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Public Report for 2011

Treasury of the Republic of Latvia

THE TREASURY

OF THE REPUBLIC OF LATVIA

Public Report for 2011

Abbreviations used in the Report

CDS	Credit Default Swap
CEB	Council of Europe Development Bank
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
eKase	Electronic payment system of the budget
ERDF	European Regional Development Fund
ESF	European Social Fund
EU	European Union
EUROSTAT	The Statistical Office of the European Community
GDP	Gross Domestic Product
JSC	Joint Stock Company
IMF	International Monetary Fund
PPP	Public-Private Partnership
FIFG	Financial Instrument for Fisheries Guidance

Units of Measure

LVL (lat)	lats, the national currency of the Republic of Latvia
EUR	euro

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The Treasurer's Statement

Safe and stable management of the public finances, optimisation of the central government budget execution procedure and the central government debt servicing costs, ensuring the sustainability of government finances, resumption of investor confidence, as well as management of financial risks essential to the state mark the competence of the Treasury during the period when the stabilisation of Latvia's financial situation and improvements in the national economy interchange with the tension in the financial sector of the country at the year-end, as well as unfavourable developments and uncertainty in the global and European financial markets.

The successful closure of the international loan programme in December was one of the most important aspects which had a material effect on the Treasury's operations. In future, according to the medium-term borrowing strategy developed by the Treasury and approved by the Minister of Finance the Treasury will have to ensure resources refinancing of government debt liabilities by borrowings in the international financial markets. The policy implemented by the government to overcome the crisis gave a positive impulse for strengthening investor confidence in the creditworthiness of the country and facilitated Latvia's return to the international financial markets. In June 2011 Latvia issued 10-year bonds with a total value of USD 500 million and in February 2012 – 5-year bonds with a total value of USD 1 billion. The two bond issues are an especially significant point of reference ensuring a stable basis and confidence in successful refinancing of the international loan programme during the years to come.

The Treasury resumed issues of 10-year T-bonds in 2011, which decreased the refinancing risks in the domestic market related to the government domestic debt and allowed to fix the debt servicing costs at low levels. Thus, the full spectrum of government securities offer was renewed to the pre-crisis level.

In 2011, the Treasury continued to improve its services by placing the greatest emphasis on the development of electronic services and online information exchange solutions. Electronic services has allowed to improve efficiency of central government budget execution process considerably resulting in standardised central government budget execution procedures, decreased bureaucratic burden on the customer and citizens, establishment of preconditions for recurrent use of information. The progress achieved by the Treasury in good management is proven by the successful supervision and recertification audits of Treasury quality management system and the Employers' Confederation of Latvia and the State Chancellery award received in December for the introduction of good management principles in the public institution through enacting a customer oriented approach, improving financial performance indicators, decreasing administrative burden, optimising resources of the Treasury and its customers, as well as recognising the Treasury as the model for other public institutions with respect to the simplification of its work and making it more comprehensible, operative and closer to the society.

The personnel that understands the Treasury's strategic priorities, unified, professional, focused and conscientious teamwork is a value developed through years, the lack whereof would make attaining of our goals and performance of tasks impossible. That way the Treasury contributes to stabilisation of the national financial system and facilitation of the welfare of people.

The Treasurer

Kaspars Āboliņš

Riga, 28 February 2012

Operational Strategy of the Treasury

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

The Strategy prescribes the following Treasury operational directions, the execution of which in 2011 is described in this Report:

1) **the central government budget execution**, which is oriented towards ensuring an effective and economical central government budget execution process and the improvement of services provided by the Treasury in accordance with the best practices of financial management;
2) **central government debt management**, to secure the necessary financial resources, including those on public capital markets, at the lowest possible cost, to limit financial risks and, to the 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 budget loans management**, by providing effective and safe cash management, limiting and monitoring financial risks, ensuring the necessary liquidity promptly and in full amount for execution of state liabilities, as well as performing effective granting and servicing state loans, with consideration of the necessity to achieve state macroeconomic stability and development targets in the medium term;
4) **Realisation of European Union policy instruments Paying and Certifying Authority functions** by organising and standardising the execution of the functions of the Paying and Certifying Authority in a way that ensures the fulfilment of requirements included in legislative acts of the granting authorities and the Republic of Latvia and also the timely

receipt of funds from the granting authorities, and also minimises the permissible risk for the inclusion of improperly incurred expenses in expense declarations and reports.

The Treasury observes **unified institution operation principles** to achieve its set targets:

1) quality and risk management;
2) personnel management;
3) effectiveness of the operational management of the internal control system;
4) use of information technology and information security;
5) lawfulness and legality of Treasury activities;
6) institutional administration;
7) institutional communication.

The principal priorities of the Strategy are as follows:

1) efficient human resource management, whereby employee development at all levels and their involvement in the attainment of the Treasury's targets is encouraged;
2) ensuring high-level access to the services provided by the Treasury, in accordance with developments in information technology and by utilising the resource optimisation capabilities they afford;
3) efficient and secure administration and monitoring of the public financial management processes in accordance with the interests of the State and its residents.

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 Treasurer manages the Treasury's operations and is appointed and dismissed from office by the Minister of Finance.

The Treasury has the following **functions**:

1) Organising the execution and financial accounting of the central government budget;
2) Providing assignations and making payments from central government budget revenue;
3) Central government debt management;
4) Functions of the Paying and Certifying Authority for EU policy instruments, the European Economic Area Financial Instrument and the Norwegian Government Bilateral Financial Instrument, 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 of Ministers Regulations No.677 of the **"Regulation of the Treasury"** of 3 August 2004 pursuant to the Public Administration Law.

The structure and work organisation of the Treasury is established by the Rules of Procedure of the Treasury.

FLOWCHART OF THE TREASURY'S STRUCTURE

TREASURER

- **DEPUTY TREASURER** on financial resource management issues
  - Financial Resources Department
  - Financing Department
  - International Cooperation Department
  - Forecasting and Financial Planning Department
  - Financial Risk Management Department
- **DEPUTY TREASURER** on central government budget execution, accounting, reporting, and transaction issues
  - Budget Execution and Monitoring Department
  - Reports Department
  - Informatics Department
  - Operations Department
- European Affairs Department
- Office
- Legal Department
- Internal Audit Department
- Quality and Risk Management Department
- Personnel Department
- Accounting Department
- Infrastructure Maintenance Department
- Client Management and Service Development Department

In order to limit the financial risks as much as possible, **the structure** of the Treasury has been developed according to the function separation principle (according to the bank and European debt management offices):

1) client servicing and financial transactions;
2) financial risk management;
3) ensuring accounting and preparation of statements.

In order to make unified decisions, the following **committees** continued their work in 2011:
Audit Committee – to improve the operation of the Treasury's internal control system, to facilitate the achievement of the Treasury's strategic goals, to protect its resources, and establish and maintain effective control of measures. The Committee reviews the findings and conclusions of internal and external auditors' reports on the Treasury's operations, recommendations included in the reports for operational improvements of the internal control system established in the Treasury, and comments provided by the audited structural units concerning the facts discovered during audits. The Committee is authorised to decide on potential measures for mitigation or prevention of the most significant risks to the Treasury.

Central Government Debt Management Committee – to facilitate effective central government debt management, develop proposals for improvement and implement the Central Government Debt Management Strategy.

Central Government Budget Accounting Committee – to update implementation of the financial accounting policy of the central government budget managed by the Treasury and to ensure effective management of accounting policy changes. The task of the Committee is to define accounting policy and its compliance with accounting standards, establish accounting policy objectives, improve and update accounting policy and facilitate compliance with the requirements established thereby.

Committee for Management of Information System Changes in the Treasury – to coordinate consideration and implementation 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 concerning monitoring of state loans, guarantees issued on behalf of state and counterparty limits.

Euro Changeover Committee – to draft proposals for ensuring the euro changeover in the areas of the Treasury's competence and coordinate the involvement of the Treasury's structural units in implementation of the relevant euro changeover measures.

Management Committee – to ensure effective management of the budget and personnel resources of the Treasury, attain the objectives stated in the Strategy, and implement priority measures and new policy initiatives.

Resource Liquidity Committee – to facilitate the quality of cash management in order to ensure proper liquidity management in compliance with the tasks set in the Treasury's Cash Management Strategy.

Quality and Risk Management Committee – to facilitate constant improvement of the Treasury's operations and compliance of its services with clients' needs by ensuring effective quality, risk and information safety management.

1. CENTRAL GOVERNMENT BUDGET EXECUTION

1.1. CHARACTERISTICS OF THE CENTRAL GOVERNMENT BUDGET EXECUTION FUNCTION

The Law on Budget and Financial Management has authorised the Treasury as the direct administration institution subordinated to the Ministry of Finance **to organise the execution and financial accounting of the central government budget and ensure the granting of allocations and execution of payments made by budget institutions within the limits of the appropriations set in the annual central government budget**.

While implementing the central government budget, the Treasury maintains **the Unified Central Government Budget Planning and Execution Information System**, where budget accounts for budget executors are opened; grants allocations and subsidies from general revenue based on the appropriation of the annual state budget and financing plans registered in the Treasury; ensures processing and performance of payment orders of the clients of the Treasury via electronic payment system of the budget *eKase*; keeps records of the central government budget revenue as well as provides information concerning the taxes and fees paid to the State Revenue Service.

Ensuring uniform accounting of public finances, the Treasury **drafts laws and regulations concerning the accounting in the central and local government budget institutions**, thereby setting universal accounting principles, a universal chart of accounts and a reporting system which is compliant with classifications approved by the Cabinet of Ministers, while yielding information on central government budget execution based on both the cash flow accounting principle and accruals principle. The uniform budget reporting system ensures aggregation of the reports submitted by central and local government budget institutions, and is used not only by the Treasury, but also by the Ministry of Finance, State Audit Office, Bank of Latvia, Central Statistical Bureau and other public administration institutions.

1.2. ORGANISATION OF THE 2011 CENTRAL GOVERNMENT BUDGET EXECUTION

GRANTING AND IMPLEMENTATION OF ASSIGNATION

In 2011, the Treasury assigned **LVL 5,186.43 million** to ensure the central government budget execution, including **LVL 3,700.38 million** for the general budget and **LVL 1,486.05 million** for the special budget. The assignments were granted to **383 state budget institutions, including 119 election commissions**.

Table 1 Number of Central Government Budget Revenue and Expenditure Accounts at the Treasury in 2010 and 2011

General budget revenue accounts			General budget expenditure accounts			Special budget accounts			Donation and grant accounts			Operations accounts			Deposited funds accounts			Certified bailiffs' accounts
2010	2011	%	2010	2011	%	2010	2011	%	2010	2011	%	2010	2011	%	2010	2011	%	2011
291	309	6,2	2041	2104	3,1	44	35	-20,5	242	193	-20,3	5843	6695	14,6	487	516	6,0	119

Source: The Treasury

The number of **general budget expenditure accounts** in 2011 as compared to 2010 **has increased by 63 accounts in total or 3.1%**. The positive increase was formed of the increasing number of implementers of the EU structural fund projects in the state administration, as well as accounts for 119 election commissions, in order to ensure the Referendum on Dismissal of the 10th Saeima and elections of the 11th Saeima. The decrease in the number of accounts was influenced by the **structural reforms performed in the state administration in 2011** resulting in the continuous reduction of budget institutions, as well as number of opened budget expenditure accounts.

In 2011 the number of **operations accounts increased by 14.6%**, including the opening of

1,470 new operations accounts and the closing of 554 accounts. The most significant **reason for increase in the number of operations accounts is the intensively used EU structural funds and the projects co-financed by the foreign financial aid**, for the implementation whereof new current accounts have been opened with the Treasury.

Pursuant to the amendments to the Law on Bailiffs that came into effect on 1 June 2011, a **certified bailiff opens a deposit account, where the funds recovered from the debtors and other amounts pertaining to the interested persons (deposit amounts) shall be kept, solely with the Treasury**. Based on the above amendments, **119 deposit accounts of certified bailiffs** were opened with the Treasury in 2011.

As a result of **the state administration structural reforms performed** in 2011 (e.g., at the Ministry of Education and Science, merging the Ministry of Regional Development and Local Government Affairs with the Ministry of Environment, etc.), as well as due to the total decrease in the amount of donation and contribution funds, **the number of accounts opened by the budget institutions for accounting of donation and grant funds decreased – 49 accounts were closed** in 2011.

ACCOUNTING AND REPORTING

Pursuant to the regulatory enactments, the Treasury **prepares** official **daily, monthly, quarterly reports and the Annual Report on the Central Government and Local Government Budget Execution** (the monthly reports are available on the website of the Treasury in the Internet, the Annual Report on the Central Government and Local Government Budget Execution is published on the webpage of the Treasury after receipt of the opinion of the State Audit Office).

The Treasury **prepares the Annual Report on the Central Government and Local Government Budget Execution by consolidation of 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 2011 the Annual Report on the performance in 2010 was prepared by **consolidation of the annual reports submitted by 14 ministries, 12 central government institutions and 118 local governments. Ministries and other central government institutions include the annual reports of the state budget institutions, derived public persons partially financed from the state budget and institutions not financed by the state budget in the consolidated central government annual report, while the annual reports of local government budget institutions and joint institutions 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 as at the end of the reporting period and on the central government budget execution results in the reporting year. The opinion of the State Audit Office on the Annual Report is very significant confirmation that the report provides a clear and true representation of the completeness and credibility of the information disclosed in the reports. The opinion of the State Audit office attests the quality of the information included in the Annual Report and used by Saeima (the Parliament), the Bank of Latvia, as well as different international institutions (European Commission, EUROSTAT, IMF, international rating agencies), potential investors that based on the information set out in the Annual Report adopt decision on the potential investments in the economy of Latvia.

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 order to ensure compliance with uniform principles in the financial accounting and reporting of state and local government budget institutions, **arrangements for improvement of budget institution accounting** were carried out, including development of supplements to the existing regulatory enactments, cooperation with other drafters of regulatory enactments within the area of accounting, as well as provision of detailed explanations to the compilers of reports.

The amendments to the Cabinet of Ministers regulations developed in 2011 and determining **the accounting procedure for budget institutions** adjusted the accounting requirements for a decrease in the long-term investment and inventory value, state or local government real properties delivered for possession to the port authorities, as well as the potential assets and liabilities. The regulations were supplemented by provisions for accounting of inventory received and delivered free of charge, as well as a new annex, which replaced Cabinet of Ministers Regulation No. 440 of 21 June 2005, Regulations regarding Fixed Asset Depreciation Norms of Budget Institutions and Application Conditions Thereof.

The 2011 amendments to the Cabinet of Ministers Regulation **on the preparation of annual reports of budget institutions**, in their turn, supplement the requirements for information disclosure on the pledged real properties and specify the reconciliation procedure for mutual settlements among the institutions of the general government sector. The regulations specify the norms for preparation of documents in the form of an electronic document and signature thereof by a safe electronic signature.

