



# THE TREASURY

OF THE REPUBLIC OF LATVIA

PUBLIC REPORT FOR

2006



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#### **ABBREVIATIONS USED IN THE REPORT**

ECDB	Council of Europe Development Bank
EIB	European Investment Bank
EU	European Union
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
NIB	Nordic Investment Bank
SSIA	State Social Insurance Agency

#### **UNITS OF MEASURE**

EUR	euro, the official currency of the European Union
LVL	lat, the national currency of the Republic of Latvia

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#### **PRINTING**

Imanta Printing House

ISBN 978-9984-39-227-1

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# THE TREASURER'S STATEMENT

The Treasury is a forward-looking institution with important historical experience. This experience makes us confident of our knowledge and abilities, as we evaluate our future development prospects through a prism of applying state-of-art technologies and modern business organisation.

The Treasury's objective is to develop as a dynamic and modern, client needs-oriented organisation in regard to the quality of its provided services, effectively and safely managing the finances entrusted to the Treasury's management, according to the best financial management practices and in compliance with the interests of the Republic of Latvia and its people.

In order to attain this objective and gain assurance of the quality of its performance and services, the Treasury launched the process of obtaining ISO quality management certification in 2005 and in March 2006 received experts' acknowledgement of its top operational standards: the Quality Management System certificate ISO 9001:2000 "Quality Management Systems. Requirements". This serves as proof to our clients and cooperation partners of the high level achieved in the areas of central government budget execution, central government debt and asset management and implementation of the functions of the Paying Authority for the EU policy instruments.

The Treasury has been given the full authority in the areas of financial management of the budgetary funds and management of the Latvian national debt and assets. In order to do this as safely and effectively as possible, the Treasury has developed an original Cost-at-risk model. Its practical application has enabled an analysis of detailed borrowing scenarios and their potential impact on the debt portfolio parameters. The Treasury takes pride in having designed and implemented such an original model, which is compliant with the best international financial management practices.

Taking into account the general development of information technology, the Treasury pays particular attention to modernisation of its information systems and introduction of new services. Our goal is to offer our clients an increasingly larger number of electronically available services in the settlement system eKase as well as to improve the efficiency of the Treasury's performance in the area of budget execution.

In the coming years, the Treasury will continue to consistently improve its performance and introduce new initiatives. Therefore, the following development priorities have been identified for 2007: development of a new system to enable the use of payment cards when collecting payments payable to the central government budget and charges on services provided by budget institutions, ensuring the financial management function for public-private partnership projects and introduction of a universal central government budget planning and execution system in the area of the central government budget execution.

**Kaspars Āboliņš**

The Treasurer

In April, 2007

# OPERATIONAL STRATEGY OF THE TREASURY

In 2006, a strategic planning system in public administration was implemented. In light of that and based on the best practice of international financial institutions, the Treasury prepared a new **Operational Strategy of the Treasury 2007–2009**, which was approved by the Minister of Finance on 17 October 2006. The Strategy was developed with the intention of improving the medium-term budgeting process by linking policy planning documents and their implementation measures with the available and required budgetary funding.

Yet before the new Strategy was approved, in its development-aimed operations as well as when making daily routine decisions and implementing long-term tasks in 2006, the Treasury acted based on the **Operational Strategy of the Treasury 2005–2008** approved by the Minister of Finance on 10 August 2004. This Strategy serves as a basis for upgrading the Treasury, while at the same time preserving the existing standards and performance efficiency.

The Treasury's goal is to develop as a dynamic and modern, client needs-oriented organisation with regard to the quality of its provided services, effectively and safely managing the finances entrusted to the Treasury's management according to the best financial management practices and in compliance with the interests of the Republic of Latvia and its people.

The main priorities of the Treasury's Operational Strategy are:

- effective use of human resource capital by promoting the development of all level staff and their involvement in the attainment of the Treasury's objectives;
- streamlined and timely planning of the Treasury's finances, in order to ensure spending efficiency of the Treasury's finances in compliance with set objectives;
- client-orientation through identification of clients' needs and ensuring the availability of high-quality services using the latest developments in information technology;
- maximum effective use of the benefits provided by modern information processing technologies to ensure the discharge of the Treasury's functions.

The Strategy sets the main principles to be complied with in the Treasury's operation and development, at the same time promoting the involvement of all Treasury staff in attaining the established objectives. The Strategy identifies five priority areas for the Treasury's operations, and the present report addresses the Treasury's performance in all those areas in 2006:

- 1) **central government budget execution** aimed at economic management of the financial resources of the central government budget, identification of services required by the Treasury's clients, improvement of the quality of the provided services in line with the best international financial management practices and applying modern technology;
- 2) **central government debt and asset management**, ensuring the central government budget deficit financing and refinancing of the central government debt at the lowest possible costs, hedging financial risks and taking into account the development of Latvia's capital market and financial system, as well as ensuring effective management of the cash assets of the central government budget and grading of government loans;
- 3) **implementation of the Paying Authority functions for the EU policy instruments** to ensure compliance with financial management requirements prescribed by the EU, applying them also to the financial management of the national financing, in order to ensure universal financial management standards for all finances assigned to the Treasury's management;
- 4) **management of the state-funded pension scheme assets** to ensure maximum safe investment of the funds assigned to its management and at the same time attain maximum income;
- 5) **corporate governance of the Treasury as a public administration institution** in attainment of the strategic objectives, the Treasury complies with universal institutional operation principles in personnel management, quality and risk management, application of information technology and information security.

# 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 in compliance with the requirements established by laws and regulations. It organises the central government budget execution, manages the central government debt and performs the functions of the Paying Authority for the EU policy instruments as well as manages the state funded pension scheme assets. The Treasury's operations are managed by the Treasurer. The Treasurer is appointed and dismissed from office by the Minister of Finance.

The Treasury has the following functions:

- 1) organising the execution and financial accounting of the central government budget;
- 2) making payments and allocations from the central government budget revenue;
- 3) central government debt and asset<sup>1</sup> management;
- 4) management of the assets of the state-funded pension scheme;
- 5) functions of the Paying Authority for the EU policy instruments established in laws and regulations and the National Fund functions delegated by the National Authorising Officer;
- 6) other functions prescribed by laws and regulations.

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

The Rules of Procedure of the Treasury were issued on 1 August 2005 pursuant to the Public Administration Structure Law, prescribing the structure, work organisation of the Treasury, functions and tasks to be implemented by the Treasury. In 2006, reorganisation of the structural units of the Treasury was carried out and amendments were introduced to the Rules of Procedure of the Treasury on 15 September 2006.

## Structure of the Treasury (31.12.2006)

In order to ensure good governance and optimise the performance of the Treasury, adequate changes have been introduced to the Treasury's structure in 2006.

With the goal of reducing the work required to maintain the Quality Management System, facilitate identification and management of operational risks, as well as to optimise the Quality Management System documents and risk management measures in accordance with the process maturity levels, the Risk Management Department and Quality Management Department were merged in 2006 to form a **Quality and Risk Management Department** directly reporting to the Treasurer.

**The Archive Sector of the Office** was liquidated and the functions of the Archive Sector undertaken by the Office.

**The International Cooperation Department** was put under direct subordination to the Deputy Treasurer for central government budget execution and financial resource management.

With the intention of improving the common decision-making process in accordance with the goals set in the Operational Strategy of the Treasury, the following committees continued their work in 2006:

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<sup>1</sup> Financial resources management.

**Audit Reports Review 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 Treasury's risks.

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

**Credit Committee** – to facilitate credit risk management by coordinating the activities of the Treasury's structural units concerning monitoring of the central government budget loans, guarantees issued on behalf of the government and counterparty limits.

**Quality Management System Monitoring Committee** – to promote implementation of the Quality Management System and ensure its monitoring, stimulate continuous improvement of the Treasury's performance as well as compliance of services with clients' interests. The task of the Committee is to define the quality policy and objectives of the Treasury, ensure their compliance with the Operational Strategy, policy and objectives of the Treasury, and actively involve all level managers and staff in implementation of the quality policy and attainment of objectives.

**Risk Management Committee** – to ensure monitoring of the risk management system, review and evaluate the most significant risks and measures for their mitigation as well as monitor implementation of risk management plans and risk management process in the institution.

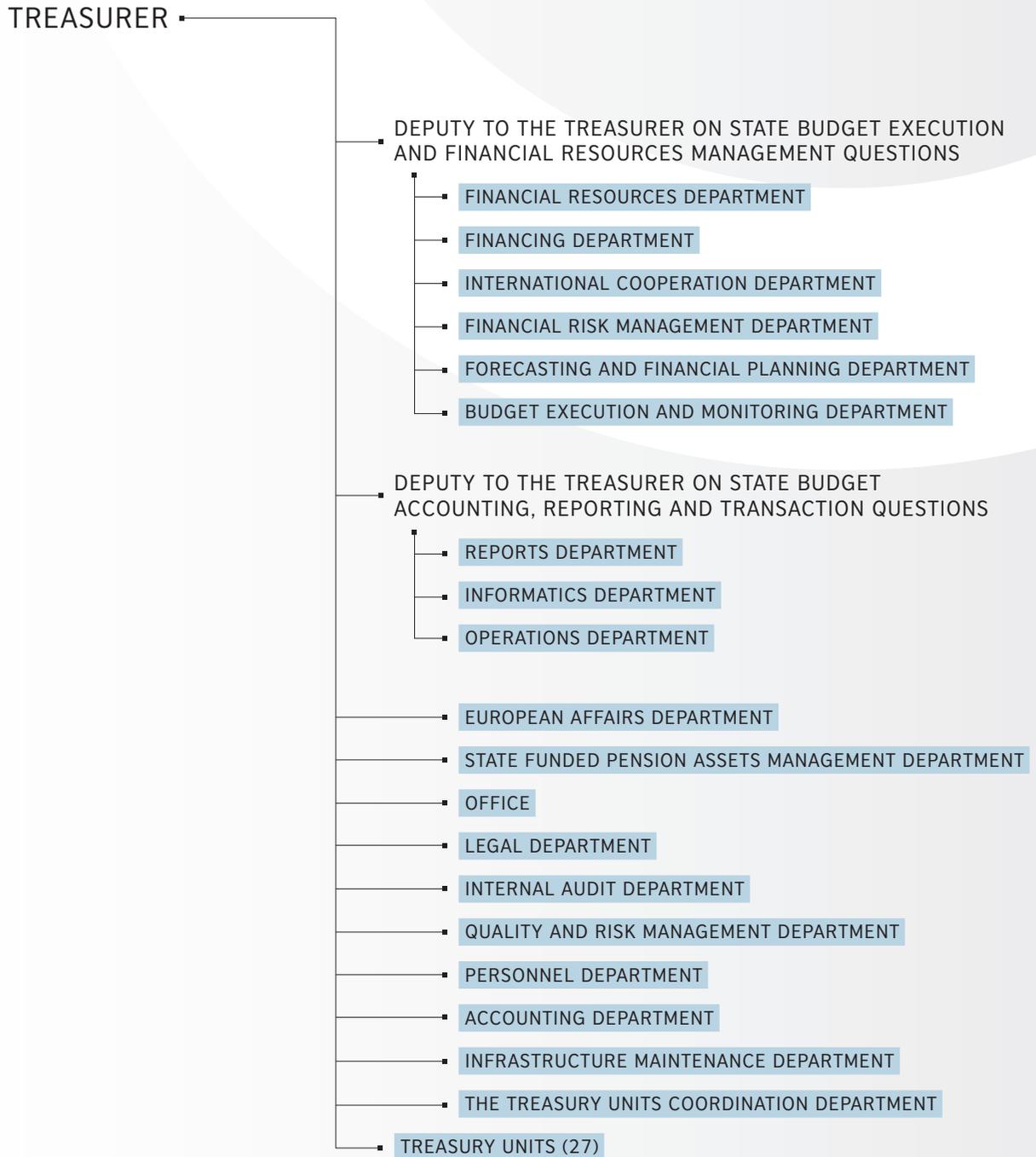
**Central Government Budget Accounting Committee** – to update implementation of the financial accounting policy of the budget managed by the Treasury and ensure effective management of accounting policy changes. The task of the Committee is to define the accounting policy and its compliance with accounting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

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

**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

In 2006, a **Management Committee** was established to ensure effective management of the budget and personnel resources of the Treasury, attain the objectives set by the Treasury's Operational Strategy, and implement priority measures and new policy initiatives. With the establishment of the Management Committee, the work of the Budget Monitoring Committee and Personnel Management Committee was discontinued.

## Flowchart of the Treasury's Structure



(Aizkraukle, Alūksne, Balvi, Bauska, Cēsis, Daugavpils, Dobeļe, Gulbene, Jēkabpils, Jelgava, Jūrmala, Krāslava, Kuldīga, Liepāja, Limbaži, Ludza, Madona, Ogre, Preiļi, Rēzekne, Rīga, Saldus, Talsi, Tukums, Valka, Valmiera, Ventspils)



# THE TREASURY'S OPERATION IN 2006:

## 1. CENTRAL GOVERNMENT BUDGET EXECUTION

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 the financial accounting of the central government budget and ensure 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 State Budget Implementation System, where budget accounts for budget executors are opened; grants allocations based on financial plans; ensures payments of budget institutions by accepting both paper documents for payment execution as well as accepting instructions online via the eKase; keeps records of the budget execution transactions effected by institutions financed from the budget, monitoring their compliance with the annual appropriations from the central government budget and keeps records of the central government budget revenue as well as provides information concerning the collected taxes and fees 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 and yields information on 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 it 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.

### Central government budget execution indicators for 2006

In 2006, for the purpose of ensuring the central government budget execution, the Treasury granted allocations in the amount of 3632.3 million lats, of which 2830.5 million lats to the basic budget and 801.8 million lats to the special budget. Allocations were granted to 819 budget institutions, for which overall 4631 accounts were opened (821 accounts or 21.5% more than in 2005). In 2006, the number of basic budget expenditure accounts increased by 819 accounts or 21.6% year-on-year (see Chart 1). The number of basic budget expenditure accounts was significantly boosted by the expansion of special purpose grants to measures implemented by local governments: a separate basic budget account was opened for each project. The number of basic budget expenditure accounts grew also as a result of reorganisation of non-profit capital corporations into public sector agencies, the financing of which is included in the annual law on state budget. Operation of some of those public sector agencies relates to coordination of the EU-funded projects, which are included in the annual law on the state budget, and it was necessary to open basic budget expenditure accounts and close grants and donations accounts for those institutions financed from the central government budget whose funding was previously transferred to grants and donation accounts. As a result, the number of grants and donations accounts decreased by 89 accounts or 18.3 % year-on-year in 2006 (see Chart 1). In 2006, the number of special budget expenditure accounts grew by 2 accounts or 15.4% year-on-year (see Chart 1), as additional accounts were opened for implementation of the European Social Fund projects.

