Certifying Authority.

With the period of the Operational Strategy of the Treasury for 2010-2012 coming to a close and having evaluated the results of its implementation and the degree of attainment of the strategic objectives and tasks and, in view of the regulatory framework and the factors affecting the operations of the Treasury, the Treasury has defined a new set of tasks towards the attainment of the strategic objective of the implementation of the functions of the Certifying and Paying Authority of the EU policy instruments for the next strategic planning period:

1) arrange and ensure the verification of statements of expenditure and expenditure reports in accordance with the requirements laid down by the granting authorities and the legislation of the Republic of Latvia;

2) ensure that the requirements of the granting authorities with respect to the drafting and submission of reports are met;

3) organise the payment system in a way that eliminates non-compliant expenditure and prevents attempts at fraud..

5. Governance of the Treasury as a Public Administration Institution

5.1. Funding of the Treasury and Spending

The Treasury's financing consists of:

1) a grant from the general revenue;
2) paid services and other own revenues:
- revenue from the servicing of state loans;
- revenue from the servicing of state guarantees.

In 2012, the Treasury implemented the following **general budget programmes and sub-programmes**:

1) Programme *Budget Implementation and Central Government Debt Management*:
   - Sub-Programme *Budget Implementation*;
   - Sub-Programme *Central Government Debt Management*;
2) Sub-Programme *Contributions to International Organisations*;
3) Sub-Programme *Compensation to Rehabilitated Citizens*;
4) Programme *State Budget Loans and Repayments Thereof*;
5) Sub-Programme *Restricted Project Competitions Financed by the European Regional Development Fund (ERDF) (2007-2013)*;
6) Sub-Programme *Technical Assistance for the Absorption of the ERDF, ESF and the Cohesion Fund (2007-2013)*;
7) Sub-Programme *Technical Assistance for the Absorption of the European Economic Area Financial Mechanism and the Norwegian Financial Mechanism*;
8) Programme *Grant to the Local Government Financial Equalisation Fund*;
9) Programme *Use of Funds for Unforeseen Events*.

The objective of the **Sub-Programme *Budget Implementation*** is the implementation and monitoring of the general central government budget that is orientated towards ensuring an effective and economical central government budget implementation process and improving the services provided by the Treasury in accordance with the best practices of financial management.

