The Treasury

of the Republic of Latvia

Public Report for 2005

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The Treasurer's statement

The Treasury was established in 1919 as one of the first public administration institutions during the first independent Republic of Latvia, and today the Treasury plays an important role in the public administration. During the period from the year 1992 until the year 2005 it has grown from the Department of the Ministry of Finance to the institution with a unique system if comparing to other Member States of the European Union. The Treasury has been committed to a broad range of operational functions such as servicing of the central government budget, central government debt management[1], implementation of the functions of the Paying Authority for the European Union funds and the management of the state funded pension scheme assets.

In 2005, the Treasury has continued moving forward along the way of development, by striving for the superior goal set in the Operational strategy — to develop as a dynamic and modern organisation which is competitive in the field of the services provided as well as effectively and securely manages funds handed over to it in accordance with interests of the state and society.

In order to improve quality of the services provided, the Treasury continues to modernise information technology systems and the infrastructure of the information technologies.

The Treasury has developed a corresponding legislative basis and has implemented the functionality in the information technology system of the central government budget and local government budget reports, which provides submission and acceptance of the annual and quarterly reports by electronic means and improves co-operation with the ministries, central public administration institutions and local governments.

In the area of central government budget execution the Treasury successfully uses and develops the State Budget Information System's sub-system *eKase* that provides payments' processing services on the Internet already for the second year.

A significant turn in the area of the use of the electronic services is the co-operation project commenced in June 2005 together with the State Social Insurance Agency on making pensions' and benefits' payments by using *eKase*. Use of the Treasury's service enables to economize the state budget funds by saving at least 700 000 lats per year.

Within the framework of reorganisation of the Treasury units commenced in 2004 with an aim to improve the work of the Treasury units with the clients, a gradual transition to the provision of services to the clients of the Treasury units in on-line mode has started that implies offering the opportunity to receive up-to-date financial services and determining as the primary function for the employees of the Treasury units the provision of the consultations' services to the clients.

[1] Hereinafter in the report referred to the central government debt.

With the requirements set by the Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T.) fulfilled, in 2005 the Treasury's rights to use S.W.I.F.T. system in IMI (Investment Management Institution) status have been confirmed, that supplies standardised and secure inter-bank financial messaging services by using the telecommunications network.

During the development of the Treasury amount of the services to be provided by electronic means has essentially increased. Thus making requirements for the information security stricter. The Treasury's Information Security Policy has been completely reviewed, in such a way ensuring its correspondence to the requirements of the standard LVS ISO/IEC 17799:2005 "Information Technology — Security Methods — Code of Practice for the Information Security Management".

In 2005, the Treasury has successfully fulfilled the tasks set in the Latvian Central Government Debt Management Strategy approved by the Minister of Finance.

In the area of the improvement of internal borrowings' mechanisms and technologies one of the most important events in 2005 was organisation of the initial allocation of the government securities by using the SAXESS system of Riga Stock Exchange. It provides opportunity for the Treasury not only to organise the auctions' process more effectively, but also to increase the foreign investors' interest and the possibilities to make investments in the government securities.

The Treasury's achievements in 2005 have been highly evaluated also by the largest international rating agencies — *Moody`s Investor Service*, *Standard&Poor`s* and *Fitch Ratings* —, which have indicated in their annual reports about Latvia that the low level of central government debt and its proper management has been one of the promoting factors for maintaining the state credit rating in the previous A-/A2 level.

One of the projects on which the Treasury has worked for more than a year and which has been completed in September 2005 is the conclusion of a new loan agreement with the European Investment Bank for the amount of 150 million euros, by which an additional source of financial resources has been provided for the central government budget co-financing in the projects of the European Union Cohesion Fund and the structural funds.

In the area of the central government debt and asset management in 2005 the work has been commenced on the implementation of the new analysis models of the debt portfolio — *Budget-at-risk* model has been implemented, with the help of which one can make the sensitiveness analysis of the interest payments for the central government debt. In 2006 it is planned to continue work on the development of the *Cost-at-risk* model. The use of these models will allow the Treasury to determine more accurately the planned interest payments for servicing the central government debt as well as to evaluate and determine the optimal borrowing strategies within the framework of the Plan for attraction of the resources for the medium term.

By carrying out the activities of the Paying Authority for the European Union structural funds, the Treasury has gained recognition of the co-operation institutions — the deadlines for consideration of the payment documents and for checking the expenditure declarations which in the Treasury Quality management documents are set shorter than the legislative acts provide, make the acquisition process of the resources of the structural funds more operative.

In 2005, the Treasury's investment plan is still one of the largest and takes a stable niche among the state funded pension scheme assets managers. The decision made by the Cabinet of Ministers at the end of the year 2005 on handing over of the portfolio of the Treasury's investment plan to the private asset managers prevents the situation that the state performs the functions which can be fully provided by the private asset managers. The Treasury will continue to manage the state funded pension scheme assets until they are fully handed over to the private asset managers.

The whole staff of the Treasury has contributed purposeful and united work in the improvement of the Treasury's Quality management system corresponding to the requirements of the international standard LV EN ISO 9001:2000 "Quality management system. Requirements". All the necessary measures to start the certification process have been taken. The certificate will assure clients and co-operation partners of the high level of the Treasury's activity. In order to implement the goals set in the Operational strategy, during the year 2005 the management of processes has been implemented in the Treasury with the help of which the supervision and measurement of the processes is carried out.

The Treasury regularly maintains the contacts with the international co-operation partners. In 2005, the Treasury was represented in the meetings of the European Bank for Reconstruction and Development bank, the World Bank and the International Monetary Fund. Possible co-operation spheres are discussed during the meetings with the international investment banks and financial institutions, with the current and potential co-operation partners.

The end of the year 2005 has been the time of changes in the Treasury — appreciating the work contributed by Ms. Irēna Krūmane while taking the Treasurer's position of the Treasury, the Cabinet of Ministers appointed her as a State Secretary of the Ministry of Finance. The decision to overtake the management of the Treasury — an important public administration institution with a wide range of functions, is a very important and accountable one. Under my management the Treasury will continue the initiated way of the development by being oriented towards the client and his needs, and by effectively using the opportunities provided by the information technologies to a maximum extent for ensuring the activity of the institution. During its time of operation the Treasury has accrued a considerable experience, which now serves as a stable basis for a further development.

Kaspars Āboliņš
the Treasurer

Operational strategy 2005 – 2008 of the Treasury

Operational strategy 2005–2008 of the Treasury serves as a basis for the Treasury's modernisation, preserving the current standards and operational efficiency.

The goal of the Treasury is to develop as a dynamic and modern organisation, competitive in the area of provided services, effectively and safely managing the finances entrusted to the Treasury's management in compliance with the interests of the state and its population, by obtaining the status of the best Treasury among the new European Union (hereinafter — EU) Member States.

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

1) orientation towards the client, client needs and interests;
2) maximally effective application of information technologies in client servicing and government debt management.

The strategy sets the main principles to be complied with in the Treasury's operation and development, when taking decisions in implementation of routine and long-term tasks, at the same time promoting the involvement of all Treasury staff in attainment of the established objectives. The strategy establishes five priority areas for the Treasury's operations, and this report reflects the Treasury's performance in all those in 2005:

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 provided services in line with the best international financial management practice and applying modern technologies;
2) **central government debt and asset management**, ensuring the financing required for the purpose of financing the central government budget deficit and refinancing of the central government debt at the lowest possible costs, hedging the financial risks and taking into account the development of the Latvia's capital market and financial system;
3) **implementation of the Paying Authority functions for the EU policy instruments**, to ensure compliance with the financial management requirements prescribed by the EU, applying them also to the financial management of the national financing, in order to ensure uniform financial management standards for all finances assigned to the Treasury's management;
4) **management of the state funded pension scheme assets**, to ensure maximum safety of invested funds assigned to management and at the same time attain as high as possible income level;
5) **corporate governance of the Treasury as a public administration institution** — in attainment of the strategic objectives, the Treasury complies with uniform institutional operation principles in quality management, personnel management, risk management, application of information technologies and information security.

Legal status and structure of the Treasury

The Treasury is a direct administration institution subordinated to the Ministry of Finance, whose operational purpose is effective implementation of public administration functions in the area of public finance management in compliance with the requirements established by legislative acts, implementing organisation of central government budget execution, central government debt management functions and functions of the Paying Authority for the EU policy instruments and management of the state funded pension scheme assets.

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

The Treasury has the following functions:

1) organising execution and financial accounting of the central government budget;
2) making payments and allocations from the central government budget revenue;
3) central government debt 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 legislative acts and the National Fund functions delegated by the National Authorising Officer;
6) other functions prescribed in legislative acts.

The legal status, functions, tasks, competence, rights and procedure for ensuring legality are determined in accordance with the Public Administration Law and Cabinet of Ministers regulations No. 677 “Regulation of the Treasury” issued on August 3, 2004.

The Rules of Procedure of the Treasury were issued on December 3, 2004 pursuant to the Public Administration Law, prescribing the structure, work organisation of the Treasury, functions and tasks to be implemented by the Treasury. As in 2005 the reorganisation of the structural units of the Treasury was carried out, in August 1, 2005 new Rules of Procedure of the Treasury have been developed and the Rules of Procedure of the Treasury, dated from December 3, 2004 have been recognised as ineffective.

Structure of the Treasury (31.12.2005)

Taking into account the considerations of the work quality, the corresponding changes in the structure of the Treasury have been made in 2005.

In order to ensure the co-ordination of the activities of the Treasury’s units, to facilitate the improvement of their activities — rational organisation of the budget expenditure system, to provide the high quality services to the clients and ensure the management of the State Budget Information System’s sub-system *eKase* — **the Treasury Units Coordination Department** established.

In order to improve the economic management of the institution, the Maintenance Unit of the Accounting Department has been transformed to **Infrastructure Maintenance Department**.

In 2005 within the framework of the reorganisation of the Informatics Department a new structural unit has been established in the Informatics Department — **Information Technology Development Unit** and in accordance with the functions to be fulfilled the name of the Information Resources and Network Security Supervision Unit has been specified — **Infrastructure Maintenance Unit**. The reorganisation of the structure has been carried out in **Operations Department** — the **Lat Payments Unit** and **the Currency Payments Unit of Operations Department** have been reorganised and **the Financial Transaction Unit, the Credit Unit, the EU Payment Unit** and **the Clearing Unit** have been established. In the structure of the Operations Department the **Accounting and Control Unit of the Reports Department** has been included as well.

For the improvement of the common decision-making process in accordance with the goals set in the Operational strategy of the Treasury, the following committees continue their work in 2005:

Audit Reports Consideration Committee — in order to improve the activity of the Treasury's internal control system and to facilitate the achievement of the Treasury's strategic goals, protection of the resources, establishment and maintenance of the effective control measures. The committee reviews the findings and conclusions contained in internal audit and external auditors' reports on the Treasury's operation, 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 entitled to decide on potential measures for mitigation or prevention of the most significant Treasury's risks.

Budget Monitoring Committee — to ensure effective and efficient spending of central government basic budget financing granted for implementation of the assigned Treasury's functions. The task of the Committee is to ensure timely planning of the required expenditure, establish priorities for allocation of the granted financing and monitor effective spending. The decisions of the committee are binding to all structural units and staff of the Treasury.

Central Government Debt Management Committee — in order to facilitate the effective central government debt management and to develop the proposals for the improvement and implementation of the Latvian Central government debt management strategy.

Credit Committee — in order to facilitate the credit risk management, by coordinating the activities of the Treasury's structural units concerning the issues of the supervision of the central government budget loans, the guarantees issued on behalf of the government and the limits of the transaction partners.

Quality Management System Monitoring Committee — to promote implementation of the Quality management system and ensure its monitoring, stimulate continuous improvement of the Treasury's operations as well as compliance of services with the clients' interests. The task of the committee is to define the quality policy and objectives of the Treasury, ensure their compliance with the strategy, policy and objectives of the Treasury, 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 evaluated 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 organise updating of implementation of the Treasury's budget accounting policy and ensure effective accounting policy change management. The operational objective of the Committee is to define the Accounting policy and its compliance with the accounting standards, establish the Accounting policy objectives and update the Accounting policy and facilitate compliance with the requirements established by the Accounting policy.

Resource Liquidity Committee — based on the Treasury's Regulations for Ensuring Liquidity, to monitor and evaluate implementation of these regulations, in order to ensure proper management of the financial resources. The operational task of the Committee is to monitor the liquidity of financial resources, to prevent payment and liquidity crises risks, improve the Treasury's regulations for ensuring liquidity and promote compliance of management of financial resources with the requirements set in the regulations.

Personnel Management Committee — to promote effective personnel management in line with the Treasury's functions and objectives. The task of the Committee is to implement personnel policy and strategy, actively involving all level managers and staff.

In 2005 **Euro Implementation Committee** was established — in order to develop the proposals for the provision of euro implementation in the competence areas of the Treasury and to co-ordinate the involvement of the Treasury's structural units in the implementation of the corresponding euro implementation measures.

Treasurer

- **Deputy Treasurer**
  - Financial Resources Department
  - Financial Risk Management Department
  - Financing Department
  - Forecasting and Financial Planning Department
  - Budget Execution and Monitoring Department
- **Deputy Treasurer**
  - Reports Department
  - Informatics Department
  - Operations Department
- European Affairs Department
- State Funded Pension Assets Management Department
- Risk Management Department
- Office
- International Cooperation Department
- Legal Department
- Internal Audit Department
- Quality Management Department
- Personnel Department
- Accounting Department
- Infrastructure Maintenance Department
- The Treasury Units Coordination Department

Treasury Units:
Aizkraukle, Alūksne, Balvi, Bauska, Cēsis, Daugavpils, Dobele, Gulbene, Jelgava, Jēkabpils, Jūrmala, Krāslava, Kuldīga, Liepāja, Limbaži, Ludza, Madona, Ogre, Preiļi, Rēzekne, Rīga, Saldus, Talsi, Tukums, Valka, Valmiera, Ventspils

The Treasury's activities in 2005

1. Central government budget execution

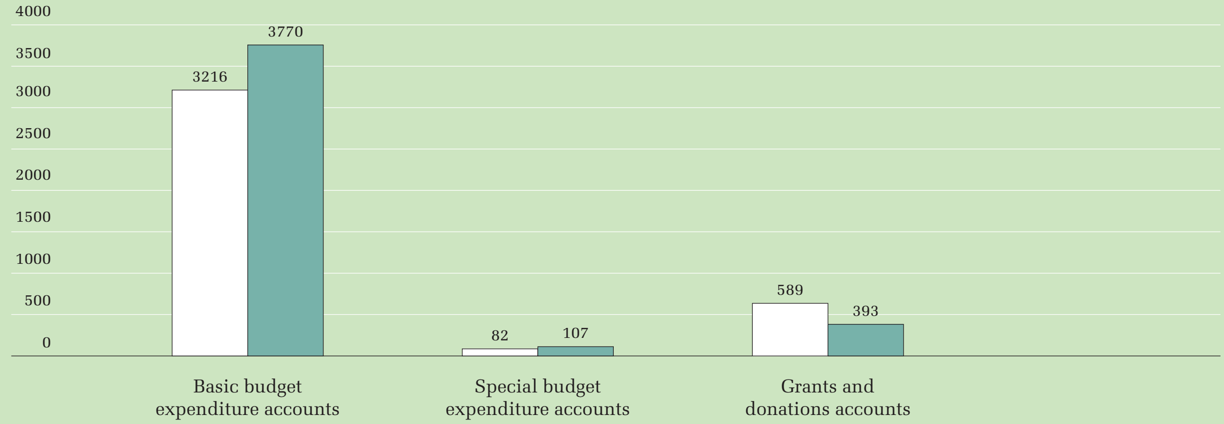
The Law on Budget and Financial Management has authorised the Treasury as a direct administration institution subordinated to the Ministry of Finance to organise the execution and the financial accounting of the central government budget, ensure granting of allocations and execution of payments made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

The Treasury implements the central government budget by maintaining the State Budget Implementation System, where budget accounts for budget executors are opened, by granting allocations based on financial plans, ensuring payments of budget institutions by accepting both paper documents for payment execution as well as accepting instructions online via the *eKase*, keeping records of the budget execution transactions effected by institutions financed from the budget, while monitoring their compliance with the annual appropriations from the central government budget, and keeping records of the central government budget revenue, as well as providing information concerning the collected taxes and fees to the State Revenue Service.