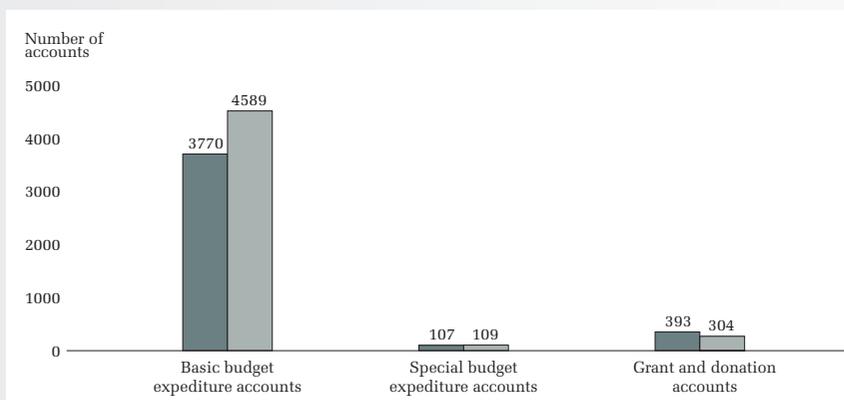


CHART 1  
Number of central government budget expenditure accounts in 2005 and 2006

■ 2005  
■ 2006

Source: The Treasury

In 2006, 285 basic budget revenue accounts were opened, which is 27 accounts or 8.7% less than in 2005.

In executing the central government budget, the Treasury processed 14 266 726 payment orders in 2006, which is 4 092 060 payment orders or 40.2% more than the number of payment orders processed in 2005. The volume of payments made increased considerably, as, starting from 1 July 2005, the SSIA transfers all social payments (pensions and benefits) to beneficiary accounts (previously – to commercial banks). More active spending of the EU money also contributed to the increase in the volume of payments.

The tax and non-tax revenue registered in the Treasury's accounts was lower than the amount planned for 2006. Nevertheless, the tax revenue was by 60.7 million lats or 3.5% higher, whereas the non-tax revenue was by 72.6 million lats or 27.8% less. Revenue from service charges and other self-generated revenue were 7.2 million lats or 6.2% lower than planned. Revenue from foreign financial assistance fell short of the plan by 111.6 million lats or 29.7% (see Chart 2). Central government basic budget revenue totalled 2336.7 million lats in 2006, as opposed to the planned amount of 2467.4 million lats, the actual implementation in comparison with the plan being 94.7%.

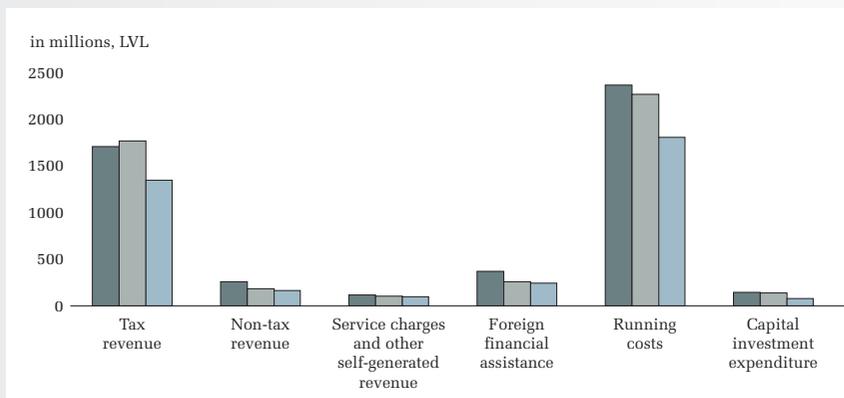


CHART 2  
Central government basic budget execution in 2006

■ Annual plan 2006  
■ Actual 2006  
■ Actual 2005

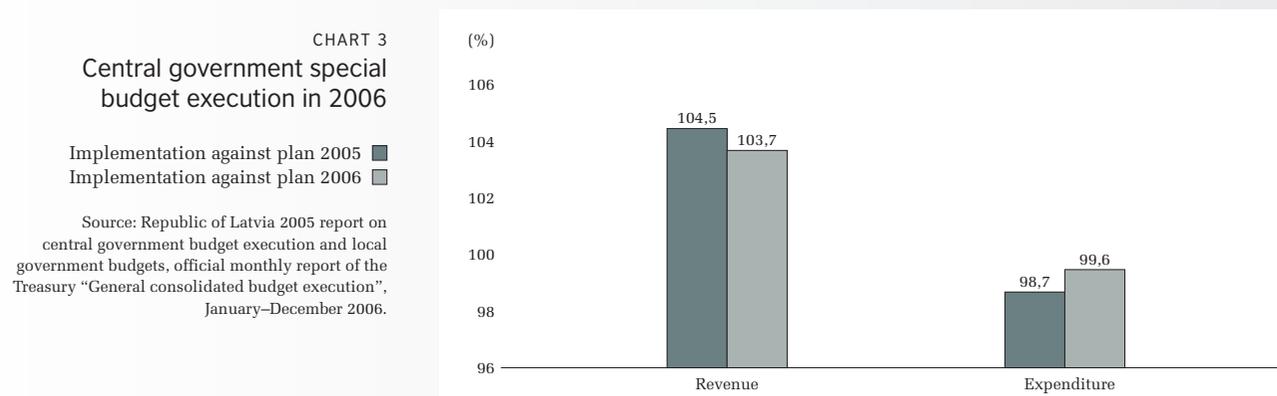
Source: Republic of Latvia 2005 report on central government budget execution and local government budgets, official monthly report of the Treasury "General consolidated budget execution", January–December 2006.

In 2006, the basic budget revenue increased by 458.3 million lats or 24.4% year-on-year, tax revenue grew by 417.2 million lats or 30.8%, non-tax revenue – by 18.6 million lats or 10.9%, revenue from service charges and other self-generated revenue – by 7.2 million lats or 7%, whereas revenue from foreign financial assistance – by 15.3 million lats or 6.1%.

Central government basic budget expenditure amounted to 2620.3 million lats in 2006, as opposed to the planned amount of 2744.4 million lats, the expenditure implementation in comparison with the plan being 95.5%. Running expenditure was 101.8 million lats or 4.3% lower than planned, whereas expenditure for capital investment was 11.4 million lats or 7.6% lower than planned.

Special budget revenue amounted to 980.4 million lats in 2006, which was 34.9 million lats or 3.7% higher than planned, whereas in 2005 the central government special budget revenue amounted to 769.3 million lats, which was 32.8 million lats or 4.5% higher than planned (see Chart 3). In 2006, special budget expenditure was 798.6 million lats, which was 3.1 million lats or 0.4% less than planned (see Chart 3), whereas in 2005 the expenditure was 8.9 million lats or 1.3% lower than planned.

The central government budget ran a fiscal deficit in the amount of 31.4 million lats in 2006, which is 0.3% of the GDP. There was a fiscal deficit in the central government budget in 2005 as well (105.2 million lats or 1.2% of the GDP).



## Accounting and reporting

In 2006, in compliance with Article 32 of the Law on Budget and Financial Management, Report on the Republic of Latvia' Central Government Budget Execution and Local Government Budgets 2005 was prepared and after having been approved by the Cabinet of Ministers, together with the Republic of Latvia State Audit Office's "Opinion concerning the Report on the Republic of Latvia's Central Government Budget Execution and Local Government Budgets 2005" and "Statement on the Report on the Republic of Latvia' Central Government Budget Execution and Local Government Budgets 2005" submitted to the Saeima (Parliament) (3 volumes, 910 pages).

In compliance with the Cabinet of Ministers' 27 June 2006 Regulations No.547 "Regulations on the National Statistical Information Programme 2006", programme sections "National Accounts System" and "Public finance, banks and other financial institutions and cash circulation", the Treasury's monthly, quarterly and annual reports on the central government budget execution and local government budgets with additional detailed information, when allowed by available resources and technical abilities, are used as a source of information by the Central Statistical Bureau and the Bank of Latvia, who are responsible for statistical information to be reported in accordance with the requirements set by the EU legislation. The Treasury is responsible for the statistical information to be prepared in accordance with the programme section "Public finance, banks and other financial institutions and cash circulation" sub-sections "Statistical information to be prepared based on other regular requests of international institutions" and "Statistical information to be regularly prepared based on domestic user requirements".



In compliance with the authority delegated by the Law on Budget and Financial Management, the Treasury drafted the following laws and regulations of the Cabinet of Ministers setting universal accounting principles for the central and local government budget institutions, creating a legal framework compliant with international standards as well as a procedure for preparation and submission of reports in 2006:

- 1) 15 August 2006 Cabinet of Ministers' Regulations No.655 "Procedure for Preparing Annual Reports of Central Government Budget Institutions and Local Governments", taking effect in 2007;
- 2) 15 August 2006 Cabinet of Ministers' Regulations No.458 "Amendments to 21 June 2005 Cabinet of Ministers Regulations No.446 "Procedure for Preparing Annual Reports of Central Government Budget Institutions and Local Governments"", applicable to the 2006 annual report;
- 3) 25 April 2006 Cabinet of Ministers' Regulations No.313 "Regulations on Contents of the Monthly Local Government Reports, Their Preparation and Submission Procedure", taking effect in 2007;
- 4) 30 May 2006 Cabinet of Ministers' Regulations No.429 "Procedure for Granting and Implementing Allocations".

In preparation of the above laws and regulations, the Treasury held active consultations with accountants-practitioners working in local governments and ministries as to the application of the provisions to be incorporated in the draft Regulations, thus providing information about the expected changes to local governments and ministries well in advance and ensuring information exchange with the Treasury as to the potential problems and their prevention when applying those provisions.

Quality discharge of the Treasury's functions requires close cooperation with central and local government institutions and Latvian Association of Local and Regional Governments. The Treasury provides ad hoc consultations to local governments on report preparation and accounting issues. In 2006, the Treasury organised workshops for the staff of central and local government institutions concerning the accounting issues and 15 November 2005 Cabinet of Ministers' Regulations No. 867 "Procedure for Keeping the Accounts in Budget Institutions". The Treasury's staff delivered presentations and provided answers to questions posed at the workshops concerning the annual reports of central and local government institutions organised by the Training Centre of the Latvian Local and Regional Governments and magazine Balance.

In line with the capacity of the budget institutions, compliance with the 2006 financial reports of central government budget institutions and local governments with the accounting principles for budget institutions (governed by 15 November 2005 Cabinet of Ministers' Regulations No. 867 "Procedure for Keeping the Accounts in Budget Institutions" as of 1 January 2006) was ensured.

Through aggregating the financial information provided by ministries, central government budget institutions and local governments and preparing the Republic of Latvia report on central government budget execution for 2005, the adequacy and quality of the financial information in light of user interests was evaluated and problematic issues concerning the need to ensure correct and balanced accounting of the central and local government property managed by the central and local government capital corporations both in the private and public sector were identified. It was concluded that the state does not manage all assets (a finding also included in the State Audit Office report).

In the reporting period, the Treasury prepared information within its competence as an institution involved in the notification preparation and its submission to the Central Statistical Bureau, in line with the provisions set by the Cabinet of Ministers' 18 July 2006 instruction No.7 "Procedure for Preparing the Notification of the Government Deficit and Government Debt". The quality of the data prepared by the Treasury was praised at the dialogue visit of the representatives of the EU institutions concerning the quality of the notification of the government deficit and government debt.

The central government budget accounting policy of the Treasury was maintained and improved, taking into account the changes and additions to the chart of accounts.

The required changes in the existing transaction accounting (posting) procedure were identified to reflect the changes in the classification of revenue and expenditure, and adequate changes to the central government budget accounting system were introduced.

## Electronic services and technology development

The Operational Strategy of the Treasury envisages improvement of the quality of services provided by the Treasury in line with the best international financial management practice and automation of transaction processing by applying modern technologies. Aggregation of the local government budget reports is an important task of the Treasury. In 2006, the reporting entities could submit and validate their monthly and quarterly reports electronically, no longer having to submit signed paper document copies of reports to the Treasury. In regards to the submission of the monthly reports of local governments, for the third year running, the Treasury has been using software for aggregation of annual and monthly reports of local governments. This software is based on the latest technology and uses the internet environment. Modifications to this software were launched in 2006, introducing electronic report validation.

Already for the third year, the Treasury has been using eKase (electronic settlement system of the central government budget) for central government budget execution. The purpose of the eKase is to provide the Treasury services over the Internet. Via eKase, the Treasury grants remote access to services to institutions financed from the budget and local governments, at the same time guaranteeing security and confidentiality of information. Using the eKase, the Treasury's clients can:

- 1) make payments;
- 2) check the results of implementation of payment instructions;
- 3) receive financial information on account position, implementation of the financial plans of the central government budget, statements of account turnover and monthly account summaries.

In 2006, 636 clients signed cooperation agreements to use the eKase system and currently more than 4000 users are registered in the eKase system. The overall share of the lats flow payments processed through the eKase in comparison with the total lats flow was 56%. In 2006, the volume of payments processed via the eKase increased by 20% year-on-year. This expansion was due to the growing number of the users of the service in 2006. As at 30 December 2006, 1239 clients had signed an agreement on using the service.

In April 2006, a risk analysis of the compliance of the payments made via the eKase with the requirements set by laws and regulations was conducted and proposals for prevention of the risks identified by the risk analysis were developed and considered.

Overpaid basic budget revenue is repaid exclusively through the eKase system.

In order to promote the use of the eKase, improve the Treasury's performance and further raise the quality of services provided by the eKase, the Treasury plans to conduct a client survey in 2007 and introduce safer user authentication tools (dynamic code generators) as well as to improve the system to incorporate foreign exchange payments.

In 2006, successful cooperation with the SSIA (started in June 2005) continued concerning disbursement of pensions and benefits via the eKase. In 2006, the SSIA made more than 6.8 million payments of pensions and benefits via the eKase transferring them directly into clients' bank accounts.

On 9 March 2006, the Treasury launched an open tender (procurement identification number FM VK 2006/3) for servicing credit cards linked to the Treasury's accounts. Four applicants submitted bids. The bids were evaluated from the perspective of the most beneficial proposal (free of charge card servicing), and the JSC Hansabanka was awarded the tender for servicing the credit cards linked to the Treasury's accounts. A contract with the bank was signed on 8 September 2006 and already at the end of September, during the annual meeting of the International Monetary Fund and the World Bank in Singapore, the representatives of the Latvian delegation had an opportunity to test and evaluate the new service.