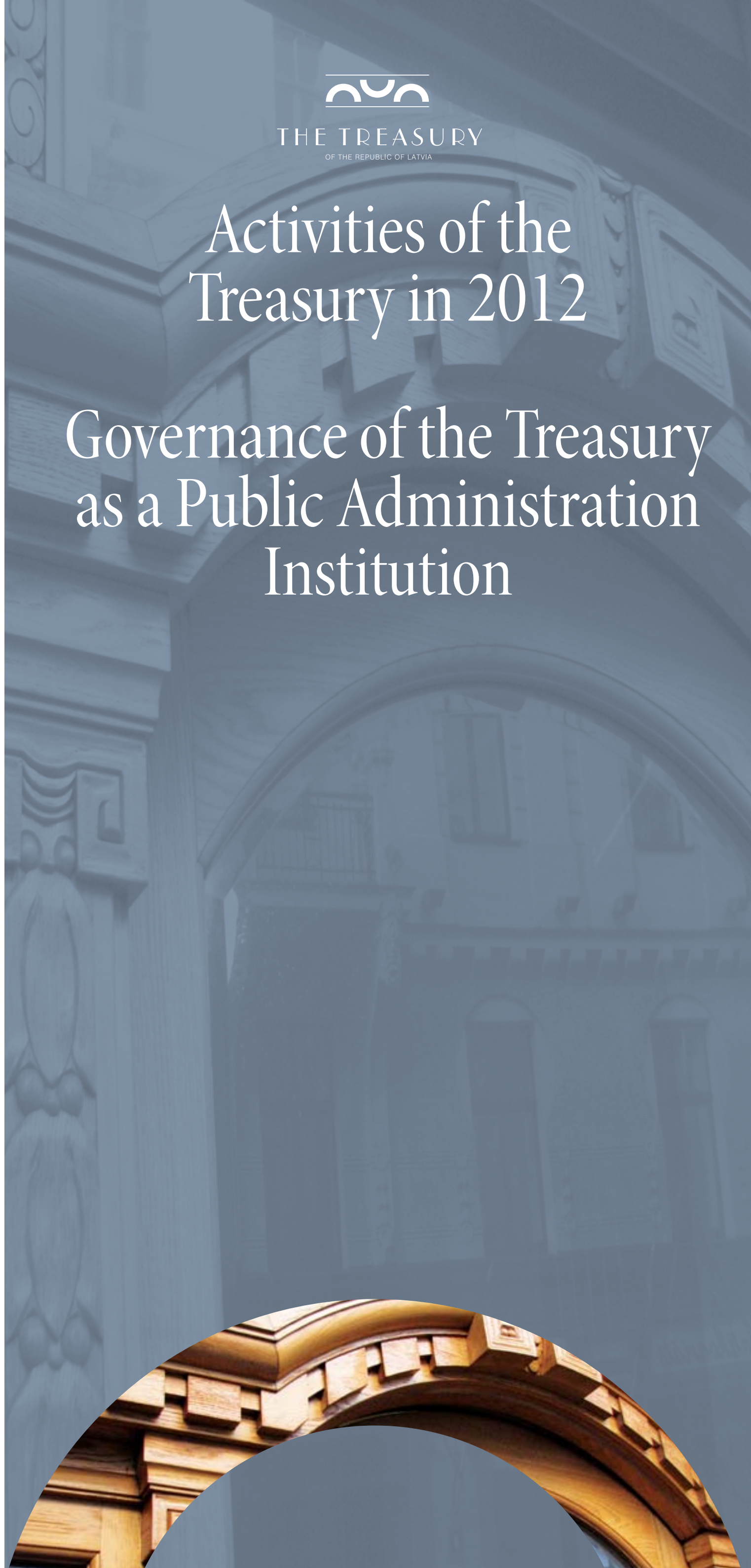
The objective of the **Sub-Programme *Central Government Debt Management*** is to secure the necessary financial resources, including those on public capital markets, at the lowest possible cost, to limit financial risks and, to the furthest extent possible, promote the financial interests of the state in the process of issuing state guarantees, taking into account the factors of national macroeconomic stability and the development of the capital market and financial system that is aimed at the introduction of the euro in the medium term, as well as to ensure efficient and reliable cash management by limiting and monitoring financial risks and provide the liquidity necessary to meet the government's financial commitments in full and in a timely manner.

The objective of the **Sub-Programme *Contributions to International Organisations*** is to make full and timely annual membership contributions of the Republic of Latvia to international financial organisations and payments into the capital and/or reserves of the international financial institutions where the Republic of Latvia is a holder of capital shares, thus ensuring that the assumed commitments are met.

The objective of the **Sub-Programme *Compensation to Rehabilitated Citizens*** is to ensure disbursement of compensations to rehabilitated citizens in accordance with the regulatory enactments.

The objective of the **Programme *State Loans and Repayments Thereof*** is to ensure state budget lending in compliance with the respective budget appropriation, offering to project implementers the most adequate financial resources, to provide current information on the portfolio of issued state loans, and to perform the actions required for the process of recovering delayed payments.

Within the **Sub-Programme *Restricted Project Competitions Financed by the European Regional Development Fund (ERDF) (2007-2013)***, the project "Improvement of the Treasury Online Data Exchange System", financed by the ERDF, was implemented to enable receipt of prompt payment information by all the institutions administering government budget payments. The project is being implemented under sub-activity 3.2.2.1.1 "Development of Information Systems and Electronic Services" of activity 3.2.2.1 "Development of Electronic Services and Information Systems of Public Administration" of measure 3.2.2 "ICT Infrastructure and Services" of the European Regional Development Fund operational programme "Infrastructure and Services".