With a view to ensuring uniform accounting of public finances, the Treasury drafts legislative acts concerning the accounting of the central and local government budget institutions, thereby setting unified accounting principles, unified chart of accounts and a reporting system, which is compliant with classifications approved by the Cabinet and yields information on budget execution based on both the cash flow 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.

In 2005, for the purpose of ensuring central government budget execution, the Treasury granted allocations in the amount of 2 867 609 981 lats, of which 2 179 636 089 lats — to the basic budget and 687 973 892 lats — to the special budget. Allocations were granted to 1 075 institutions financed from the budget, for which overall 4 270 accounts were opened (383 accounts or 9.9% more than in 2004). In 2005, the number of basic budget expenditure accounts increased by 554 accounts or 17.2% year-on-year (see Chart 1). The number of basic budget expenditure accounts was significantly boosted by expansion of special purpose grants to local government investment and special purpose grants to local government activities: 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 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 196 accounts or 33.3% year-on-year in 2005 (see Chart 1). In 2005, the number of special budget expenditure accounts grew by 25 accounts or 30.5% 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 2004 and 2005*

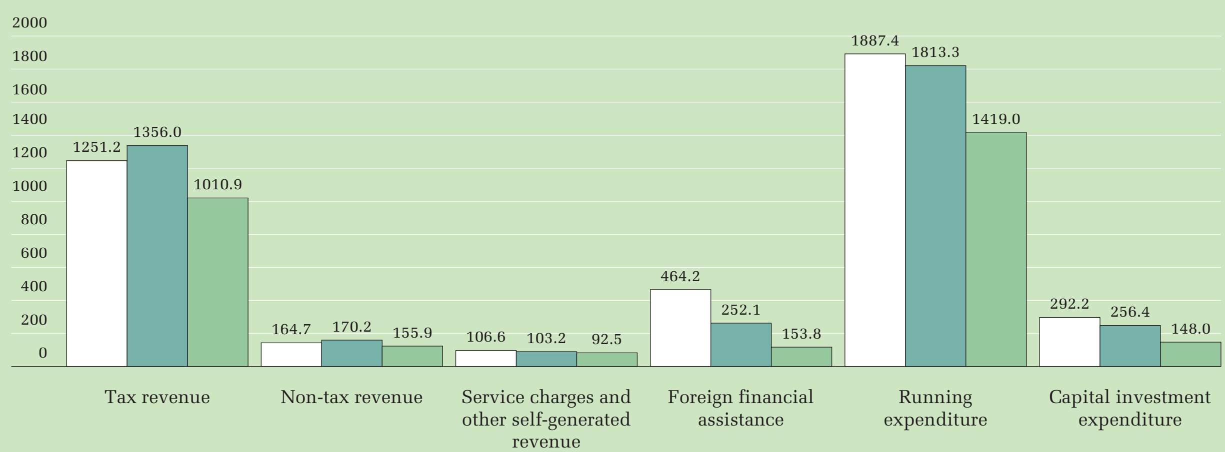


Source: The Treasury

In 2005, 312 basic budget revenue accounts were opened, which is by 51 accounts or 14% less year-on-year, as the number of accounts designated for receiving excise tax was reduced.

In executing the central government budget, the Treasury processed 10 174 644 payment orders in 2005, which is by 3 778 423 payment orders or 59.1% more than the number of payment orders processed in 2004. The volume of payments made increased considerably, as, starting from July 1, 2005, the State Social Insurance Agency (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 volume of payments.

Chart 2 *Central government basic budget implementation in 2005 (in millions, LVL)*



Source: The Treasury

Tax and non-tax revenue exceeded the 2005 plan: tax revenue was 104.8 million lats or 8.4% higher, whereas non-tax revenue was 5.5 million lats or 3.3% higher than planned. Revenue from service charges and other self-generated revenue was 3.4 million lats or 3.2% lower than planned. Revenue from foreign financial assistance fell short of the plan by 212.1 million lats or 45.7% (see Chart 2). Central government basic budget revenue totalled 1 881.5 million lats in 2005, as opposed to the planned amount of 1 986.8 million lats, the actual implementation in comparison with the plan being 94.7%.

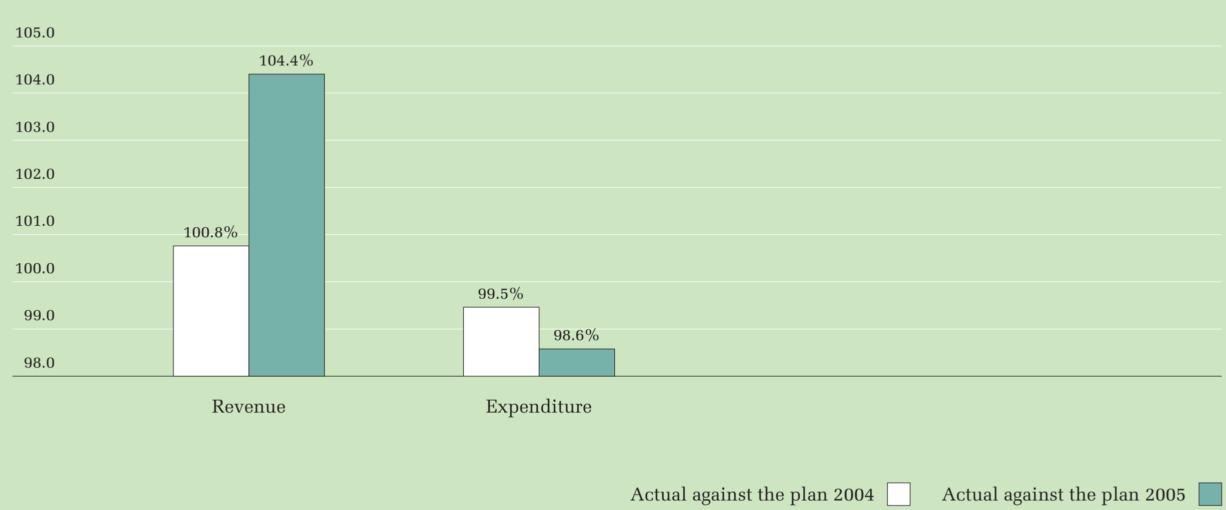
In 2005, basic budget revenue increased by 468.5 million lats or 33.2% year-on-year, tax revenue grew by 345.1 million lats or 34.1%, non-tax revenue — by 14.3 million lats or 9.2%, revenue from service charges and other self-generated revenue — by 10.7 million lats or 11.6%, whereas revenue from foreign financial assistance — by 98.4 million lats or 64.0%.

Central government basic budget expenditure amounted to 2 069.7 million lats in 2005, as opposed to the planned amount of 2179.6 lats, the expenditure implementation against the plan being 95%. Running expenditure was 74.1 million lats or 3.9% lower than planned, whereas expenditure for capital investment was 35.8 million lats or 12.3% lower than planned.

In 2005, special budget revenue amounted to 769.3 million lats, which is 32.8 million lats or 4.4% higher than planned, whereas in 2004 the central government special budget revenue amounted to 658 million lats, which was 5.4 million lats or 0.8% higher than planned (see Chart 3). In 2005, special budget expenditure was 678.1 million lats, which is 9.8 million lats or 1.4% less than planned (see Chart 3), whereas in 2004 the expenditure was 3.1 million lats or 0.5 % lower than planned.

The central government budget ran a fiscal deficit in the amount of 98.7 million lats in 2005, which is 1.2 % of the gross domestic product (GDP). There was a fiscal deficit in the central government budget in 2004 as well (82.7 million lats or 1.1 % of the GDP).

Chart 3 *Central government special budget execution in 2005 (%)*



In 2005, in compliance with Article 32 of the law "On Budget and Financial Management", the Republic of Latvia Report on Central Government Budget Execution and Local Government Budgets 2004 was prepared and after being approved by the Cabinet, together with the Republic of Latvia State Audit Office opinion concerning the Republic of Latvia Report on Central Government Budget Execution and Local Government Budgets 2004 and Report on the Republic of Latvia Report on Central Government Budget Execution and Local Government Budgets 2004 submitted to the Saeima (Parliament) (3 volumes, 839 pages).

Aggregation of the local government budget reports is an important task of the Treasury. In 2005, the Treasury drafted legislative acts of the Cabinet concerning the preparation and submission of monthly and quarterly reports, thereby ensuring that in 2006 the reporting entities will be able to submit and accept their monthly and quarterly reports electronically, no longer having to submit signed paper document copies of reports to the Treasury. As regards the submission of the monthly reports of local governments, for the second 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 technologies and uses the internet environment online. It is planned to implement modifications to this software in 2006, introducing electronic report validation; therefore, the Treasury organised regional informational seminars about the electronic validation software for local government and institution staff in 2005, in order to facilitate successful implementation of the software and prevent any potential ambiguity.

In compliance with the authority delegated by the Law on Budget and Financial Management, the Treasury drafted the following legislative acts of the Cabinet setting unified 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 2005:

1) June 21, 2005 Cabinet Regulations No.440 “Regulations on Fixed Asset Depreciation Ratios and their Application Provisions for Budget Institutions”;
2) June 21, 2005 Cabinet Regulations No.446 “Procedure for Preparation of Annual Reports of Central Government Budget Institutions and Local Governments” and December 13, 2005 Cabinet Regulations No.951 “Amendments to June 21, 2005 Cabinet Regulations No.446 “Procedure for Preparation of Annual Reports of Central Government Budget Institutions and Local Governments””;
3) June 21, 2005 Cabinet Regulations No.425 “Procedure for Local Governments to Prepare and Submit Monthly Reports on Budget Execution, Financing, Amount of Borrowing and Guarantees” and October 25, 2005 Cabinet Regulations No.812 “Amendments to June 21, 2005 Cabinet Regulations No.425 “Procedure for Local Governments to Prepare and Submit Monthly Reports on Budget Execution, Financing, Amount of Borrowing and Guarantees””;
4) June 28, 2005 Cabinet Regulations No.478 “Procedure for Development of Financial Plans”;
5) July 5, 2005 Cabinet Regulations No.487 “Procedure for Registration of Long-term Commitments of Institutions Financed from Budget”;
6) October 25, 2005 Cabinet Regulations No.811 “Procedure for Preparing Quarterly Financial Reports of Central Government Budget Institutions and Local Governments”;
7) November 15, 2005 Cabinet Regulations No.867 “Procedure for Keeping the Accounts in Budget Institutions”.

In preparation of the above legislative acts, 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 local governments and Latvian Association of Local and Regional Governments. The Treasury provides ad hoc consultations to local governments on report preparation and accounting issues personally, by telephone as well as in writing.

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. Already for the second year, the Treasury has been using the state budget information system’s sub-system called the *eKase* in central government budget execution. The purpose of the sub-system is to provide the Treasury services over the Internet.

With the *eKase*, the Treasury grants remote access to services for institutions financed from the budget and local governments, at the same time guaranteeing the required information security and confidentiality. 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 2005, 604 clients signed cooperation agreements on using the *eKase* system. 32% of the total lats flow is processed through the *eKase*.