With the start of a new budgetary year on 1 January 2007, the Treasury and the JSC Hansabanka managed to secure full system compatibility, in order to ensure successful operation of the credit cards linked to the Treasury's accounts and enable the budget institutions to incur budgetary expenditure using credit cards. It is planned that credit card services will be used for expenditures incurred by staff on business trips and visits, as well as running expenses.

Introduction of credit cards linked to the Treasury's accounts will enable the staff of the central government budget institutions to make cashless payments during business trips, complying with the Law on Budget and Financial Management requiring that central government budget expenditure is made from accounts opened with the Treasury.

In 2006, alongside with implementation of new information technology projects, gradual implementation of the "Concept for Review and Optimisation of the Functions of the Regional Treasury Units and Resources Required for their Implementation" continued. Within the framework of the concept, in order to improve client service at Treasury Units, gradual transition to online servicing of clients at Treasury Units was ongoing, thus providing an opportunity to receive modern financial services and establishing the primary function of the Treasury Units' staff: providing consultations to clients.

In 2006, the use of the S.W.I.F.T. (Society for Worldwide Interbank Financial Telecommunication) for payment information exchange and validation of the provisions of the concluded financial deals with the Bank of Latvia and credit institutions was launched. The areas of the S.W.I.F.T. system application were expanded: the required changes were introduced to the Treasury's information systems with a view to enable automated generation of the S.W.I.F.T. reports and process the received S.W.I.F.T. reports. New S.W.I.F.T. messages for exchange of securities information were also tested.

Implementation of the Ministry of Finance and the Treasury project "On Expansion of the SAP System to Provide Support to the Central Government Budget Planning and Execution Monitoring Functions" started. Within the framework of the project, to a predetermined extent, the existing central government budget execution system will be replaced.



## 2. CENTRAL GOVERNMENT DEBT AND ASSET MANAGEMENT

The Minister of Finance has authorised the Treasury as a subordinate institution of the Ministry of Finance to manage the central government debt and temporarily free central government budget assets, engage in financial derivatives deals and other deals within the framework of the central government debt management as well as to organise granting and monitoring of the central government budget loans and guarantees.

The annual Law on the State Budget sets the maximum allowable level of outstanding government debt as at the end of the year, whereas 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 Latvian Central Government Debt Management Strategy approved by the Minister of Finance.

The amount of government borrowing, central government debt and the respective costs to be set aside to meet the debt commitments are affected by the size of the overall financing need, comprised of the fiscal deficit to be financed from the central government budget, the amount of central government debt commitments to be settled, as well as the amount of the required reserve liquidity to ensure the implementation of the central government budget cycle and commitments. Planned measures to satisfy the overall financing need within the current year and the financial instruments best suited for financing are prescribed in an annual Medium-Term Funding Plan, which is developed by the Treasury, based on the guidelines established in the Latvian Central Government Debt Management Strategy and approved by the Minister of Finance. Prior to approval, the opinion of the Bank of Latvia is sought.

Based on the need established in the Latvian Central Government Debt Management Strategy to ensure the daily minimum reserve liquidity, the Treasury places the temporarily free liquidity on time deposits with commercial banks and the Bank of Latvia in compliance with the Minister of Finance's authorisation and the limits established for the Treasury's counterparties.

Within the framework of the central government debt management, the Treasury organises the visits of analysts from the three largest international rating agencies (Fitch Ratings, Standard & Poor's and Moody's Investors Service) to Latvia, thus providing investors with an opportunity to receive the latest information about Latvia, analyse the opinion concerning Latvia's development trends and potential risks. Investors use this information to assess investment opportunities in Latvia (including investment into government-issued securities). Therefore, a credit rating is an important factor for Latvia ensuring availability of financing, which affects the price of borrowing. Rating agencies upgrade the credit rating of the Republic of Latvia and review its future outlook on an annual basis and also grant ratings to each specific government-issued security.

The Minister of Finance has authorised the Treasury to ensure granting of the central government budget loans and servicing of the granted loans within the limits prescribed by the annual budget law.

The Treasury participates in the process of guarantees issue on behalf of the government by examining and evaluating the risks pertaining to granting government guarantees. The Treasury organises the process, in order to ensure signing of the guarantee agreements: i.e., participates in drafting of the guarantee agreements, guarantee service and guarantee collateral agreements. After the guarantee agreements have been signed, the Treasury keeps accounts of the commitments associated with guarantees issued on behalf of the government. The maximum size of guarantees issued on behalf of the government and project implementers are set in the annual Law on state budget.

## Central Government Debt Management Strategy

In 2006, the Treasury fully implemented the Latvian Central Government Debt Management Strategy approved by the Minister of Finance. Borrowing was made in line with the basic principles established in the Strategy, and financial derivatives were applied, in order to ensure compliance with the debt portfolio parameters prescribed by the Strategy.

The Latvian Central Government Debt Management Strategy sets the central government debt management goals and objectives. The Strategy outlines the medium-term operations of the Treasury in managing the central government debt in line with the economic development trends as well as the situation on Latvian and global financial markets. The updated Latvian Central Government Debt Management Strategy was approved on 16 March 2006 by the Minister of Finance. Several changes affecting the wording have been introduced.

Latvian Central Government Debt Management Strategy distinguishes between debt portfolio management and borrowing management. The goal of the central government debt portfolio management is to manage the financial risks of the central government debt portfolio, and several parameters of the central government debt portfolio structure have been set for the purpose of achieving this objective:

- 1) the share of the lats debt;
- 2) maturity profile;
- 3) the share of the fixed rate;
- 4) interest rate duration;
- 5) currency composition for the net foreign currency debt.

The goal of the central government borrowing management is to ensure the availability of the necessary financial resources and their liquidity for financing the deficit of the central government budget and refinancing of the central government debt as well as borrowing on favourable terms and conditions. Several basic principles were established for the purpose of achieving this objective:

- 1) to ensure continuous opportunities for attracting financial resources;
- 2) to maintain the daily minimum reserve liquidity;
- 3) to perform each borrowing transaction in a professional manner;
- 4) to foster the development of financial markets;
- 5) when engaging in borrowing transactions, ensure compliance with the basic principles of the central government debt portfolio management;
- 6) to create an excellent "borrower" image for Latvia.

A development concept for the Latvian government securities market was prepared within the framework of debt management. The Treasury evaluated the potential future development prospects for the government securities market and outlined the potential development scenario, which provides for concentrating borrowing in larger benchmark issues on the international financial market after the planned introduction of the single euro currency. The analysis of the market development scenarios reconsidered the usefulness and need for introducing a primary dealer institution. Due to the scenario taken, it was decided not to introduce the primary dealer institution.

Continuing the implementation of the debt portfolio analysis models, the Cost-at-risk model was improved at the highest level. Its practical application enabled a detailed analysis of the established borrowing scenarios and their potential impact on the debt portfolio parameters. Application of the model already developed enables more accurate forecasting of the medium-term central government debt servicing payments. At the beginning of 2006, the relatively simple Cost-at-risk model was used by the Treasury to evaluate the structural parameters of the Latvian central government debt portfolio. The Treasury concluded that it is not necessary to change the parameters prescribed in the Latvian Central Government Debt Management Strategy, as they have been set at an optimum level. Yet after the Treasury specialists improved the

methodology of the model and software, the model was used within the framework of borrowing scenario simulations for the 2007–2009 Funding Plan, providing additional information required to make a decision as to which of them is the most adequate. According to the 2007–2009 Plan for Attracting Financing, basic financing will be provided through domestic securities and additional funds will be drawn from the EIB. Nevertheless, the government's borrowing activities in 2007 will be marked by some differences in the schedule of the primary placement tenders for the government securities, information on the planned issues provided therein, tender dates, instruments and amounts, in order to ensure more flexible attraction of funding as required by the current financing needs.

In 2006, the Treasury started to regularly analyse the activity with which funds are obtained every month and prepare a detailed assessment of the factors impacting borrowing both within the context of the Latvian and international finance and capital markets. Opportunities of early repayment under borrowing contracts signed with international financial institutions were reviewed regularly; nevertheless, no early repayments were effected, due to the estimated price of the borrowed funds. Once every quarter, borrowing deals will continue to be compared against the time and cost benchmarks established in 2005.

By the end of November 2006 budget execution was marked by large amounts of free budgetary funds, the range of counterparties for money market transactions was expanded, and the temporarily free funds were additionally placed on time deposits with international banks as well. At the end of August 2006, the Treasury concluded an agreement with the Bank of Latvia on placement of the lats funds solely with the Central bank, thus increasing the effectiveness of the measures implemented by the Bank of Latvia to absorb the liquidity from the lats financial market. The placement of funds with the Bank of Latvia ensured implementation of a balanced monetary and fiscal policy, facilitating the improvement of national macroeconomic indicators, including stabilisation of the inflation rate. In order to improve the management of temporarily free budgetary funds and instruments and methods to be used, the Treasury developed the Cash Assets Management Strategy, which was approved by the Minister of Finance at the end of 2006.

In 2006, the Treasury prepared an analytical Central Government Debt Management Report for 2005 for the first time, 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 the central government debt management, performance indicators and future trends. The Central Government Debt Management Report was also sent to other bodies implementing similar central government debt management functions in the EU (debt management bureaus). The cooperation partners (including banks) expressed their appreciation of such a form of presenting information on the latest developments in the Latvian central government debt management.

## Changes in the central government debt in 2006

In 2006, implementing measures to attract funds for the purpose of financing the fiscal deficit of the central government budget, refinancing of the central government debt, as well as the ensuring the amount of the required reserve liquidity to ensure the implementation of the central government budget cycle and commitments, borrowings were made both on the domestic as well as the external financial market.

Of the domestic borrowing instruments, 6- and 10-month short-term T-bills and a long-term bond issue programme with a maturity of 10 years were used to cover the financing needed in 2006. At the end of the year, three tenders within the framework of the new 5-year bond issue programme were held. About 166.7 million lats at nominal were raised by means of securities issues on the domestic financial market in 2006. Borrowings on the external financial market in 2006 consist of 75 million euro taken from the EIB for the purpose of co-financing the EU Cohesion Fund and structural funds projects and 1.67 million lats taken based on previously concluded contracts from international financial institutions to finance long-term investment projects.

Overall, the central government debt has remained basically unchanged year-on-year. As a result of the borrowing measures implemented in 2006, the central government debt decreased by 4.34 million lats and amounted to 1001 million lats at nominal at the end of December. The largest changes were reported for the external debt, which grew by 37.8 million lats.

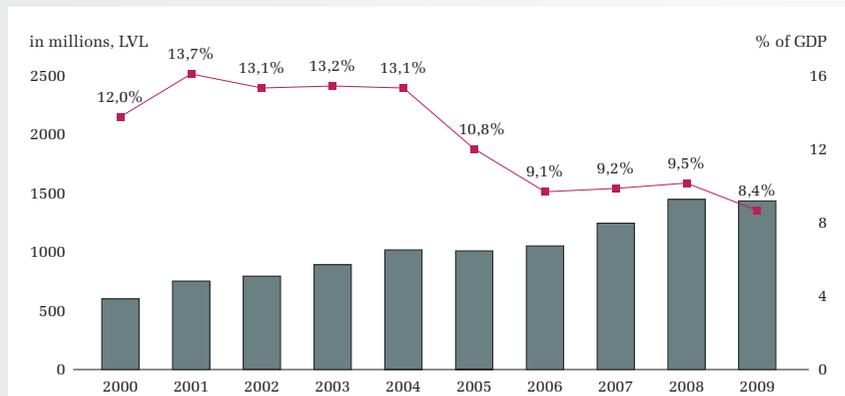


CHART 4  
Central government debt in 2000–2009

Source: The Treasury

In previous years, the ratio of the central government debt to GDP was relatively low, with a clearly marked downward trend in the last years, which is a positive sign, as acknowledged also by international rating agencies when establishing Latvia's credit rating. According to the Republic of Latvia Convergence Programme 2006–2009, the government has a plan to gradually reduce the budgetary deficit; therefore, the central government debt is expected to remain at a stable level in the medium-term, not exceeding 9.5% of GDP.

## Domestic debt of the central government

On 31 December 2006, the **domestic (lats) debt of the central government** amounted to 419.56 million lats at nominal.

On 31 December 2006, the domestic debt of the central government amounted to 419.56 million lats, of which 99.8% was comprised of domestic securities and 0.2% of borrowings of budget institutions outside the Treasury.

As in 2005, the domestic debt reported “zero growth” in 2006, i.e. the domestic market securities maturing in 2006 were again refinanced using other domestic market securities. Moreover, domestic debt shrank slightly in 2006 (by 4.34 million lats at nominal).

In 2006, the shares of the various types of outstanding domestic government securities in the domestic debt also changed slightly (see Chart 5).

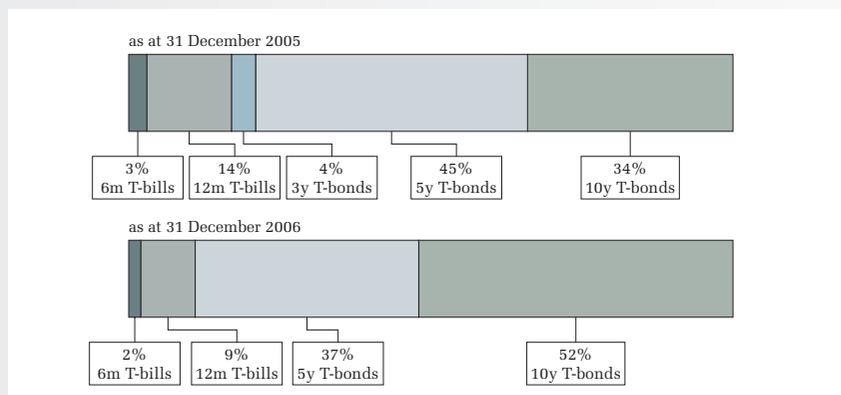


CHART 5  
Breakdown of domestic government securities by type of security

Source: The Treasury

In 2006, three issues of 6-month T-bills were tendered amounting to 12.75 million lats at nominal, which is 7.69 million lats less than in 2005, and three issues of 12-month T-bills amounting to 39.68 million at nominal, which is 19.35 million lats less than in 2005. The 10-year bond issue programme, which was started in 2005, continued (the amount issued in 2006 totalled 72.03 million lats), and a new 5-year bond issue programme was started in the amount of 42.28 million lats.