The EU technical assistance project "Technical Assistance to Ensure the Operations of the Treasury as the Certifying Authority and Paying Authority" is being implemented as part of the ***Sub-Programme Technical Assistance for the Absorption of the ERDF, ESF and the Cohesion Fund (2007–2013)***; The objective of the project is to ensure the sound and effective performance of the functions of the Certifying Authority and Paying Authority and to provide a qualified staff. As part of the technical assistance project, support is being provided to the Treasury towards the sound and effective performance of the functions of the Paying Authority and Certifying Authority of the EU Structural Funds and the Cohesion Fund, as prescribed by the Law on the Management of European Union Structural Funds and the Cohesion Fund.

As part of the **Sub-Programme *Technical Assistance for the Absorption of the European Economic Area Financial Mechanism and the Norwegian Financial Mechanism***, the Treasury participates in the implementation of the project of the Ministry of Finance, "Technical Assistance Fund for 2011-2017".

The objective of the **Programme *Grant to the Local Government Financial Equalisation Fund*** is to ensure the transfer of the grant from the central government budget to the Local Government Financial Equalisation Fund and the depositing of the relevant funds into the budgets of the respective local governments in compliance with the effective laws and regulations.

As part of the **Programme *Use of Funds for Unforeseen Events***, the Treasury made a contribution to the IMF's Poverty Reduction and Growth Trust, as per Cabinet Order No 565 of 29 November 2012 "On the Allocation of Funds from the State Budget Programme 'Funds for Unforeseen Events'" and Ministry of Finance Order No 664 of 13 December 2012.

Table 7
General government budget financing and spending
(summary by programme, LVL)
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year: approved by law	In the reporting year: actual implementation
1.	**Financial resources for covering expenditures (total)**	**223,876,917**	**241,912,377**	**241,975,124**
1.1.	grants	221,498,669	240,295,902	239,409,765
1.2.	paid services and other own revenues	2,378,248	1,616,475	2,565,359
1.3	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**222,953,930**	**241,596,877**	**241,038,336**
2.1.	maintenance expenditure (total)	222,642,128	240,795,305	240,414,718
2.1.1.	running costs	5,286,796	6,177,706	6,000,299
2.1.2.	interest	198,407,707	216,317,200	216,297,120
2.1.3.	subsidies, grants and social benefits	77,581	156,971	74,943
2.1.4.	regular payments into the European Community budget and international cooperation	3,393,358	2,652,057	2,598,235
2.1.5.	maintenance cost transfers	15,476,686	15,491,371	15,444,121
2.2.	expenditure for capital investment	311,802	801,572	623,618
3.	**Financial balance**	**922,987**	**315,500**	**936,788**
4.	Financing	-922,987	-315,500	-936,788
4.1.	increase (-) or decrease (+) in the balance of funds from paid services or other own revenues	-922,987	85,000	-936,788
4.2.	shares and other holdings in the equity of economic operators	-	-400,500	-

Table 8
General government budget financing and spending for the general budget Programme *Budget Implementation and Central Government Debt Management* (LVL)
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**204,907,991**	**222,639,492**	**223,492,854**
1.1.	grants	202,529,743	221,023,017	220,927,495
1.2.	paid services and other own revenues	2,378,248	1,616,475	2,565,359
1.3	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**203,985,004**	**222,724,492**	**222,556,066**
2.1.	maintenance expenditure (total)	203,694,503	222,415,118	222,249,524
2.1.1.	running costs	5,286,796	6,097,918	5,952,404
2.1.2.	interest	198,407,707	216,317,200	216,297,120
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	-	-	-
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	290,501	309,374	306,542
3.	**Financial balance**	**922,987**	**-85,000**	**936,788**
4.	Financing	-922,987	85,000	-936,788
4.1.	increase (-) or decrease (+) in the balance of funds from paid services or other own revenues	-922,987	85,000	-936,788