In 2011 for the purpose of supervision of fiscal discipline by the Fiscal Discipline Supervision Committee and at the request of international lenders and the most significant users (EUROSTAT, the European Central Bank, international financial institutions, as well as Saeima (the Parliament), 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 central government budget execution, most significant financial indicators, by summarising the information from the financial statements of the state and local governments, as well as related and associated companies. The analysis of risks existing in the budget financial management process was performed as well**, by adopting the respective decisions on limiting or eliminating them in 2011 and in the mid-term perspective.

1.3. DEVELOPMENT OF THE SERVICES AND ELECTRONIC SERVICES OF THE TREASURY

One of the operational priorities set in the Strategy of the Treasury stipulates that the services provided by the Treasury 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. In 2011 the Treasury maintained and continued development of the following services and information exchange systems for the clients of the Treasury:

UNIFIED CENTRAL GOVERNMENT BUDGET PLANNING AND EXECUTION INFORMATION SYSTEM

The Unified Central Government Budget Planning and Execution Information System maintained by the Treasury ensures the full state budget management cycle – from the budget planning until execution and supervision of the execution thereof:

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

2) **the central government budget execution functionality** ensures the Treasury and state budget institution processes in the system, e.g., the account formation, assignment granting and performance process, the central government budget revenue process, the daily, monthly and annual closing process, as well as the local government balancing fund and personal income tax distribution process (this functionality is carried out by the Treasury).

The Data Warehouse of the Unified Central Government Budget Planning and Execution Information System ensures making reports on the central government budget execution in accordance with the central government budget structure.

In March 2011, the Treasury introduced a new service – **instalment of cash**. The aforementioned service replaces the previous cash instalments into the client accounts opened with the Treasury, thus, within the framework of unified process, ensuring the clients of the Treasury **a possibility to make cash instalments in different currencies into the account opened with the Treasury free of charge**.

As from 23 September 2011, **the Treasury is a member of the Bank of Latvia's Interbank Automated Payment System**, thus acquiring additional time for the exchange of payment orders with the members of that system, facilitating the procedure for processing those payment data in the Treasury and reducing the operational risks. Upon joining the Bank of Latvia's Interbank Automated Payment System, the Treasury made the necessary amendments to the **Unified Central Government Budget Planning and Execution Information System that is integrated with *eKase*. The Bank of Latvia's Interbank Automated Payment System is a real-time system for gross settlement for large volumes and urgent payments in lats that ensures interbank real-time settlements by offering its members the possibility to perform immediate settlements and continuous management of liquidity.** Thus, the Treasury is able to keep track of its current account balances and payment flow in real time.

INFORMATION SYSTEM "REPORTS OF THE CENTRAL GOVERNMENT BUDGET AND LOCAL GOVERNMENT BUDGET"

Those submitting reports for budget institutions may submit monthly, quarterly and annual reports to the Treasury and confirm them electronically in the information system "Reports of the Central Government Budget and Local Government Budget", thus ensuring mutual economy of administrative and time resources.

On 2 December 2011, for the development of the information system **"Reports of the Central Government Budget and Local Government Budget", the Treasury** received the Annual Efficient Management Award granted by the Employers' Confederation of Latvia and the State Chancellery **for the introduction of good management principles in the state administration institution through enacting a customer oriented approach, improving financial indicators, decreasing administrative burden, optimising the resources of the Treasury and its customers, as well as recognising the Treasury as the model for other direct management institutions with respect to simplification of its work and making it more comprehensible, operative and closer to the society**.

In 2011, within the scope of the annual stock taking procedure of the system, **the reconciliation procedure options were expanded**:

1) **the mutual data reconciliation between the partners of the general government sector** may be performed not only with respect to the mutual claim and liability account balances and mutual transfer charges, but it is also possible to reconcile cash transactions of any kind and assets and liabilities received and transferred on a non-cash basis;
2) currently **reconciliation of settlements with the Treasury** may be performed not only by the cities, towns, districts, ministries and institutions under their supervision, but also state and local government capital companies, as well as ports. The reconciliation of the data for 2011

was performed with respect to the paid and received funds from the personal income tax and local government financial adjustment fund, the funds received from the state social security mandatory instalments, entrepreneurship risk state duty, the loans granted by the Treasury and guarantees issued on behalf of the state, term deposits with the Treasury and interest in the account balances. Electronic reconciliation with the Treasury ensures a more effective exchange of information, reduced circulation of document hard copies and necessity to store thereof, thus having the possibility to save the time and financial resources both for the Treasury and its customers and cooperation partners.

The Treasury has supplemented the range of services rendered to the local governments, and in cooperation with the local governments it has developed a new service – the possibility for the local governments to plan the budget in the information system "Reports of the Central Government Budget and Local Government Budget". The planning functionality has been introduced in the system considering the desire and suggestions of the local governments to ensure central government budget planning of the respective degree of detailed elaboration. The system offers the local governments a possibility to plan the initial budget split by budget types for each year and to make amendments to the budget, as well as to plan the budget independently by choosing particular settings for creating forms and the possibility to develop and print reports on each form.

The information system "Reports of the Central Government Budget and Local Government Budget" offers extended electronic services user options, ensures more effective exchange of information between transaction partners and availability of different types of information together. Users of the electronic service may **supervise the financial indicators of their institution and the bodies under their supervision in a more convenient manner, and obtain more effective and quality information for the implementation of the financial management processes**.

BUDGET ELECTRONIC PAYMENT SYSTEM *eKASE*

The Treasury ensures rendering payment services electronically using *eKase*. **Through *eKase* the Treasury ensures the possibility for the customers to perform payment orders, view the payment order performance results, as well as to receive the financial information offered by the Treasury:** account status (balance), account turnover statements and summary on revenues or resources for covering expenses and expenditures.

Within the framework of the project Improvement of the Treasury Online Data Exchange System, financed by the ERDF in 2011, the development of the eKase online data exchange module was commenced, the purpose whereof is to ensure the possibility for all the institutions administering the central government budget payments to effectively obtain data on the payments transferred into the central government budget accounts, thus **ensuring effective and complete payment recognition process**. Within the scope of the ERDF project, the payer will also be ensured a possibility **to verify that the payment made by it has been transferred into the appropriate central government budget account** and that the payer may receive the requested service.

INFORMATION SYSTEM “FINANCIAL PLAN PROCESSING”

The financing plan processing information system **is used by the users of all ministries and central government institutions in order to prepare and submit the approved financing plans to the Treasury**. In 2011 **9,567 general budget and special budget financing plans were registered and processed** in the system.

During the improvement of the system at the end of the year, **a new version of the information system** was developed and introduced that improved the convenience of its use, data integrity and also ensures the possibility for the institutions supervised by the ministries to use it by setting the respective access regimes. Considering the amendments to the 28 December 2010 Cabinet of Ministers Regulation No. 1220 Procedures for Granting and Implementing Assignations, as from 1 January 2012, **approval of the financing plan projects in the system is performed only electronically**.

CREDIT CARDS TIED TO THE TREASURY ACCOUNTS

The Treasury in collaboration with JSC Swedbank provides budget institutions the opportunity to perform budget expenditures **with credit cards tied to the Treasury accounts**. Credit card services are provided for expenditures incurred by staff on business trips and visits, as well as administrative expenses. By introducing credit cards tied to the Treasury accounts the employees of central government budget institutions are ensured the possibility to make non-cash payments during their business trips, complying with the Law on Budget and Finance Management, which requires that central government budget expenditures are to be made from accounts opened with the Treasury.

In 2011 the services provided by credit cards tied to Treasury accounts were used by **95 state budget institutions and a total of 925 credit cards were issued to them**.

PAYMENT CARD ACCEPTANCE DURING COLLECTION OF CENTRAL GOVERNMENT BUDGET PAYMENTS

In 2011 the Treasury in co-operation with JSC SEB banka and JSC Citadele banka continued introduction of the service of accepting payment cards at the institutions administering the central government budget payments.

The agreement entered into by JSC SEB banka and the Treasury provides for free-of-charge installation, servicing of payment card terminals and staff training in the operation of the terminal and the general principles of accepting payment cards.

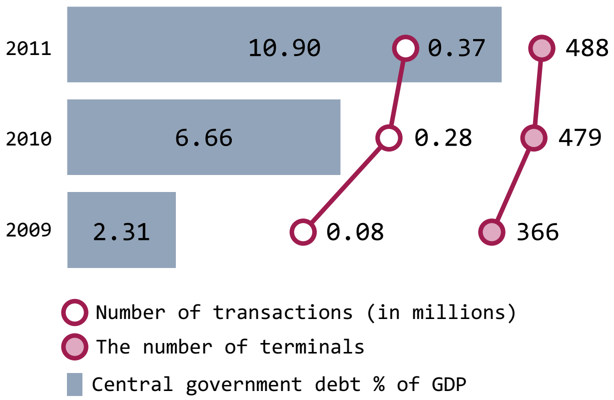


Chart 1 Dynamics of the service of payment card acceptance (VISA, MasterCard and American Express) (2009 – 2011)

Source: The Treasury

The purpose of the payment card acceptance service is **to ensure the possibility for private individuals to use *VISA*, *VISA Electron*, *MasterCard*, *Maestro* and *American Express* payment cards as a means of payment for the services rendered by the state budget institutions at the state budget institutions (as well as institutions and organisations collecting state budget payments)**.

In 2011, **488 payment card terminals were installed** in the institutions administering budget payments. In 2011, **372,767 transactions for the total amount of LVL 10,899,318 were performed** with payment cards in the institutions administering budget payments. As compared to the data of 2009 and 2010, **a rapid increase in the number of transactions and the amounts collected may be observed**, the fact of which indicates that the inhabitants approve of the service and the use of payment cards in settlements with the state increases.

Within the framework of the agreement made between the Treasury and JSC SEB banka on ensuring lending of the POS terminals and acceptance of the MasterCard and VISA system payment cards and payment for the transactions performed by those cards, **on 1 August 2011, the Treasury, JSC SEB banka and the State Land Service in cooperation with the card settlement centre (*FirstData Latvia*) introduced the service for the acceptance of *MasterCard* and *VISA* system payment cards in the portal** www.kadastrs.lv. On 6 December 2011, such an agreement was also made among the Treasury, JSC Citadele banka and the State Land Service on the acceptance of *American Express* payment cards in the portal www.kadastrs.lv.

CENTRALISED FINANCIAL ACCOUNTING SOLUTION

As from 2011, the Treasury has introduced and maintains the Horizon centralised resources management system, **ensuring the financial management, accounting and personnel accounting of the Ministry of Finance and the institutions under the supervision thereof (departments of the Ministry of Finance) in a unified system**. The system ensures the export of the quarterly and annual financial statements to the functionality of the information system "Reports of the Central Government Budget and Local Government Budget" thus decreasing the amount of manual work. The centralised solution ensures compliance with the accounting and personnel accounting principles according to unified guidelines and classifiers, obtaining data for the adoption of management decisions that can be classified in a uniform manner. Relative savings have been acquired as well – the system is installed on one server in the departments of the Ministry of Finance: the centralised technical maintenance thereof is performed by the Treasury, and other institutions of the departments do not have to assign financial and time resources for the technological support of accounting systems. Unified installation ensures centralised management of classifiers, by making the necessary amendments in the Treasury and concurrently delivering thereof to the other institutions.

During the implementation of the system after assessment of the work load of employees for performance of uniform manual operations involved in the accounting, as well as in order to ensure uniform and efficient organisation of the accounting process of the institutions under supervision of the Ministry of Finance, the Ministry of Finance adopted a decision on the takeover of the accounting and personnel management process of the Lottery and Gambling Supervision Inspection by the Treasury as from 1 March 2011. During further optimising of the accounting process within the departments of the Ministry of Finance, the Treasury ensures the accounting of the Procurement Supervision Office as from 2012.

DEVELOPMENT OF SERVICES FOR LOCAL GOVERNMENTS

In 2011, the Treasury developed the short-term and mid-term plan for development of the services of the Treasury in order to ensure the possibility of the local governments to perform the budget in the Treasury in full.

Since the local governments and their institutions are one of the largest and most significant customer groups of the Treasury, we have evaluated and now offer the range of services necessary for the local governments, which would ensure performance of the budget in the Treasury in full. Currently, the Treasury offers and provides the following services to the local governments:

1) opening of accounts;
2) rendering payment services;
3) use of the reporting information system;
4) credit card and payment card acceptance services;
5) the possibility to place the free funds of local governments (that have not been received from the central government budget) in term deposits, as investments in the account earning profit on the balance of the account or as an investment in the government securities;
6) granting and servicing the state budget loans.

1.4. PERFORMANCE INDICATORS OF THE RESULTS OF ACTIVITIES WITHIN THE CENTRAL GOVERNMENT BUDGET EXECUTION PRESCRIBED IN THE OPERATIONAL STRATEGY OF THE TREASURY

Table 2 Performance Indicators of the Results of Activities within the Central Government Budget Execution

No.	Result of activity	Performance indicators	Indicators (numeric values)		
			Last known precise measurement (2010)	Planned in 2011	Performance in 2011
1.	Optimised results of central government budget execution process	Proportion of the payments processed through *eKase* in the total amount of payments, %.	99	99	99
		Number of institutions using the Treasury online data exchange system, % of the total number of institutions.	-	50	2[1]
		Decrease in number of payments which do not match the economic classification and purpose of payment made to the central government budget accounts (except tax payments), % of the total number of payments.	-	20	-[2]

1 Pursuant to the approved project plan, it is planned to commission the data exchange module of *eKase* on 1 April 2012. While the current online data exchange system pilot version was used by eight customers of the Treasury in 2011.

2 Since the work on the unified service classifier and the unified supporting document identifier solution, which will ensure attaining the result prescribed in the strategy in mid-term, is in progress, the development and implementation index set for 2011 has not been reached.

2. CENTRAL GOVERNMENT DEBT MANAGEMENT

2.1. CENTRAL GOVERNMENT DEBT MANAGEMENT FUNCTION

In accordance with authorisation from the Minister of Finance, **the Treasury performs the management of central government debt and temporarily free funds, transactions with derivatives and other transactions within the framework of government debt management, as well as organising the issue and monitoring of state loans and guarantees**.

The annual State Budget Law sets the maximum allowable level of outstanding government debt as at the end of the year, whereas the objectives, basic principles and tasks of the central government debt portfolio and borrowing management within the framework of the medium-term government debt management are established by the **Central Government Debt Management Strategy** approved by the Minister of Finance.

In compliance with the Central Government Debt Management Strategy, **central government debt portfolio management** is conservative and aimed at limiting and preventing financial risks, allowing use of derivatives, determined in the Central Government Debt Management Strategy, only to ensure management of financial risks. The approach in **government borrowing management** is to ensure borrowing opportunities, liquidity and beneficial borrowing conditions.