## Foreign debt of the central government

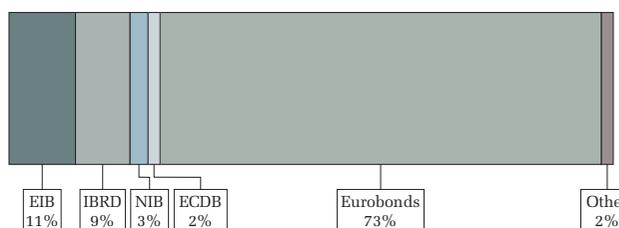
On 31 December 2006, the **foreign (foreign currency) debt of the central government** amounted to 581.47 million lats at nominal.

In 2006, the foreign debt of the central government increased by 37.8 million lats. The expansion of the foreign debt is due to the fact that Latvia has partly used the financing available as a result of the agreement signed by the Republic of Latvia on 29 September 2005 with the EIB concerning a 150 million euro loan to ensure the national co-financing to the EU structural funds and Cohesion Fund projects, with the first loan disbursement amounting to 75 million euro.

As of 31 December 2006, the major part (73%) of the central government foreign debt consisted of borrowing on the capital market, i.e. euro bonds maturing in 2008 and 2014 (see Chart 6).

CHART 6  
Breakdown of foreign debt  
by lender at the end of 2006

Source: The Treasury



## Management of the central government borrowing

The goal of the central government borrowing management is to ensure the availability of the necessary financial resources and their liquidity for financing the deficit of the central government budget and refinancing of the central government debt, as well as borrowing on favourable terms and conditions.

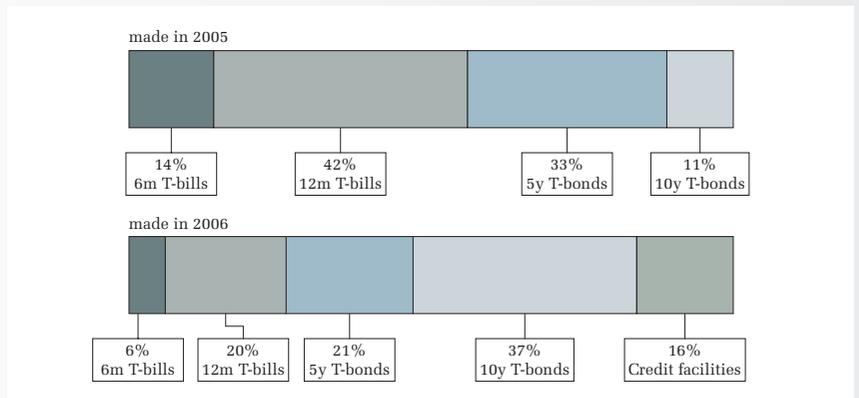
### *Domestic borrowing*

In 2006, the amount issued was considerably lower than the planned amount: instead of the 297.8 million lats planned, securities in the amount of 166.7 million lats were issued. The amount issued was reduced mainly on account of better performance of the central government budget (the budget deficit was lower than initially planned). In 2006, the amount of outstanding government securities declined by 4.2 million lats to hold at 418.7 million lats. In contrast to the previous year, mostly long-term resources (5- and 10-year bonds) were used for financing, amounting to 58% of the total financing, whereas the short-term resources, such as 6- and 12-month T-bills and bank credit facility (with a maturity of a couple of days to 6 weeks) accounted for 42% of the total financing.



CHART 7  
Domestic borrowing  
by type of securities

Source: The Treasury



Both short-term T-bill and bond rates were on the rise almost throughout 2006. The growth of interest rates on T-bills (see Chart 7) is primarily related to the fact that the Bank of Latvia continued to tighten the monetary policy in 2006 and raised the refinancing rate by 0.5% on two occasions, from 4% to 5%. This action had a dampening effect also on the interbank lats liquidity, as the base for calculation of the minimum reserves of commercial banks was expanded to include all loans (including with a maturity over 2 years).

Bond rates grew primarily as a result of the decreasing correlation between the euro and lats long-term rates. This result was affected by the growing uncertainty as to the timeframe for the euro introduction in Latvia against the background of unfavourable macroeconomic data: persistently high inflation, continued rapid expansion of the current account deficit, etc. (see Chart 9).

CHART 8  
Yields on 6 and 12 month T-bills  
and 6 and 12 month RIGIBID rates

Source: Bloomberg, The Treasury

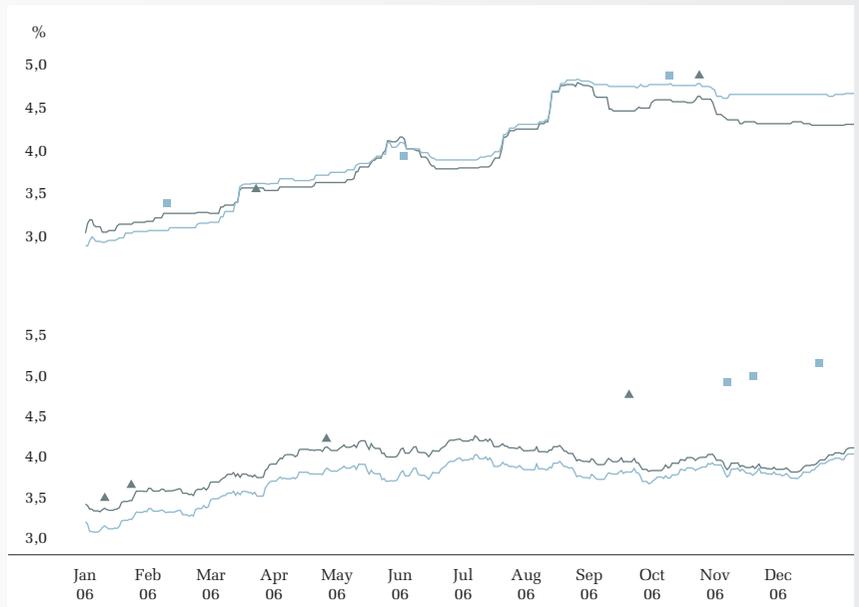
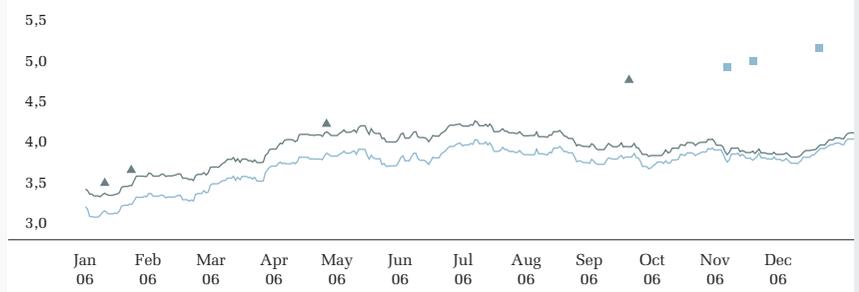


CHART 9  
Yields on 5 and 10 year lats  
T-bonds and 5 and 10 year  
EUR SWAP rates

Source: Bloomberg, The Treasury



Analysis of investor activity in primary placement of government securities in the reporting period reveals that the demand at both tenders of T-bills and bonds was lower than in 2005. The total bids at competitive multi-price tenders were only slightly above the total allotment amount offered by the Treasury, whereas at the fixed rate tenders the total bids were lower than the allotment amount offered by the Treasury (see Charts 10 and 11).

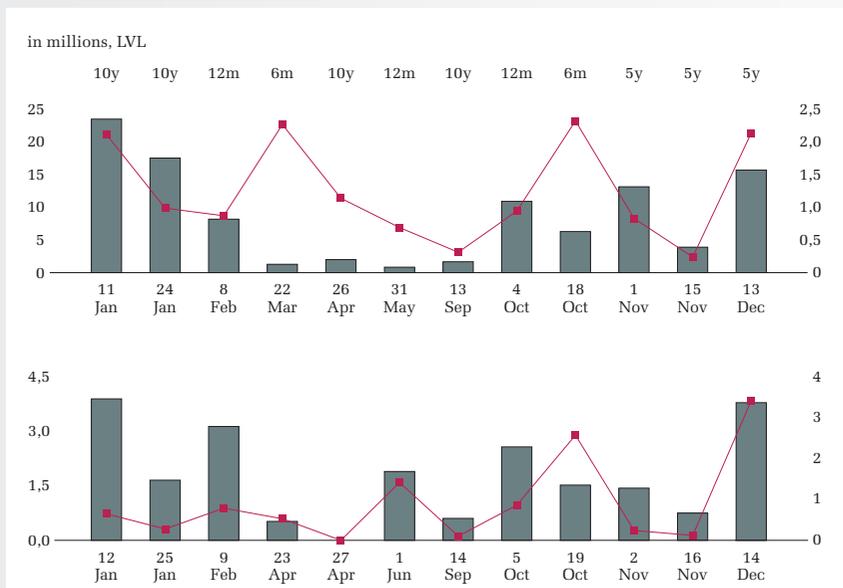


CHART 10  
Primary trading activities for government securities at competitive multiprice tenders in 2006

■ Amount sold (on the left)  
■ Bid-cover ratio (on the right)

Source: The Treasury

CHART 11  
Primary trading activities for government securities at fixed rate tenders in 2006

■ Sold amount (on the left)  
■ Bid-cover ratio (on the right)

Source: The Treasury

## Foreign borrowing

Already at the end of 2005, when planning the resource attraction measures, the decision to use funding from the EIB was made, provided that the bank can offer better borrowing terms in comparison with other funding sources, i.e. other cooperation partners of the Treasury, at the moment when funding is needed. As there was a financing need, already at the beginning of 2006 a borrowing transaction amounting to 75 million euro was effected using the above-mentioned EIB financing. The decision with regard to this specific borrowing was taken as the bank offered a good price for the funds, which was lower in comparison with other available sources. The Treasury was also given an opportunity to set the most convenient repayment schedule and timeframe. After several procedures concerning the spending of the received funds are implemented, it will be possible to use the remaining part of the borrowing in 2007.

Borrowing from other international financial institutions was also used to finance investment projects in 2006, yet in very small amounts: the total costs amounted to 1.67 million lats. These funds were spent on a Latvian local governments and environmental infrastructure project (EIB financing) and Liepāja Regional household waste maintenance project (World Bank financing).

## Central government debt portfolio management

The objective of the central government debt portfolio management is to manage the financial risks on the central government debt portfolio. The central government debt portfolio management activities are mainly aimed at hedging and prevention of financial risks, preventing uncontrolled growth of the costs of financial resources.

The Latvian Central Government Debt Management Strategy sets the parameters of the central government debt portfolio to attain the central government debt portfolio management goals and objectives with the help of using financial derivatives.

In order to assess how the Latvian Central Government Debt Management Strategy has been implemented, the actual debt portfolio composition parameters on 31 December 2006 have been compared against the debt portfolio composition parameters on 31 December 2005 and the debt portfolio composition parameters set in the Strategy (see Table 1).

TABLE 1

Compliance of the central government debt composition parameters with the debt portfolio parameters set in the Latvian Central Government Debt Management Strategy

Parameters	On 31.12.2005		On 31.12.2006		Strategy	
Share of the lats debt	43%		42%		> 35%	
Maturity profile (%)	< 1 year	< 3 years	< 1 year	< 3 years	< 1 year	< 3 years
	19	43	13	30	< 25	< 50
Share of fixed rates	63.5%		64.3%		60% - 70%	
Interest rate duration (in years)	3.18		3.06		3.25 (+/- 0.25)	
Currency composition of net foreign currency debt	EUR	99.96%	EUR	98.92%	EUR 100% +/- 5%	

Source: The Treasury

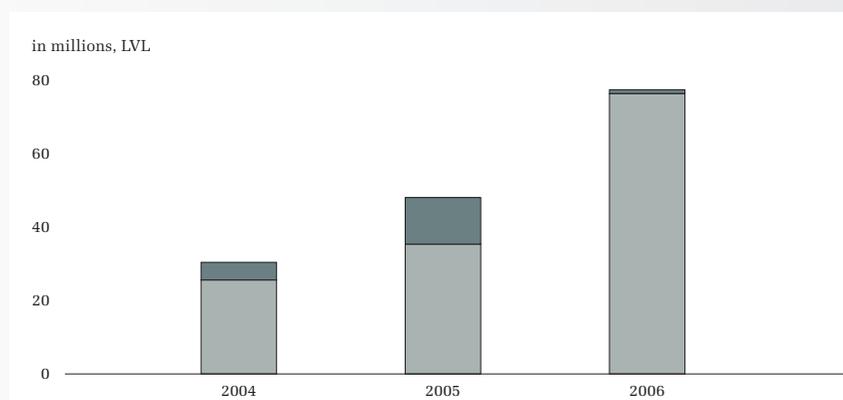
## Central government budget lending

Every year, loans from the central government budget are granted in accordance with the provisions of the annual law on the state budget. The structure of the central government budget loans has changed in the last years: in 2001, the largest share of the central government budget loans was granted to the special budget, which can be explained by the fact that at that time such large projects as the World Bank Welfare Reform project, Healthcare Reform project and others were implemented. From 2003, however, the largest share of the central government budget loans is granted to Latvian local governments.

CHART 12  
Central government budget lending costs by type of borrower

Local government budgets ■  
Other ■

Source: The Treasury



The Operational Strategy 2007–2009 of the Treasury sets an objective of maintaining the dominating role in granting loans to local governments for the Treasury (at least 65% of the local government debt). The Treasury has steadily moved towards the attainment of this objective by providing quality services in the budget execution process and also offering the most advantageous borrowing terms. In the last three years, local governments have received the largest share of the central government budget loans, and in 2006 these loans even amounted to 76.2 million lats or 98% of the total central government budget lending costs. Although in cases when another lender offers more advantageous borrowing terms than those provided by the Treasury, local governments may use the Minister of Finance's permission to borrow from that lender, the Treasury remains the dominant lender. In 2006, local governments borrowed only 9.6 million lats or 11% of the total loans received by local governments in 2006 from other lenders.