Table 9
General government budget financing and spending for the general budget Sub-Programme *Budget Implementation (LVL)*
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**4,393,905**	**3,633,992**	**4,582,876**
1.1.	grants	2,015,657	2,017,517	2,017,517
1.2.	paid services and other own revenues	2,378,248	1,616,475	2,565,359
1.3.	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**3,470,918**	**3,718,992**	**3,646,088**
2.1.	maintenance expenditure (total)	3,180,417	3,409,618	3,339,546
2.1.1.	running costs	3,180,417	3,409,618	3,339,546
2.1.2.	interest	-	-	-
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	-	-	-
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	290,501	309,374	306,542
3.	**Financial balance**	**922,987**	**-85,000**	**936,788**
4.	Financing	-922,987	85,000	-936,788
4.1.	increase (-) or decrease (+) in the balance of funds from paid services or other own revenues	-922,987	85,000	-936,788

Table 10
General government budget financing and spending for the general budget Sub-Programme *Central Government Debt Management* (LVL)
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	Pārskata gadā	
			approved by law	actual implementation
1.	**Financial assets to cover expenditure (total)**	**200 514 086**	**219 005 500**	**218 909 978**
1.1.	grants	200,514,086	219,005,500	218,909,978
1.2.	paid services and other own revenues	-	-	-
1.3.	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**200,514,086**	**219,005,500**	**218,909,978**
2.1.	maintenance expenditure (total)	200,514,086	219,005,500	218,909,978
2.1.1.	running costs	2,106,379	2,688,300	2,612,858
2.1.2.	interest	198,407,707	216,317,200	216,297,120
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	-	-	-
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	-	-	-

Table 11
General government budget financing and spending
For the general budget Sub-Programme *Contributions to International Organisations* (LVL)
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**3,393,358**	**2,692,468**	**2,254,855**
1.1.	grants	3,393,358	2,692,468	2,254,855
1.2.	paid services and other own revenues	-	-	-
1.3.	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**3,393,358**	**2,291,968**	**2,254,855**
2.1.	maintenance expenditure (total)	3,393,358	2,291,968	2,254,855
2.1.1.	running costs	-	-	-
2.1.2.	interest	-	-	-
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	3,393,358	2,291,968	2,254,855
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	-	-	-
3.	**Financial balance**	**-**	**400,500**	**-**
4.	Financing	-	-400,500	-
4.1.	shares and other holdings in the equity of economic operators	-	-400,500	-

Table 12
General government budget financing and spending for the general budget *Sub-Programme Compensation to Rehabilitated Citizens* (LVL)
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**77,581**	**156,971**	**74,943**
1.1.	grants	77,581	156,971	74,943
1.2.	paid services and other own revenues	-	-	-
1.3.	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**77,581**	**156,971**	**74,943**
2.1.	subsidies, grants and social benefits	77,581	156,971	74,943
2.1.1.	running costs	-	-	-
2.1.2.	interest	-	-	-
2.1.3.	subsidies, grants and social benefits	77,581	156,971	74,943
2.1.4.	regular payments into the European Community budget and international cooperation	-	-	-
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	-	-	-

Table 13
General government budget financing and spending for the general budget Programme *Grant to the Local Government Financial Equalisation Fund* (LVL)
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**15,476,686**	**15,491,371**	**15,444,121**
1.1.	grants	15,476,686	15,491,371	15,444,121
1.2.	paid services and other own revenues	-	-	-
1.3.	oreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**15,476,686**	**15,491,371**	**15,444,121**
2.1.	maintenance expenditure (total)	15,476,686	15,491,371	15,444,121
2.1.1.	running costs	-	-	-
2.1.2.	interest	-	-	-
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	-	-	-
2.1.5.	maintenance cost transfers	15,476,686	15,491,371	15,444,121
2.2.	expenditure for capital investment	-	-	-