The amount of government borrowing, central government debt level and the respective costs to be set aside to meet the central government debt obligations are affected by **the size of the total financing requirement**, comprised of the financial balance of the central government budget, the financing necessary for granting state budget loans, the amount of central government debt obligations to be settled, as well as the amount of the required liquidity reserve to ensure the implementation of the central government budget cycle and commitments. Planned measures to satisfy the total financing requirement within the current year and the choice of financial instruments best suited for financing are prescribed in the annual **medium-term Funding Plan**, which is developed by the Treasury based on the guidelines established in the Central Government Debt Management Strategy and approved by the Minister of Finance. Prior to approval, the opinion of the Bank of Latvia is sought.

Within the framework of the central government debt management the Treasury organises the visits of the analysts of three largest international rating agencies ***Fitch Ratings, Standard & Poor`s*** and ***Moody`s Investors Service***, as well as the Japanese rating agency ***R&I*** to Latvia, as well as ensures them with most recent information on Latvia, which allows the rating agencies to update their opinion. Based on the available information, the investors assess the possibilities of making investments in Latvia (incl., in the government securities). Therefore, the credit rating is an essential factor for the availability of financial funds to the state, as well as it is reflected in the price of the borrowed resources. The rating agencies not only review the **credit rating** of the Republic of Latvia and its outlook every year, but also assign a rating to a particular government security. At the end of 2011, **the Latvian credit rating for long-term obligations in foreign currency is Baa3 (*Moody's Investors Service*) with a positive outlook, BBB- (*Fitch Ratings*) with a stable outlook and BB+ (*Standard & Poor's* and *R&I*) with a positive outlook. Upon increasing the credit rating and outlook of the country to positive, the agencies pointed out the stable economic development of Latvia, the strong government finances, decrease of the central government foreign debt and increasing stability of the financial sector**. Under the management of the Treasury, the Cabinet of Ministers is informed on the credit rating of Latvia and the factors influencing thereof, as well as proposals for improvement of the credit rating.

The Treasury participates in the process of **guarantee issue on behalf of the state** by examining and evaluating the risks pertaining to granting state guarantees. The Treasury organises the process of the guarantee agreements signing: i.e., drafts guarantee agreements, guarantee servicing and supervision agreements and guarantee securities agreements. After signing of the guarantee agreements the Treasury ensures accounting for the obligations undertaken in the name of the state. The permissible amounts of state guarantees and the project implementers are determined by the annual state budget law.

2.2. CENTRAL GOVERNMENT DEBT MANAGEMENT STRATEGY

The Central Government Debt Management Strategy outlines **the medium term activities of the Treasury in central government debt management** in accordance with economic development trends, as well as by performing analysis of the situation in the Latvian and global financial markets. The Central Government Debt Management Strategy **sets targets and assignments in central government debt management**.

In order to comply with the best international practice, distinction has been made within the framework of the central government debt management between the central government debt portfolio management and the central government borrowing management. **The goal of the central government debt portfolio management** is to optimize the central government debt service costs over long term while hedging financial risks.

The goal of the Central Government Borrowing Management is to maintain opportunities for attracting resources in the international and domestic capital markets on optimum borrowing terms.

The Treasury, if necessary, reviews the Central Government Debt Management Strategy and the compliance of the debt portfolio structure parameters with the macroeconomic and financial market situation and forecasts.

2.3. COMMUNICATION WITH INVESTORS

In order to implement purposeful management of investor relations and define the corresponding measures to be undertaken, the Treasury continues informing investors and co-operation partners on a regular basis by preparing the regular information updates.

The Treasury prepares an analytical **Report on Central Government Debt Management** (in Latvian and English) for each year, so as to provide the Treasury's clients, including the existing and potential cooperation partners of the Treasury and investors in government securities, with information on the latest developments in government debt management, performance indicators and future trends. The Report on Central Government Debt Management is also sent to other bodies implementing central government debt management functions in the EU (debt management offices), as well as to several embassies of the Republic of Latvia abroad. The cooperation partners (including banks) expressed their appreciation of this form of presenting information on the latest developments in the Latvian central government debt management.

Once a quarter the Treasury publishes on its website **Central Government Debt Management quarterly bulletin** (in Latvian and English), where it provides the current central government budget execution and debt management data, the latest information on the credit rating of Latvia, borrowings made in the domestic and foreign capital markets, central government debt portfolio management, government securities' auction trends and results, as well as on local government loans.

Every week the Treasury summarises, sends to the investors and publishes on its website a **Weekly Update** (in English) of the most important events in central government budget and debt management, with latest information on the financial sector of Latvia, economics and politics.

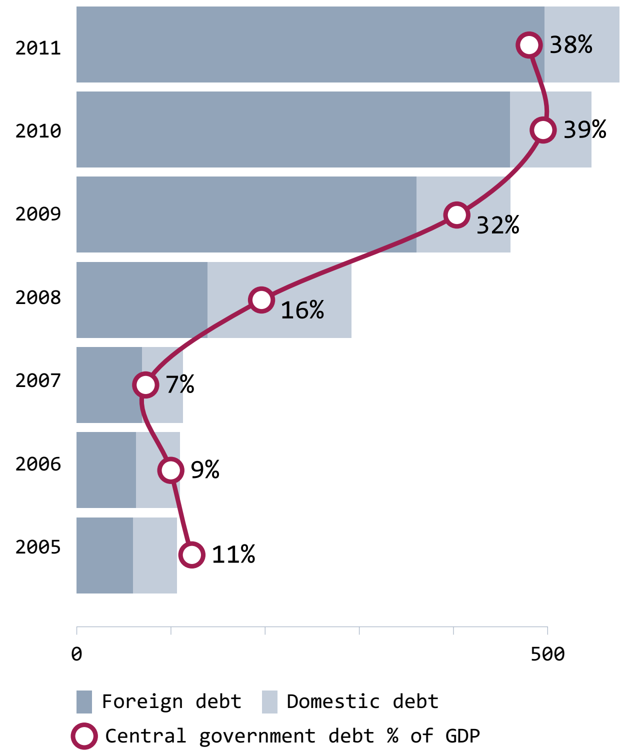


Chart 2 Central Government Debt (nominal value) in 2005-2011 (in millions, LVL/% of GDP)

Source: The Treasury

2.4. CHANGES IN THE CENTRAL GOVERNMENT DEBT

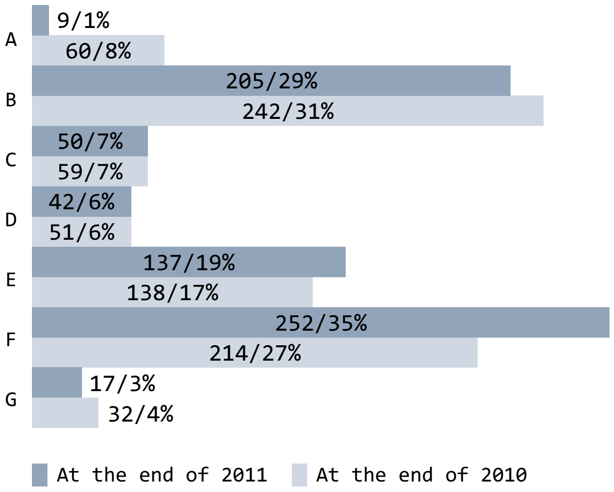
In 2011, loans in the domestic and international financial markets were borrowed, as well as the financing of the international loan programme was used in order to cover the overall financing requirement in the amount of LVL 1,092.8 million, incl., refinancing of the central government domestic and foreign debt obligations in the amount of LVL 511.4 million.

Considering the central government borrowing and repayment of the central government debt performed in 2011 **the central government debt increased by LVL 274.0 million in 2011** and reached LVL 5,216.3 million in the nominal value of 38% of the GDP at the end of 2011, not exceeding the maximum central government debt level as at the yearend amounting to LVL 6,000 million prescribed in the annual state budget law (see Chart 2).

2.5. CENTRAL GOVERNMENT DOMESTIC DEBT

The central government domestic debt according to the nominal value as at 31 December 2011 was **LVL 717.9 million**, the major part whereof was comprised of the debt in lats (domestic borrowing securities) amounting to LVL 712.3 million.

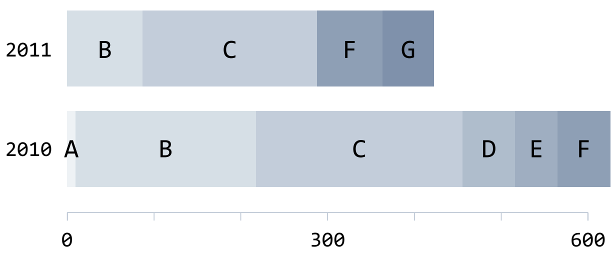
In 2011, **the decrease of the central government domestic debt by LVL 78.1 million** according to the nominal value was observed, incl., the decrease of the lats debt by LVL 83.7 million according to the nominal value and increase of the foreign currency debt by LVL 5.6 million according to the nominal value.



A 6-m / **B** 1-y / **C** 2-y / **D** 3-y / **E** 5-y / **F** 10-y / **G** 11-y

Chart 3 Government Domestic Securities in Circulation (million LVL / % of total amount)
m – month, y – year

Source: The Treasury



A 3-m T-bills / **B** 6-m T-bills / **C** 12-m T-bills
D 2-y bonds / **E** 3-y bonds / **F** 5-y bonds
G 10-y bonds

Chart 4 Government security issues by maturities in 2010 and 2011 (million LVL)
m – month, y – year

Source: The Treasury

The percentage proportion of the types of government domestic borrowing securities in circulation in the domestic debt changed in 2011 (see Chart 3).

In 2011, the Treasury continued regular government securities auctions. Both the short-term and longer term government securities were offered to investors. The Treasury issued 6 and 12-month T-bills mainly to ensure relatively cheap liquidity resources and to maintain operations of the government domestic securities' market as well as to ensure a regular update of the benchmark for short-term borrowing in lats. **In order to ensure an adequate supply of government securities to the institutional investors, the Treasury offered a 5-year bond programme and resumed offering the 10-year bond programme, which also reduced the refinancing risks related to the central government domestic debt and ensured fixing the debt servicing expenses at relatively lower levels.**

BORROWINGS IN THE DOMESTIC FINANCIAL MARKET

In order to maintain the securities market and ensure adequate amount of investments to the institutional investors as in 2010, the Treasury continued government domestic securities auctions in 2011 as well: the amount of resources attracted through government domestic securities in 2010 was LVL 630.3 million, in 2011 – LVL 427.1 million, thus, as compared to 2010, **the total amount of resources attracted in the domestic financial market from securities issues in 2011 decreased by LVL 203.2 million**.

In order to cover the financing requirement of 2011, the following government domestic borrowing instruments were used: short-term government domestic T-bills with the maturity of 6 and 12 months, as well as mid-term government domestic T-bonds with a maturity of 5 and 10-years.

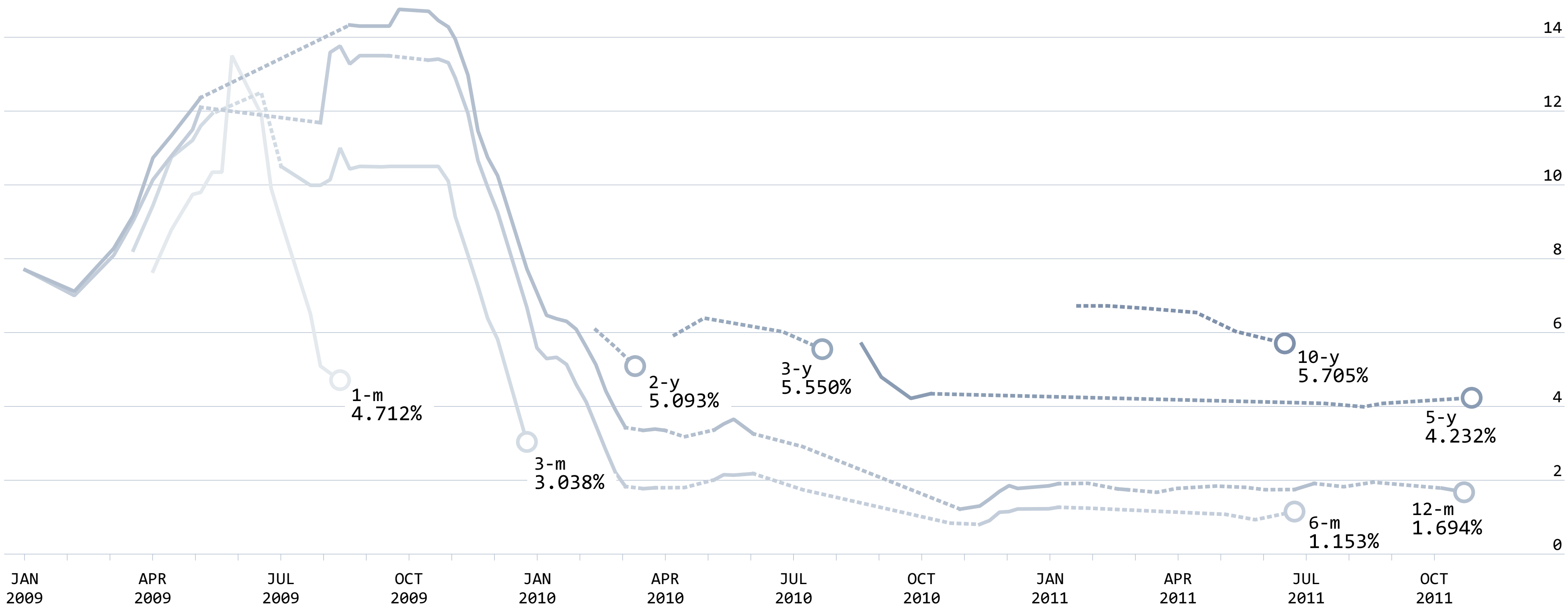


Chart 5 Average Weighted Interest Rates at the Competitive Auctions of Government Domestic Securities
m – month, y – year

Source: The Treasury

In February 2011, after an interval of almost three years, the Treasury successfully resumed the long-term bond (with the maturity of 10 years) programme, which continued the profit curve extension process commenced in 2010. Thus, **the full spectrum offer of government securities was renewed as at the level prior to the international loan programme**. When, during the first half of the year the 10-year bonds had been regularly offered on a monthly basis by mainly focusing on the institutional investors, adequately large investors' interest was observed and the average profit rates gradually decreased. As from the beginning of the long-term bond programme in February 2011, the average profit rates of 10-year bonds have decreased from 6.724% to 5.705% (-1.01%) unlike the long-term rate increase trend observed in the global financial markets.