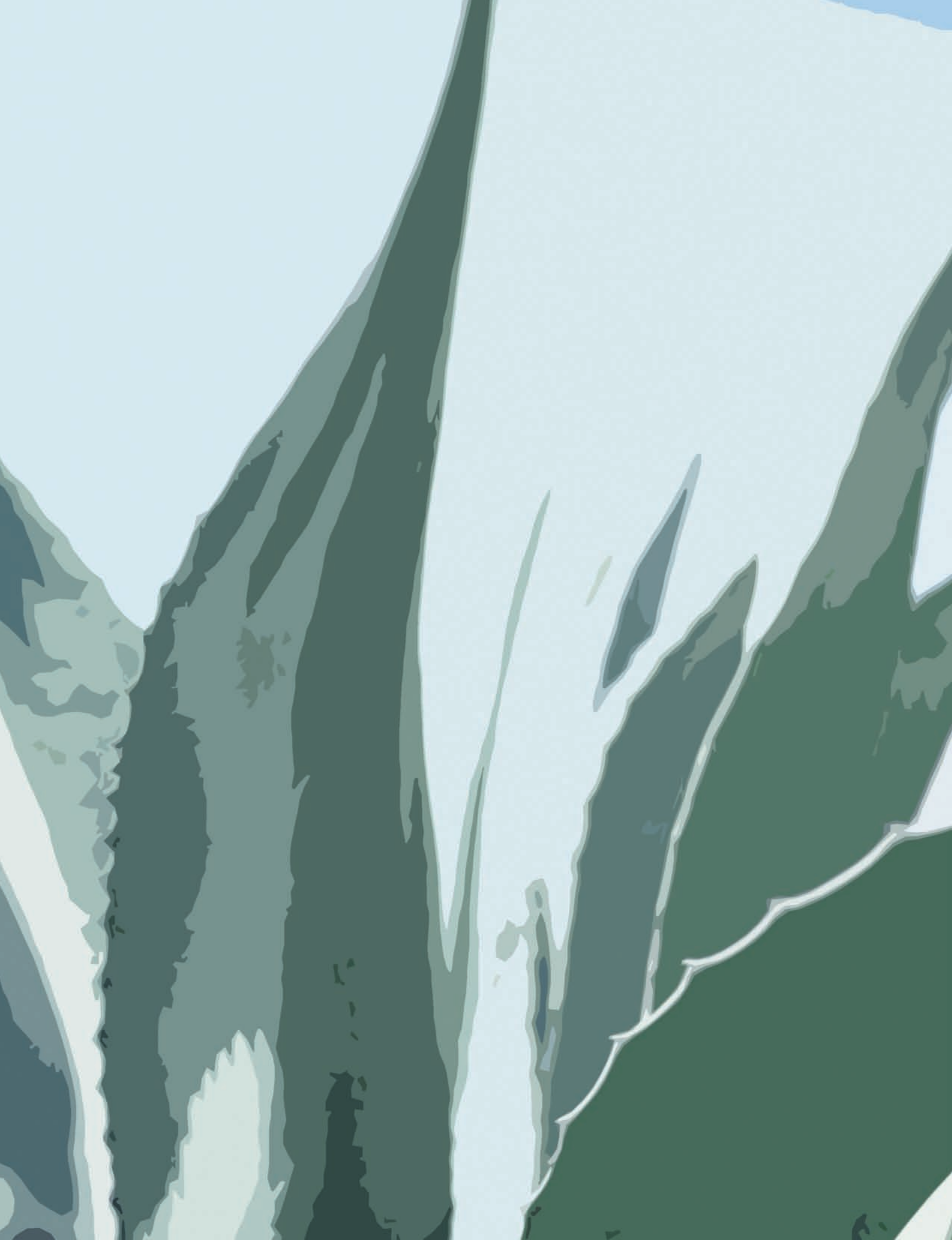
In June 2005, a cooperation project with the SSIA concerning disbursement of pensions and benefits via the *eKase* was launched. From July 1, 2005, the SSIA started transferring pensions and benefits directly into the client's bank account or Postal Settlements System account via the *eKase*. Thus, the SSIA used the opportunities provided by the *eKase* and, starting from July 1, 2005, no longer uses the services of intermediary banks to transfer pensions and benefits into client accounts. Currently, the SSIA makes approximately 600 000 payments per month via the *eKase*. Previously, monthly cash-less transfers made by the SSIA amounted to 58 000 lats. The service provided by the Treasury enables economy of central government budget, saving up at least 700 000 lats per year.

In order to facilitate implementation of the *eKase*, identify the potential problems and seek adequate solutions, the Treasury delivered presentations of the *eKase* at the regional Treasury Units in the beginning of 2005. 598 clients of the Treasury Units attended the presentations. To improve the Treasury's performance and the quality of services provided by the *eKase*, an *eKase* system's client survey was conducted in 2005. Proposals received were collated and taken on board in further work with the *eKase*. The survey data suggest that more than a half of respondents overall believe that the *eKase's* performance is good or excellent.

The Treasury considers that the *eKase* system is strategically significant and will continue its development and improvement in the future, offering the clients an access to a comprehensive and functional financial system. In 2005, gradual implementation of the "Concept for Review and Optimisation of the Functions of the Regional Treasury Units and Resources Required for their Implementation" started, concurrently with the implementation of the new information technology projects. 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 commenced, thus providing an opportunity to receive modern financial services and establishing the primary function of the Treasury Units' staff: providing consultations to clients.

On November 21, 2005, the Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T.) (an organisation ensuring standardised and safe interbank transmission of financial reports by using the telecommunications network) acknowledged that the Treasury has complied with the requirements previously set by the organisation and confirmed the Treasury's right to use the S.W.I.F.T. system in the status of an IMI (Investment Management Institution) from December 4, 2005. Participation in the S.W.I.F.T. enables the Treasury to receive and send payment information to the Bank of Latvia and credit institutions via an internationally recognised and safe interbank communication system and ensure swift information exchange. The Treasury uses the S.W.I.F.T. reporting system to confirm the provisions of the concluded financial deals and to exchange payment information.

While implementing the central government budget sub-programme "Contributions to international organisations" of the Ministry of Finance, the Treasury has made timely and full payments of annual participation fees payable by the Republic of Latvia to international organisations as well as made contributions to the capital and/or reserves of the international financial institutions, in which the Republic of Latvia holds capital shares, thus ensuring settlement of the undertaken commitments.



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 central government budget assets, engage in financial derivatives deals and other deals within the framework of the central government budget management as well as to organise granting and monitoring of the central government budget loans and guarantees.

The annual Law on State Budget sets the maximum allowable level of outstanding 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 government debt management in the medium-term are established by the Latvian Central Government Debt Management Strategy — approved by the Minister of Finance.

The amount of the 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 Plan for Attracting Resources, 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 it is discussed with the Bank of Latvia.

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 assets on time deposits with commercial banks and the Bank of Latvia in compliance with a Minister of Finance 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 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 regular information about Latvia, analyse the opinion concerning Latvia's development trends and potential risks. The investors use this information to assess the possibilities to invest in Latvia (including investment into government securities). Therefore, a credit rating is an important factor for Latvia ensuring availability of financing and it 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 specific government securities.

As delegated by the Minister of Finance, the Treasury ensures granting of the central government budget loans and servicing of the granted loans within the limits prescribed by the annual budget law.

Central Government Debt Management Strategy

In 2005, 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 for portfolio management, in order to ensure compliance with the debt portfolio parameters prescribed by the strategy.

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 March 2, 2005 by the Minister of Finance, and the main changes are as follows:

1) due to repegging the lats to the euro and in order to reduce the foreign exchange risk for the central government debt, it has been established that the benchmark for the net foreign currency debt is 100% euro with the allowable deviation of +/-5% (previously — in line with the composition of the SDR basket of currencies);
2) considering that the lats has been repegged from the SDR basket of currencies to the euro, thus reducing the foreign exchange risk for euro borrowing, and also the fact that the lats interest rates remained higher than the euro interest rates and Latvia was planning to join the single financial market of the euro area in a near future, thus reducing the weight of measures to promote the development of the domestic financial market, the minimum allowable share of the domestic currency debt in the portfolio was reduced.

The Latvian Central Government Debt Management Strategy distinguishes between the debt portfolio management and the 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 domestic currency debt;
2) maturity profile;
3) the share of fixed rate;
4) weighted average 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:

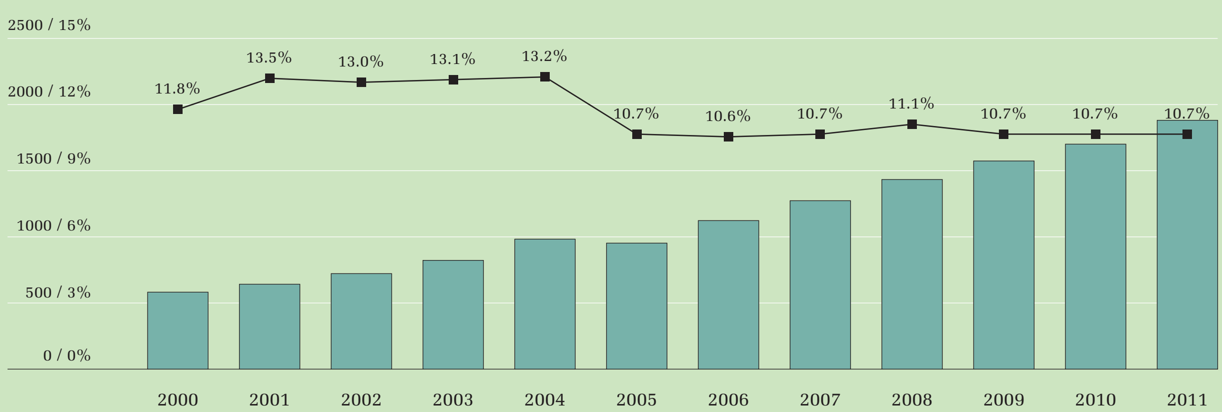
1) to ensure continuous opportunities for attracting financial resources:
2) to maintain the daily minimum reserve liquidity;
3) to perform each borrowing transaction in a professional manner;
4) to foster the development of financial markets;
5) when engaging in borrowing transactions, ensure compliance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

Changes in the Central Government Debt in 2005

Taking into account that the law "On State Budget 2005" stipulated that the fiscal deficit of the central government budget, which needs to be financed, would be 141.2 million lats, whereas the actual deficit amounted to 98.7 million lats, not all of the planned borrowing measures were implemented in 2005, including the European Investment Bank (EIB) loans to co-finance the transport infrastructure projects and co-finance the projects financed from the EU structural funds and the Cohesion Fund were not used. In 2005, the central government debt refinancing operations and early repayments of several loans amounted to an equivalent of 35.2 million lats. Although the central government debt was pushed up in 2005 as a result of overtaking the commitments of the SJSC *Latvian Mortgage and Land Bank*, in course of the year the central government debt 20.3 million lats and as of 31 December 2005 totalled 960.3 million lats (at nominal) or 11.2% of GDP, which is below the maximum end-of-the-year debt limit of 1 114.0 million lats stipulated in the law "On State Budget 2005".

The forecasts of the Treasury and the Ministry of Finance suggest that the central government debt will not exceed 12% of GDP (see Chart 4) in the medium-term.

Chart 4 *Growth of the Central Government Debt (in millions, LVL) and Growth Forecast (% of GDP)*



Source: The Treasury

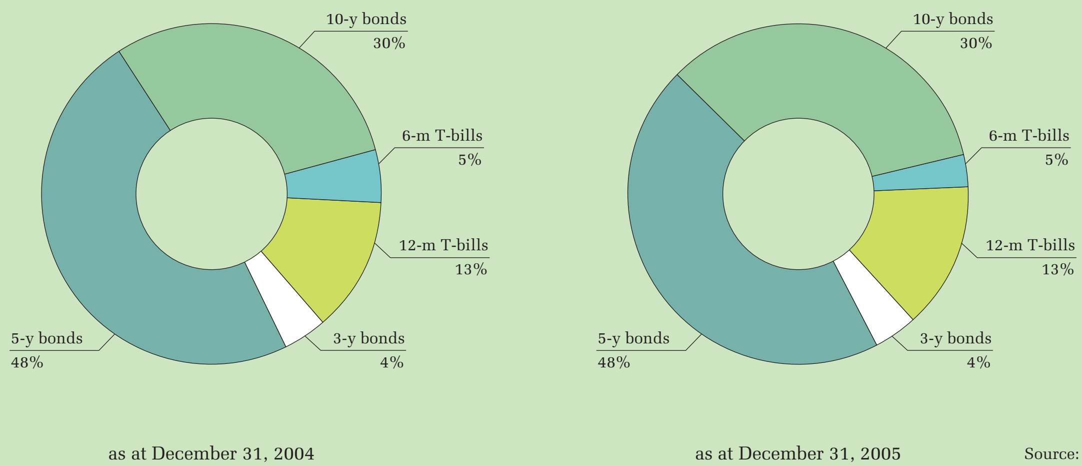
as at 01.05.2006.

Domestic Debt of the Central Government

As at 31 December 2005, the domestic (lats) debt of the central government amounted to 422.95 million lats at nominal.

In 2005, the domestic debt had a "zero growth", i.e. the domestic market securities to the redeemed in 2005 were refinanced using other government debt domestic securities, thereby even slightly reducing the outstanding amount of these securities. Considering the convergence of the long-term lats and euro interest rates and the existing macroeconomic risks, the Funding Plan 2006 provides for an increase in the domestic debt by about 121 million, mainly as a result of increasing the share of outstanding securities with a 5- and 10-year maturity. In 2005, the shares of the various types of outstanding government domestic securities in the domestic debt have slightly changed (see Chart 5).

Chart 5 *Domestic debt by type of borrowing (%)*



Source: The Treasury

In 2005, four issues of 6-month T-bills were released amounting to 20.18 million lats, which is 9.8 million lats less than in 2004, and six issues of 12-month T-bills amounting to 57.59 million which is 4.5 million lats more than in 2004. 5- and 10-year bond issue programmes totalling 61.61 million were also implemented.

Foreign Debt of the Central Government

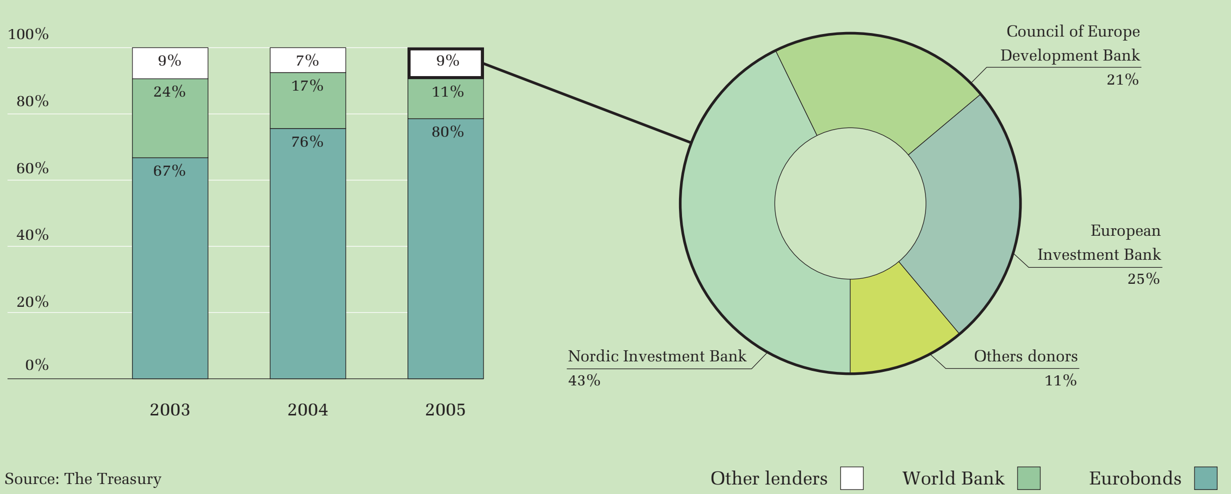
As at 31 December 2005, the foreign (foreign currency) debt of the central government amounted to 537.36 million lats at nominal.

In 2005, the foreign debt shrank by 17.6 million lats as a result of early repayment of several foreign loans, including the repayment of the World Bank "PSAL I" loan in the amount of 41 million US dollars, Japanese Bank for International Cooperation — JBIC (previously — Export-Import Bank of Japan) Rehabilitation loan in the amount of 5.6 million lats, Japanese Bank for International Cooperation and European Bank for Reconstruction and Development loans in the amount of 423 million Japanese yens and 3.7 million US dollars, as well as early repayment of World Bank loan used to implement Riga solid waste management project.

Early repayment of the above loans was partly (in the amount of 22 million lats) financed from proceeds from the financial derivatives deals concluded in 2004 and 2005, applied to ensure the compliance with the open foreign currency position and interest rate duration parameters prescribed in the Latvian Central Government Debt Management Strategy .