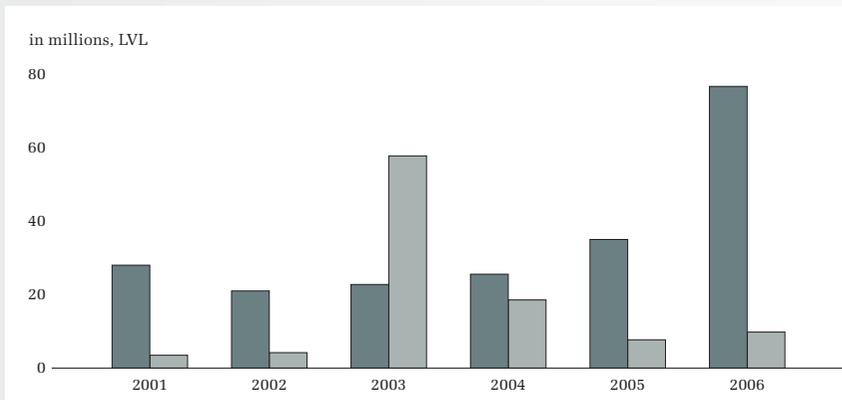


CHART 13  
Costs to local governments  
by type of lender

■ The Treasury  
■ Others

Source: The Treasury

On 31 December 2006, the local government debt to the Treasury amounted to 167 million lats, representing an increase of 58 million lats over the beginning of 2006, and the total local government was 284 million lats at the end of 2006.

As the Treasury's lending costs incurred by the local governments increased considerably and their debt commitments to the Treasury amounted to 59% at the end of 2006, in order to attain the above-mentioned target of 65% of the total local government borrowing portfolio, the Treasury has set the objective of raising its competitiveness by developing a new methodology for setting lending rates in 2007, which would ensure more flexible lending terms that would be more tuned to the market developments.

## Government guarantees

Article 37 of the Law on Budget and Financial Management stipulates that only the Minister of Finance has the authority to grant guarantees in the name of the Government within the limits set in the annual law on state budget, committing public funds to implement the Public Investment Programme projects and business support programmes as well as study and student credits. Guarantees are issued in accordance with the Cabinet of Ministers Regulations No.513 "Procedure for Issuing and Monitoring Guarantees" adopted on 12 July 2005.

68 government guarantees have been granted for implementation of the Public Investment Programme projects and business support programmes since 1993. For the amounts of actual guarantees issued during the last six years against the provisions of the state budget law, see Chart 14.

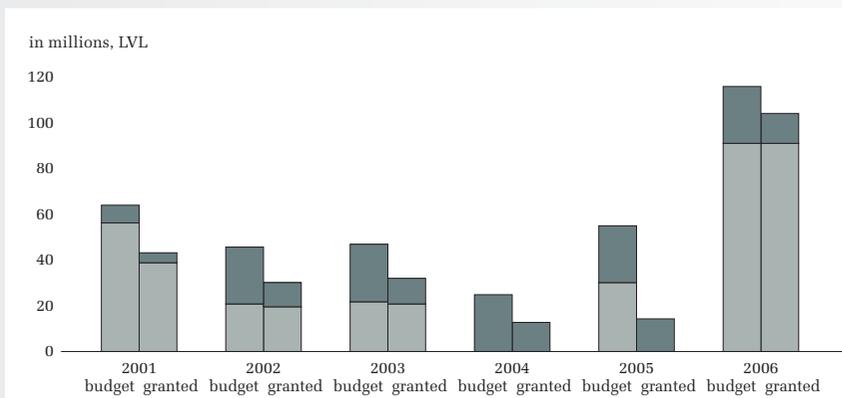


CHART 14  
Planned and granted  
government guarantees

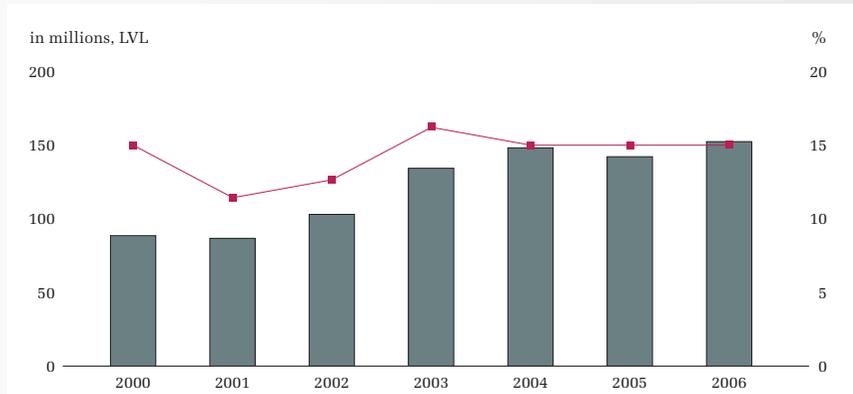
■ Projects  
■ Student and study credits

Source: The Treasury

In 2006, the largest government support amounting to 115.7 million lats was granted to investment projects, of which the major beneficiary was the healthcare sector or several hospitals receiving the total amount of 51.51 million lats. The second largest support sector in 2006 was micro enterprises and small enterprises, where projects are implemented via the *Latvian Mortgage and Land Bank*.

CHART 15  
**Outstanding amounts of government guaranteed loans in comparison with the central government debt**

Government guaranteed loans at end of period ■  
 Guarantees vs Central Government Debt (%) ■  
 Source: The Treasury



In the last years, the amount of guaranteed loans stabilised and amounted to 150.7 million lats or 15% of the total central government debt at the end of 2006.

## Liquidity management

The objective of liquidity management is to ensure availability of cash to meet the financial commitments in due time and in the full amount. The Treasury sets the requirements for providing cash liquidity and a procedure for meeting the liquidity requirements.

The Treasury engages in the following activities with a view to comply with the liquidity providing requirements:

- 1) monitors the stock of liquid cash as well as compliance with the liquidity limits and size of the cash liquidity reserve;
- 2) timely identifies and prevents situations that may impair the cash liquidity and result in a payment or liquidity crisis;
- 3) ensures constant opportunities to borrow cash by concluding respective agreements with domestic and international financial market participants (credit institutions);
- 4) places the temporarily free funds, so as to maintain an adequate stock of liquidity which would ensure the required cash liquidity reserves and compliance with liquidity limits within the relevant period.

In its daily financial assets management, the Treasury complies with the set liquidity provision requirements, thus mitigating the probability of a risk of payment or liquidity crisis materialising.

The Treasury places the temporarily free funds on time deposits with credit institutions in Latvia and abroad and the Bank of Latvia in compliance with the Treasury's counterparty limits. Following a collection of quotes from the potential counterparties, the Treasury places the funds at the highest offered rate, thus increasing the central government budget revenue from placement of the temporarily free funds. In order to assess the effectiveness of the management of the temporarily free funds, the Treasury drafted benchmark-setting methods for placement of the temporarily free funds in 2005 as well as approved return on investment benchmarks, based on the financial market rates. On average, the Treasury placed the temporarily free funds above the set benchmark in 2006, which suggests that the funds are managed in a relatively effective way. Benchmark implementation was better in the second half of the year, when against the background of even tighter liquidity on the money market funds were placed on the domestic interbank market at relatively high rates.



In 2006, the Treasury ensured the availability of the required liquid funds every day, based on the financing needs and financial market developments, as well as placed the temporarily free funds, maintaining the required liquidity reserve and complying with the liquidity limits. It also monitored the stock of liquid funds: compliance with the liquidity limits and maintenance of the liquidity reserve. In 2006, available balances were used to provide liquidity. The balances had increased as a result of a surplus in the central government budget up to the last quarter of the year. Funds were also raised on both the domestic financial market (short-term 6- and 12- month T-bills and 5- and 10-year Treasury bonds) and foreign financial market (drawdown of funding from international financial institutions for long-term investment projects based on previously signed agreements). A loan of the EIB to provide co-financing to projects financed from the EU structural funds and Cohesion Fund was also used. When necessary, additional liquidity was raised by resorting to the established standby borrowing facility.

In 2006, the Treasury ensured the liquidity in due time and in the required amount, complying with the set liquidity requirements, and at the same time placed the temporarily free funds in compliance with the desirable average benchmark.

### 3. IMPLEMENTATION OF THE FUNCTIONS OF THE PAYING AUTHORITY FOR THE EU POLICY INSTRUMENTS

In accordance with the provisions of the EU Regulations, a Paying Authority is one or several national, regional or local institutions or bodies, chosen 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, the same as other institutions involved in implementation of the EU policy instruments, must ensure operation of the instruments in compliance with the European Community interests, effective management and monitoring of structural funds in accordance with the provisions of the EU Regulations and guidelines.

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

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

- 1) EU structural funds – European Regional Development Fund, European Social Fund, European Agricultural Guidance and Guarantee Fund and Financial Instrument for Fisheries Guidance;
- 2) Cohesion Fund;
- 3) European Community initiative EQUAL.

The Treasury acts as a Paying Authority also for the European Economic Area and Norwegian government financial mechanisms.

When certifying the expenditure included in the EU policy instrument claims and Declarations of Expenditure, the task of the Paying Authority is to ascertain the correctness, eligibility of expenditure incurred within the framework of projects and their compliance with the EU Regulations, as well as the sufficiency of the management control systems or checks established by the Intermediate Bodies/ Managing Authority. In order to ensure the above, the Paying Authority has the right to request the Managing Authority to implement additional controls in the Intermediate Bodies/ Managing Authority, as well as conduct financial controls and audits of the Intermediate Bodies/ Managing Authority.

In 2006, in compliance with the authority delegated by the Law on Management of the EU Structural Funds, the Treasury drafted 20 June 2006 Cabinet of Ministers' Regulations No.496 "Procedure for Ensuring the Financial Management of the EU Structural Funds", setting a procedure for the Intermediate Bodies to check the structural funds claims, submit payment orders and prepare and submit Declarations of Expenditure. As authorised by the Law on Management of the EU Cohesion Fund Projects, the Treasury drafted 10 October 2006 Cabinet of Ministers' Regulations No.845 "Procedure for an Intermediate Body to Check Payment Documents of a Cohesion Fund Project Submitted by an Implementing Agency and to Submit Them to the Paying Authority", setting a procedure for an Intermediate Body to check payment documents of a Cohesion Fund project submitted by an Implementing Agency and to submit them to the Paying Authority, as well as a procedure for the Paying Authority to ensure checking of payment documents submitted by an Intermediate Body and to make disbursements.

In 2006, the Treasury checked 1973 payment orders within the framework of the EU structural funds and made structural funds disbursements in the amount of 80 871 thousand lats. The number of payment orders checked increased by 30% year-on-year.

15 EU structural funds Declarations of Expenditure claiming 124 903 thousand euro from the European Commission were submitted to the European Commission in 2006 (see Table 2).

TABLE 2

Declarations of Expenditure for the EU structural funds submitted to the European Commission and funding received from the European Commission in 2006

Fund	Claim date	Claimed amount per current Declaration, in thousands of EUR	Amount claimed repeatedly, in thousands of EUR	Total amount claimed, in thousands of EUR	Amount calculated by The Treasury <sup>2</sup> , in thousands of EUR	Amount received from the EU, in thousands of EUR
ERDF	09.03.2006	14 941	0	14 941	14 941	14 941
ERDF	06.07.2006	938	0	938	938	938
ERDF	31.10.2006	15 831	0	15 831	15 831	15 831
ERDF	27.12.2006	33 537	0	33 537	0	0
<b>Total ERDF</b>		<b>65 247</b>	<b>0</b>	<b>65 247</b>	<b>31 710</b>	<b>31 710</b>
EAGGF	22.02.2006	15 151	1 347	16 498	15 093	15 093
EAGGF	31.05.2006	3 367	1 405	4 772	3 548	3 548
EAGGF	10.10.2006	6 282	1 224	7 506	6 117	6 117
<b>Total EAGGF</b>		<b>24 800</b>	<b>3 976</b>	<b>28 776</b>	<b>24 758</b>	<b>24 758</b>
FIFG	22.02.2006	1 427	0	1 427	1 427	1 427
FIFG	31.05.2006	570	0	570	570	570
FIFG	10.10.2006	1 633	0	1 633	1 462	1 462
FIFG	29.12.2006	1 592	172	1 764	0	0
<b>Total FIFG</b>		<b>5 222</b>	<b>172</b>	<b>5 394</b>	<b>3 458</b>	<b>3 458</b>
ESF	20.03.2006	3 885	0	3 885	3 870	3 870
ESF	29.06.2006	4 957	15	4 972	0	0
ESF	17.10.2006	8 489	0	8 489	0	0
ESF	30.11.2006	8 140	0	8 140	0	0
<b>Total ESF</b>		<b>25 471</b>	<b>15</b>	<b>25 486</b>	<b>3 870</b>	<b>3 870</b>
<b>Total EU structural funds</b>		<b>120 740</b>	<b>4 163</b>	<b>124 903</b>	<b>63 797</b>	<b>63 797</b>

Source: The Treasury

The amounts received from the European Commission coincide with the Treasury's estimates, in compliance with the performance indicators set in the Operational Strategy of the Treasury.

In comparison with the previous year, EU structural funds Declarations submitted to the European Commission have grown almost twofold, which can be explained by the fact that the majority of the EU structural funds projects have now been approved and are being implemented increasingly more successfully as the implementing authorities have accumulated experience. On 31 December 2006, N+2<sup>3</sup> principle as regards the 2004 EU structural funds financing allocation was fulfilled, i.e., payment claims and Declarations of Expenditure had been sent, declaring the entire amount of the EU structural funds financing granted in 2004 (committed amount). In 2006, drawdown from already 2006 financing allocations started within the framework of the European Agricultural Guidance and Guarantee Fund and the Financial Instrument for Fisheries Guidance.

In 2006, the Treasury checked 51 payment orders within the framework of the European Community initiative EQUAL and made disbursements in the amount of 2 192 thousand lats. The number of payment orders checked increased by 41% year-on-year.

<sup>2</sup> The Treasury calculates the amount to be expected from the European Commission, as the intensity of the European Community financing activities is different throughout a measure and the European Commission makes reimbursements based on the European Commission financing rate set for the measure in the financial table of the Single Programming Document.

<sup>3</sup> Based on Article 31 of 21 June 1999 EU Council regulation (EC) No.1260/1999, the European Commission automatically reduces the amount of financing available under structural funds by the outstanding (undisbursed) amount which has not been paid to the structural funds beneficiary and has been declared to the European Commission by the end of the second year following the year of commitment.

Within the framework of the European Community initiative EQUAL, 4 European Community initiative Declarations of Expenditure claiming 2 374 thousand euro from the European Commission were submitted to the European Commission in 2006 (see Table 3).

TABLE 3

Declarations of Expenditure for the European Community initiative EQUAL submitted to the European Commission and funding received from the European Commission in 2006

Initiative	Claim date	Claimed amount per current Declaration, in thousands of EUR	Amount claimed repeatedly, in thousands of EUR	Total amount claimed, in thousands of EUR	Amount received from the EU, in thousands of EUR
EQUAL	07.03.2006	480	0	480	480
EQUAL	24.05.2006	585	0	585	585
EQUAL	04.09.2006	399	0	399	399
EQUAL	30.11.2006	910	0	910	0
<b>Total EQUAL</b>		<b>2 374</b>	<b>0</b>	<b>2 374</b>	<b>1 464</b>

Source: The Treasury

In comparison with the previous year, the Declarations of Expenditure for the European Community initiative EQUAL submitted to the European Commission have grown twofold.