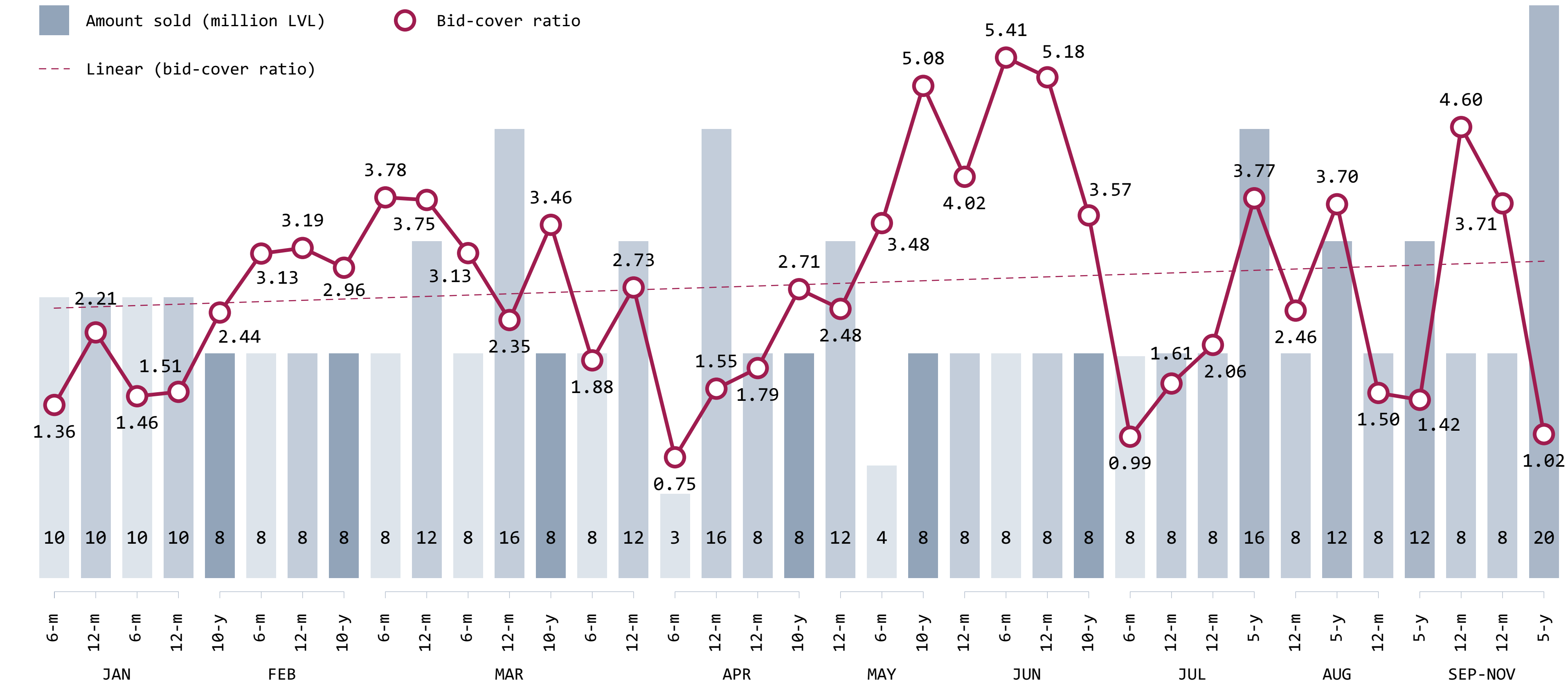
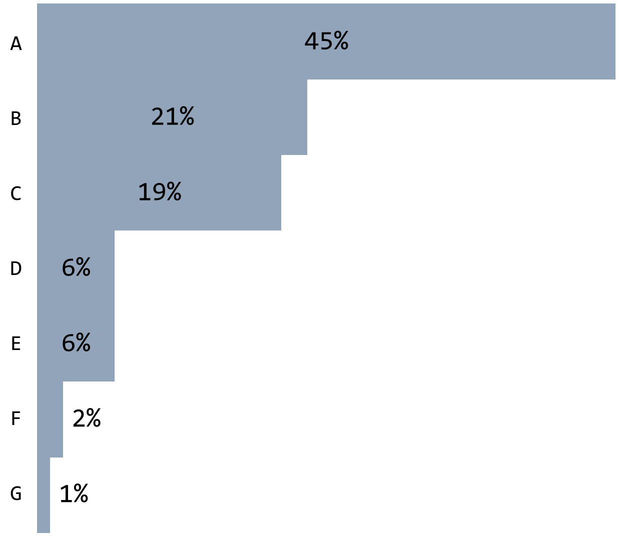


Chart 6 Activity of Primary Market of Government Securities in the Competitive Multi-price Auctions
m – month, y – year

Source: The Treasury

Successful resumption of the 10-year bond issue was essential for the satisfaction of the institutional investor demand (successful renewal of the market operations) **and determining the compliance with the Maastricht criterion benchmark rate, as well as a good precondition for organising borrowing in the foreign market**. The successful resumption of the 10-year bond programme allowed reducing the volume and frequency of issue of shorter term (6 and 12-month) securities by the Treasury mainly being focused on the issue of mid-term and long-term bonds.

The bid-to-cover ratio in the competitive multi-price auctions during the year was mainly above



A European Commision
B IMF
C Euro bond
D World Bank
E EIB
F Nordic Investment Bank
G Others

Chart 7 Central Government External Debt on 31 December 2011 by Creditors (%)

Source: The Treasury

one: the demand exceeded the supply – sometimes even more than five times. An especially high demand for government securities was observed in the auctions of government securities that were organised in May and June, the fact of which is related to the confidence of the market participants and positive figures from the market.

2.6. CENTRAL GOVERNMENT EXTERNAL DEBT

The central government external debt according to the nominal value as at 31 December 2011 was **LVL 4,498.3 million**.

In 2011, the central government external debt **increased by LVL 351.8 million**, the fact of which was related to the return of Latvia to the international financial markets in 2011, as well as issue of new euro bonds in the amount of USD 500 million.

The major part of the **central government external debt** is comprised of loans from the European Commission (45%). A slightly smaller portion of the **central government external debt** is comprised of the IMF loans (21%) and loans from the international capital market (19%), which are euro bonds reaching maturity in 2014, 2018 and 2021 (see Chart 7).

BORROWING IN THE EXTERNAL FINANCIAL MARKET

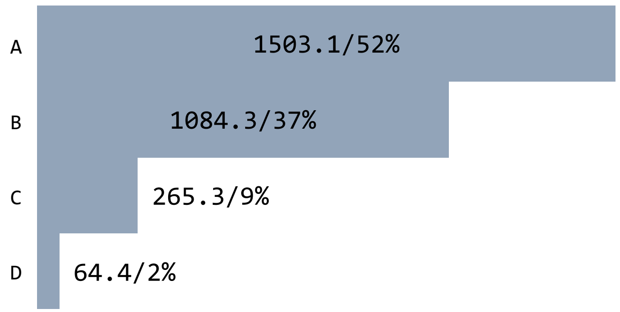
On 9 June 2011, Latvia successfully returned to the international financial markets by issuing 10-year bonds in the amount of USD 500 million with a fixed income rate of 5.25% and a maturity date on 16 June 2021. **This issue attested to Latvia's ability to independently finance the central government budget requirements** and has established a safe basis for a successful refinancing of loans in the financial and capital markets during forthcoming years. The issue of bonds was performed in accordance with the approved mid-term borrowing strategy and shall be considered to be an important baseline for the commencement of refinancing of the international loan programme.

THE INTERNATIONAL LOAN PROGRAMME

Borrowing made within the framework of the international loan programme in 2009-2011 was a significant financing source for the government, as well as it ensured the possibility for the government to maintain the substantial financial buffer , which was one of the most important factors for proving the solvency of the state, calming the financial market fluctuations and resumption of investor confidence during the period, when, considering the rapid downturn of the economic development pace of Latvia and reduction of the credit ratings to the speculative level, the borrowing possibilities of the state in the financial markets were strongly limited.

In 2008-2011, the financing in the amount of EUR 7.5 billion was available within the international loan programme in order to stabilise the financial system of Latvia, to restructure the national economy of Latvia through the improvement of the competitiveness of the state, as well as to reduce the influence of risks slowing down the development of economy, thus creating stable basis for sustainable economic development.

Within the framework of the international loan programme, the last tranche from the World Bank in the amount of EUR 100 million was borrowed in 2011. The total amount of the borrowing from the international loan programme reached LVL 3.1 billion amounting to ~60% of the total initially planned amount of the programme (see Table 3). LVL 2.9 billion were used for covering the financial needs during the validity of the programme (see Chart 8). The balance of the received loans in the accounts of the Treasury opened with the Bank of Latvia as at



A Financing the central government budget deficit and state loans
B Repayment of central government debt
C Financial sector stabilty measures
D EBRD support to JSC Parex banka

Chart 8 Utilization of the International Loan Programme financing (as at 31 December 2011, million LVL/%)

Source: The Treasury

the end of 2011 was LVL 220.5 million, LVL 174.8 million whereof, pursuant to the requirements of the lenders, are still marked for the potential financial sector stabilisation measures.

In December 2011, the international loan programme was officially completed, and during its validity it had ensured a basis for sustainable growth of the national economy of Latvia.

Table 3 Financing received within the framework of the international loan programme, EUR million)[3]

Lender	Funding received				Funding received TOTAL by creditors	Funding available, but not requested	TOTAL
	2008	2009	2010	2011			
IMF	600	200	300		1100	600	1700
European Commission		2200	700		2900	200	3100
The World Bank		200	100	100	400		400
Nordic Countries					0	1900	1900
Czech Republic, Poland					0	300	300
EBRD – investment in JSC Parex banka capital		100			100		100
TOTAL	**600**	**2700**	**1100**	**100**	**4500**	**3000**	**7500**

Source: The Treasury

3 The amounts have been rounded up.

LOANS FROM EIB AND CEB

On 30 October 2008 an agreement was signed with the EIB on the loan for ensuring central government budget co-financing for the EU structural funds and Cohesion Fund projects during the 2007 – 2013 programming period. On 26 February 2009 the agreement amount was increased to 750 million euros, of which 225 million euros have been received. The loan is meant for co-financing the EU structural funds and Cohesion Fund projects in the 2007-13 programming period in areas that are of particular significance for the development of Latvia. These include projects to promote entrepreneurship and, in particular, innovation. The funds will also be available for the development of employment: for the promotion of higher education, continuing education and life-long education and for investments in the development of infrastructure: for the development of the transportation system, information technology and environmentally friendly energy sources. In order to maintain the possibility to attract the resources of the EIB according to the Treasury's mid-term borrowing strategy, in 2011 the agreement on prolonging the deadline for the submission of the loan disbursement request until 30 October 2012 was made with the bank.

On 30 April 2009, Latvia signed an agreement with the CEB on the co-financing of projects in the educational sphere, improvement of urban and rural infrastructure for a total amount of EUR 50 million. The first tranche of the loan, amounting to EUR 25 million, has been received. After negotiations with the CEB, the deadline for withdrawing the loan was prolonged to 30 June 2012, thereby maintaining the option to request the remaining part of the loan.

LATVIA IN THE PUBLIC CAPITAL MARKETS

The state CDS trading level has a significant role in determining price for new loan resources by investors, especially considering the relatively low volumes of Eurobond trading. The state CDS level shows higher risk level and includes market expectations with respect to future credit risk changes.

During the first half of 2011, the stabilisation of the financial situation of Latvia and positive changes in the credit ratings were reflected in the Latvian euro bond secondary trade levels, as well as in the Latvian CDS quotation levels. While, during the second half of 2011, the overall market tension of the euro zone had a direct influence on the securities mark-ups in the secondary market and on the CDS levels.

Chart 9 Latvia's Euro Bond Yields in the Secondary Market (Basis points)

Source: Bloomberg, The Treasury

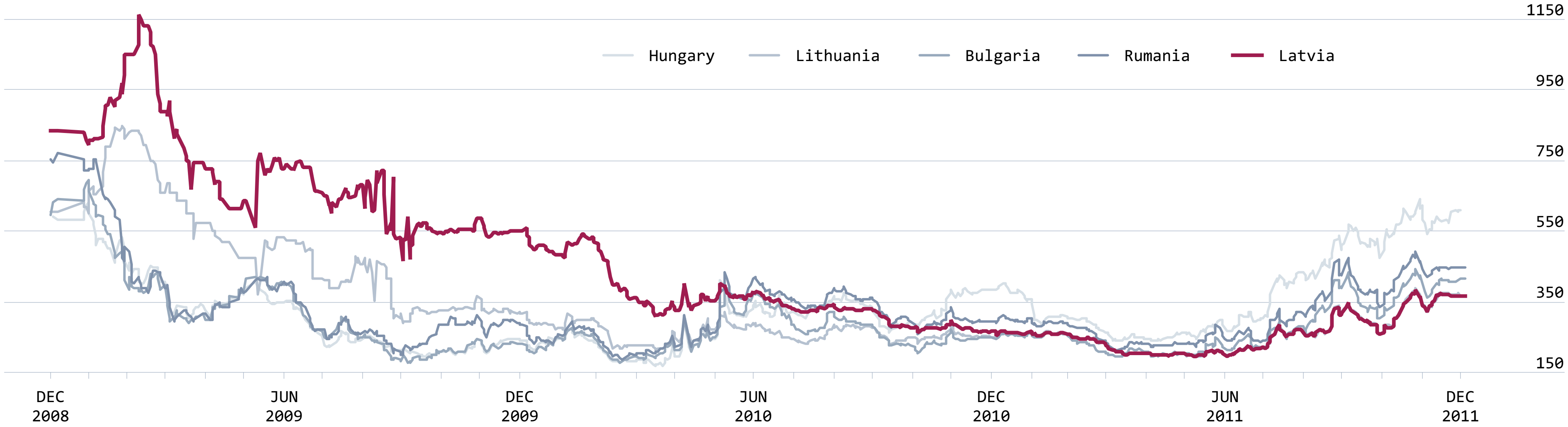


Chart 10 5-year CDS level (Latvia, Lithuania, Hungary, Romania, Bulgaria), Basis points

Source: Bloomberg

2.7. CENTRAL GOVERNMENT DEBT PORTFOLIO MANAGEMENT

In 2011 all central government debt structure parameters specified in the Central Government Debt Management Strategy have been complied with, and the minimum lats debt share in the debt portfolio remained within permissible deviation limits (see Table 4).

Table 4 Compliance of the Central Government Debt Structure Parameters with the Central Government Debt Portfolio Structure Parameters established by the Central Government Debt Management Strategy

PARAMETERS	ON 31.12.2010		ON 31.12 2011		STRATEGY	
Share of the lats debt	16,1%		**13,7%**		>= 35%[4]	
Maturity profile	< 1 year	< 3 year	< 1 year	< 3 year	< 1 year	< 3 year
	< 7,9%	< 24,7%	10,0%	43,1%	< 25%	< 50%
Share of fixed rates	**75,6%**		**79,5%**		**>= 60%**	
Average weighted fixed period in years	3,62		3,50		3,4 – 4,0	
Net Foreign Currency Debt Composition	EUR 100,05%		EUR 99,74%		EUR 100% (+/- 5%)	

Source: The Treasury

Deviations from the limits set for the lats debt share emerged in preceding years and are related to the fact that, because of considerable funds borrowed from the IMF, the European Commission and other international lenders, it has not been possible to borrow funds in lats in an amount that would be adequate to compensate for the increase of central government debt in foreign currencies.