As at December 31, 2005, the major part (78%) 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 *Foreign currency debt by type of borrowing (%)*



Source: The Treasury

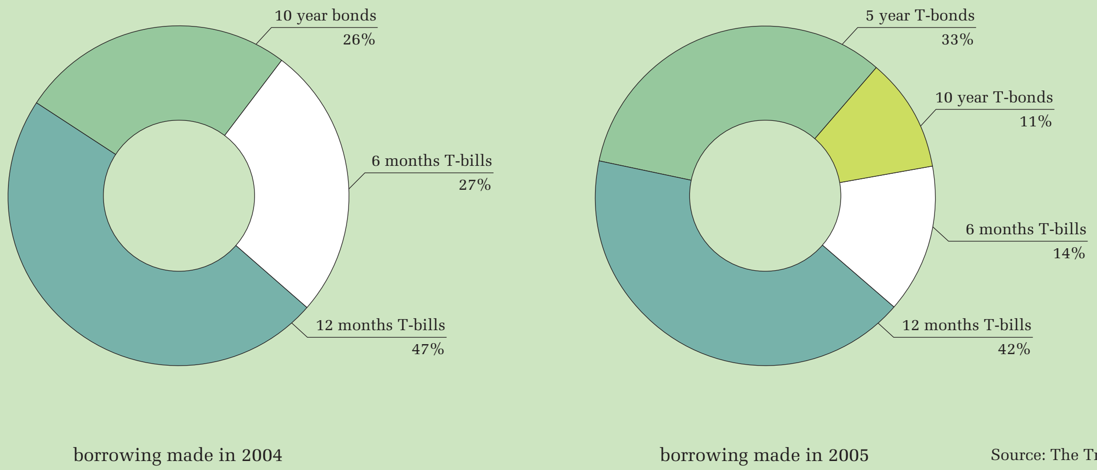
Management of the central government borrowing

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 2005, almost all planned government securities issues were placed on the domestic market (it was planned to issue securities in the amount of 142.1 million lats, whereas the actual amount issued was 139.4 million lats). The actual amount was slightly smaller mainly as a result of cancelling one 1-year T-bills auction in August 2005 due to better than planned budget execution. In the course of 2005, the amount of outstanding government securities shrank by 2.3 million lats to stand at 420.7 million lats. Similarly as before, 56% of the total financing used were short-term (6- and 12-months) T-bills, whereas 44% of the total financing used were medium-term (5-year) and long-term (10-year) Treasury bonds in 2005.

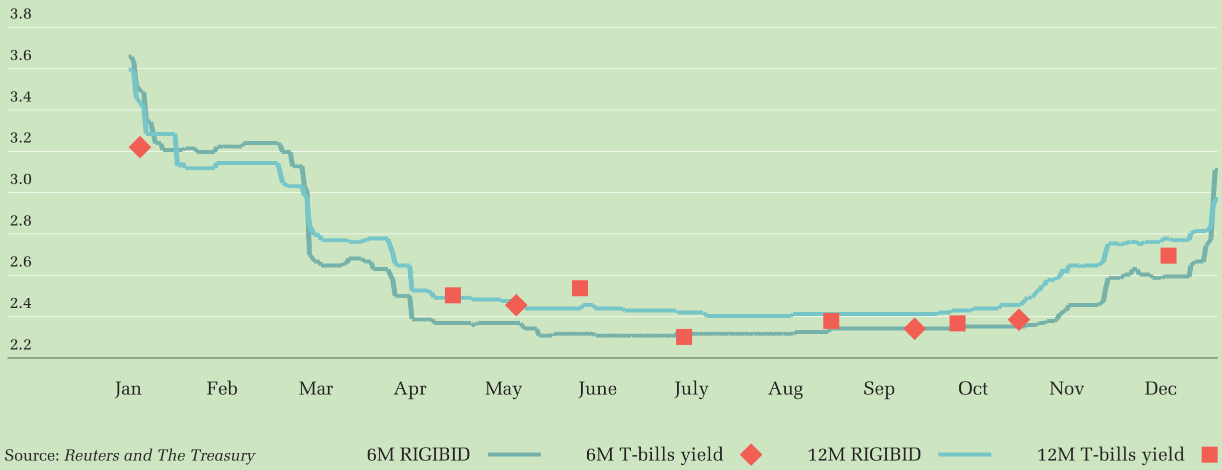
Chart 7 *Domestic borrowing by type of securities (%)*



Source: The Treasury

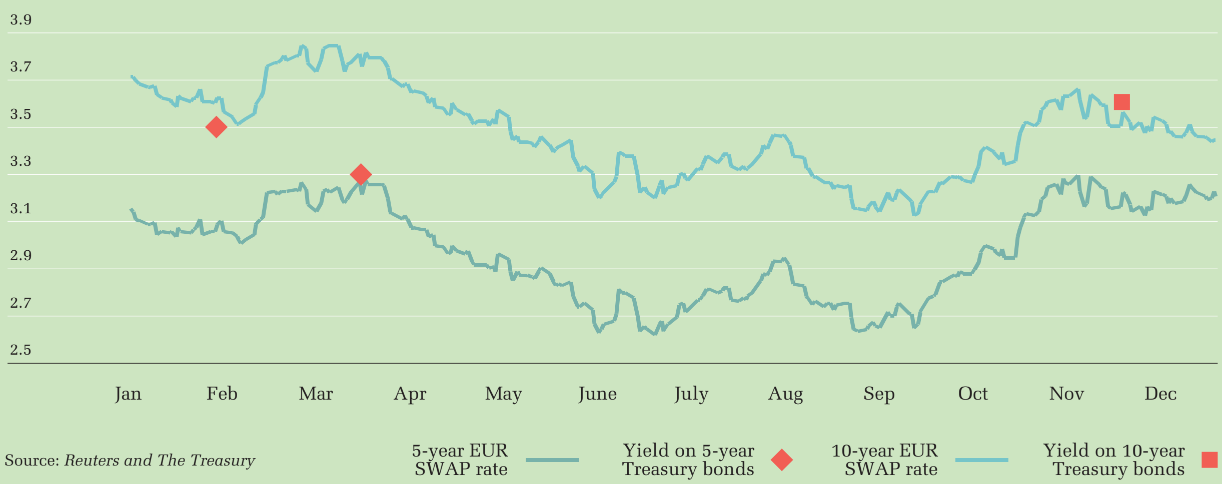
In 2005, the interest rates on the short-term domestic government securities reached an all-time-low levels. Throughout the year, the interest rates on T-bills were broadly stable at 2.35%–2.55%, except at the 6-month T-bills auction at the beginning of 2005, after which the interest rates declined, reaching the minimum at the first auction organised via the Riga Stock Exchange system SAXESS in July 2005 (2.302%). The most significant factor pushing down the short-term interest rates relates to the convergence of foreign currency and lats interest rates, directly affected by the Bank of Latvia's decision to peg the national currency to the euro (single European currency) from January 1, 2005. At the end of the year, with the Bank of Latvia raising the minimum reserve ration for commercial banks from 6% to 8%, the rates on T-bills slightly rose from the historically lowest levels and reached 2.681% at the December auction, preserving the upward trend in the future as well (up to 3% on average). Taking into account that primary auctions of short-term T-bills are mainly organised in the second and third quarter, overall borrowing has been successful from the point of view of both the timing of the planned issues and relative costs (see Chart 8). Average yields on medium-term and long-term Treasury bonds at the primary auctions were also at their historical lows, with the yields on 5-year bonds reaching 3.30%–3.50%, whereas those on 10-year bonds dropping to 3.621%, which is significantly lower than at 2004 auctions (4.86%–4.88%). This was mainly the result of deeper convergence between the medium-term and long-term interest rates in lats and euro as well as the fact that, with the economic activity remaining low, the euro area long-term interest rates reached a historically low levels since the implementation of the single currency (see Chart 9).

Chart 8 *Yields on 6- and 12-month T-bills and 6- and 12-month RIGIBID rates 2005 (%)*



Source: *Reuters and The Treasury*

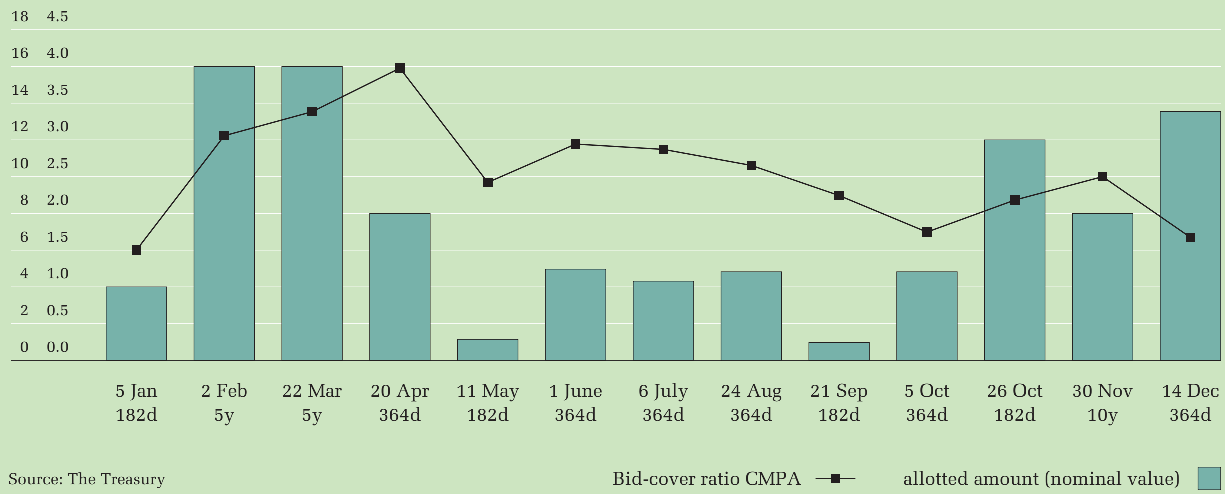
Chart 9 *Yields on 5- and 10-year lats Treasury bonds and 5- and 10-year EUR SWAP rates (%)*



Source: *Reuters and The Treasury*

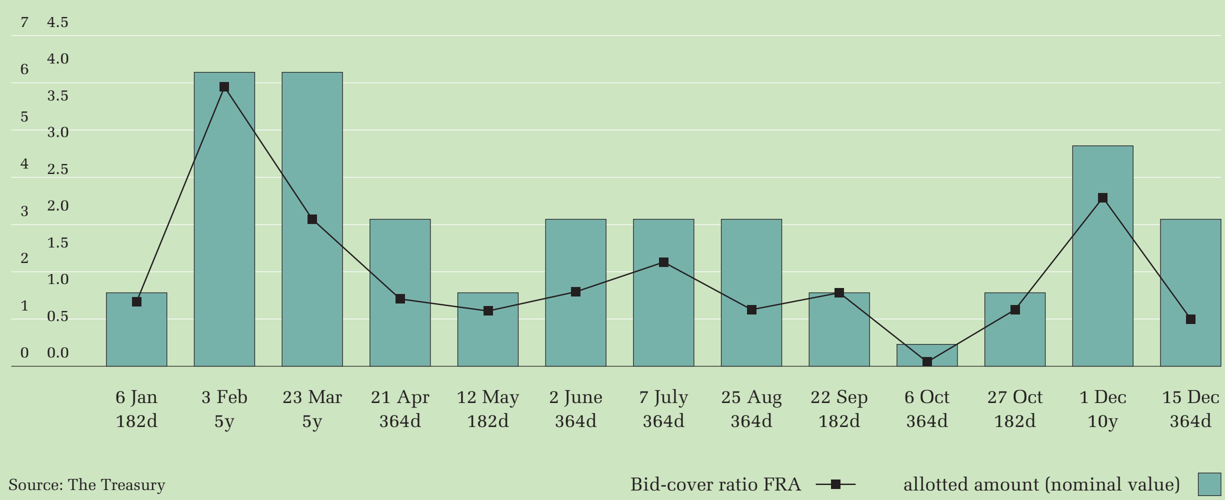
Evaluating the investors' activity on the primary market for government securities within the reporting period, it has to be noted that the bids at both auctions for T-bills and government bonds were quite high and exceeded the Treasury's offering amount 2.6 and 2 times on average at the competitive mulit-price auctions and fixed rate auctions, respectively (see Chart 10 and 11). This factor has ensured a standing possibility to attract the required lats liquidity whenever warranted by the financing needs.

Chart 10 *Primary trading activity for government securities at competitive multi-price auctions in 2005 (in LVL million/Bid-cover ratio CMPA)*



Source: The Treasury

Chart 11 *Primary trading activity for government securities at fixed rate auctions in 2005 (in LVL million/Bid-cover ratio FRA)*



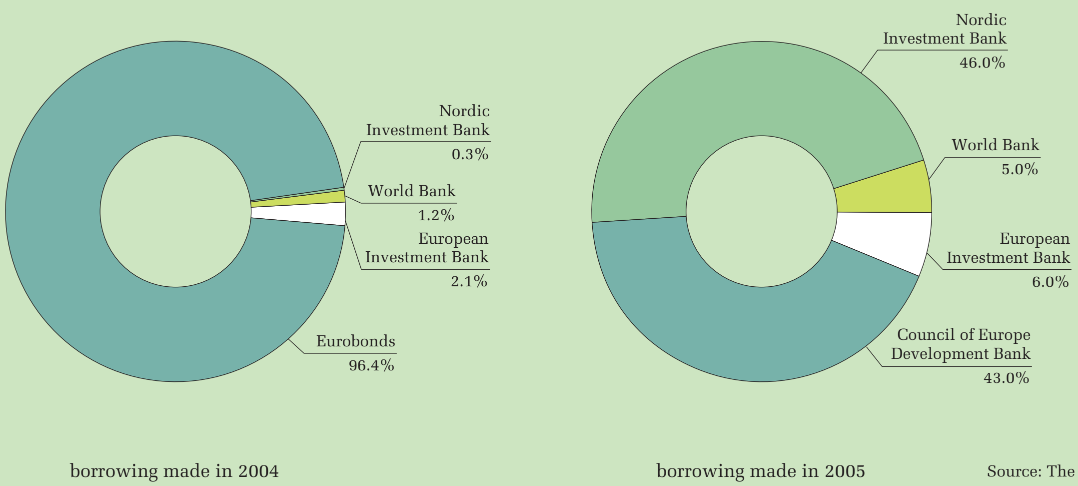
Source: The Treasury

In 2005, the Treasury implemented an important project for improvement of the domestic government borrowing mechanisms and technologies: from July 1, 2005 primary placement of government securities is effected by using the SAXESS system offered by Riga Stock Exchange acting as a primary placement agent for government securities, thus improving the efficiency of the primary government securities placement mechanism and increasing the investors' interest about investment in government securities. As a result, direct participation of foreign investors (banks) was observed at several auctions after the new procedure was introduced. The attitude of local financial market participants towards these changes is also favourable, as suggested by the yield rates on government securities that have dropped to their historical lows since launching the government securities issues. Virtually at all primary auctions of government securities bids considerably exceeded the allotment amounts, and the only reason why not all the government securities were sold as planned was the significantly better than expected central government budget execution. The fact that the auctions are fully managed by the Treasury, while the Riga Stock Exchange offers the technical solution used in public debt management by other European countries as well is also a good primary market development.