Table 14
General government budget financing and spending
For the general budget Sub-Programme
***Restricted Project Competitions Financed by the European Regional Development Fund (ERDF) (2007-2013)* (LVL)**
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**21,301**	**497,698**	**322,521**
1.1.	grants	21,301	497,698	322,521
1.2.	paid services and other own revenues	-	-	-
1.3.	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**21,301**	**497,698**	**322,521**
2.1.	maintenance expenditure (total)	-	5,500	5,445
2.1.1.	running costs	-	5,500	5,445
2.1.2.	interest	-	-	-
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	-	-	-
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	21,301	492,198	317,076

Table 15
General government budget financing and spending
For the general budget Sub-Programme
***Technical Assistance for the Absorption of the ERDF, ESF and the Cohesion Fund (2007–2013)* (LVL)**
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**-**	**62,000**	**31,610**
1.1.	grants	-	62,000	31,610
1.2.	paid services and other own revenues	-	-	-
1.3.	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**-**	**62,000**	**31,610**
2.1.	maintenance expenditure (total)	-	62,000	31,610
2.1.1.	running costs	-	62,000	31,610
2.1.2.	interest	-	-	-
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	-	-	-
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	-	-	-

Table 16
General government budget financing and spending
For the general budget Sub-Programme *Technical Assistance for the Absorption of the European Economic Area Financial Mechanism and the Norwegian Financial Mechanism* (LVL)
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**-**	**12,288**	**10,840**
1.1.	grants	-	12,288	10,840
1.2.	paid services and other own revenues	-	-	-
1.3.	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**-**	**12,288**	**10,840**
2.1.	maintenance expenditure (total)	-	12,288	10,840
2.1.1.	running costs	-	12,288	10,840
2.1.2.	interest	-	-	-
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	-	-	-
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	-	-	-

Table 17
General government budget financing and spending
for the general budget Sub-Programme *Use of Funds for Unforeseen Events* (LVL)
Source: The Treasury

Item No	Financial assets	Previous year (actual implementation)	In the reporting year	
			approved by law	actual implementation
1.	**Financial resources for covering expenditures (total)**	**-**	**360,089**	**343,380**
1.1.	grants	-	360,089	343,380
1.2.	paid services and other own revenues	-	-	-
1.3.	foreign financial assistance	-	-	-
1.4.	donations and grants	-	-	-
2.	**Expenditure (total)**	**-**	**360,089**	**343,380**
2.1.	maintenance expenditure (total)	-	360,089	343,380
2.1.1.	running costs	-	-	-
2.1.2.	interest	-	-	-
2.1.3.	subsidies, grants and social benefits	-	-	-
2.1.4.	regular payments into the European Community budget and international cooperation	-	360,089	343,380
2.1.5.	maintenance cost transfers	-	-	-
2.2.	expenditure for capital investment	-	-	-

Central Government and Local Government Procurement

Procurement by the Treasury takes place in accordance with the Public Procurement Law by applying the procedures of an open competition, negotiated procedure and procurement procedure pursuant to Article 81 of the Public Procurement Law. In order to conduct procurement, the Treasurer issues a decree to form a procurement commission that is competent within the field of procurement for which the contract is to be entered into. Procurements are recorded and contracts are controlled within the Horizon accounting software. In 2012, the Treasury conducted 23 procurements (excluding procurement under LVL 3,000) and concluded contracts worth LVL 2,336,385, excluding VAT.

5.2. Personnel and Personnel Management

In 2012, there were **185 official positions** at the Treasury: **168 civil service positions and 17 staff positions. The average number of employees** in 2012, including the employees on a long-term leave of absence, was **184**, including **167 civil servants** and **17 staff**.

The **percentage breakdown** of the Treasury **personnel by age and gender did not change significantly in 2012** in comparison with the previous years (see Figures 13 and 14).