Within the framework of the Cohesion Fund, 55 Declarations of Expenditure were submitted to the European Commission in 2006, of which 2 were the final Declarations of Expenditure, claiming 81 839 thousand euro from the European Commission. The Treasury disbursed 103 087 thousand euro or 72 450 thousand lats from the Cohesion Fund in 2006.

The amount of expenditure declared within the framework of the EU structural funds, Cohesion Fund and the European Community initiative EQUAL and the number of Declarations of Expenditure sent to the European Commission continued to grow in 2006, suggesting that progress in spending has been achieved (see Table 4).

TABLE 4

Comparison of expenditure certified for the European Commission in 2006 with the 2005 data

EC policy instrument	2005		2006	
	Sent declarations	Declared expenditure, in thousands of EUR	Sent declarations	Declared expenditure, in thousands of EUR
Cohesion Fund	44	74 102	55	128 316
Structural funds	9	73 034	15	177 864
EQUAL	2	512	4	3 165
<b>Total</b>	<b>55</b>	<b>147 648</b>	<b>76</b>	<b>309 345</b>

Source: The Treasury

Although the number of Declarations of Expenditure submitted to the European Commission in 2006 did not increase notably, the amount of declared expenditure grew three-fold.

To ascertain the accuracy, eligibility and compliance of the expenditure made within the framework of the EU structural funds and the European Community initiative EQUAL projects with the EU and member state Regulations, the Treasury continued sample checks of project financing claims included in the Declarations of Expenditure in 2006. The checks were started at the recommendation of the European Commission auditors in 2005. In 2006, 161 project financing claims were reviewed. In 2006, auditors from the DG Employment and Social Affairs of the European Commission acknowledged that the management and control system implemented by the Paying Authority had improved.

To achieve the indicators set in the operational Strategy of the Treasury and accelerate spending from the EU policy instruments, including receipt of funding from the European Commission, the Treasury requires a shorter payment document processing and Declaration of Expenditure verification timeframe in its quality management documents than requested by laws and regulations.

According to the provisions of the EU structural funds and Cohesion Fund management draft law, the Treasury will act as a Certifying Authority and Paying Authority for the European Regional Development Fund, European Social Fund and Cohesion Fund in the programming period 2007–2013. The functions of the Certifying Authority include preparation of certified Declarations 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, in turn, is to receive funding from the European Commission and make disbursements to beneficiaries within the shortest possible period and in the full amount. To ensure the discharge of the above-mentioned functions, the Treasury will draft the required internal quality documents in the first half of 2007. Development of the new procedures will take into account the recommendations made by the independent evaluation of the Declaration of Expenditure verification and expenditure certification procedure used in the current programming period.

In order to establish universal principles for planning, financial management of the EU funding granted for the programming period 2007–2013 and making disbursements and submitting Declarations, the Treasury started work on drafting adequate Cabinet of Ministers' Regulations in cooperation with the Ministry of Finance in 2006, and the work will continue in 2007. At the same time, the Treasury will continue to discharge the functions of the Paying Authority, certifying the expenditure incurred within the projects approved under the EU structural funds, Cohesion Fund and the European Community initiative EQUAL in the programming period 2004–2006.

The Treasury acts as a Paying Authority also for the European Economic Area and Norwegian government financial mechanisms, and developed part of the planned quality management system documents for implementation and administration of those mechanisms in 2006 as well as participated in drafting the Cabinet of Ministers' Regulations required to govern the financial management of the financial instruments. The first project applications within the framework of these instruments were submitted to the Financial Instruments Bureau in 2006, and the first disbursements under the projects could be expected to start in summer 2007.

## 4. MANAGEMENT OF THE ASSETS OF THE STATE-FUNDED PENSION SCHEME

The Treasury manages the state-funded pension scheme assets (second-tier pensions) in accordance with the “State-Funded Pensions Law” which assigns this function to the Treasury as the government agent.

On November 2005 the Cabinet of Ministers expressed support to option D of the concept “On Further Operation of the Treasury in Management of the State-Funded Pension Scheme Assets”, providing for a transfer of the Treasury’s investment plan portfolio to private asset managers. The Treasury prepared adequate amendments to the Law on State-Funded Pensions, which were adopted by the Parliament on 28 September 2006. According to Paragraph 9 of the Transition Provisions of the Law on State-Funded Pensions, the Treasury prepared the draft Cabinet of Ministers’ Regulations “Amendments to 27 May 2003 Cabinet of Ministers’ Regulations No.272 “Regulations on Operation of the State-Funded Pension Scheme”” in 2006, as well as the draft Cabinet of Ministers’ Regulations “Transfer of the Funded Pension Capital Managed by the Treasury: Tender Procedures, Procedure and Timeframe for Capital Transfer, as well as the Procedure for the Managers of the Funded Pension Scheme Assets to Reimburse the Capital Transfer Related Expenses”, which has been submitted to the Cabinet of Ministers for review.

In 2006, the Treasury received for management purposes from the SSIA state funded pension scheme assets in the amount of 4 040 461 lats and redeemed investment plan shares in the amount of 6 456 096 lats. On 31 December 2006, the net value of the Treasury’s investment plan assets amounted to 12 251 525 lats, which is 2 422 072 lats less than at the end of 2005.

TABLE 5  
Performance results of the investment plan\* (in millions of LVL)

	Quarter I 2006	Quarter II 2006	Quarter III 2006	Quarter IV 2006
Value of investment plan assets	13.110	12.667	12.401	12.259
Time deposits	2.624	2.908	2.844	2.715
Debt securities	10.486	9.666	9.272	8.597
incl. government debt securities	9.533	8.716	8.338	7.644
incl. mortgages	0.952	0.950	0.934	0.953
Cash	0.001	0.092	0.285	0.947
Investment plan liabilities	(0.009)	(0.008)	(0.008)	(0.008)
Total investment plan value	13.101	12.659	12.393	12.251
Changes, % against the previous period	(10.72%)	(3.37%)	(2.10%)	(1.14%)
Investment plan share value, in lats	1.2439223	1.2423368	1.2425706	1.2438849
Changes, % against the previous period	(0.05%)	(0.13%)	0.02%	0.11%
Weighted average investment maturity, in years	2.58	2.55	2.40	2.35

\* Last date of the relevant quarter  
Source: The Treasury

Although the asset value has decreased, and it’s been four years since private asset managers were engaged in management of the second-tier state-funded pensions, the Treasury’s investment plan still occupies a stable niche and is one of the biggest state-funded pension scheme asset managers. The net assets of the Treasury’s investment plan amount to 9.63% of the total net assets of the second-tier at the end of 2006. The market share of the Treasury’s investment plan among the conservative investment plans amounts to 45.75%. The investment plan has been able to maintain a sufficiently high yield, and at the end of the year the annual yield of one share of the investment plan from the start of operation (7 September 2001) amounted to 4.13%.

In accordance with the Treasury investment plan's investment policy and restrictions established in the Law on State Funded Pensions, funds were invested in domestic government securities, mortgages and time deposits in banks. On 31 December 2006, 22.16% of the total investment plan assets were placed with banks; 62.39% of the total assets were invested in domestic government securities and 7.78% in mortgages. 7.73% of the total assets are kept on the current account.

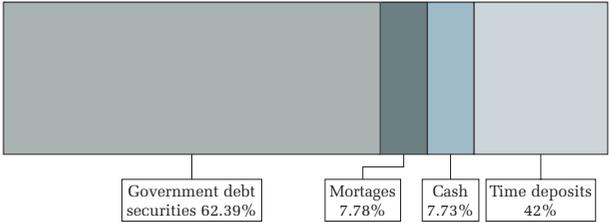


CHART 16  
Investment portfolio\*

\*Of asset value on 31 December 2006  
Source: The Treasury

The Treasury manages the state-funded pension scheme assets by investing in low risk financial instruments and in compliance with the investment diversification principle, as well as ensures adequate investment liquidity, so as to be able to execute the SSIA instructions to redeem shares of the investment plan in a timely manner. The Treasury has developed and electronically maintains a register of the shares of the investment plan, registering any actions involving the shares of the investment plan, and provides information to the SSIA and Financial and Capital Market Commission following the procedure set in laws and regulations. In accordance with the 27 May 2003 Cabinet of Ministers' Regulations No.272 "Regulations on Operation of the State-Funded Pension Scheme" and the prospectus of the Plan, the Treasury received as a remuneration for the management of the investment plan assets 0.75% of the average annual value of the plans (net) assets in 2006.



## 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) grant from general revenue;
- 2) foreign financial assistance;
- 3) service charges and other self-generated revenue:
  - revenue from central government loan service,
  - revenue from central government guarantee service,
  - revenue for management of the assets of the state funded pension scheme.

#### Central government basic budget spending

In 2006, the Treasury implemented the following basic budget programmes and sub-programmes:

- 1) programme "Budget execution and central government debt management":
  - sub-programme "Budget execution";
  - sub-programme "Central government debt management";
- 2) sub-programme "Contributions to international organisations";
- 3) sub-programme "Compensation to rehabilitated citizens";
- 4) programme "Central government budget loans and their repayments";
- 5) programme "Grant to local government cohesion fund".

The objective of the sub-programme "Budget execution" is execution of the central government budget within the framework set by the annual law on the state budget, focusing on efficient management of the central government budget funds, identification of services required by the Treasury's clients, improvement of the quality of the services offered in line with the best international financial management practice and applying the latest technologies.

The objective of the sub-programme "Central government debt management" is effective management of the central government debt and assets, ensuring the funds required for the purpose of financing the central government deficit and refinancing of the central government debt at the lowest possible costs by hedging the financial risks and taking into account the development of the Latvian state capital market and the overall financial system.

The objective of the sub-programme "Contributions to international organisations" is making timely and full annual participation fee 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, ensuring settlement of the undertaken commitments.

The objective of the sub-programme "Compensation to rehabilitated citizens" is to ensure disbursement of compensations to rehabilitated citizens in compliance with the laws and regulations. The objective of the programme "Central government budget loans and their repayments" is to ensure granting of central government budget loans, based on an adequate appropriation, offering the most adequate financing to project implementers, ensure up-to-date information on the government loan portfolio, and take all the required steps to collect delayed payments.

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

## Information on central government basic budget funding and its spending

TABLE 6

Central government basic budget funding and its spending (summary of all programmes, LVL)

No.	Financial assets	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
<b>1.</b>	<b>Financial assets to cover expenditure (total):</b>	<b>57 642 338</b>	<b>64 026 611</b>	<b>64 225 308</b>
1.1.	Grants	56 476 645	62 946 324	62 946 324
1.2.	Service charges and other self-generated revenue	1 098 829	1 080 287	1 278 984
1.3.	Foreign financial assistance	66 864	0	0
<b>2.</b>	<b>Expenditure (total):</b>	<b>56 550 866</b>	<b>64 274 791</b>	<b>62 407 098</b>
2.1.	Running costs (total):	56 249 566	62 879 602	61 246 956
2.1.1.	Current expenditure	3 779 144	3 969 602	3 947 436
2.1.2.	Payments on borrowing and loans	50 078 633	54 280 000	53 053 767
2.1.3.	Subsidies and grants	2 391 789	4 630 000	4 245 753
2.2.	Capital investment expenditure	301 300	1 395 189	1 160 142

Source: The Treasury

In 2006, funding approved in the central government basic budget to cover expenditure was 64 026 611 lats, including:

- 1) grant from general revenue in the amount of 62 946 324 lats, which is 6 469 679 more than in 2005;
- 2) self-generated revenue from the servicing of central government loans, guarantees and management of the state funded pension scheme assets in the amount of 1 080 287 lats, which is the same as in 2005.

With the adoption of the Law “Amendments to the Law “On State Budget 2006”” the allocations granted to the Treasury were increased by 248 180 lats. It was financed from the balance of the self-generated revenue of the previous years.

Total allocations granted under the appropriation procedure amount to 64 274 791 lats, which is 6 346 859 lats more than in 2005. Of the granted allocations, 62 407 098 lats were actually spent, which is 5 856 232 lats more than in 2005 or 97% of the total allocations granted in the reporting year.

TABLE 7

Central government basic budget funding and its spending, basic budget programme “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
<b>1.</b>	<b>Financial assets to cover expenditure (total):</b>	<b>54 367 338</b>	<b>64 026 611</b>	<b>59 595 308</b>
1.1.	Grants	53 201 645	58 316 324	58 316 324
1.2.	Service charges and other self-generated revenue	1 098 829	1 080 287	1 278 984
1.3.	Foreign financial assistance	66 864	0	0
<b>2.</b>	<b>Expenditure (total):</b>	<b>54 159 077</b>	<b>59 644 791</b>	<b>58 161 345</b>
2.1.	Running costs (total):	53 857 777	58 249 602	57 001 203
2.1.1.	Current expenditure	3 779 144	3 969 602	3 947 436
2.1.2.	Payments on borrowing and loans	50 078 633	54 280 000	53 053 767
2.2.	Capital investment expenditure	301 300	1 395 189	1 160 142

Source: The Treasury

TABLE 8

Central government basic budget funding and its spending, basic budget sub-programme "Budget execution" (LVL)

No.	Financial assets	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
<b>1.</b>	<b>Financial assets to cover expenditure (total):</b>	<b>3 767 338</b>	<b>4 996 611</b>	<b>5 195 308</b>
1.1.	Grants	2 601 645	3 916 324	3 916 324
1.2.	Service charges and other self-generated revenue	1 098 829	1 080 287	1 278 984
1.3.	Foreign financial assistance	66 864	0	0
<b>2.</b>	<b>Expenditure (total):</b>	<b>4 000 444</b>	<b>5 244 791</b>	<b>5 009 744</b>
2.1.	Running costs (total):	3 699 144	3 849 602	3 849 602
2.1.1.	Current expenditure	3 699 144	3 849 602	3 849 602
2.2.	Capital investment expenditure	301 300	1 395 189	1 160 142

Source: The Treasury

In 2006, capital investment increased by 1 093 889 lats over the previous reporting period as a result of significant spending on the project "Implementation of the Universal Central Government Budget Planning and Execution System (SAP)".

The cash balance under the basic budget sub-programme "Budget execution" at the end of the period amounted to 419 314 lats. This amount is comprised of revenue from service charges that have been above the plan for several years.