Foreign borrowing

Taking into account that mainly domestic borrowing was used to cover the financing needs of the central government budget in 2005 and the proceeds from the Eurobond issue launched in 2004 were also still available, no Eurobonds were issued in 2005 and the amount of external financing used is relatively small (24.8 million lats[2] within the framework of previously signed contracts with international financial institutions (see Chart 12).

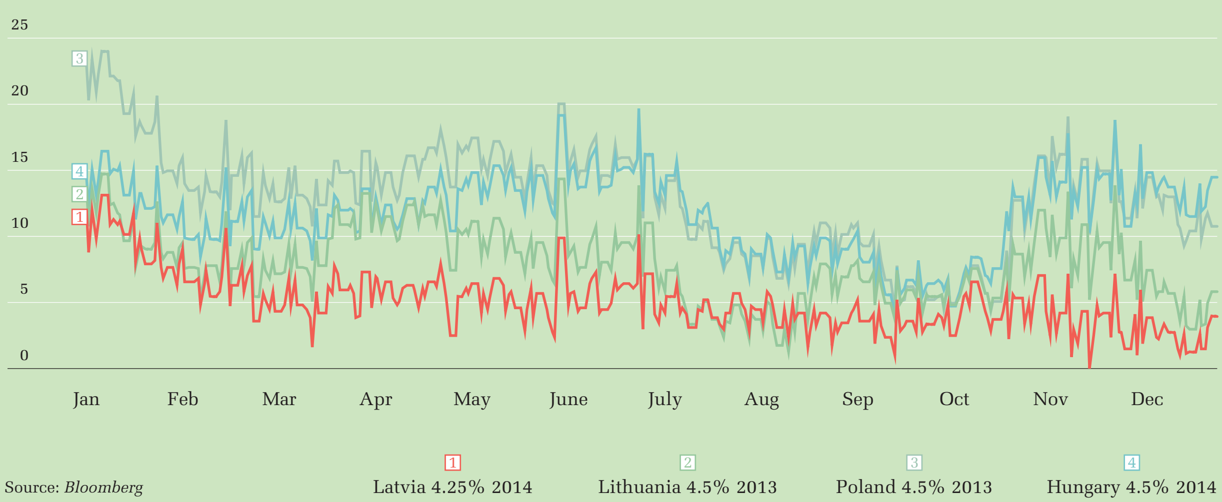
Chart 12 *Actual foreign borrowing (%)*



Source: The Treasury

Nevertheless, the spread of the 2004 Eurobonds over the euro swap rates narrowed further, enabling Latvia to receive the required financing on international capital markets at more favourable terms and conditions than some "old" EU Member States (Greece, Italy). Latvia's spread above the euro swap rates continued to decline in 2005 and reached 3–5 basis points at the end of the year.

Chart 13 *The spread of Latvian, Polish, Lithuanian and Hungarian 10-year euro bonds over EUR SWAP benchmark rates in 2005*



Source: *Bloomberg*

[2] Including the taken over *Latvian Mortgage and Land Bank's* commitments in Nordic Investment Bank and Council of European Development Bank.

On September 29, 2005, an agreement was signed in Riga between the Republic of Latvia and the European Investment Bank about a 150 million euro loan to ensure central government co-financing to the EU Cohesion Fund projects and part of the EU structural funds projects. One of the most significant provisions that make the European Investment Bank loan especially attractive, as financing is the drawdown flexibility granted to the Republic of Latvia and no other commissions being charged on the borrower apart from the interest rate. According to the contract, it is planned to start drawing down from this loan in 2006, by receiving a part of the loan amounting to 75 million euro from the European Investment Bank.

Central government debt portfolio management

In 2005, the objective of the central government debt portfolio management was 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 the financial risks, preventing uncontrolled growth of the costs of financial resources. 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. The strategy provide for the use of financial derivatives in order to attain the objectives and implement the tasks prescribed in the Latvian Central Government Debt Management Strategy.

In order to assess how the Latvian Central Government Debt Management Strategy has been implemented, the actual debt portfolio composition parameters as at December 31, 2005 have been compared against the debt portfolio composition parameters as at December 31, 2004 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 ones set in the Latvian Central Government Debt Management Strategy*

Parameters	Actual debt composition prameters as at 31.12.2004				Actual debt composition prameters as at 31.12.2005		Debt composition prameters set in the strategy[3]	
Share of the lats debt	43%				43%		> 35%	
Maturity profile	< 1 year 15%		< 3 years 35%		< 1 year 19%	< 3 years 43%	< 1 year < 25%	< 3 years < 50%
Share of fixed rates	67.60%				63.48%		60 - 70%	
Interest rate duration (in years)	3.39				3.18		3.25 (+/- 0.25)	
Currency composition Net foreign currency debt	EUR 37.00%	USD 38.00%	GBP 12.00%	JPY 13.00%	EUR 99.96%		EUR 100.00% (+/- 5%)	

Source: The Treasury

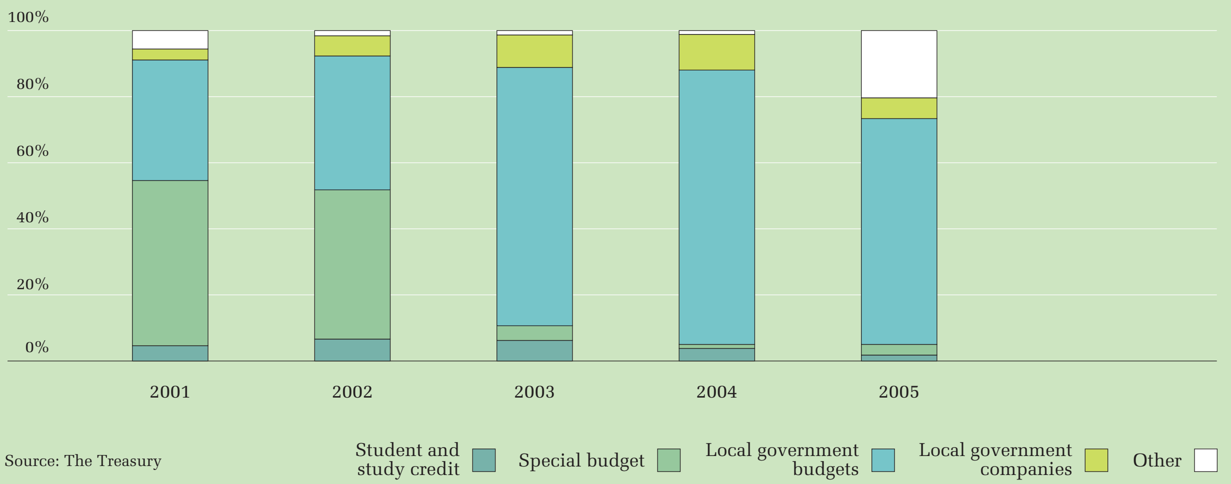
In 2005, all the debt portfolio composition parameters set in the Latvian Central Government Debt Management Strategy have been complied with, including the maturity profile, optimum share of the fixed interest rate, interest rate duration as well as the net foreign currency debt composition. In April 2005, the interest rate duration exceeded the upper limit set in the Latvian Central Government Debt Management Strategy. In order to depress the duration to the level set in the Latvian Central Government Debt Management Strategy, at the same time also reducing the share of the fixed rates in the debt portfolio, the Treasury entered into a 9-year swap on April 7, 2005, linking it to a part of the euro bond issue launched in 2004. As a result of this deal, the duration was decreased to 3.49 years, which is compliant with the allowable limit set in the strategy.

[3] From 2005, the open currency position set in the Latvian Central Government Debt Management Strategy is repegged to the euro (from the SDR basket of currencies).

Central government budget lending

Every year, loans from the central government budget are granted in accordance with the provisions of the annual law on state budget. The structure of the central government budget loans has changed in the course of time (see Chart 14): in 2001, the largest share of the central government budget loans was granted to 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.

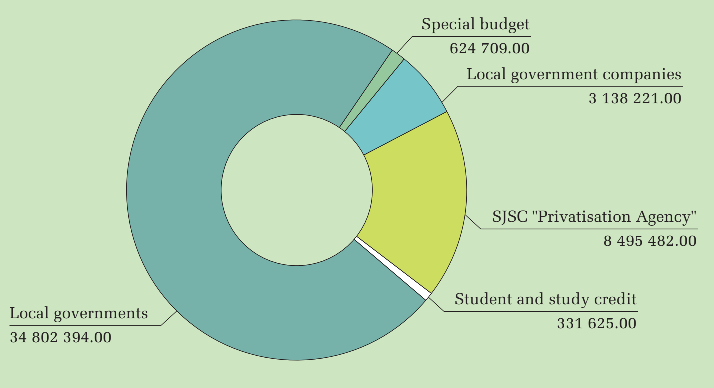
Chart 14 *Loans granted from the central government budget (%)*



Source: The Treasury

In 2005, loans in the amount of 47 392 431 lats were granted from the central government budget (see Chart 15).

Chart 15 *Loans granted from the central government budget by beneficiary (in LVL)*



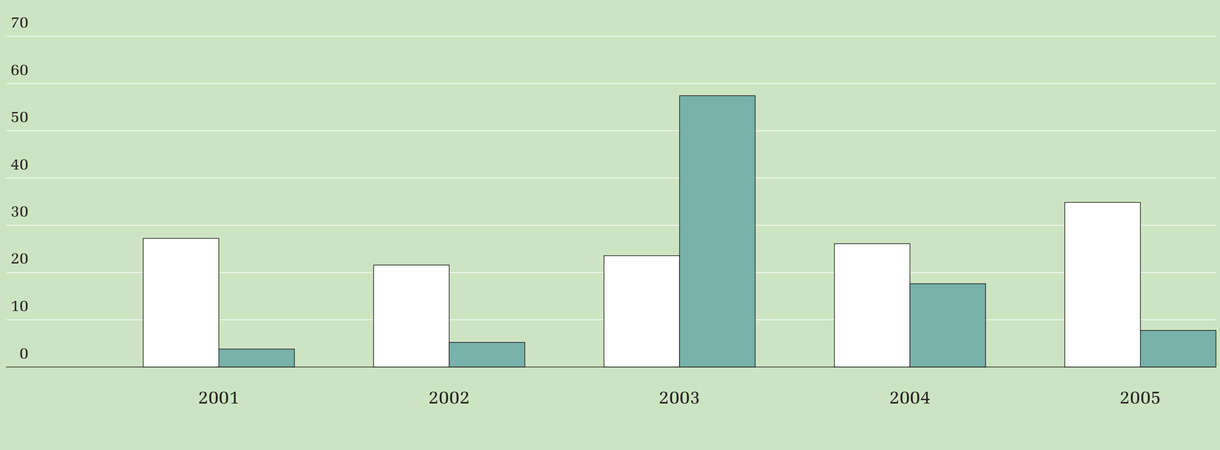
Source: The Treasury

During 2005, the fixed 10-year interest rate on the central government budget loans granted in lats was 4.0%-5.36%, 1-year rate was 2.87%-4.25%, whereas the 5-year rate on the central government budget loans was 3.8%. To the new central government budget loans granted in 2005 the EIB funding, the floating interest rate set by the European Investment Bank was applied: 2.60%-2.65% per annum on loans granted in euro. The applicable annual rate on the US dollar-denominated loans was 3.56%-4.02% (US dollar loans were granted from the credit facility of the Nordic Investment Bank and in accordance with the agreements concluded during the previous years, where the funding was not yet used in full).

The largest percentage share of all loans granted from the central government budget is comprised of the central government budget loans to local governments. The borrowing procedure for the local governments is set by December 17, 2002 Cabinet Regulations No.543 “Regulations on Local Government Borrowing and Guarantees”. Local governments may borrow in Latvia and abroad by issuing securities or concluding borrowing agreements. The annual law on state budget stipulates the total allowable increase in the local government borrowing and guarantee commitments (The Law “On State Budget 2005” stipulates that the local government borrowing and guarantees are allowed to increase by a maximum of 43 283 918 lats, including the borrowing may increase by a maximum of 29 283 918 lats).

In 2001-2005, the Treasury has maintained its dominating role in granting loans to local governments, except in 2003, when Riga City Council and Daugavpils City Council were allowed to take long-term loans outside the Treasury and beyond the set local government borrowing limits in the total amount of 54.5 million lats, for the purpose of refinancing short-term commitments (see Chart 16).

Chart 16 *Loans granted to local governments in 2001–2005 by donor (in millions, LVL)*



Source: The Treasury

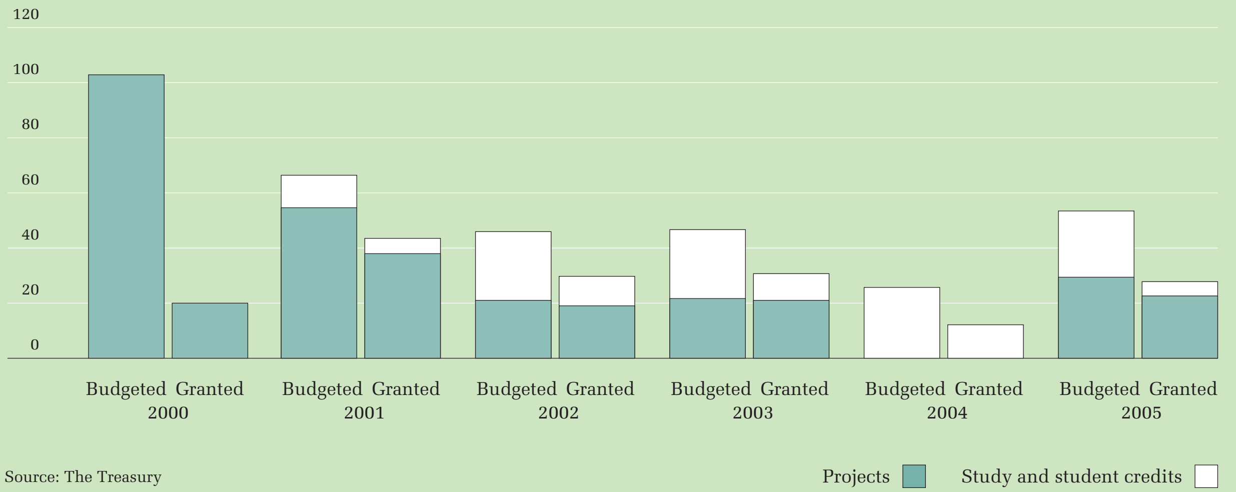
The Operational strategy of the Treasury sets an objective of attaining a dominating role in granting loans to local governments for the Treasury, achieving that the total share of the central government budget loans to local governments amounts to 65% of the total loan portfolio of the local governments.