Figure 13.
Breakdown of the Treasury personnel by gender, 2007 to 2012 (%)
Source: The Treasury

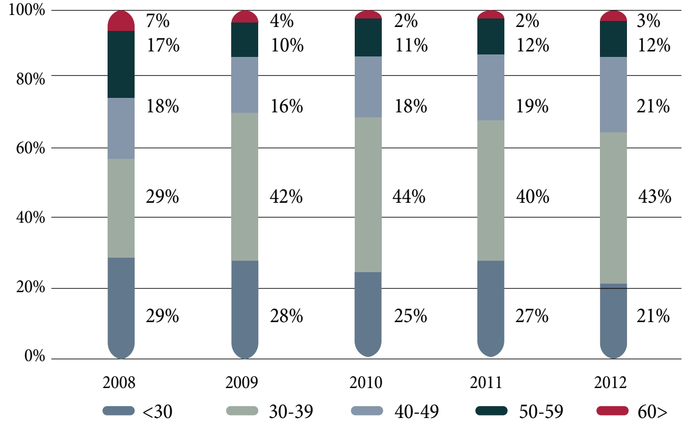


Figure 14.
Breakdown of the Treasury personnel by age, 2007 to 2012 (%)
Source: The Treasury

In 2012, **12 employees, or 7% of the total, were released** (see Figure 15). If the percentage of personnel turnover is considered over recent years, it is clearly evident that it declined markedly in 2012.

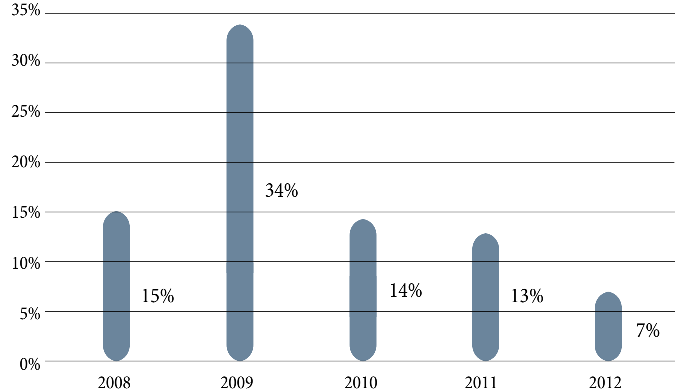


Figure 15.
Released personnel (2008 to 2012) (%)
Source: The Treasury

In the reporting year, 15 professional staff entered into civil service or employment legal relations with the Treasury. In order to attract professional personnel, the Treasury continues its collaboration with higher education institutions and a recruitment agency. In order to ensure a professional and impartial personnel selection process, the Treasurer issues a decree to establish a selection commission that organises several rounds of personnel selection using a scoring system and arranging practical tests and interviews.

The Treasury continues its usual practice of promoting the professional advancement and career development of its professionals: eight civil servants were reappointed to higher-level positions – both permanently and for the duration of the absence of a colleague – while four civil servants were moved to positions in other structural units. Furthermore, three civil servants who had been appointed to a position for a fixed period were given the opportunity to continue their civil service relations with the Treasury following indefinite reappointment.

The Treasury pays special attention to introducing new employees to their job responsibilities and the operations of the institution by preparing a work plan for the trial period of the new employees and familiarising them with the functions of the Treasury and the team. At the conclusion of the trial period, the performance of 18 new employees received a positive assessment.

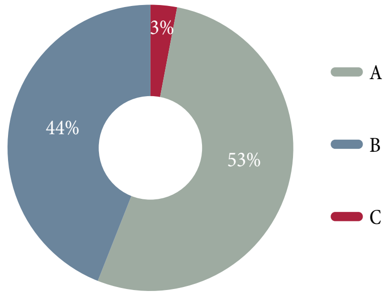
Based on the results of the performance appraisals following the completion of the trial period, 14 civil service candidates were granted the status of a civil servant.

During the annual **job performance** appraisal, the performance of 161 civil servants and staff members was evaluated. The results of performance appraisals are used to motivate the personnel, for professional advancement and career growth and to identify training needs.

he positive results of the performance appraisal (no employee received D or E assessments) attest that the employees of the Treasury have reached a high level of professionalism and have developed their skills by performing their work duties efficiently and participating in the attainment of the overall goals of the institution (see Figure 16).