4 *It is stated in the strategy that the lats debt share in the government debt portfolio shall be at least 35%, provided that the lats. debt share of at least 35% shall be ensured in mid-term, if that complies with the Latvia state macroeconomic, capital market and the entire finance system development trends, and if the weighted average yield of medium-term and long-term government domestic securities offered at the auctions held by the Treasury is less than 100 basis points above borrowing opportunity level in EUR.*

Following an increase in demand for domestic securities, during the first three quarters of 2011 an increase in the levels of lats debt was observed, however, after the decision by the supervisory board of the Financial and Capital Market Commission to suspend activities of JSC Latvijas Krājbanka in November 2011, which had material effect on liquidity and demand for domestic securities, the level of lats debt decreased. Still, it should be admitted that the lats market capacity would also have a restrictive impact on the increase of borrowings in lats.

To comply with the central government debt portfolio parameters specified in the Central Government Debt Management Strategy, in 2011 the FX forward contracts and cross currency and interest rate swap transactions were used to manage the net foreign currency debt exposure and to increase the fixed rate proportion in the total debt portfolio and the duration indicator – both new transactions were made and the previously concluded transactions were terminated.

At the beginning of 2011, following an exchange of the currency assets from US dollars, British pounds and Japanese yens to lats, the net foreign currency debt exposure increased, but it still remained within the limits of the permissible deviation set by the Central Government Debt Management Strategy. Considering the upward trend of the value of the euro which was observed in the first quarter of 2011, a decision was made to conclude several FX forward futures contracts, thereby closing the net foreign currency debt exposure and fixing the decrease of the government debt at a lower level than prior to the establishment of the exposure. **Thus, as the result of the aforementioned activities, the Treasury has attained a decrease of the central government debt.**

In 2011, several cross currency swap transactions were concluded for the management of the net foreign currency debt exposure, thereby ensuring its maintenance within the limits of permissible deviation specified in the Central Government Debt Management Strategy.

Considering the downward trend of interest rates in the eurozone, which was observed from the second quarter of 2011, the market value of the concluded interest rate swap transactions decreased during 2011. In order to increase the duration ratio, as well as to decrease the transaction partner risk, at the beginning of 2011, the Treasury adopted a decision on the termination of an interest rate swap transaction. Meanwhile, in the fourth quarter of 2011, when long-term interest rates in the eurozone were at their historically lowest levels, in order to increase the duration ratio and to maintain it within the limits set in the strategy, the Treasury concluded a new interest rate swap transaction while simultaneously implementing the interest rate risk management measures. As a result of this, **in 2011**, the Treasury **achieved reduction in central government debt servicing costs**.

2.8. ISSUANCE OF STATE GUARANTEES

Article 37 of the Law on Budget and Financial Management stipulates that **only the Minister of Finance has the authority to grant guarantees on behalf of the state** (state guarantees) within the limits set in the annual State Budget Law, committing public funds to implement the Public Investment Programme projects and business support programmes as well as study and student credits.

The Treasury ensures the selection of the applicants for the provision of state guarantees and the procedure for inclusion on the list of applicants for guarantees and their projects in the draft annual state budget law, as well as participates in the

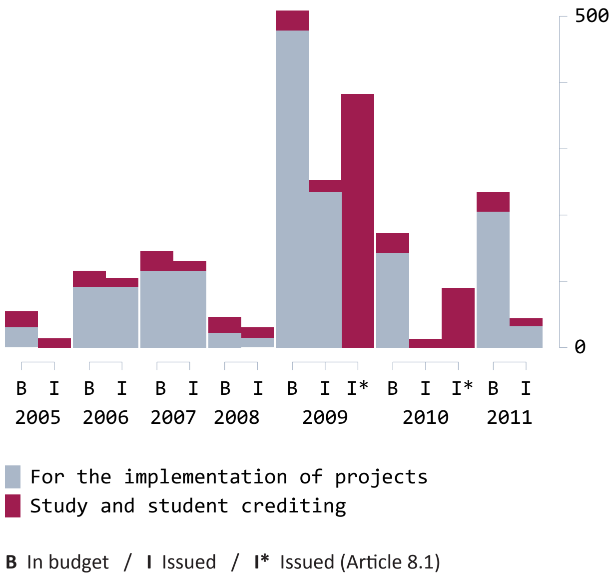


Chart 11 State Guarantees from 2005 to 2011 (in millions, LVL)

Source: The Treasury

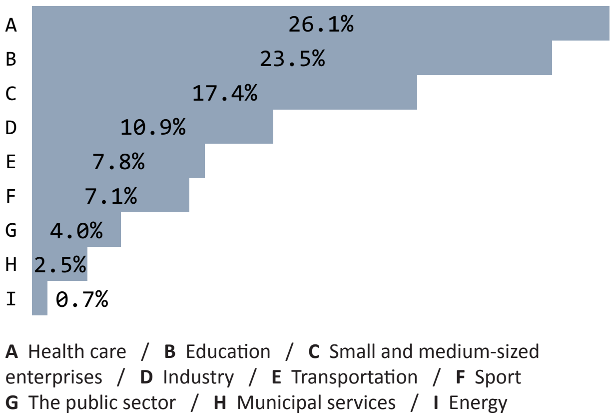


Chart 12 State Guarantees Issued According to General Procedure, by Sectors (%)

Source: The Treasury

procedure for granting state guarantees through reviewing and assessment of the risks related to granting state guarantees and drafting the decision of the Minister of Finance, the draft guarantee agreements, the draft guarantee servicing agreements and the draft guarantee securities agreements. After signing the guarantee agreements, the Treasury **ensures accounting for the obligations undertaken on behalf of the state**. The permissible amounts of state guarantees and the project implementers are determined by the annual state budget law.

In 2011, having analysed the experience of other countries, having analysed the potential recipients of the state guarantees and the goals of guarantees, as well as having assessed the risk ratios and government guarantee securities, the Treasury developed **the basic principles for granting state guarantees**, which will be further used to ensure the efficient use of the state guarantees as the support instrument, concurrently decreasing the influence of such support instrument on the central government debt and central government budget deficit.

In 2011, state guarantees prescribed by the law on the annual state budget were issued for obligations under the study and student crediting programme for the total amount of LVL 12 million: to association Latvijas Olimpiskā komiteja (Latvian Olympic Committee) LVL 3.2 million, to LLC Latvijas Piens LVL 5 million, to state JSC Valsts nekustamie īpašumi (State Real Estate Agency) LVL 23.833 million.

Pursuant to Article 11 of the law On State Budget for 2011, the state guarantee in the amount of LVL 71 million for the loan of JSC Citadele banka from the EIB was issued in accordance with the JSC Parex banka state support restructuring plan approved by the European Commission.

The state guaranteed loans have been issued also for support of different industries: 17.4% – for the facilitation of development of SMEs, 26.1% – for health care, 23.5% – for education, 10.9% – for industry.

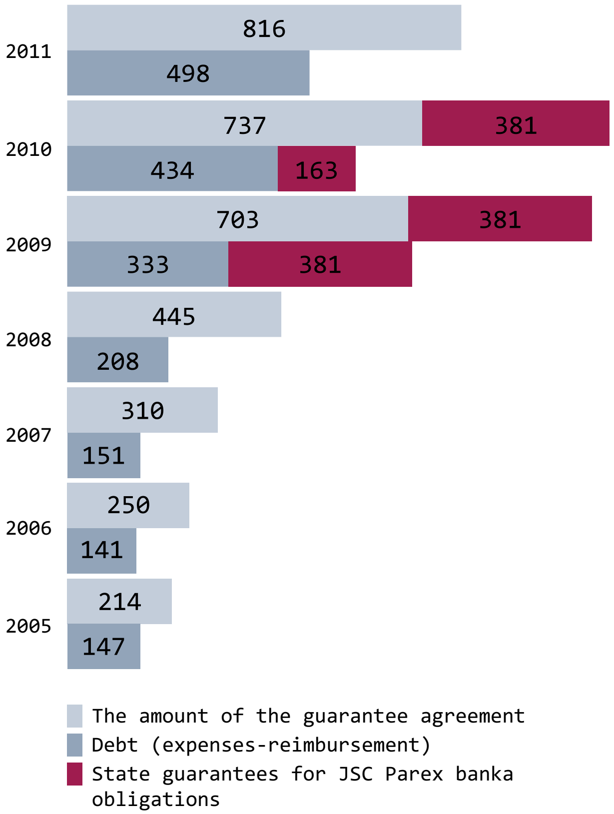


Chart 13 State guaranteed debt outstanding (thousand LVL)

Source: The Treasury

Pursuant to Article 7 of the law On State Budget for 2012, it is planned to issue state guarantees for the total amount of LVL 124.13 million, including the guarantees to the state JSC Latvijas Hipotēku un zemes banka (Latvian Motgage and Land Bank) in the amount of LVL 71 million and to LLC JP Termināls in the amount of LVL 24.402 million that are the guarantees not issued in 2011 that have been carried over to 2012. LVL 28.7 million have been prescribed for guarantees under the study and student crediting programme, as well as, pursuant to Article 12 of the law On State Budget for 2012, in addition to the guarantees stated in Article 7 thereof, it has been planned to issue a guarantee for obligations of the state JSC Latvijas Hipotēku un zemes banka (Latvian Motgage and Land Bank) against the international creditors in the amount of LVL 49 million.

The balance of the state guaranteed loans as at the end of 2011 was LVL 498.4 million (see Chart 13), the amount of which, as compared to the balance of the state guaranteed loans at the end of 2010 of LVL 597.1 million had decreased by LVL 98.7 million.

2.9. FACILITATING PUBLIC-PRIVATE PARTNERSHIP

Pursuant to Cabinet of Ministers Regulation No. 1152, adopted 6 October 2009, Procedure for the Conduct of Financial and Economic Calculations, Determination of the Type of a Public-Private Partnership Agreement and the Provision of an Opinion Regarding Financial and Economic Calculations, the Treasury has participated in the PPP project assessment and supervision mechanism by rendering its opinion both on the necessity to adjust the conditions specified in the project financial and economic calculations and on the potential influence of the project on the amount of the state budget long-term liabilities and the central government debt (opinions on five PPP projects were rendered).

The agreement with the international lenders prescribes the restrictions for such PPP projects the influence whereof on the amount of the state budget long-term liabilities as negative. The influence of only one project – Development of the Centralised Heating Supply System of the Town of Seda – on the amount of the state budget long-term liabilities was not evaluated as negative, the fact of which allowed performing further activities with that project in accordance with the Public-Private Partnership Law.

The Treasury was involved in drafting amendments to Cabinet of Ministers Regulation No. 1152, adopted 6 October 2009, Procedure for the Conduct of Financial and Economic Calculations, Determination of the Type of a Public-Private Partnership Agreement and the Provision of an Opinion Regarding Financial and Economic Calculations. In order to assess the expedience of the project and evaluate its fiscal influence, significant amendments to the regulation have been made, by introducing a mandatory requirement for the project applicants to submit the financial calculations in Microsoft Office Excel or any equivalent form, which ensures clarity of formulas used in calculations. In 2011, the work on the development of draft amendments to the Public-Private Partnership Law was commenced.

2.10. PERFORMANCE INDICATORS OF THE RESULTS OF ACTIVITIES WITHIN THE CENTRAL GOVERNMENT DEBT MANAGEMENT PRESCRIBED IN THE OPERATIONAL STRATEGY OF THE TREASURY

Table 5 Performance indicators of the results of activities within the Central Government Debt Management

No.	Result of activity	Performance indicators	Indicators (numeric values)		
			Last known precise measurement (2010)	Planned in 2011	Performance in 2011
1.	Provided financial resources necessary for financing the central government budget execution and refinancing of the central government debt with the lowest possible costs, limiting the financial risks and considering the development of the capital market and financial system of Latvia.	Ensured compliance with the approved central government debt portfolio management indicators (%)	100	100	100
2.	Performed activities of investor relationship management programme (investor meetings, telephone conferences, video conferences, development and sending of informative materials)	Implemented investor relationship activities prescribed in the Funding Plan (%)	100	100	100
3.	Performed activities aimed at compliance with the Maastricht criteria within the competence of the Treasury.	The central government debt at the end of the year does not exceed the criteria for the level of central government debt in the Maastricht Treaty (% of the GDP)	44.7% of the GDP (criterion – 60% of the GDP)	Compliant with the criterion	Interim assessment: 44.3% of the GDP (criterion – 60% of the GDP)[5]
		Long-term interest rate criteria has been complied with (the rates of the government domestic borrowing ~10-year bonds shall not exceed 2% + the average indicator of three Member States with the lowest inflation)	As at December 2010, the Maastricht criterion for the government long-term securities rate was 5.20%. Government securities long-term interest rate in the secondary market, (12-month average ratio), which, in its turn, is used for determining the compliance with the Maastricht criterion, was 10.34%	Compliant with the criterion	Compliant with the criterion[6]

Source: The Treasury

5 Data on the amount of central government debt as at the end of 2011 will be available in April 2012.

6 Successful issue of ten year bonds in the initial market also influenced the long-term interest rate of government securities in the secondary market, which is used to determine the compliance with the Maastricht criterion. In December 2011, the Latvian government securities long-term interest rate was 5.9% (-3.7% as from the beginning of the year) and Latvia has been complying with the respective criterion as from August 2011 (as at December 2011 it was 7.3%).

3. CASH AND STATE BUDGET LOANS MANAGEMENT

3.1. CASH MANAGEMENT

The Treasury Cash Management Strategy approved by the Minister of Finance establishes the goals, tasks, basic principles and responsibility of the Treasury by performing timely and effective cash management, observing liquidity requirements and restricting financial risks.

Following the terms of the lenders within the framework of the international loan programme in 2011, the Treasury continued placing the resources only in the Bank of Latvia. Upon the closing of the international loan programme, in 2012, within the framework of management of the temporarily free resources, the Treasury plans resumption of the placement of financial resources in cooperation both with the local and foreign transaction partners. Therefore, at the end of 2011, the Treasury had already revised the **Treasury Cash Management Strategy** in accordance with the financial market situation by updating the basic principles for financial risk management and investment structure parameters, as well as envisaging several strategically new trends.

3.2. ISSUING AND SERVICING OF STATE LOANS

Pursuant to the delegation of the Minister of Finance in line with the 29 October 2010 Internal Regulation of the Ministry of Finance, Procedures for Authorisation of **the Treasury, the Treasury ensures granting and servicing of state loans in the amount prescribed in the annual state budget law**. The procedure for granting state loans **is governed by the Law on Budget and Financial Management, the annual state budget law**, as well as the 19 January 2010 Cabinet of Ministers Regulation No. 63 **Procedures for the Issue and Servicing of State Loans**.