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 and within the limits set in the annual law on state budget, if they commit public funds for implementation of the Public Investment Programme projects and business support programmes, as well as study and student credit. Guarantees are issued in accordance with the Cabinet Regulations No.513 "Procedure for Issuing and Monitoring Guarantees" adopted on July 12, 2005.

57 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 17.

Chart 17 *Amounts of issued guarantees against the provisions of the annual state budget law 2000-2005 (in millions, LVL)*



Source: The Treasury

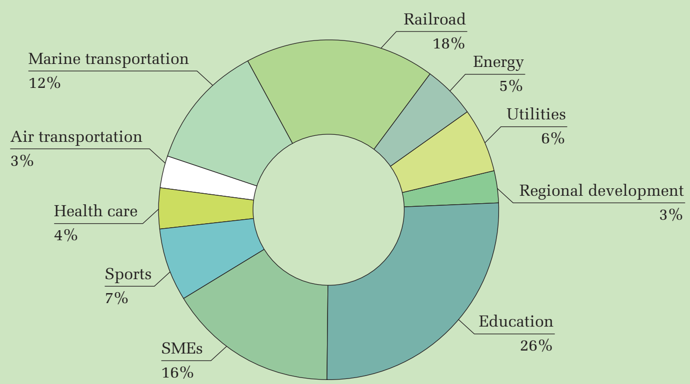
The 2005 Law on State Budget provided for guarantees for *Latvian Mortgage and Land Bank* commitments with regard to credits issued to Latvian micro- and small enterprise development projects in the amount of 30 million lats and student and study credits in the amount of 24.84 million. In practice, guarantees in the amount of 14.12 million lats have been granted to student and study credits, whereas granting guarantees for *Latvian Mortgage and Land Bank* commitments has been transferred to 2006.

Nevertheless, guarantees granted for project implementation have grown by 15.63 million lats in 2005, as an agreement on the Nordic Investment Bank was signed between Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden on February 11, 2004, and Latvia became a full-fledged member of the Nordic Investment Bank on January 1, 2005. To meet the commitments following from the above agreement, two guarantee agreements were signed, which were approved by the Cabinet on 21 December 2004 by Regulations No.1052 "On Guarantee Agreement between the Republic of Latvia and the Nordic Investment Bank as Concerns Lending to Environmental Investment Projects and Guarantees for Lending to Environmental Investment Projects in Compliance with Article 7 and 9 of the Statutes Annexed to the Agreement on the Nordic Investment Bank singed on February 11, 2004 between the Kingdom of Denmark, Republic of Estonia, Republic of Finland, Republic of Iceland, Republic of Latvia, Republic of Lithuania, Kingdom of Norway and Kingdom of Sweden".

The balance of the outstanding loans guaranteed by the government amounted to 141.28 million lats at the and of 2005.

Loans guaranteed by the government have been granted to support various sectors. 26% of the total guarantees granted were extended to education, 18% to railroad, 12% to marine transportation, 16% to promotion of development of the small and medium-sized companies (see Chart 18).

Chart 18 *Breakdown of government-guaranteed loans by areas as at the end of 2005 (%)*



Source: The Treasury

The majority of the government-guaranteed loans were received from foreign donors, comprising 58% of the total guarantees. The remaining 42% have been lent by domestic donors. The biggest donor for guaranteed loans is the European Investment Bank (40% of the total guaranteed loans), the second biggest being the Parex Bank (12%).

2006 budget provides for government guarantees totalling 115.65 million lats, of which 24.84 million lats for study and student credits, 30 million lats to *Latvian Mortgage and Land Bank* for loans to development projects of micro- and small enterprises of Latvia, 51.51 million lats for implementation of 8 Latvian hospital projects, and 9.3 million lats for supporting 2 projects of the Latvian Olympic Committee.

Liquidity management

Based on the task established in the Latvian Central Government Debt Management Strategy to ensure availability of daily minimum reserve of financial resources, in order to settle the financial commitments of the central government in due time and in full amount, identify and prevent situations that could impair the liquidity of the financial resources, the Treasury prepares the Treasury's Regulations for Ensuring Liquidity, setting the liquidity ensuring requirements and compliance procedure for those requirements.

The Treasury engages in the following activities with a view to comply with the requirements set in the Regulations:

1) monitors the stock of the liquid financial resources, as well as compliance with the liquidity limits and liquidity reserve;
2) timely identifies and prevents situations that may impair the financial liquidity and create a payment or liquidity crisis;
3) ensures constant opportunities to attract financial resources and places the temporarily free funds, so that to maintain adequate stock of liquidity which would ensure the required liquidity reserves and compliance with liquidity limits within the relevant period.

Compliance with the liquidity requirements prevents the risk of payment or liquidity crisis. In its daily asset management, the Treasury complies with the set liquidity requirements.

The Treasury places the temporarily free funds on time deposits with commercial banks and the Bank of Latvia in compliance with the Treasury's counterparty limits, placing the funds at the highest offered rate and thus increasing the central government budget revenue from placement of the free central government funds. In order to assess the effectiveness of the placement of the temporarily free funds, the Treasury drafted a benchmark-setting model for placement of the temporarily free funds in 2005, as well as approved return on investment benchmarks, based on the financial market rates. Comparing the rates started in the fourth quarter of 2005, on average, the Treasury placed the temporarily free funds above the benchmark in the fourth quarter of 2005, which points to effective investment of the temporarily free funds.

In 2005, 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 has also monitored the stock of liquid funds: the compliance with the liquidity limits and maintenance of the liquidity reserve. In 2005, to ensure liquidity funds were raised from 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). If necessary, additional liquidity can be raised by taking short-term loans on the money market (agreements on money market deals have been concluded), established standing borrowing facility.

In 2005, the Treasury ensure 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 stated benchmarks.

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 (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, ensure effective management and monitoring of structural funds in accordance with the provisions of the EU Regulations and guidelines.

When checking (certifying) the submitted EU policy instrument claims or 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 rights 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.

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

In April 2005, the Treasury as the Paying Authority for the EU structural funds made the first disbursements within the framework of the European Social Fund.

Overall, the Treasury has verified 1520 payment orders and made structural funds disbursements in the amount of 49 332 lats within the framework of the EU structural funds.

9 EU structural funds Declarations of Expenditure claiming 47 598 euro from the European Commission were submitted to the European Commission in 2005.

Table 2 *Declarations of Expenditure for the EU structural funds submitted to the European Commission and funding received from the European Commission (in thousands, EUR)*

Fund	**Claim date**	**Claimed amount**	**Amount calculated by the Treasury[4]**	**Amount received from the European Commission**
ERDF	06.06.2005.	5 270	5 270	5 270
ERDF	15.11.2005.	6 047	6 047	6 047
Total ERDF		11 317	11 317	11 317

[4] The Treasury calculated the amount to be expected from the European Commission, as the intensity of the European Community financing to activities is different throughout a measure and the European Commisison makes reimbursement based on the European Commission financing rate set for the measure in the financial table of the Single Programming Document.

EAGGF	24.02.2005.	6 483	5 431	5 431
EAGGF	21.07.2005.	15 161	13 230	13 230
EAGGF	14.10.2005.	9 437	8 090	8 090
total EAGGF		**31 081**	**26 751**	**26 751**
FIFG	24.02.2005.	1 981	1 981	1 981
FIFG	21.07.2005.	3 229	3 229	3 229
FIFG	14.10.2005.	1 236	1 236	1 236
total FIFG		**6 446**	**6 446**	**6 446**
ESF	24.11.2005.	3 084	3 084	3 084
total ESF		**3 084**	**3 084**	**3 084**
Total for structural funds		**51 928**	**47 598**	**47 598**
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.

The first disbursements within the framework of the European Community initiative EQUAL were made in June 2005 and already in August the Treasury certified the first Declaration of Expenditure and sent a claim for 88 thousand euro to the European Commission. In November 2005, another EQUAL Declaration of Expenditure claiming 296 thousand euro was forwarded to the European Commission. Overall, 36 payments amounting to 602 thousand lats were made from the EQUAL in 2005.

Table 3 *Declarations of Expenditure for the EQUAL submitted to the European Commission and funding received from the European Commission (in thousands, EUR)*

Initiative	**Claim date**	**Claimed amount**	**Amount received from the European Commission**
EQUAL	19.08.2005.	88	88
EQUAL	23.11.2005.	296	296
Total EQUAL		**384**	**384**
Source: The Treasury			

44 EU Declarations of Expenditure claiming 49 145 euro from the European Commission were submitted to the European Commission in 2005 within the framework of the Cohesion Fund. The Treasury disbursed 72 831 euro or 51 186 lats from the Cohesion Funds in 2005.

It has to be noted that the amount of expenditure certified within the framework of the EU structural funds, Cohesion Fund and the European Community initiative EQUAL and the number of Declarations of Expenditure has considerably increased in 2005, pointing to progress in spending the funding.

Table 4 *Comparison of expenditure certified for the European Commission in 2005 with the 2004 data (in thousands, EUR)*				
EU policy instrument	**2004**		**2005**	
	Certified declarations	**Certified expenditure**	**Certified declarations**	**Certified expenditure**
Cohesion Fund	15	16 968	44	74 102
Structural funds	3	4 256	9	73 034
EQUAL	0	0	2	512
Total	**18**	**21 224**	**55**	**147 648**
Source: The Treasury				

In 2005, the number of Declarations of Expenditure submitted to the European Commission increased three times, whereas the amount of certified expenditure — seven times.

To achieve the indicators set in the operational strategy and accelerate spending from the EU policy instruments, including receipt of funding from the European Commission, the Treasury in its quality management documents provides for shorter payment document processing and Declarations of Expenditure verification periods than requested by laws and regulations.

The Treasury acts as a Paying Authority also for the European Economic Area and Norwegian government financial mechanisms, and has planned to develop quality management documents for implementation and administration of those mechanisms in 2006.

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.

In 2005, the Treasury received for management purposes from the SSIA state funded pension scheme assets in the amount of 5 503 396 lats and redeemed investment plan shares in the amount of 6 471 626 lats. On December 31, 2005, the net assets value of the Treasury's investment plan amounted to 14 673 597 lats, which is 301 501 lats less than at the end of 2004.

Table 5 *Performance results of the investment plan[5] (in millions, LVL)*

	Quarter I 2005	Quarter II 2005	Quarter III 2005	Quarter IV 2005
Value of investment plan assets	15.643	15.616	15.404	14.683
Time deposits	3.554	3.033	2.977	2.397
Debt securities	11.749	12.388	12.426	12.285
Including government debt securities	10.607	11.229	11.269	11.162
Including mortgages	1.142	1.159	1.157	1.123
Cash	0.340	0.195	0.001	0.001
Investment plan liabilities	(0.130)	(0.010)	(0.010)	(0.010)
Total investment plan value	15.512	15.606	15.394	14.674
Change, % against previous period	3.59%	0.61%	(1.35%)	(4.68%)
Investment plan share value, in lats	1.2160399	1.2308127	1.2406082	1.2445219
Change, % against previous period	2.02%	1.22%	0.80%	0.32%
Weighted average investment maturity, in years	2.86	2.84	2.68	2.60

Source: The Treasury

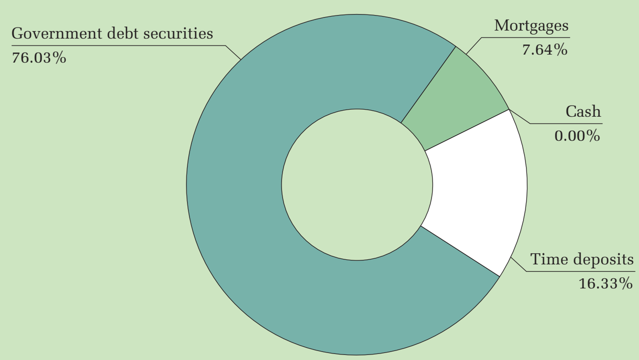
Although the asset value has decreased and it's been three years, since private asset managers have been engaged in management of the second tier state funded pensions, the Treasury's investment plan still occupies a stable niche and The Treasury is one of the biggest state funded pension scheme assets managers. The net assets of the Treasury's investment plan amount to 17.82% of the total net assets of the second tier. 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 (September 7, 2001) amounted to 5.12%.

[5] As on the last date of the relevant quarter.

Table 6 *Profitability of the investment plan*[6]					
1-month	**3-months**	**6-months**	**1-year**	**2-years**	**Since start of operation**
6.03%	1.24%	2.20%	4.35%	4.48%	5.12%
Source: The Treasury					

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. As of December 31, 2005, 16.33% of total investment plan assets were placed with banks; 76.06% of total assets were invested in domestic government securities and 7.63% in mortgages.

Chart 19 *Investment portfolio*[7] *(%)*



Source: The Treasury

Although the lats interest rates rose significantly towards the end of 2005, reflecting a significant liquidity deficit in the Latvian interbank sector, which mainly formed starting from December 24, 2005, when the Bank of Latvia raised the minimum reserve ration to 8%, 1-year RIGIBOR overall declined by 0.72% points in 2005 to stand at 3.52% at the end of the year. Prices on the debt securities market went up sharply at the end of the year, pushing the yields down. In 2005, the annual yield on short-term Treasury bills fluctuated from 2.30%-3.29%, medium-term securities 1.81%-3.50%, long-term securities 3.20%-4.10%, mortgages 3.75%-5.40%. Overall yield of the Plan as at December 31, 2005 amounted to 4.35%, exceeding the corresponding maturity RIGIBOR rate. As at December 31, 2005, the value of one share of the investment plan was 1.2445219 and had increased by 21.48% since the start of operation.

Profitability of the investment plan has decreased by 0.25% points year-on-year. This can be explained by both shrinking of the assets, which was affected by the fact that share redemptions exceeded receipts of new funds by 968 230 lats as well as the growing activity of private asset managers in attracting clients. The Treasury will continue with the management of the state funded pension scheme assets, preserving the previous asset investment policy, ensuring adequate profitability in light of the financial market developments and maximum

[6] Annual percentage as on December 31, 2005, calculated using the Act/360 method.
[7] Of asset value as on December 31, 2005.

safety and liquidity of investment, based on the Cabinet November 7, 2005 decree No.715 “On the Concept “On Further Operation of the Treasury in Management of the State Funded Pension Scheme Assets”” stipulating transfer of the Treasury’s investment plan assets to private asset managers, to the date set in amendments to the Law on State Funded Pensions.