The greatest asset of the Treasury is its highly educated and professional personnel. **Of the entire staff, 98% are university graduates** (of those, 50% have obtained a master's degree).

Promoting the professional and personal development of human resources remains an important area of personnel management, and in the **organisation of the training process**, in 2012 the Treasury continued



A: performance in all areas exceeds the requirements of the respective industry
B: performance in some areas exceeds requirements and in all other areas conforms with the requirements of the respective industry
C: performance conforms with the requirements of the respective industry
D: performance does not meet the requirements of the respective industry in all areas, performance needs to be improved
E: performance does not meet the requirements in the respective industry, all areas require significant and immediate improvements

Figure 16.
Results of the job performance appraisal process in 2011-2012 (%)
Source: The Treasury

to search for solutions for the professional development and enhancement of competencies of its employees, which included efforts such as various free workshops and experience-sharing events. As in previous years, educational sessions organised by the Treasury civil servants themselves were of relevance as well – in areas such as information security, management and mitigation of corruption risks, government budget implementation, media communication, government debt and asset management and improvement of the quality management system.

In 2012, as part of the ESF project "Support for Reforms within the Area of Budget and Financial Policy", some civil servants involved in the area of finance were given the opportunity to participate in exchange trips and to attend specialised advanced training sessions in Latvia as well as abroad on the best practices and competence of other countries in such areas of finance as government borrowing strategy and methods for optimising the cost of central government debt, financial derivatives, credit risk analysis and management, etc.

Every year, the Treasury assesses the educational and training needs of the civil servants and staff and approves a Training Plan for the subsequent year. Educational needs are determined by considering the strategic direction of the institution, the functions of the structural unit and other criteria that justify the need for training that would lead to the effective performance of work duties.

5.3. Quality and Risk Management

Since 2006 the Treasury's quality management system has been certified in accordance with the requirements of the ISO 9001 standard (since 2009, in accordance with ISO 9001:2008). The Treasury is continuously improving its quality management system to ensure that it not only conforms to the effective requirements of legislative acts, regulatory enactments and the ISO 9001:2008 standard, but that it also secures a balance between satisfying client needs and the monitoring functions the Treasury is expected to provide in accordance with the interests of the State and its residents, and instils confidence in its clients regarding the consistency of the quality of the services provided by the Treasury.

The scope of activity of the quality management system subject to certification is the implementation of the central government budget, central government debt management, cash and state loan management, implementation of the functions of the EU Paying and Certifying Authority and National Fund management functions, all of which are the basic operational processes of the Treasury. **In 2012, the quality management system of the Treasury was successfully recertified**, thereby gaining assurance regarding the continuous compliance of the system with the requirements of ISO 9001:2008. **During the audit, excellent internal information circulation and employee understanding of the strategic progress and priorities of the Treasury's operations were noted.**

In order to make sure that the existing services of the Treasury are improved and new services are developed, a **project management methodology** was introduced in 2012 as part of the ESF project "Improvement and Development of the Quality of Treasury Services". The Project Management Manual produced by the Treasury in 2012 defines an organisational framework for project management and common project management principles, taking into account the specific features of Treasury projects, its structure and organisational culture. The Treasury uses the methodology in the planning and management of development projects.

In 2012, the Treasury took part in the **international Quality Innovation of the Year Competition**, which enjoys wide publicity in the Nordic countries and which was organised for the first time to also include Latvian entities. The Quality Innovation of the Year Competition was held in Finland, Estonia, Sweden and Latvia in 2012. Participants were honoured by the presence and welcome of Juris Bone, Ambassador of Latvia in Finland, and Eero Heineluoma, Speaker of the Finnish Parliament. In Latvia, the competition was organised by the Latvian Association for Quality together with the long-standing organiser, the Finnish Quality Association.