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

1) budget and financial management;
2) stabilisation of local government finances;
3) investments;
4) implementation of commercial activity assistance programmes;
5) implementation of projects and measures co-financed by the EU;
6) implementation of projects funded through foreign financial aid.

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

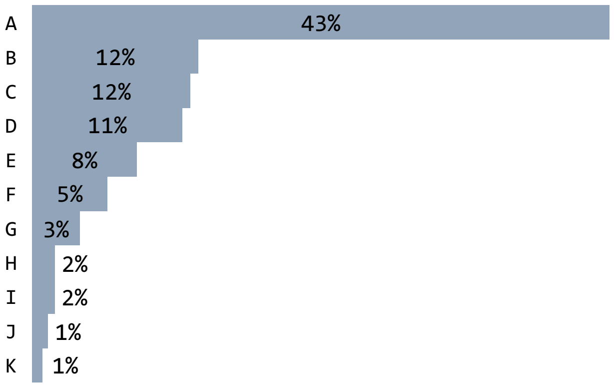
The Treasury performs the state loan supervision and debt recovery activities. In cases when the local governments have failed to perform the obligations under the agreements, the Treasury is entitled to deduct the outstanding amounts from the personal income tax amounts pertaining to the local government or the local government financial balancing fund grant. In cases when the commercial companies have failed to perform the obligations under the signed agreements, complaints on the repayment of the loan are brought to the borrowers or a claim is brought to the court on the recovery of debt and an application on claim security. If a commercial company has been liquidated and the debt recovery is no longer possible, the Treasury shall write off the cancelled debt obligations of the liquidated commercial company in accordance with the 15 July 2003 Cabinet of Ministers Regulation No. 389 Procedure for Cancellation of State Loans by the Minister of Finance. The debt obligations of the 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 the state loans to be granted in 2011 was determined to be **LVL 527.8 million**, including the total increase in the state loans specified in the annual state law amounting to LVL 208 million and repayments of the state budget loans granted during the preceding years amounting to LVL 319.8 million in 2011.

When granting state loans in 2011, the Treasury complied with the agreement attained with the international lenders, which has been set out in the Letter of Intent of the Republic of Latvia dated 27 July 2009 stating that **the Republic of Latvia undertakes to comply with the set restriction with respect to the maximum amount of state loans to be granted, to issue loans solely to the local governments, save if the loan has been prescribed for the implementation of the EU projects or foreign financed projects or is closely related to the bank restructuring programme, by prior consulting the European Commission and the IMF**.

In 2011, the largest amount of state loans was granted to the financial institutions (state JSC Latvijas Hipotēku un zemes banka (Latvian Mortgage and Land Bank) and the Financial and Capital Market Commission) – **making up LVL 196.5 million or 53%** of the total amount of state loans. The state loan to the Financial and Capital Market Commission, amounting to LVL 185.6 million, was granted in accordance with the norms of the law On Budget and Financial Management for ensuring the payment of the guaranteed reimbursements provided for in the law from the Deposit Guarantee Fund due to the insolvency of JSC Latvijas Krājbanka.

In 2011, state budget loans to the amount of LVL 110.3 million or 29.8% of the total amount of state loans **were granted to local government authorities. The major part of this - 89% of the state loans issued to local government authorities – were for the implementation of EU co-financed projects.** The remaining portion was issued for budget and financial management, financial stabilisation, ensuring heating season and the purchase of fuel, for the purchase of transportation necessary for the performance of autonomous functions, implementation of those infrastructure projects, where the actual investment of the local governments is not less than 75% of the total expenditure and the amount of the necessary loan



A Development of territory / **B** Water-supply / **C** Culture, recreation / **D** Education / **E** Power industry / **F** Stability of finances / **G** Tourism / **H** Other / **I** Social security
J Budget and financial management / **K** Environmental protection

Chart 14 Breakdown of State Budget Loans Issued in 2011 to local governments by Purposes (%)

Source: The Treasury

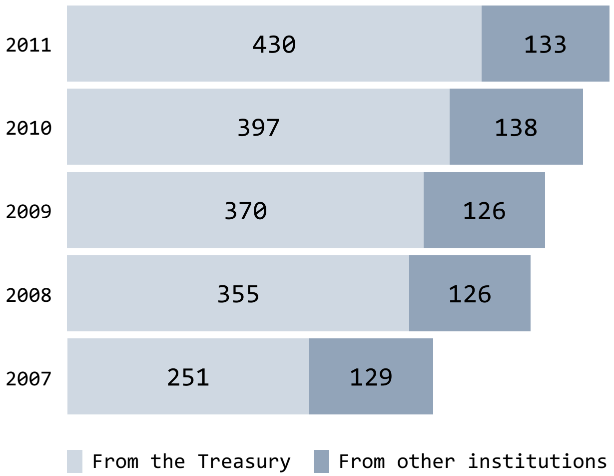


Chart 15 Debt of local governments during the period from 2007 to 2011 (LVL million)

Source: The Treasury

does not exceed 25% of the total expenditure until full commissioning of the object in 2011, and implementation of those local government projects, the government loan agreements whereon had been made by the local governments in 2009 and 2010 while the financing for the implementation of the projects was necessary in 2011 as well.

State loans to the amount of LVL 62.6 million or 16.9% of the total amount were also granted to a number of non-financial merchants for the implementation of EU co-financed projects for refurbishing and repairing water supply and heating systems (LLC Grobiņas siltums, LLC Dobeles ūdens, LLC Brocēnu siltums, etc.). With reference to the goals specified in Article 81 of the law On Budget and Financial Management, not exceeding 10% of the GDP amount set in the law On the State Budget for 2011, a state loan amounting to LVL 16 million was granted to JSC Air Baltic Corporation.

The remaining part of the state loans, making up LVL 0.77 million or 0.2% of the total amount, was granted to merchants which are managed and financed by local governments, such as hospitals for the implementation of EU co-financed projects (LLC Viļānu slimnīca (Viļāni hospital), LLC Priekules slimnīca (Priekule hospital), LLC Jēkabpils reģionālā slimnīca (Jēkabpils Regional hospital)) and LVL 0.45 million or 0.1% were granted to the state financed institution Riga Technical University, which used the loan to ensure current assts due to the suspension of financial services rendered by JSC Latvijas Krājbanka.

The local governments may borrow loans from other lenders solely with the consent of the Minister of Finance and in case the loan terms of the other lender are more favourable as compared to the ones offered by the Treasury. In 2011, the local governments have borrowed state loans from the Treasury amounting to 99% of the total sum of received loans (both from the Treasury and from other lenders). **The total outstanding debt of the local governments** as at 31 December 2011 was LVL 562.7 million, incl., the debt obligations to the Treasury in the amount of LVL 430.2 million.

Pursuant to the law On State Loans for 2012, the total increase of state loans in 2012 is set at LVL 208 million, which includes a total increase of local government borrowings amounting to LVL 76 million.

3.3. LIQUIDITY MANAGEMENT

The **objective** of liquidity management is **to ensure availability of cash to meet financial liabilities** in due time and in the full amount. The Treasury engages in the following activities with the intention of complying with the liquidity requirements:

1) monitors the stock of liquid resources as well as compliance with the liquidity limits and size of the liquid resources reserve;
2) timely identifies and prevents situations that may impair liquidity and result in a payment or liquidity crisis;
3) deposit temporarily free funds so as to maintain an adequate stock of liquidity that would ensure the required liquid resources reserve and compliance with liquidity limits within the relevant period.

In managing financial resources, the Treasury observes the liquidity requirements, thus preventing the occurrence of a liquidity crisis. Based on the results of the analysis of the performance of liquidity requirements set for 2010, as well as considering the liquidity management practice, **the procedure for calculation and determination of liquidity indicators was optimised and simplified** in 2011 in order to increase the liquidity management efficiency.

In 2011, **based on the financing requirement and financial market developments**, the Treasury **ensured** the availability of the liquid resources **required for execution of financial obligations, as well as deposited temporarily free funds solely in the Bank of Latvia**.

In 2011, the resources available in the Treasury accounts, the resources attracted in the domestic and external financial markets, as well as the resources available under the international loan programme were used to ensure liquidity.

SUPPORT MEASURES FOR ENSURING THE LIQUIDITY OF JSC PAREX BANKA AND JSC CITADELE BANKA

In 2011, within the framework of the support measured for ensuring the liquidity of JSC Parex banka, in accordance with the authorisation of the Minister of Finance, the capital was increased twice: on 2 September by LVL 20 million, when the accrued interest on deposits was capitalised, and on 14 December by LVL 19.8 million, when the term deposits of the Treasury in the amount of LVL 18.5 million were suspended (LVL 12.4 million thereof were capitalised) and the accrued interest on those term deposits in the amount of LVL 7.4 million was capitalised.

On 5 May, JSC Parex banka repaid the syndicated loan of LVL 163.4 million, which had been secured by the state guarantee.

On 29 December, upon change of the status of JSC Parex banka, all the state aid term deposits in the equivalent of LVL 427.8 million were converted into dematerialised bonds of closed issued of JSC Parex banka.

At the end of 2011, the amount of bonds issued by JSC Parex banka was the equivalent of LVL 427.8 million, and the investment in the capital of JSC Parex banka was LVL 206.4 million, while the state aid term deposits were cancelled.

In 2011, JSC Citadele banka repaid three state aid term deposits; one in the amount equivalent to

LVL 32.75 million was repaid on the planned deadline on 30 September, and two term deposits were repaid prior to their maturity: on 18 January and 20 December respectively, each in the amount equivalent to LVL 32.75 million. In 2011, JSC Citadele banka repaid the state aid term deposits in the total amount of LVL 98.25 million, and the remaining amount of term deposits as at the end of 2011, which is planned to be repaid during the first quarter of 2012, is LVL 32.75 million.

3.4. PERFORMANCE INDICATORS OF THE RESULTS OF ACTIVITIES WITHIN THE CASH MANAGEMENT AND STATE BUDGET LENDING PRESCRIBED IN THE OPERATIONAL STRATEGY OF THE TREASURY

Table 6 Performance indicators of the results of activities within the cash management and state budget lending

No.	Result of activity	Performance indicators	Indicators (numeric values)		
			Last known precise measurement (2010)	Planned in 2011	Performance in 2011
1.	Efficient and safe cash management.	Ensured interest income from the investment of funds of the central government budget in the amount prescribed in the annual state budget law (% compliance with the annual plan).	145,7[7]	100	286,4

Source: The Treasury

7 Interest income from deposits and account balances in 2011 were worth 43,2 million lats or 286% of the amount prescribed in the State Budget Law for 2011.

4. IMPLEMENTATION OF THE FUNCTIONS OF THE PAYING AND CERTIFYING AUTHORITY FOR EUROPEAN UNION POLICY INSTRUMENTS

In accordance with the provisions of the regulatory enactments, the Treasury performs the functions of the Paying and Certifying Authority of the EU policy instruments, the European Economic Area financial instruments and the Norwegian government bilateral financial instrument, as well as for the Latvian and Swiss cooperation programme.

In 2011, in order to ensure implementation of those functions, the Treasury participated in the development of the regulatory base necessary for the administration and implementation of the European Economic Area financial instruments and the Norwegian government bilateral financial instrument of the 2009-2014 planning period and in commentation of the draft Cabinet of Ministers orders on the programmes co-financed by the financial instruments, as well as in development of amendments to several regulatory enactments related to administration of financial instruments.

In order to find a systematic, uniform approach and practice for the preparation of confirmation for approval of the statement of expenditure, in 2011, the Treasury developed **Guidelines for the Preparation of Confirmation for Approval of the Statement of Expenditure** providing explanations to the responsible and cooperation institutions on preparation of the aforementioned confirmation. Support has been also provided to the managing authority for the improvement of the functionality of the EU Structural Fund and Cohesion Fund management information system, since it has been planned to release the responsible and cooperation institutions from the process of preparation of the statement of expenditure and for the Treasury to commence preparation of the statement of expenditure using the data from the information system.

4.1. FUNCTION OF THE PAYING AUTHORITY DURING THE PROGRAMMING PERIOD FROM 2004 TO 2006

In accordance with the provisions of EU Regulations, a **Paying Authority is one or several national, regional or local authorities or bodies designated by the Member State to certify the incurred expenditure, submit payment claims and Declarations of Expenditure, and receive payments from the European Commission**. The Paying Authority, as well as other institutions involved in implementation of the EU policy instruments, have to ensure operation of the instruments in compliance with EU interests, as well as effective management and monitoring of structural funds in accordance with the provisions of EU Regulations and guidelines.

The functions of the Paying Authority are to receive funds from the European Commission and to perform payments to the final beneficiaries within the shortest term and in full amount.

The Treasury started implementing Paying Authority functions as of 1 May 2004.

The Treasury performed the **functions** of Paying Authority for the **following EU policy instruments**:

1) **EU structural funds** – ERDF, ESF, EAGGF and FIFG;
2) **Cohesion Fund**;
3) **European Community initiative *EQUAL*.**

The EU Structural Fund final statement of expenditure (statement, according to which the part of the EU financing for the declared and not yet received elegible expenditure was requested from the European Commission) for each of the funds were submitted in 2010, and as from submission of the final documents to the European Commission **the closure process of the 2004-2006 EU Structural Fund planning period was commenced**. The closure procedure is a time consuming process, therefore we consider the final payments received from the European Commission in full within the framework of the EAGGF and ESF in 2011 to be very positive information.

Pursuant to the terms of the regulations, the eligibility period of project expenditure financed by the Cohesion Fund ends on 31 December 2010; therefore, in 2011, **the Treasury performed the necessary verification on checks to ensure submission of the final statements of expenditure to the European Commission by the deadline set in the regulatory enactments**, i.e., by 30 June 2011. In 2011, **within the framework of the Cohesion Fund, 22 statements of expenditure** were submitted to the European Commission, **17 whereof were the closing statements of expenditure** and five were interim statements of expenditure, in total **requesting EUR 81,915 thousand** from the European Commission. **Since the major part of the projects financed by the Cohesion Fund were completed in 2010 and the final statements of expenditure thereon had been sent in 2011, the amount of declared expenditures in 2011 as compared to 2010 was considerably larger (see Table 7).**

Table 7 Comparison of the Cohesion Fund expenditures certified for the European Commission in 2011 with the data on 2010, EUR thousand

EU policy instrument	2010		2011	
	Sent returns	Declared expenditures	Sent returns	Declared expenditures
Cohesion Fund	12	71 803	22	318 273

Source: The Treasury

4.2. FUNCTIONS OF THE PAYING AUTHORITY FOR THE EUROPEAN ECONOMIC AREA FINANCIAL INSTRUMENT AND THE BILATERAL FINANCIAL INSTRUMENT OF THE NORWEGIAN GOVERNMENT

The Treasury is the paying authority also for the Financial instrument of the European Economic Area and the bilateral Financial instrument of the Norwegian government (during the 2004 2009 planning period).