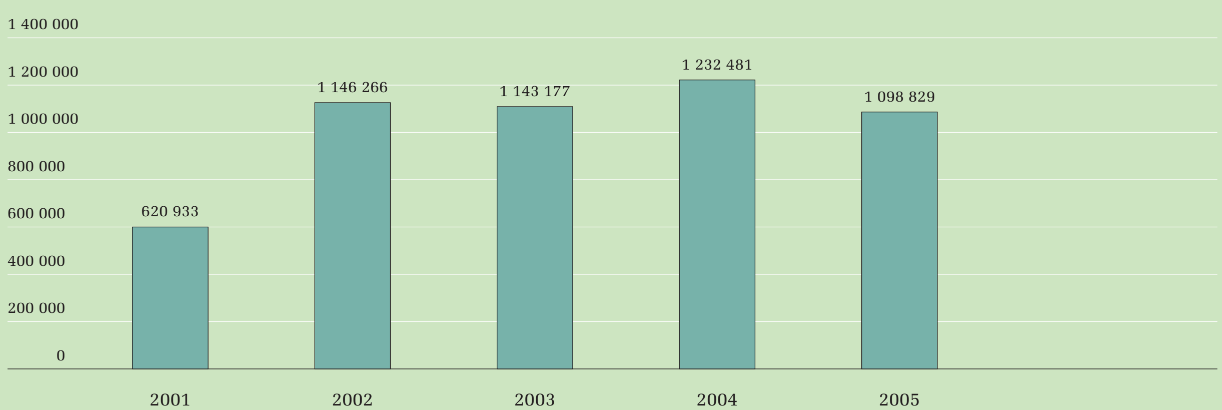
The Treasury manages the state funded pension scheme assets by investing in low risk financial instruments and in compliance with investment diversification principle, as well as ensures adequate investment liquidity, so that to be able to execute the SSIA instructions to redeem shares of the investment 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 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 Cabinet of Ministers regulations and the prospectus of the Plan, in 2005 the Treasury received as remuneration for management of the investment plan assets 0.75% of the average annual value of the plans (net) assets.

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.

Chart 20 *Dynamics of the Treasury's self-generated revenue (in LVL)*



Source: The Treasury

Central government basic budget spending

In 2005, the Treasury implemented four 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) programme "Central government budget loans and their repayments";
4) sub-programme "Compensation to rehabilitated citizens".

The objective of the sub-programme "Budget execution" is execution of the central government budget within the framework set by the annual law on state budget, focusing on efficient management of the central government budget funds, identification of services required by the Treasury's clients, improvement 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 budget 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 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 programme "Central government budget loans and their repayments" is to ensure granting of central government budget loans, based on an appropriation, offering the most adequate financing to project implementers, ensure up-to-date information on the government loan portfolio, take all the required steps to collect the delayed payments.

The objective of the sub-programme "Compensation to rehabilitated citizens" is to ensure disbursement of compensations to rehabilitated citizens in compliance with legislative acts.

International projects

In 2005, PHARE programme project 2002/000-590-08-01 "Public Finance System" was implemented, within the framework of which:

1) financial management system for the EU financial instruments in Latvia was ensured: the capacity of the Treasury as a Paying Authority to implement functions relating to transition from the pre-accession assistance to the structural funds and Cohesion Fund;
2) financial control and internal audit system were prepared for transition from the pre-accession assistance to the structural funds and Cohesion Fund;
3) a stable cooperation system between the Paying Authority and other institutions involved in management of the EU structural funds and Cohesion Fund was established.

Information on central government basic budget funding and its spending

Table 7 *Central government basic budget funding and its spending (summary of all programmes in LVL)*

No.	Financial assets	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
1.	**Financial assets to cover expenditure (total):**	**59 905 551**	**57 624 932**	**57 642 338**
1.1.	grants	58 465 275	56 476 645	56 476 645
1.2.	service charges and other self-generated revenue	1 232 481	1 080 287	1 098 829
1.3.	foreign financial assistance	207 795	68 000	66 864

2.	**Expenditure (total):**	**57 699 163**	**57 927 932**	**56 550 866**
2.1.	running costs (total):	57 621 163	57 626 632	56 249 566
2.1.1.	subsidies and grants, including contributions to international organisations	6 061 391	3 275 000	2 391 789
2.1.2.	other running costs	49 757 114	52 189 605	51 698 060
2.2.	capital investment expenditure	78 000	301 300	301 300
Source: The Treasury				

In 2005, the amount of funding approved in the central government basic budget to cover expenditure was 57 624 932 lats, including:

1) grant from general revenue in the amount of 56 476 645 lats, which is 1 988 630 lats less than in 2004;
2) self-generated revenue from 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 2004;
3) foreign financial assistances project 20020005900801 "*Public Finance System*" in the amount of 68 000 lats;
4) balance of self-generated revenue as on January 1, 2005 in the amount of 303 000 lats.

Total allocations granted under appropriation procedure amount to 57 927 932 lats, which is 228 769 lats less than in 2004. Of the granted allocations, 56 550 866 lats were actually spent, which is 1 148 297 lats less than in 2004 or 97% of the total allocations granted in the reporting year.

Spending of the foreign financial assistances project 20020005900801 "*Public Finance System*" amounted to 66 864 lats.

Information on central government budget spending

Table 8 *Central government basic budget funding and its spending: basic budget sub-programme "Budget execution" (in LVL)*

No.	Financial assets	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
1.	**Financial assets to cover expenditure (total):**	**3 495 551**	**3 749 932**	**3 767 338**
1.1.	grants	2 055 275	2 601 645	2 601 645
1.2.	service charges and other self-generated revenue	1 232 481	1 080 287	1 098 829
1.3.	foreign financial assistance	207 795	68 000	66 864
2.	**Expenditure (total):**	**3 198 888**	**4 052 932**	**4 000 444**
2.1.	running costs (total):	3 120 888	3 751 632	3 699 144
2.1.1.	subsidies and grants, including contributions to international organisations	–	–	–
2.1.2.	other running costs	1 318 230	1 589 605	1 539 427
2.2.	capital investment expenditure	78 000	301 300	301 300
Source: The Treasury				

In 2005, capital investment increased by 223 300 lats over the previous reporting period as a result of significant spending in procurement of intellectual property amounting to 106 686 lats and movable property amounting to

194 614 lats. The intellectual property consists of procurement of licences and new software products, including:

1) software "Annual report on central government budget and local government budget execution" — 43 748 lats;
2) *eKase* software — 31 276 lats.

When introducing the above software, morally and technically obsolete hardware was replaced, with the respective spending amounting to 165 141 lats.

The balance under the basic budget sub-programmes "Budget execution" as at the end of the period amounts to 468 798 lats. This amount is comprised of revenue from service charges that has 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" (in LVL)*

No.	Financial assets	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
1.	**Financial assets to cover expenditure (total):**	**49 500 000**	**50 600 000**	**50 600 000**
1.1.	grants	49 500 000	50 600 000	50 600 000
1.2.	service charges and other self-generated revenue	–	–	–
1.3.	foreign financial assistance	–	–	–
2.	**Expenditure (total):**	**48 438 884**	**50 600 000**	**50 158 633**
2.1.	running costs (total):	48 438 884	50 600 000	50 158 633
2.1.1.	subsidies and grants, including contributions to international organisations	–	–	–
2.1.2.	other running costs	48 438 884	50 600 000	50 158 633
2.2.	capital investment expenditure	–	–	–

Source: The Treasury

Due to excellent central government budget performance at the beginning of 2005 that freed up large amount of available central government 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 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 at the Latvian Central Depository and 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 deposits from other level budgets and special budget accounts have been made.

Table 10 *Central government basic budget funding and its spending: basic budget programme "Contributions to international organisations" (in LVL)*

No.	Financial assets	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
1.	**Financial assets to cover expenditure (total):**	**5 910 000**	**2 475 000**	**2 475 000**
1.1.	grants	5 910 000	2 475 000	2 475 000
1.2.	service charges and other self-generated revenue	–	–	–

1.3.	foreign financial assistance	–	–	–
2.	**Expenditure (total):**	**5 408 385**	**2 475 000**	**1 713 638**
2.1.	running costs (total):	5 408 385	2 475 000	1 713 638
2.1.1.	subsidies and grants, including contributions to international organisations	5 408 385	2 475 000	1 713 638
2.1.2.	other running costs	–	–	–
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 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 commitments of a member state are fully satisfied in compliance with the payment schedules. The Treasury ensures that participation fees are paid into the following international financial institutions: the World Bank, International Bank for Reconstruction and Development, European Investment Bank, Nordic Investment Bank, Council of Europe Development Bank, World Customs Organisation and European Tax Administration Organisation. In 2005, all participation fees were made in the required amounts and within the set timeframe.

In 2005, the planned amount of total contributions was 2.5 million lats, whereas the actual spending amounted to 700 thousand lats less, and the International Development Agency did not require the Republic of Latvia to make a payment against the notes issued to it and no payment had to be made under the European Community programme *FISCALIS*.

Table 11 *Central government basic budget funding and its spending: basic budget programme "Compensations to rehabilitated citizens" (in LVL)*

No.	Financial assets	In the preceding year (actual)	In the reporting year	
			approved by the law	actual
1.	**Financial assets to cover expenditure (total):**	**1 000 000**	**800 000**	**800 000**
1.1.	grants	1 000 000	800 000	800 000
1.2.	service charges and other self-generated revenue	–	–	–
1.3.	foreign financial assistance	–	–	–
2.	**Expenditure (total):**	**653 006**	**800 000**	**678 151**
2.1.	running costs (total):	653 006	800 000	678 151
2.1.1.	subsidies and grants, including contributions to international organisations	653 006	800 000	678 151
2.1.2.	other running costs	–	–	–
2.2.	capital investment expenditure	–	–	–
Source: The Treasury				

In 2005, compensations to rehabilitated citizens were paid in accordance with December 30, 1997 Cabinet 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 *Implementation of the performance indicators of the basic budget sub-programme "Budget execution" (in LVL)*				
No.	**Performance indicators**	**In the preceding year (actual)**	**In the reporting year**	
			approved by the law	**actual**
1.	Maximum number of institutions	1	1	1
2.	Maximum number of staff positions	258	298	250
3.	Treasury's expenditure per one lats of granted central government budget allocations	0.001	0.001	0.001
4.	Treasury's expenditure per one lats of the serviced central government debt	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 has been prepared	1	1	1
6.	Official monthly Treasury reports "General government consolidated budget execution" have been prepared	12	12	12
7.	Official monthly Treasury reports "Central government debt", "External debt of the central government" and "Granted government guarantees" have been prepared	12	12	12
8.	Number of implemented clients' payment documents (in millions)	6.1	6.1	10.0
9.	Annual report of the foreign debt of the central government and guarantees issued has been prepared and submitted to the World Bank	–	1	1
10.	Annual report on management of the state funded pension scheme assets under the Treasury's investment plan has been prepared	–	1	1
11.	Payments of the EU funding have been received	–	5	14
12.	Number of the processed structural funds payment orders	–	3 600	1520
13.	Internal quality management system documents have been drafted in order to ensure the operation of the established financial management and control system for the structural funds	–	6	6
Source: The Treasury				

Table 13 *Service charges, their pricing, other self-generated revenue (in LVL)*			
No.	**Service charges and other self-generated revenue**	**Pricing**	**Actual revenue**
1.	Revenue from servicing central government loans	0.5% of the balance of extended loans per annum	849 332
2.	Revenue from servicing central government guarantees	0.1% from the balance of outstanding guarantees per annum	132 520
3.	Revenue from management of state funded pension scheme assets	0,75% of the average asset value of the investment plan per annum	116 977
	Total		**1 098 829**
Source: The Treasury			

Central and local government procurement

The Treasury effects procurement in compliance with the Law "On Procurement for the State and Local Government Needs", by way of an open tender, negotiation procedure and invitation to submit price quotations. In the event of an open tender, negotiation procedure and invitation to submit price quotations, the Treasurer establishes a tender committee, competent in the particular area of procurement where contract will be signed. For the purpose of registering procurement and monitoring contracts, a register of procurement contracts has been established in the Treasury. In 2005, the total number of purchases amounted to 24 (excluding the purchases under 1000 lats), and contracts in the amount of 795 247 lats VAT exclusive (including purchases under 1000 lats in the amount of LVL 57 671 VAT exclusive) were concluded.

5.2. Personnel and personnel management

Personnel provision

As of January 3, 2005, there were 277 staff positions in the Treasury, of which 248 — were civil servant and 29 — employee positions. The fulfilment of the Treasury functions has been provided by 260 staff members. As of December 30, 2005 there were 269 staff positions in the Treasury, of which 235 — were civil servant and 34 — employee positions, the public civil service or employment relations — with 258 staff members.

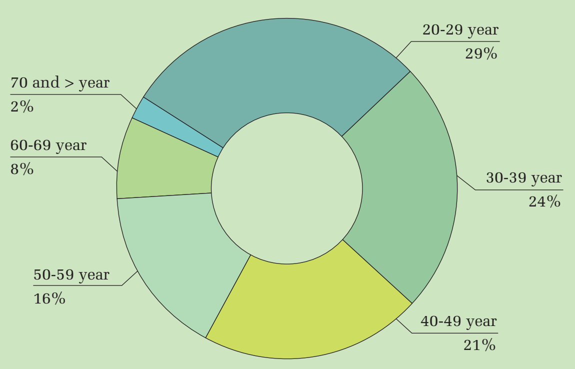
In 2005 in accordance with the personnel management principles determined in the Operational strategy of the Treasury, the Personnel policy of the Treasury has been developed, as well as the personnel management process and its sub-processes have been provided and described.

In 2005, in order to organise the budget execution process and to use the Treasury resources more effectively, as well as in order to improve the quality of the services provided, the optimisation of the number of personnel involved in the budget execution process has been commenced. For the purposes of implementation of the goal:

1) the functions of the Treasury units reviewed and the staff positions of the Treasury units transformed;
2) Treasury Units Coordination department established and Procedure for the provision of the continuousness of the Treasury units' activity developed.

In 2005 171 job descriptions have been updated and improved (63% of the number of the Treasury's staff positions), in order to facilitate the fulfilment of the functions and assignments of the structural units, as well as in order to specify the duties and responsibilities in the area of quality management and risks' management. Most of the Treasury's staff (74%) is at the age from 20 until 49 years (see Chart 21).