TABLE 9

Central government basic budget funding and its spending,  
basic 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
<b>1.</b>	<b>Financial assets to cover expenditure (total):</b>	<b>50 600 000</b>	<b>54 400 000</b>	<b>54 400 000</b>
1.1.	Grants	50 600 000	54 400 000	54 400 000
1.2.	Service charges and other self-generated revenue	–	–	–
1.3.	Foreign financial assistance	–	–	–
<b>2.</b>	<b>Expenditure (total):</b>	<b>50 158 633</b>	<b>54 400 000</b>	<b>53 151 601</b>
2.1.	Running costs (total):	50 158 633	54 400 000	53 151 601
2.1.1.	Current expenditure	80 000	120 000	97 834
2.1.2.	Payments on borrowing and loans	50 078 633	54 280 000	53 053 767
2.2.	Capital investment expenditure	–	–	–

Source: The Treasury

Taking into account the 2006 central government budget performance that freed up large amounts of temporarily free central government budget funds, the previously planned borrowing amount was reduced. At the same time, the previously planned central government debt service payments were also reduced. Interest payments have been made within the framework of the basic budget sub-programme "Central government debt management" on government borrowing, outstanding government securities, coupon payments on government bonds as well as other central government debt management related payments (including payment of a charge for registration of domestic government securities and their retention and securities events service at the Latvian Central Depository, as well as their listing on the main list of Riga Stock Exchange), legal, audit, rating agency fees and fees for other central government debt management related services. Account service fees have been paid to banks, payments on balances of time deposits made with the Treasury from special budget cash balances.

TABLE 10

Central government basic budget funding and its spending,  
basic 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
<b>1.</b>	<b>Financial assets to cover expenditure (total):</b>	<b>2 475 000</b>	<b>3 830 000</b>	<b>3 830 000</b>
1.1.	Grants	2 475 000	3 830 000	3 830 000
1.2.	Service charges and other self-generated revenue	–	–	–
1.3.	Foreign financial assistance	–	–	–
<b>2.</b>	<b>Expenditure (total):</b>	<b>1 713 638</b>	<b>3 830 000</b>	<b>3 656 969</b>
2.1.	Running costs (total):	1 713 638	3 830 000	3 656 969
2.1.1.	Subsidies and grants, including contributions to international organisations	1 713 638	3 830 000	3 656 969
2.2.	Capital investment expenditure	–	–	–

Source: The Treasury

The Republic of Latvia is a member of several international financial institutions and organisations. By joining them it has not only acquired certain rights but has also undertaken commitments to make payments into their capital and reserves and annual participation fees. Therefore, the Treasury ensures within the framework of this programme that the undertaken member state commitments are fully satisfied in compliance with the payment schedules. The Treasury ensures that participation fees are paid into the following international financial institutions: IBRD, EIB, NIB, ECDB, World Customs Organisation and European Tax Administration Organisation. In 2006, all participation fees were made in the required amounts and within the set timeframe.

In 2006, the planned amount of total contributions was 3 830 000 lats. All the planned commitment payments to international financial organisations were made in time and in full amount, totalling 3 656 969 lats. The difference was due to the World Bank payment being claimed in a smaller amount than initially planned. Payments into capital and reserves, as well as participation fees into all the planned seven institutions and organisations were made. Consequently, the key objective of the sub-programme was attained. No new measures or activities that may have an impact on implementation of the sub-programme were implemented in 2006.

TABLE 11

Central government basic budget funding and its spending,  
basic budget programme "Compensations to rehabilitated citizens" (LVL)

No.	Financial assets	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
<b>1.</b>	<b>Financial assets to cover expenditure (total):</b>	<b>800 000</b>	<b>800 000</b>	<b>800 000</b>
1.1.	Grants	800 000	800 000	800 000
1.2.	Service charges and other self-generated revenue	–	–	–
1.3.	Foreign financial assistance	–	–	–
<b>2.</b>	<b>Expenditure (total):</b>	<b>678 151</b>	<b>800 000</b>	<b>588 784</b>
2.1.	Running costs (total):	678 151	800 000	588 784
2.1.1.	Subsidies and grants, including contributions to international organisations	678 151	800 000	588 784
2.2.	Capital investment expenditure	–	–	–

Source: The Treasury

In 2006, compensations to rehabilitated citizens were paid in accordance with 30 December 1997 Cabinet of Ministers' Regulations No.443 "Procedure to Recover the Property or Compensate its Value to Persons who Lost it as a Result of Alienation due to Failure to Pay Increased Tax Fees or who Escaped from Political Repressions of the Communist Regime".

TABLE 12

Central government basic budget funding and its spending,  
basic 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
<b>1.</b>	<b>Financial assets to cover expenditure (total):</b>	<b>7 152 897</b>	<b>7 152 897</b>	<b>7 152 897</b>
1.1.	Grants	7 152 897	7 152 897	7 152 897
1.2.	Service charges and other self-generated revenue	–	–	–
1.3.	Foreign financial assistance	–	–	–
<b>2.</b>	<b>Expenditure (total):</b>	<b>7 152 897</b>	<b>7 152 897</b>	<b>7 152 897</b>
2.1.	Running costs (total):	7 152 897	7 152 897	7 152 897
2.1.1.	Subsidies and grants	7 152 897	7 152 897	7 152 897
2.2.	Capital investment expenditure	–	–	–

Source: The Treasury

TABLE 13

Implementation of the performance indicators of the basic budget sub-programme "Budget execution"

No.	Performance indicators	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
1.	Number of institutions	1	1	1
2.	Number of staff positions	250	301	246
3.	Treasury's expenditure per one lats of the granted central government budget allocations (Ls)	0,001	0,001	0,001
4.	Treasury's expenditure per one lats of the serviced central government debt (Ls)	0,003	0,003	0,003
5.	Report on central government budget execution and on local government budgets (their financial position) for the financial year prepared	1	1	1
6.	Official monthly Treasury reports "General government consolidated budget execution" prepared	12	12	12
7.	Official monthly Treasury reports "Central government debt", "External debt of the central government" and "Granted government guarantees" prepared	12	12	12
8.	Number of implemented clients' payment documents (in millions)	10	6	14
9.	Annual report of the foreign debt of the central government and guarantees issued prepared and submitted to the World Bank	1	1	1
10.	Annual report on management of the state funded pension scheme assets under the Treasury's investment plan prepared	1	1	1
11.	Payments of the EU funding received	14	18	88
12.	Number of processed structural funds payment orders	1 520	3 600	3 293
13.	Internal quality management system documents drafted, in order to ensure the operation of the established financial management and control system for the structural funds	6	6	8

Source: The Treasury



## Central and local government procurement

The Treasury effected procurement in compliance with the Law “On Procurement for the State and Local Government Needs” and from 1 May 2006 – by way of an open tender, negotiation procedure and invitation to submit price quotations as well as following the procedure for tenders where the expected price of the contract is 1000–10 000 lats. In the event of tender, the Treasurer establishes a tender committee, competent in the particular area of procurement where the contract will be signed. Procurement is registered and contracts are monitored in the register of procurement contracts of the Treasury. In 2006, the total number of purchases amounted to 45 (excluding the purchases under 1000 lats), and contracts in the amount of 396 031.18 lats (VAT exclusive) were concluded.

## 5.2. PERSONNEL AND PERSONNEL MANAGEMENT

### Personnel recruitment

As of 2 January 2006, there were 271 staff positions in the Treasury (238 civil servant and 33 employee positions, including 7 manual workers). As of 2 January 2006, civil service or employment relations were established with 250 staff members.

As of 29 December 2006, there were 272 staff positions in the Treasury (240 civil servant and 32 employee positions, including 7 manual workers). As of 29 December 2006, civil service or employment relations were established with 250 staff members.

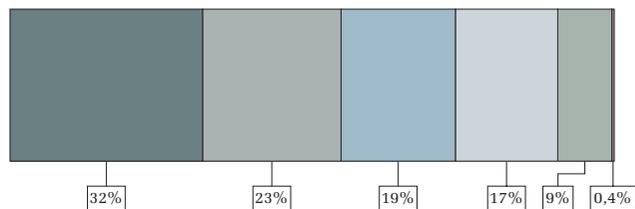
In 2006, 109 job descriptions were updated and improved (40% of the number of the Treasury’s staff positions), in order to facilitate the fulfilment of the functions and assignments of the structural units, in order to specify the duties and responsibilities in the area of quality management and risk management.

Most of the Treasury’s staff (74%) falls within the age range of 20 – 49 years (see Chart 17).

CHART 17  
Breakdown of the Treasury’s  
personnel by age group



Source: The Treasury



The breakdown between women and men employed has not changed significantly in comparison with previous years. In 2006, 84% of those employed by the Treasury were women and 16% were men (see Chart 18). In the regional Treasury units (except for Riga Treasury Unit), only women are employed.

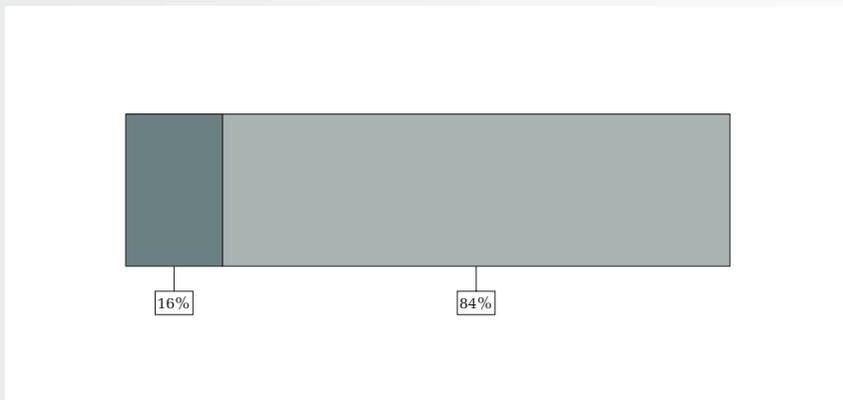


CHART 18  
Breakdown between women and men employed by The Treasury in 2006

■ men  
■ women

Source: The Treasury

In 2006, the breakdown by gender for the heads or deputy heads of structural units was 77% women and 24% men respectively (see Chart 19).

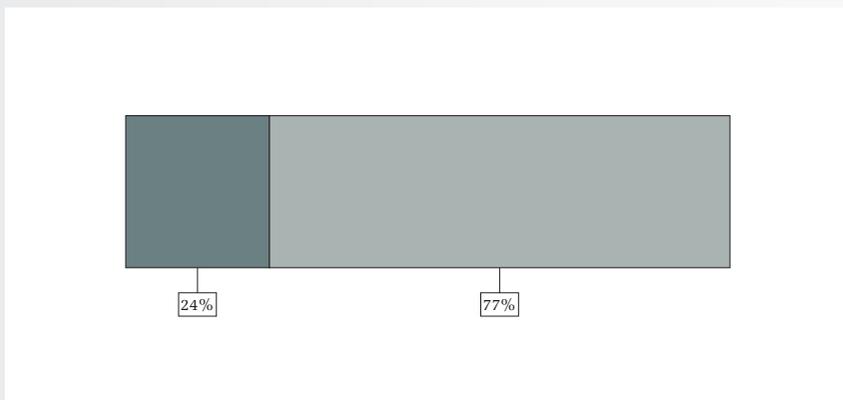


CHART 19  
Proportion of women and men employed as heads of the structural units of the Treasury in 2006

■ men managers  
■ women managers

Source: The Treasury

Twenty-three civil servants and employees were dismissed from civil service or employment at the Treasury. During the reporting year, staff turnover was 9% (see Chart 20 for staff turnover by years).

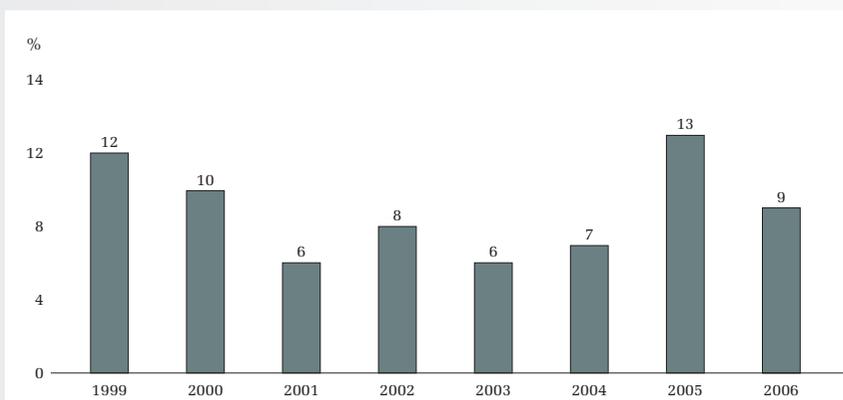


CHART 20  
Staff turnover at the Treasury by years in 1999–2006

Source: The Treasury

In the reporting year, 48 applicant selection competitions were held for vacant staff positions at the Treasury. Twenty-five new specialists established civil service or employment relations with the Treasury following the selection process. The Treasury continues to promote career growth for their specialists: 27 specialists of the Treasury were granted the opportunity of career development, by transferring them to other staff positions, as a result of staff appraisal and internal selection competitions.

In order to attract those who might take an interest in working at the Treasury and to select the most suitable candidates, the Treasury continues its cooperation with the personnel selection company “CV-online” Ltd.

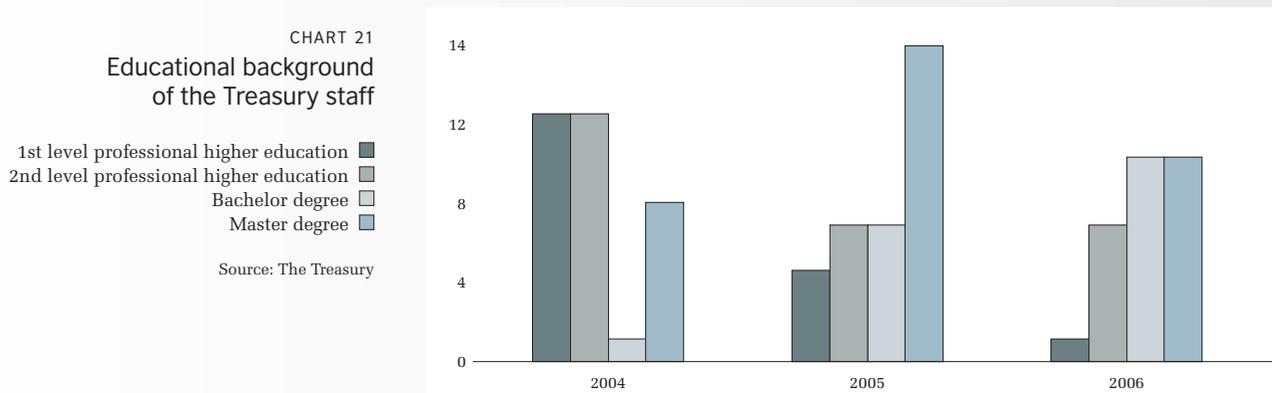
In order to evaluate civil servant candidates and new employees at the Treasury, appraisal discussions to evaluate performance during the trial period were held. At the end of the trial period, performance results were evaluated for 23 new employees. All new employees got a positive appraisal, which confirms that the candidates selected meet the requirements, possess profound professional knowledge and adequate skills, and are able to cope successfully with the new work responsibilities.