The **risk management** of the Treasury is integrated into the quality management system, which ensures the identification and implementation of preventive steps and focuses on the attainment of the Treasury's strategic objectives.

5.4. Internal Control System

The **internal control system** of the Treasury has been established based on the basic elements of an internal control system: a control environment, work performance appraisal, risk management, control activities, monitoring, efficient circulation of information and mutual communication.

The Treasury has developed the **control environment culture** by ensuring that the operations comply with the quality management system and the code of ethics, and by facilitating employee participation in the improvement of the internal control system. The Treasury has implemented an organisational structure that clearly defines the responsibility, authority, distribution of duties and procedure for reporting.

Risk management and quality management have been integrated into the daily operations, project management and information system management processes of the Treasury that advance the **control activities** of the Treasury from reactive to proactive, thus decreasing the likelihood of potential losses and ensuring the continuity of the operations. The processes of the Treasury and the controls to be performed when implementing them have been set out in the internal documents governing the quality management system.

The Treasury conducts the **monitoring of the internal control system** through process management by measuring the quality criteria of the process activity, through the strategic management process by analysing the results of the activity, through control self-assessments in the processes of risk management and irregularity prevention, and through the implementation of recommendations for the improvement of the internal control system provided as a result of audits and other assessments.

The **internal audits** and **inspections, audits performed by external auditors**, the results of the audits and the **process of implementation of recommendations** from external and internal audits in 2012 all attest to the fact that the **internal control system of the Treasury functions well**, and the assessed controls are generally adequate, sufficient and efficient, providing sufficient assurance that the risks of the Treasury are being managed and its objectives are being achieved. The internal control system in place at the Treasury ensures the execution of the defined institutional tasks in accordance with the strategic objectives and in compliance with the requirements set out in the external and internal regulatory enactments, as well as the credibility and adequacy of the reports produced. The Treasury is continuously improving its processes by following best practice examples and the expertise of financial sector organisations.

Public Communication

Measures for Public Information and Education

Fully-fledged communication between the Treasury and the general public is possible if an effective exchange of information is in place. The Treasury regularly informs the mass media about matters that fall within its scope of competence, it prepares and distributes press releases and provides answers to questions of interest to the mass media.

The communication processes of the Treasury are significantly influenced by the national socio-political and economic conditions: the Treasury remains at the epicentre of events and **the interest of mass media and the public in the operations, functions and responsibilities remained high**.

In accordance with the **Communication Strategy of the Treasury for 2010-2012 (updated for 2011-2013), the Treasury Communication Plan for 2011** was developed and implemented in order to ensure the planning of efficient and successful operations, to create and maintain a favourable and cooperative environment for internal communication within the Treasury and to advance the image of the Treasury by introducing additional external communication activities. In 2012, the **Communication Strategy of the Treasury for 2012-2015** was produced and approved.

Since 2002, the Treasury has maintained a website (www.kase.gov.lv), which provides information on the institution and its functions. Information on the latest developments at the Treasury is posted and updated regularly. It is possible to ask questions and file submissions and applications electronically. Visitors to the homepage can receive prompt answers to their enquiries, whereas the Treasury has the opportunity to acquaint itself with issues that are of interest to the clients and the general public. If necessary, the Treasury can prepare more in-depth information to post on the website and for distribution to the clients. The Treasury can also identify potential problems and prevent them.

THE TREASURY
OF THE REPUBLIC OF LATVIA

The Treasury's Development Priorities for 2013

1) **Ensure the adaptation of the Treasury's information systems for the introduction of the euro.**

2) **Introduce savings bonds in the management of government borrowing.**

3) **Conduct measures to secure funding for the repayment of central government debt scheduled for 2014/2015 in accordance with the medium-term borrowing strategy.**

4) **Diversify the investor base.**

5) **Reduce the risks in the management and control system of the Certifying Authority.**

6) **Develop a customer relationship management system in the administration of the institution by transitioning to the MS Share Point platform and introducing modules to support the internal processes of the Treasury.**