65 individual projects, three programmes (integration of environmental policy in Latvia, facilitation of PPP, cross-border cooperation) and six grant schemes (strengthening of civil society and public integration, academic studies, non-governmental organisation fund, scholarship grant scheme, project preparation fund, short-term expert fund) for the total amount of LVL 31.6 million were implemented within the framework of the financial instruments. Since the eligibility period the projects expired in April 2011 submission of the project interim reports to the Financial Mechanism Office was ensured by the deadline specified in the regulatory enactments, i.e. by the end of October 2011. An addition 36 project comletion reports were sent, from which closing payment requests for 21 project of have been approved by the Financial Mechanism Office and the final payments have been received within the framework of those projects (see Table 8). Submission of the remaining project completion reports to the Financial Mechanism Office will be continued in 2012.

Table 8 Funds Claimed and Received in 2011 within the Framework of the European Economic Area Financial Instrument and the Norwegian Government Bilateral Financial Instrument, Compared with 2010, (thousand EUR)

Type of payment	Number of reports sent		Amount claimed		Amount received	
	2010	2011	2010	2011	2010	2011
Interim/ final	142	165	16 621	15 414	16 885	15 145[8]

Source: The Treasury

8 The amount has been specified taking into consideration the funds repaid to the Financial Mechanism Office, which were received in advance, but were not used.

4.3. FUNCTIONS OF A PAYING AUTHORITY WITHIN THE FRAMEWORK OF THE LATVIAN AND SWISS CO-OPERATION PROGRAMME

By the end of 2011, the competent institutions of Switzerland had approved six individual projects, one programme, three grant schemes, one technical support, including the project preparation fund project for the total financing of LVL 32.8 million (100% of the total available financing). 11 of the planned 12 project agreements have been signed between Latvia and Switzerland. It is planned to sign the final project agreement and to commence implementation thereof during the 1st quarter of 2012.

The Paying Authority **verified and submitted 13 fund payment requests to the competent institutions of Switzerland** within the Latvia and Switzerland cooperation programme in 2011, from which three requests whereof were advance payment requests and ten were interim payments. In 2011, the projects were actively implemented, which fact is proven also by the information on the amount of claimed financing in 2011 as compared to the data of 2010 disclosed in Table 9.

Table 9 Funds Claimed and Received in 2011 within the Latvian and Swiss Co-operation Programme, (million CHF)

Type of payment	Number of reports sent		Amount claimed		Amount received	
	2010	2011	2010	2011	2010	2011
Advance	2	3	5 822	7 763	5 822	7 763
Interim	9	10	250	9 550	223	9 529
Total	**11**	**13**	**6 072**	**17 313**	**6 045**	**17 292**

Source: The Treasury

4.4. FUNCTION OF THE CERTIFYING AUTHORITY AND PAYING AUTHORITY DURING THE PROGRAMMING PERIOD OF 2007-2013

In compliance with the Law of the EU Structural Funds and Cohesion Fund management, the Treasury acts as a **Certifying Authority** and Paying Authority for the European Regional Development Fund, European Social Fund and Cohesion Fund in the programming period from 2007–2013. **The functions of the Certifying Authority include preparation of certified Statements of Expenditure and payment claims and their submission to the European Commission, as well as certifying that the declared expenditure is compliant with the existing European Community and Member State Regulations.** The function of the **paying authority** is to ensure accounting of the EU Funds financing received and used from the European Commission and to make **payments to the final beneficiaries within the shortest possible time**.

In 2011, within the framework of the EU Funds for the 2007-2013 planning period, the paying authority verified and processed **7,535 payment claims, including 607 advance payments**. The Paying Authority performed repayments to the final beneficary from the EU funds in the amount of LVL 454,228 (EUR 643,295). The Treasury has paid LVL 86,826 as advance payments within the framework of the EU fund projects.

In 2011, the certifying authority received **242 statements of expenditure** from the cooperation and responsible institutions **and verified them within the set deadline and submitted 22 statements of expenditure to the European Commission**.

Table 10 Expenditures Certified for the European Commission and Refunds received in 2011, compared with 2010, million EUR

EU policy instrument	Eligible expenditures declared		Requested from European Commission		Received from European Commission	
	2010	2011	2010	2011	2010	2011
Operational programme (ESF)	176 728	152 004	143 699	129 090	135 187	123 459
Operational programme (ERDF)	55 214	82 192	35 594	34 516	41 156	26 000
Operational programme	207 202	492 672	174 198	409 595	234 800	362 571
incl. ERDF	*105 567*	*307 579*	*92 110*	*262 709*	*98 063*	*231 871*
incl. Cohesion Fund	*101 635*	*185 093*	*82 088*	*146 886*	*136 737*	*130 700*
Total	**439 144**	**726 868**	**353 591**	**573 201**	**411 143**	**512 030**

Source: The Treasury

4.5. PERFORMANCE INDICATORS OF THE ACTIVITY RESULTS PRESCRIBED IN THE OPERATIONAL STRATEGY OF THE TREASURY WITHIN THE IMPLEMENTATION OF THE FUNCTIONS OF THE PAYING AND CERTIFYING AUTHORITY FOR EU POLICY INSTRUMENTS

Table 11 Performance Indicators of the Results of Activities within Implementation of the Functions of the Paying and Certifying Authority for EU Policy Instruments

No.	Result of activity	Performance indicators	Indicators (numeric values)[9]		
			Last known precise measurement (2010)	Planned in 2011	Performance in 2011
1.	Completely paid certified expenditures.	Payments received from the European Commission, % of the payments requested from the European Commission.	100	100	100

Source: The Treasury

9 The cases when the European Commission applies financial adjustments or withdraws claims of debtors' not timely paid by another authority are not taken into account.

5. CORPORATE GOVERNANCE OF THE TREASURY AS A PUBLIC ADMINISTRATION INSTITUTION

5.1. THE TREASURY'S FINANCING AND ITS SPENDING

The Treasury's financing is comprised of:

1) A grant from general revenue;
2) Service charges and other self-generated revenue:
   - revenue from the state loan service,
   - revenue from the central government guarantee service.

In 2011, the Treasury implemented the following **general budget programmes and sub-programmes**:

1) Programme "Central Government Budget Execution and Central Government Debt Management":
   - sub-programme "Central Government Budget Execution";
   - sub-programme "Central Government Debt Management";
2) Sub-programme "Contributions to International Organisations";
3) Sub-programme "Compensation to Rehabilitated Citizens";
4) Programme "State Loans and their Repayments";
5) Sub-programme Projects of Limited Tenders Financed by the European Regional Development Fund (ERDF) (2007-2013);
6) Sub-programme Implementation of the European Social Fund (ESF) Projects and Events (2007-2013);
7) Programme Grant to Local Government Equalisation Fund.

The objective of the **sub-programme "Central Government Budget Execution"** is the ensuring of an effective and economical budget execution process and the improvement of 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 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, as well as to ensure efficient and safe cash management through the limitation and supervision of financial risks, timely and full ensuring of the liquidity necessary for performance of financial obligations of the government.

The objective of the **sub-programme "Contributions to International Organisations"** is to make 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, in due time and full amount, thus ensuring settlement of the undertaken commitments.

The objective of the **sub-programme "Compensation to Rehabilitated Citizens"** is to ensure disbursement of compensation to rehabilitated citizens in compliance with the laws and regulations.

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

Within the framework of **the sub-programme, Projects of Limited Tenders 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 ensure the receipt of prompt payment data information to all the institutions administering the government budget payments. The project is implemented within the scope of 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 activity programme Infrastructure and Services.

Implementation of the project co-financed by the European Social Fund “Improvement and Development of the Services Rendered by the Treasury of the Republic of Latvia” has been completed within the framework of **the sub-programme “Implementation of the European Social Fund (ESF) Projects and Events (2007-2013)”**. The project goal is to facilitate improvement, development and accessibility of the services rendered by the Treasury, to increase the efficiency of servicing procedure through reduction of the administrative burden and servicing fees for the current and potential customers.

The objective of the **programme “Grant to Local Government Equalisation Fund”** is to ensure transferring of the grant from the central government budget to the Local Government Financial Cohesion Fund in compliance with the effective laws and regulations.

Table 12 Government General Budget Financing and its Application (summary by programme, LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**253 438 068**	**224 755 369**	**223 885 405**
1.1.	Grants	251 029 871	223 138 894	221 507 157
1.2.	Service charges and other self-generated revenue	2 408 197	1 616 475	2 378 248
1.3	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**252 151 594**	**224 755 369**	**222 962 418**
2.1.	Maintenance costs (total)	251 878 936	224 441 296	222 650 616
2.1.1.	Running costs	6 561 235	6 019 984	5 295 284
2.1.2.	Interests	233 180 357	199 122 370	198 407 707
2.1.3.	Subsidies, grants and social benefits	167 351	156 971	77 581
2.1.4.	Regular payments to the European Community budget and international cooperation	2 117 096	3 650 600	3 393 358
2.1.5.	Maintenance cost transfers	9 852 897	15 491 371	15 476 686
2.2.	Expenditures for capital investments	272 658	314 073	311 802

Source: The Treasury

Table 13 Government General Budget Funding and its Spending for the General Budget Programme "Central Government Budget execution and Central Government Debt Management" (LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**241 300 724**	**205 425 402**	**204 907 991**
1.1.	Grants	238 892 527	203 808 927	202 529 743
1.2.	Service charges and other self-generated revenue	2 408 197	1 616 475	2 378 248
1.3.	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**240 007 720**	**205 425 402**	**203 985 004**
2.1.	Maintenance costs (total)	239 735 062	205 132 631	203 694 503
2.1.1.	Running costs	6 554 705	6 010 261	5 286 796
2.1.2.	Interests	233 180 357	199 122 370	198 407 707
2.1.3.	Subsidies, grants and social benefits	-	-	-
2.1.4.	Regular payments to the European Community budget and international cooperation	-	-	-
2.1.5.	Maintenance cost transfers	-	-	-
2.2.	Expenditures for capital investments	272 658	292 771	290 501

Source: The Treasury

Table 14 Government General Budget Funding and its Spending, General Budget Sub-Programme “Central Government Budget Execution” (LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**4 533 023**	**3 632 132**	**4 393 905**
1.1.	Grants	2 124 826	2 015 657	2 015 657
1.2.	Service charges and other self-generated revenue	2 408 197	1 616 475	2 378 248
1.3.	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**3 240 019**	**3 632 132**	**3 470 918**
2.1.	Maintenance costs (total)	2 967 361	3 339 361	3 180 417
2.1.1.	Running costs	2 967 361	3 339 361	3 180 417
2.1.2.	Interests	-	-	-
2.1.3.	Subsidies, grants and social benefits	-	-	-
2.1.4.	Regular payments to the European Community budget and international cooperation	-	-	-
2.1.5.	Maintenance cost transfers	-	-	-
2.2.	Expenditures for capital investments	272 658	292 771	290 501

Source: The Treasury

Table 15 Government General Budget Funding and its Spending, General Budget Sub-programme “Central Government Debt Management” (LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**238 567 973**	**201 793 270**	**200 514 086**
1.1.	Grants	238 567 973	201 793 270	200 514 086
1.2.	Service charges and other self-generated revenue	-	-	-
1.3.	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**236 767 701**	**201 793 270**	**200 514 086**
2.1.	Maintenance costs (total)	236 767 701	201 793 270	200 514 086
2.1.1.	Running costs	3 587 344	2 670 900	2 106 379
2.1.2.	Interests	233 180 357	199 122 370	198 407 707
2.1.3.	Subsidies, grants and social benefits	-	-	-
2.1.4.	Regular payments to the European Community budget and international cooperation	-	-	-
2.1.5.	Maintenance cost transfers	-	-	-
2.2.	Expenditures for capital investments	-	-	-

Source: The Treasury

Table 16 Government General Budget Funding and its Spending, General Budget Sub-programme “Contributions to International Organisations” (LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**2 117 096**	**3 650 600**	**3 393 358**
1.1.	Grants	2 117 096	3 650 600	3 393 358
1.2.	Service charges and other self-generated revenue	-	-	-
1.3.	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**2 117 096**	**3 650 600**	**3 393 358**
2.1.	Maintenance costs (total)	2 117 096	3 650 600	3 393 358
2.1.1.	Running costs	-	-	-
2.1.2.	Interests	-	-	-
2.1.3.	Subsidies, grants and social benefits	-	-	-
2.1.4.	Regular payments to the European Community budget and international cooperation	2 117 096	3 650 600	3 393 358
2.1.5.	Maintenance cost transfers	-	-	-
2.2.	Expenditures for capital investments	-	-	-

Source: The Treasury

Table 17 Government General Budget Funding and its Spending, General Budget Programme "Compensations to Rehabilitated Citizens" (LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**167 351**	**156 971**	**77 581**
1.1.	Grants	167 351	156 971	77 581
1.2.	Service charges and other self-generated revenue	-	-	-
1.3.	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**167 351**	**156 971**	**77 581**
2.1.	Maintenance costs (total)	167 351	156 971	77 581
2.1.1.	Running costs	-	-	-
2.1.2.	Interests	-	-	-
2.1.3.	Subsidies, grants and social benefits	167 351	156 971	77 581
2.1.4.	Regular payments to the European Community budget and international cooperation	-	-	-
2.1.5.	Maintenance cost transfers	-	-	-
2.2.	Expenditures for capital investments	-	-	-

Source: The Treasury

Table 18 Government General Budget Funding and its Spending, General Budget Programme "Grant to Local Government Financial Cohesion Fund" (LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**9 852 897**	**15 491 371**	**15 476 686**
1.1.	Grants	9 852 897	15 491 371	15 476 686
1.2.	Service charges and other self-generated revenue	-	-	-
1.3.	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**9 852 897**	**15 491 371**	**15 476 686**
2.1.	Maintenance costs (total)	9 852 897	15 491 371	15 476 686
2.1.1.	Running costs	-	-	-
2.1.2.	Interests	-	-	-
2.1.3.	Subsidies, grants and social benefits	-	-	-
2.1.4.	Regular payments to the European Community budget and international cooperation	-	-	-
2.1.5.	Maintenance cost transfers	9 852 897	15 491 371	15 476 686
2.2.	Expenditures for capital investments	-	-	-

Source: The Treasury

Table 19 Government General Budget Funding and its Spending, General Budget Sub-programme "Projects of Limited Tenders Financed by the European Regional Development Fund (ERDF) (2007-2013)" (LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**-**	**21 302**	**21 301**
1.1.	Grants	-	21 302	21 301
1.2.	Service charges and other self-generated revenue	-	-	-
1.3.	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**-**	**21 302**	**21 301**
2.1.	Maintenance costs (total)	-	-	-
2.1.1.	Running costs	-	-	-
2.1.2.	Interests	-	-	-
2.1.3.	Subsidies, grants and social benefits	-	-	-
2.1.4.	Regular payments to the European Community budget and international cooperation	-	-	-
2.1.5.	Maintenance cost transfers	-	-	-
2.2.	Expenditures for capital investments	-	21 302	21 301