Based on the appraisal results of the trial period, the State Department of Civil Service granted the status of civil servant to 9 civil servant candidates of the Treasury in 2006. In order for the new civil servants and employees to better understand their role in implementing the Treasury's strategic goals, they were introduced to the structural units of the Treasury, their functions and staff members as part of an employee orientation program.

In 2006, 28 Treasury staff members underwent annual performance appraisal. These staff members were not appraised at the beginning of 2006 for the performance during 2005. According to the strategic management plan of the Treasury, the next performance appraisal period will be from 1 June to 15 July 2007.

## Personnel development

The greatest value of the Treasury is highly educated and professional personnel. 96.8% of the staff have a university degree (including 28% have obtained a Master's degree) One staff member has a Doctor's degree. The tendency to develop professionally and to raise the educational level has persisted over the years. (see Chart 21).



Training needs identification and the development of a training plan for the civil servants and employees of the Treasury for the next year was completed before the end of the current fiscal year. 245 (98%) civil servants and employees of the Treasury have attended 481 training courses.

In 2006, organisation of the training process focussed specifically on the training needs of the Treasury's employees.



### 5.3. QUALITY AND RISK MANAGEMENT

On 15 March 2006, the Treasury was awarded the Quality Management System certificate ISO 9001:2000 "Quality Management Systems. Requirements", which confirms the compliance of the Quality Management System with the international standard. The compliance of the Treasury's Quality Management System with the requirements of the ISO 9001:2000 standard was ascertained by the international auditor company "SGS Latvia Ltd.", which conducted audits throughout the Treasury, including the regional Treasury Units. The awarded certificate serves as a proof to the clients and cooperation partners of the top quality performance of the Treasury in the areas under certification: central government budget execution, central government debt and asset management and the Paying Authority for the EU policy instruments and the National Fund for foreign financial assistance. The Treasury is committed to continue working in compliance with the requirements of the ISO 9001:2000 standard, ensuring continuous improvement of its performance as well as further development of services in line with client needs. This commitment was demonstrated by the oversight audit conducted in December 2006, during which the auditors ascertained the compliance of the Treasury's Quality Management System with the requirements of the ISO 9001:2000 standard and that the Treasury systematically ensures the compliance of the product coming from the operational areas subject to certification with the requirements of the standard, as well as implements the established policy and objectives. The next oversight audit is expected in autumn 2007.

On 21 December 2006, the Treasury's client service manual was approved with the goal of helping the staff understand the key values in client servicing. The manual sets the client service principles: appropriate behaviour, dress code, internal communication culture, aesthetic appearance of the working place etc., as well as helps any staff member to understand how work should be organised, in order to achieve the goals set by the Treasury.

Optimisation of documents governing the quality management system was started, and in the long-term, by 2009, the Treasury has a plan of a transition to a modular quality management system, reworking the documents governing the quality management system into flowcharts supplemented with identified risks and controls.

The Treasury has scheduled an internal and external client survey in 2007, in order to improve the quality of the provided services and identify the gaps in its operation so far.

With the goal of achieving more effective operational risk management, changes to the Treasury's structure were implemented in the reporting period by merging the Quality Management Department and Risk Management Department. The implemented structural and organisational changes will enable a classification of all the processes of the Treasury according to their maturity, assigning to each process a degree of significance, acceptable level of risk and selecting the required process control degree. Based on this classification, requirements to the level of detail of quality management documents of process and risk management measures will be set. The implemented changes will enable a reduction of the number and scope of quality management documents in less important areas, focussing on the processes most exposed to risks.

## 5.4. INTERNAL CONTROL SYSTEM

The internal control system of the Treasury was established, based on comprehensive basic elements of an internal control system: control environment, performance appraisal, risk management, control activities, monitoring and effective information flows and intercommunication. Internal control within the structural units of the Treasury is one of the means to prevent potential losses. In order to reduce risks inherent in 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 results of internal and external audits completed in 2006 confirmed that overall the established internal control system provides sufficient and reasonable assurance that the Treasury's assigned tasks are implemented in accordance with the strategic objectives, of performance efficiency, data correctness and reliability, compliance with legislative requirements as well as risk management and protection of the resources at the Treasury's disposal against potential losses. The internal control system is under continuous development: not only requirements of laws and regulations are regularly taken on board, but also best practices and experience of the financial sector.

The recommendations provided within the framework of internal audits conducted in 2006 relate to improving the budget planning and execution control process of the Treasury as an institution, quality management system documents, payment execution process and the internal control system, taking into account the functions of the Treasury as the Paying Authority for the EU policy instruments and the Treasury as the National Fund for ensuring the management foreign financial assistance.

In 2006, a self-appraisal of the Treasury's Internal Audit Department was conducted. Proposals for improvement regarding the planning, implementation and monitoring of recommendations were provided. Implementation of the changes is ongoing.

The Treasury's Audit Reports Review Committee ensures continuous supervision of the operation of the Treasury's internal control system. It has reviewed the findings and conclusions about the Treasury's operations included in internal and external audit reports, the proposals included in the reports for improvement of the operation of the internal control system established in the Treasury, and the comments provided by the audited structural units about audit findings.

## 5.5. INFORMATION TECHNOLOGY DEVELOPMENT

The core business of the Treasury is directly dependant on the information systems ensuring the discharge of the Treasury's basic functions. Therefore in order to improve the quality of services provided, the Treasury implements continuous measures to modernise its information systems and information technology infrastructure.

By implementing the Treasury's Operational Strategy, information technology development continued in 2006 by providing centralised 2007 budget plan formulation and aggregation to all ministries and their subordinated institutions in addition to the existing Treasury's services available electronically: the eKase which is being used in the area of central government budget execution to provide Treasury services over the internet already for the third year as well as the electronic central government and local government budget report validation and submission system.

An important step in the development of the Treasury's information technology was the implementation of the project „Implementation of a Universal Central Government Budget Planning and Execution Information System“. The Project was launched together with the Ministry of Finance. Within the framework of this project, a common management system of the public finances will be established, which will merge the functionality of the Treasury management system (central government debt and asset management) and the budget execution information system, by integrating them into one system, thus preventing the shortcomings of the current systems, reducing the transaction processing time and the number of the complicated data exchange procedures. Implementation of the system planning block will provide an opportunity for centralised aggregation and processing of budget plans, by making this process less time-consuming and using modern information technology. The newly established system can be considered also as the first step towards creation of a financial portal, which would ensure that clients have access to all financial services provided by the Treasury in one information system.

In 2006, work on implementing a new accounting software started, in order to modernise the Treasury's accounting records by ensuring fast processing of the accounting information and more effective control of the process. Within the framework of this project, the functionality of financial accounting and management accounting was introduced at the end of 2006. The final phase of the project, the personnel management module, will be introduced during the fourth quarter of 2007, thus ensuring both optimisation of the accounting processes as well as improvement of personnel management processes.



# THE TREASURY'S DEVELOPMENT PRIORITIES FOR 2007

## Central government budget execution

- 1) Configure the SAP system to support budget execution functions.
- 2) Develop a system that supports applying for payment cards when collecting budgetary revenue and charges on services delivered by budget institutions.
- 3) Inform and consult clients on applying for credit cards when incurring running expenditure, as well as monitor the credit card service provision process and propose changes to improve the process, if required.
- 4) Continue making maximum effective use of information technology in client servicing, increasing the share of payments made via eKase. Introduce a dynamic password system in the eKase system.
- 5) In order to ensure quality provision of services to local governments as the main clients of the Treasury, develop an information package on the types of services provided by the Treasury in account servicing, granting loans and in relation to deposits.
- 6) Base budget planning and execution on universally approved classifications developed in compliance with the requirements of international financial institutions.
- 7) Develop, approve and apply universal budget execution and financial management procedures in central government budget execution.
- 8) Develop electronic services and on-line information exchange with the Treasury's clients, ensure a universal reporting system for the central and local government budget reports and statistical reports.
- 9) Ensure participation of the Treasury in the EU real time gross settlement system TARGET2, implementing efficient and fast euro payments information exchange.
- 10) Prepare for participation in the Bank of Latvia Electronic clearing system for euro settlements from 01.01.2008.
- 11) Improve the accounting of central and local government budget institutions, ensuring the compliance of financial reports with the guidelines provided by the International Public Sector Accounting Standards (IPSAS), International Accounting Standards (IAS).
- 12) Draft a Cabinet of Ministers' instruction "Procedure for Making Payments at the Treasury" and Cabinet of Ministers' Regulations "Procedure for Suspending Allocations for the EU Policy Instrument Financing".

## Central government debt and asset management

### Borrowing management

- 1) In order to balance the costs of financing with a view to ensure medium-term hedging of financial risks (with risk hedging taking a priority), analyse the impact of a macroeconomic crisis on the central government debt and its service costs (prepare a stress test).
- 2) In order to achieve maximum favourable borrowing terms and conditions, assess the need to introduce changes and the potential for their implementation in the current model of primary placement of government securities.
- 3) In order to ensure regular evaluation of the effectiveness of the government borrowing in comparison with the developed maturity and cost benchmarks for borrowing transactions, consider the possibilities for implementing improvement measures in regard to the benchmark model methodologies.
- 4) In order to secure continuous borrowing opportunities both on the domestic and international financial markets, improve the range of financial instruments at Latvia's disposal and evaluate the usefulness of CP (Commercial Papers) and MTN (Medium Term Note) programme implementation model in covering the financing needs of the central government budget.
- 5) In order to ensure more effective access to information regarding central government debt management, implement additional measures to improve the types of delivery of the information provided by the Treasury and ensure that the information is better targeted to the needs of its users.
- 6) In order to identify the overall financing need for 2008–2010, evaluate the liquidity and financial market risks and select the most suitable medium-term instruments for financing the fiscal deficit of the central government budget and refinancing of the central government debt, develop Funding Plan 2008–2010.

### Central government debt portfolio management

In order to improve the debt portfolio evaluation methods and risk management instruments, develop an option evaluation model, methodology guidelines and implement the required changes in the internal systems to enable the use of options.

### Liquidity management

- 1) In order to implement the Cash Management Strategy:
  - ensure the first transactions involving fixed income securities as well as the first application of the financial derivatives in liquidity management,
  - implement an investment market value risk assessment model (Value-at-Risk), preparing the modelling methodology best suited for the Treasury;
  - implement Delta model to reflect the sensitivity of the financial derivatives used in financial risks hedging to price developments of financial investments, developing methodology guidelines and a system model.
- 2) In order to ensure regular evaluation of transactions involving the central government funds against the developed investment benchmarks within the framework of the financial management, evaluate the effectiveness of the developed benchmarks and review the adequacy of the benchmarks in the context of the methods applied to place the cash assets and the financial market developments.
- 3) In order to ensure the application of the principle of prudence in cash management transactions, with the timeliness of providing funding and restriction of the counterparty risk being the key factors, improve the analytical capacities of the Treasury with regard to counterparties.

### **Central government budget lending**

In order to improve the Treasury's competitiveness in granting the central government budget loans and ensure lending rates better reflecting the market developments, develop a more flexible lending rate setting methodology, and draft Cabinet of Ministers' Regulations "Procedure for Granting and Servicing Central Government Loans".

### **Implementation of new initiatives**

- 1) Considering the current developments in application of public-private partnerships in implementation of public investment projects in Latvia, develop methodology guidelines for reallocation of risks and accounting in public-private partnership projects.
- 2) In order to ensure more effective planning of the central government budget and limit the financial risks of central budget institutions pertaining to budgetary payments in foreign currencies, prepare proposals for a measure to be implemented with to start managing the financial risks of central government institutions.

### **Implementation of the functions of the Paying Authority for the EU policy instruments**

- 1) In order to discharge the functions of a Paying Authority (receive funding from the European Commission and make disbursements to beneficiaries within the shortest possible timeframe and in full amount), draft the required internal quality management system documents.
- 2) In order to set universal principles for planning of the EU funding granted for the 2007–2013 programming period, its financial management, disbursements and submission of declarations, draft adequate Cabinet of Ministers Regulations in cooperation with the Ministry of Finance.
- 3) Continue the discharge of functions of the Paying Authority, certifying the expenditure incurred within the framework of the EU structural funds, Cohesion Fund and European Community initiative EQUAL projects approved for the 2004–2006 programming period.
- 4) Make the first disbursements for implementation and administration of the European Economic Area and Norwegian government financial mechanisms.

### **Management of the assets of the state-funded pension scheme**

Taking into account that the Treasury's operation in management of the state funded pension scheme assets is discontinued, ensure the liquidity of the Treasury's investment plan.

### **Corporate governance of the Treasury as a public administration institution**

- 1) Maintain the quality management system in compliance with the requirements of the certificate ISO 9001:2000 "Quality Management Systems. Requirements".
- 2) Conduct an internal and external client survey, in order to improve the quality of the services delivered and identify any gaps in current operation.
- 3) Continue making maximum effective use of information technology in serving our clients.
- 4) In order to ensure further personnel development, improve performance and training needs identification as well as develop a methodology for personnel career planning and ensure its implementation.

## PUBLIC COMMUNICATION

Successful cooperation based on mutual understanding can be ensured via fully-functional flows between the Treasury and the public.

One of the main priorities of the Treasury's Operational Strategy is an orientation towards clients, their needs and interests. The Treasury learns about client satisfaction by means of questionnaires.

The Treasury maintains its internet website ([www.kase.gov.lv](http://www.kase.gov.lv)), providing information on the Treasury and its functions since 2003. Information about topical issues of the Treasury is regularly updated on the website. It is possible to ask questions as well as submit applications, proposals and complaints electronically. Visitors to the website can receive fast answers to their questions, whereas the Treasury can identify potential problems concerning client cooperation and prevent them.

In order to ensure public awareness of its operations, the Treasury regularly informs the mass media about general budget execution, topical issues concerning central government debt and assets management, management of the state-funded pension scheme assets and implementation of the functions of the Paying Authority for the EU policy instruments as well as other topical issues.