Source: The Treasury

Table 20 Government General Budget Funding and its Spending, General Budget Sub-programme "Implementation of the European Social Fund (ESF) Projects and Activities (2007-2013)" (LVL)

No	Financial assets	In the preceding year (Actual)	In the reporting year	
			Approved by the law	Actual
1.	**Financial assets to cover expenditure (total)**	**6 530**	**9 723**	**8 488**
1.1.	Grants	6 530	9 723	8 488
1.2.	Service charges and other self-generated revenue	-	-	-
1.3.	Foreign financial aid	-	-	-
1.4.	Donations and grants	-	-	-
2.	**Expenditure (total)**	**6 530**	**9 723**	**8 488**
2.1.	Maintenance costs (total)	6 530	9 723	8 488
2.1.1.	Running costs	6 530	9 723	8 488
2.1.2.	Interests	-	-	-
2.1.3.	Subsidies, grants and social benefits	-		
2.1.4.	Regular payments to the European Community budget and international cooperation	-	-	-
2.1.5.	Maintenance cost transfers	-	-	-
2.2.	Expenditures for capital investments	-	-	-

Source: The Treasury

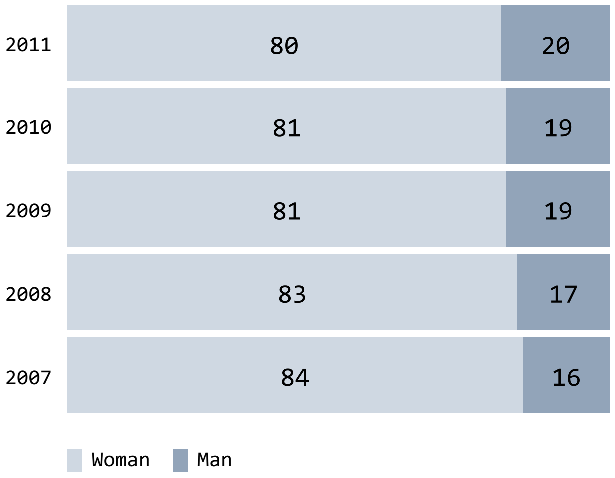


Chart 16 Breakdown of the Treasury Personnel by Gender from 2007 - 2011 (%)

Source: the Treasury

Chart 17 Distribution of the Personnel of the Treasury by Age Groups from 2007 - 2011 (%)

Source: the Treasury

STATE AND LOCAL GOVERNMENT PURCHASES

The procurements in the Treasury are performed in accordance with the Public Procurement Law by applying an open tender, negotiation procedure and procurement procedure, pursuant to Article 81 of the Public Procurement Law. The Treasurer forms a procurement commission that is competent within the area of the procurement an agreement is made on. Procurements are registered and the agreements are controlled by the accounting software "Horizon". In 2010 the Treasury performed 19 procurements (excluding procurements below 3000 lats) and made agreements for 738 090 lats, excluding VAT.

5.2. PERSONNEL AND PERSONNEL MANAGEMENT

At the beginning of 2011, there were **182 official positions** in the Treasury: **165 civil service** and **17 staff positions**. At the end of 2011, in its turn, there were **168 civil service** and **17 staff positions** in the Treasury totalling **185 official positions**. In 2011, **the average number of employees** including the employees in long-term absence was **181**, incl. **164 civil service** and **17 staff positions**.

Breakdown of the Treasury **personnel by age and gender has not materially changed in 2011** as compared to the preceding years (see Charts 16 and 17).

In 2011, **24 civil servants and staff members, or 34% of the personnel, were laid off** (see Chart 18). Taking a look at the percentage change of the employees laid off during the period of the last five years it is obvious that there have been minor changes, save in 2009, when the comparatively large amount of employees laid off was related to the structural reform carried out in the Treasury.

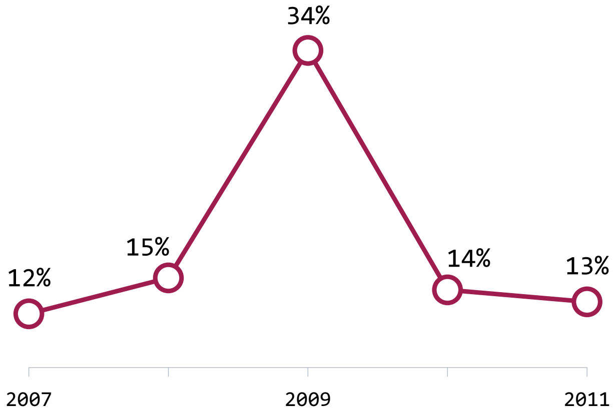
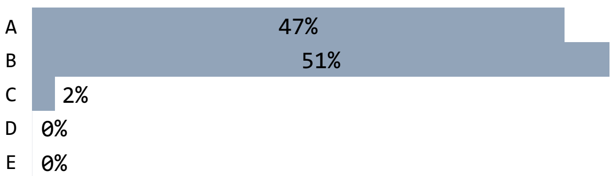


Chart 18 Personnel lay-offs at the Treasury (2007-2011) (%)

Source: the Treasury



A performance in all areas exceeds requirements of the respective industry
B performance in particular areas exceeds requirements; however, the remaining areas are in compliance with the requirements of the respective industry
C performance is in compliance with the requirements of the respective industry
D performance is not in accordance with the requirements of the respective industry in all areas, improvement of performance is required
E performance does not comply with the requirements in the respective industry, all areas require significant and immediate improvements

Chart 19 Results of the Job Performance Appraisal Process in 2010/2011 (%)

Source: the Treasury

During the reporting year, 26 specialists have entered into the civil service or legal employment relationship with the Treasury. In order to attract professional personnel, the Treasury continues its collaboration with higher education institutions and personnel selection agency. In order to ensure a professional and impartial personnel selection process, the Treasurer issues an order on the establishment of the selection commission that organises several rounds of personnel selection by using a scoring system and arranging practical tests and interviews.

The Treasury continues its usual practice of promoting the careers of its professionals: three employees have been promoted to higher-level positions, while four employees have been moved to positions in other structural units.

The Treasury pays special attention to introducing new employees to their job responsibilities and the operations of the institution by preparing the new employee's work plan for the test period and familiarising him or her with the functions of the Treasury and the team. At the conclusion of the test period, the performance of 16 new employees received positive assessment.

Based on the results of the performance appraisals after the test period, seven civil servant candidates were granted the status of a civil servant.

During the annual **job performance appraisal**, the job performance of 160 civil servants and staff members was evaluated. Job performance appraisals are used to motivate the personnel, to develop professional growth and career of personnel, as well as to determine the training needs.

The positive results of job performance appraisal (no employee has received appraisal "D" or "E") prove the fact that the employees of the Treasury have reached high level of professionalism and developed their skills through efficient performance of their job duties and involvement in attaining the overall goals of the institution (see Chart 19).

The Treasury's greatest asset is its highly educated and professional personnel. **98% of the employees are university graduates** (43% of employees hold a master's degree).

Despite the limited financial resources, facilitation of professional and personal development of human resources remains an important area of personnel management, and also in 2011, in terms of **organising the training process**, the practice of finding solutions for the professional development and enhancement of employee competencies by way of various free seminars and experience-sharing events continued. As in previous years, educational sessions organised by the employees themselves were topical as well: within the area of information security, project management (Microsoft Office Project), and corruption risk management. Collaboration continued with training specialists engaged during the preceding years, through organising training on the improvement and development of quality of the services rendered by the Treasury.

In 2011, within the framework of the ESF project Support to Reforms within the Area of Budget and Financial Politics, certain employees involved in the financial area had an opportunity to go on exchange trips, as well as to attend specialised high level training both in Latvia and abroad on the best practices of other countries and competence in such financial areas as the government borrowing strategy and methods for optimising the central government debt expenditures, financial derivatives, credit risk analysis and management, etc.

Every year, the Treasury assesses the educational and training needs of the civil servants and staff members 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 for the performance of the duties of specific positions.

After implementation and maintenance of the Centralised Financial Accounting Solution in the departments of the Ministry of Finance, as from 2011 the Treasury ensures personnel accounting procedure also for the Lottery and Gambling Supervision Inspection.

5.3. QUALITY AND RISK MANAGEMENT

A **quality management system** has been created at the Treasury through the use of the Treasury's capacity for improvement and available resources to ensure the compliance of the services provided by the Treasury with the interests of the State, residents and clients, as well as with the requirements of regulatory enactments.

As from 2006 the Treasury is an ISO certified authority. Since 2009 the Treasury quality management system has been certified in accordance with the requirements of ISO 9001:2008 standard. The scope of activity of the quality management system to be certified is the performance of the central government budget, central government debt management, cash and state budget loan management, implementation of the paying, certifying authority and National Fund management functions, all of which are the basic operational processes of the Treasury. **In 2011, the second supervisory audit of the Treasury quality management system was carried out** to ensure confidence in the constant compliance of the Treasury's quality management system with the requirements of ISO 9001:2008 standard. **During the audit excellent internal information circulation and employee understanding of the strategic priorities of the Treasury's operations was observed.**

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 introduction of good management principles in the state administration institution through enacting the customer oriented approach, improving financial indicators, decreasing administrative burden, optimising the resources of the Treasury and its customers, as well as

recognising the Treasury as the model for other direct management institutions with respect to the simplification of its work and making it more comprehensible, operative and closer to the public.

In 2011, the Treasury, in co-operation with the Society Integration Foundation, successfully finalised the ESF project commenced in 2010, Improvement and Development of the Services Rendered by the Treasury. In order to clarify customer satisfaction with the services offered, the Treasury carried out a comprehensive study throughout Latvia: the opinions of 512 Treasury customers on the quality of the services rendered by the Treasury and on the overall image of the Treasury were queried through telephone interviews. The results of the polling performed within the framework of the project show that 97% of the polled customers are satisfied with the fact that the Treasury is introducing e-services more extensively. 79% of the polled customers admitted that service accessibility ensured throughout Latvia is very important, since it ensures material saving of administrative, time and other resources of the authority. **In 2011, within the scope of the project, the service quality improvement and development plan, as well as the project management methodology was developed based on the results obtained from the study.** 100 employees of the Treasury attended project management training in order to ensure improvement of the current services and development of new services. Introduction of the project management methodology is one of the Treasury's development priorities for 2012. **The ESF project introduced by the Treasury has been included as a sample in the informative material of the Treasury and Society Integration Foundation on the successfully implemented ESF projects in Latvia, since it provides confidence that the work performed and the results attained have been used for improvement of public services and increase in their quality.**

Unfortunately, the Treasury did not succeed in 2011 in attracting ERDF financing for the project for the introduction of the customer relationship management system; and the Treasury will search for other solutions thereto in 2012, since the introduction of such a system is very essential for fast and quality servicing of customers.

In 2011, **the Treasury Risk Management Policy was updated** in order to comply with the strategy of the Treasury and the external regulatory enactments, the risk environment and the organisational culture.

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 control functions the Treasury is expected to provide in accordance to the interests of the State and its residents, as well as to instil confidence in its clients regarding the consistency of the quality of the services provided by the Treasury.

5.4. INTERNAL CONTROL SYSTEM

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

Internal control within the structural units of the Treasury is one of the means to prevent potential loss. In order to reduce risks inherent in the administration of transactions, the Treasury implements the double authorisation principle, which determines that transactions have to be validated by at least two independent employees. Transacting is governed by internal quality management documents.

The Treasury has established **the control environment culture** by ensuring that operations comply with the quality management system and the code of ethics, by introducing and periodically monitoring the strategic direction of the functions, plans and work performance results of the Treasury, ensuring overall risk management procedure and facilitating involvement of the employees in improvement of the internal control system. The Treasury has implemented such organisational structure that clearly defines the responsibility, authority, distribution of duties and procedure for reporting.

The **risk management** and quality management have been integrated in the daily operations, project management, information system management processes of the Treasury that advance the **control activities** of the Treasury from reactive to proactive, thus decreasing the probability of the potential loss 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 performs **supervision of the internal control system** through process management by measuring the process activity quality criteria, through the strategic management process by analysing the activity results, through control self-assessments in the risk management, incompliance prevention processes, through implementation of recommendations for improvement of the internal control system provided as the result of audits and other assessments.

The **internal audits** and **inspections, audits performed by external auditors** in 2011 and **audit results**, as well as the **procedure for introduction of recommendations** of external and internal audits prove that **the internal control system of the Treasury functions well**, and overall the assessed controls are adequate, sufficient and efficient providing due confidence in the management of the Treasury's risks and attaining of the authority's goals. The internal control system developed in the Treasury ensures the performance of the tasks set by the authority in accordance with the strategic goals and in compliance with the requirements set out in the external and internal regulatory enactments, as well as credibility and adequacy of the prepared statements. The Treasury is continuously improving its processes considering the samples of best practices and competence of the financial sector organisations, which indicates the efficiency and productivity of the activities. The Treasury performs constant supervision and assessment of operational risks and secures its resources against potential loss.

Public Communication

ACTIVITIES FOR PUBLIC INFORMATION AND EDUCATION

Valuable communication between the Treasury and society is possible by ensuring an effective exchange of information. The Treasury informs the mass media on a regular basis regarding relevant issues: 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 circumstances: the Treasury remained at the epicentre of events and **the interest of mass media and the public in the operations, functions and responsibilities of the Treasury was still topical.**

Pursuant to **the Communication Strategy of the Treasury for 2010-2012 approved in 2011 (updated for 2011-2013), the Communication Plan of the Treasury for 2011** was developed and implemented in order to ensure the planning of operative and successful operations, to create and maintain a favourable internal communication cooperation environment in the Treasury and to develop the image of the Treasury by introducing additional external communication activities.

Since 2002, the Treasury has been maintaining its Internet homepage (www.kase.gov.lv), where information on the institution and its functions is available. Information on the Treasury's current events is updated and adjusted on a regular basis. It is possible to ask questions as well as submit applications electronically. Visitors to the homepage can receive prompt answers to their questions, whereby the Treasury has the opportunity to acquaint itself with questions of interest from their clients and, if necessary, prepare more in-depth information both on the Internet webpage and for distribution in the Treasury's Units, as well as identify potential problems and prevent them.

The Treasury's Development Priorities for 2012

1) Further development of the services rendered by the Treasury by using the resource optimisation possibilities and review of the control procedure efficiency, active information technology management, information security and its risk management.
2) Expansion of the scope and improvement of the quality of services rendered to the local governments.
3) Timely provision of resources for financing the central government budget execution and central government debt refinancing both in the domestic and the foreign public financial and capital markets.
4) Assessment and development of possibilities for the introduction of new domestic borrowing instruments.
5) Measures for introduction of a primary dealer system, incl. development of amendments to the regulatory enactments (medium term development of the government security market).
6) Updating and implementation of the Cash Management Strategy.
7) Improvement of the expenditure certification procedure in accordance with the recommendations of external auditors and the European Commission.
8) Re-certification of the Treasury's Quality Management System in accordance with the requirements of ISO 9001:2008 standard.
9) Introduction of project management.