Chart 21 *Breakdown of the Treasury's personnel by age groups (%)*

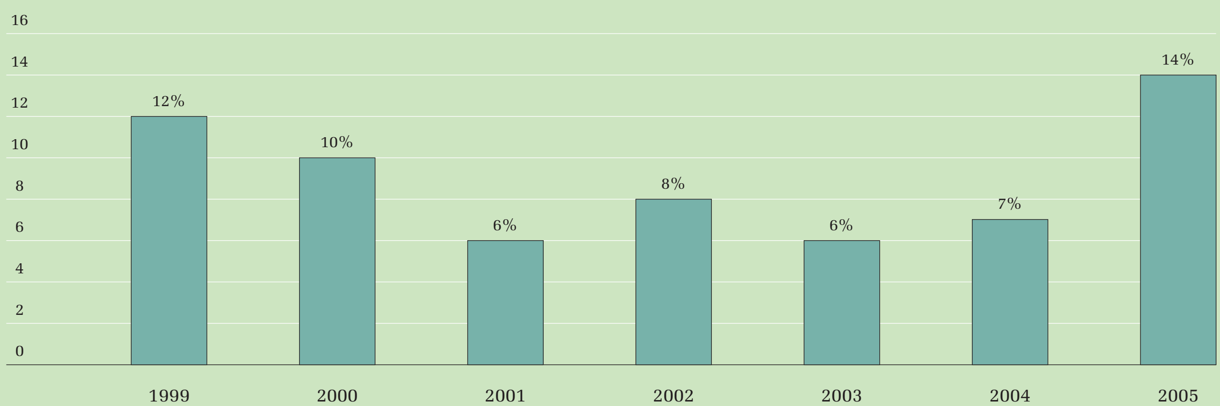


Source: The Treasury

The proportion of the number of the females and males employed, in comparison with the previous years, has not essentially changed. In 2005 the employed persons in the Treasury includes 84% females and 16% — males. In the Treasury units (except for Riga Treasury unit) only females are employed.

36 civil servants and employees were dismissed from the civil service or work in the Treasury during the reporting year, the personnel turnover was 14% (see Chart 22 on personnel turnover by years). Comparatively high personnel turnover in 2005 may be explained by the reorganisation of the Treasury units, as a result of which 10% of the civil servants and employees of the Treasury units have been dismissed (according to the data of the best practice of the personnel management the personnel turnover up to 15% per year is to be considered as a natural process). Taking into account the high professional level and education, the employees dismissed successfully participated in the competitions for new jobs.

Chart 22 *Personnel turnover in the Treasury percentage-wise per years 1999 – 2005 (%)*



Source: The Treasury

In the reporting year 38 applicant selection competitions were announced for vacant staff positions in the Treasury. 25 new specialists have established the civil service or employment relations during the selection process in the Treasury. The Treasury continues the practice implemented in the years 2003 and 2004 – to promote the career of their specialists: 42 specialists of the Treasury have been granted the possibility to create the career development, by transferring them to the other staff positions as a result of evaluation and internal selection competitions.

The Treasury, in order to attract the persons interested in and to select the most suitable candidates, has concluded the contract with the job seeking and personnel selection company SIA "CV-online", as well as co-operates with many higher educational establishments of Latvia, by placing advertisements in the homepages of the higher education establishments concerning the possibilities to work in the Treasury and by ensuring the places of practice in the Treasury for the students of these higher educational establishments. In 2005 the contracts of practice have been concluded with six students. Civil established with two of them.

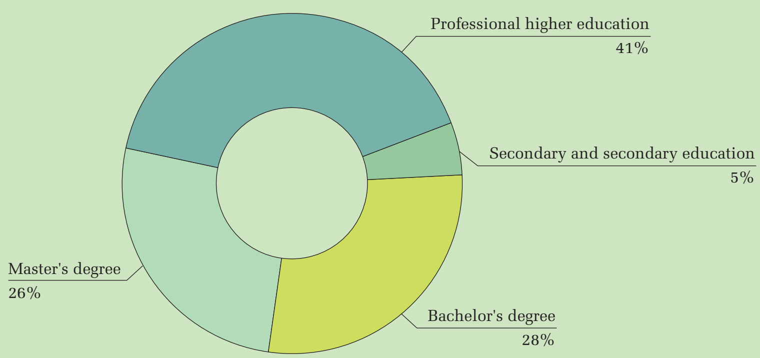
For getting acquainted the new candidates for civil servants' positions and the employees with the work responsibilities the discussions for the evaluation of the performance results during the trial period have been carried out. At the end of the trial period the performance results were evaluated for 27 new employees. All new employees have got a positive evaluation, which certifies that during the selection process the candidates which correspond to the requirements with the skills to apply the professional knowledge and successfully to cope with the new work responsibilities have been selected.

Based on the evaluation results of the trial period, the State Department of Civil Service granted the status of a civil servant to 18 civil servant candidates of the Treasury in 2005. In order the new civil servants and employees would understand their role in the implementation of the Treasury's strategic goals better, the acquaintance of them with the Treasury's structural units, their functions and staff members have been organised.

Personnel development

The greatest value of the Treasury is highly educated and professional personnel (see Chart 23).

Chart 23 *Level of education of the civil servants and employees in 2005 (%)*



Source: The Treasury

The tendency to develop professionally and to raise the educational level has been maintained during the years. The number of the persons having obtained the Master's degree has increased (see Chart 24).

Chart 24 *Levels of education obtained by the staff members*

Source: The Treasury

The determination of the training needs and the development of the plan of the studies for the staff members of the Treasury for the next year have been made before the end of the current fiscal year. The Training classificatory has been developed and implemented for the improvement of the organisation of the training process. A special programme has been developed for the improvement of the managerial skills of the heads of the structural units. 187 civil servants and employees of the Treasury have attended 330 training courses.

The Treasury, by supporting the wish of the employees to widen the skills and knowledge, as well as by ensuring the raise of the career development, facilitates the contribution of the staff members in the implementation of the Treasury's strategic goals.

5.3. Quality management

In 2005 the Treasury's Quality management system has been improved in accordance with the requirements of the international standard LV EN ISO 9001:2000 "Quality management system. Requirements" as well as all the necessary measures have been carried out, including the conclusion of the service contract with the auditors' company so that the certification process could be performed according to the requirements of the international standard already in January 2006.

In order to implement the goals set in the Treasury's operational strategy more effectively and to ensure effective operation, supervision and development of the institution, during 2005 the process management, with the help of which the monitoring and measurement of the processes takes place, has been implemented. The Treasury's processes, the measurement parameters and criteria of the processes, the structural units involved in the implementation of the processes as well as the responsible persons for carrying out the measurements and the achievement of the results have been determined.

In 2005 internal audits of the Quality management system have been initiated in the Treasury in order to provide the Treasury's management with the evaluation on the correspondence of the Treasury's Quality management system to the international standard LVS EN ISO 9001:2000, the quality policy and to provide awareness about the correspondence of the Treasury's activity to the requirements of the legislative acts, documents governing the Quality management system and other documents as well as to determine whether the Quality management system has been effectively implemented, correspondingly maintained and improved.

5.4. Internal control system and risk management

The internal control system of the Treasury was established, based on the comprehensive basic elements of the internal control system: the control environment, the performance evaluation, the risk management, the control activities, monitoring and internal communication. The internal control in the Treasury's structural units is one of the means of prevention of the potential losses. In order to eliminate risk in the administration of the transactions, the Treasury implements the double authorisation principle, which determines that the transactions have to be accepted at least by two independent employees. The carrying out of the transactions is determined in the internal quality management documents.

In 2005, the results of the internal and external audits carried out certify that in total the internal control system established provides a sufficient and justified awareness about the fulfilment of the assignments set for the Treasury corresponding to the strategic goals, the effectiveness of the activity, the accuracy and credibility of the data, the compliance with the requirements provided by the legislative acts, as well as the risk management and the protection of the resources at its disposal against the potential losses and the ensurance of the continuousness of the operation. The internal control system is continuously developed by regularly including not only the requirements of the legislative acts, but also the best practice and the experience of the financial sector.

During the reporting period, in order to provide the certification of the quality management system corresponding to the requirements of the international standard LV EN ISO 9001:2000 “Quality management system. Requirements”, 17 internal audits of the quality management system have been carried out. In the scope of the audits all the processes of the Treasury’s basic activities have been included – the budget execution, the management of the central government debt and assets and the implementation of the functions of the national fund of the foreign financial assistance and the ones of the Paying authority of the European Union policy instruments, as well as the support processes — the provision of the infrastructure and work environment and the management processes — management of the quality, risks, personnel and documents and the records.

In 2005, the evaluation of the monitoring process of the audit planning, work performance and implementation of the proposals made by the Treasury’s Internal Audit Department has been carried out. As a result, the effectiveness of the monitoring system of the audit planning and implementation of the audit proposals have been improved.

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

During the last years the amount of the services to be provided electronically has essentially increased in the Treasury, which sets the heightened requirements for the information security. For the fulfilment of these requirements the Treasury’s Information’s security policy has been completely re-developed, by achieving its correspondence to the requirements of the standard LVS ISO/IEC 17799:2005 “Information technology — Security methods — Code of practice for the management of the information security”.

By implementing the Anti-corruption state programme for 2004-2008, the anti-corruption measures plan of the institution has been developed, which has been successfully executed during the reporting period by identifying and evaluating the risks related to the corruption and by implementing all the measures eliminating the risk provided by the plan.

In order to evaluate the Treasury’s risk control system and the most essential risks, the creation of the risk profile of the institution was carried out in the reporting period in co-operation with the company’s “Marsh” experts of the Latvian branch, by using the “Risk focus” tool. The evaluation results obtained certify that the comprehensive practice has been implemented in the Treasury, which helps to eliminate the influence of the operational risks of the institution.

5.5. Information technology development

The basic activity of the Treasury directly depends on the information systems, with the help of which the fulfilment of the Treasury's basic functions has been provided. Therefore the Treasury, in order to raise the quality of services provided, continuously carries out the measures with an aim to modernise the information systems and the information technology infrastructure.

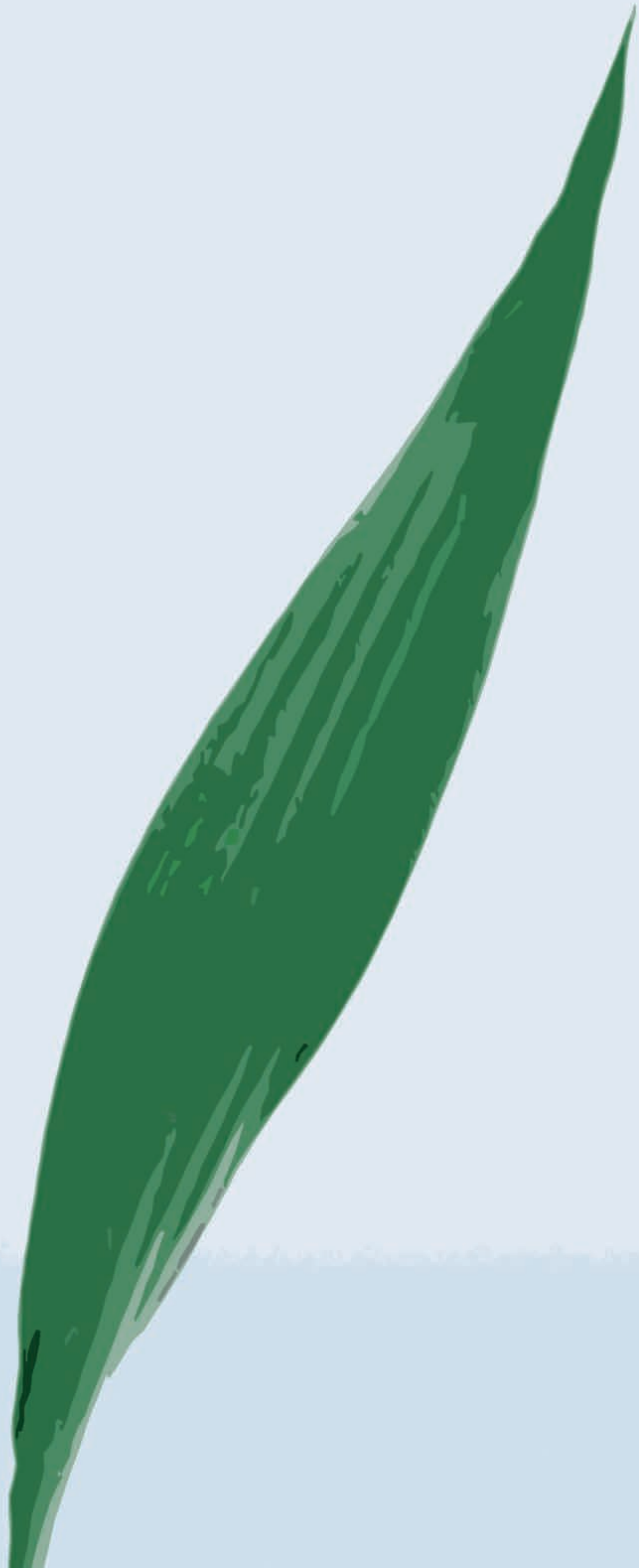
By implementing the Treasury's Operational strategy, in 2005 important changes have been made in the information technology development by providing the availability of the Treasury's services in the Internet. In 2005, the Treasury's clients may carry out the following on-line operations:

1) in the area of the central government budget execution — in *eKase* — 604 clients, of which the largest one — SSIA makes about 600 000 electronic payments per month, that is for 99% more, in comparison with the number of the electronic payments made during the previous year;
2) in the report system of the central government budget and local government budgets used by all the local governments and ministries the functionality has been implemented in 2005, which includes the electronic submission and acceptance of the reports.

By continuing developing the information technologies, the Treasury together with the Ministry of Finance has initiated the implementation of the project "Implementation of the common information system for the central government budget planning and execution". Within the framework of this project it has been provided to establish the common management system of the public finances, which unifies the Treasury's management system (central government debt and asset management) and the functionality of the information system of the budget execution, by integrating them into one system, thus preventing the shortcomings of the current systems, reducing the processing time of the transactions and the number of the complicated data exchange procedures. The implementation of the system planning block will ensure the possibility to carry out the centralised summarisation and processing of the budget plans, by making this process less time consuming and corresponding to the possibilities provided by the information technologies. The newly established system may be considered also as the first step to the creation of the financial portal, which would provide the availability of all the financial services provided by the Treasury to a client in one information system.

In 2005 new firewall software has been purchased, by implementing the intent to establish the large capacity firewall system for the protection of the Treasury's information resources against the unsanctioned access and threats from the side of the external networks, which is one of the pre-conditions, in order to provide the continuousness of the Treasury's work.

In 2005, together with the Ministry of Finance the work has been commenced on the purchase of the new accounting software, in order to modernise the Treasury's accounting records, by ensuring the operative processing of the accounting information and more effective control of the process. The implementation of the software into operation has been planned in the second half of 2006.



Communication with the society

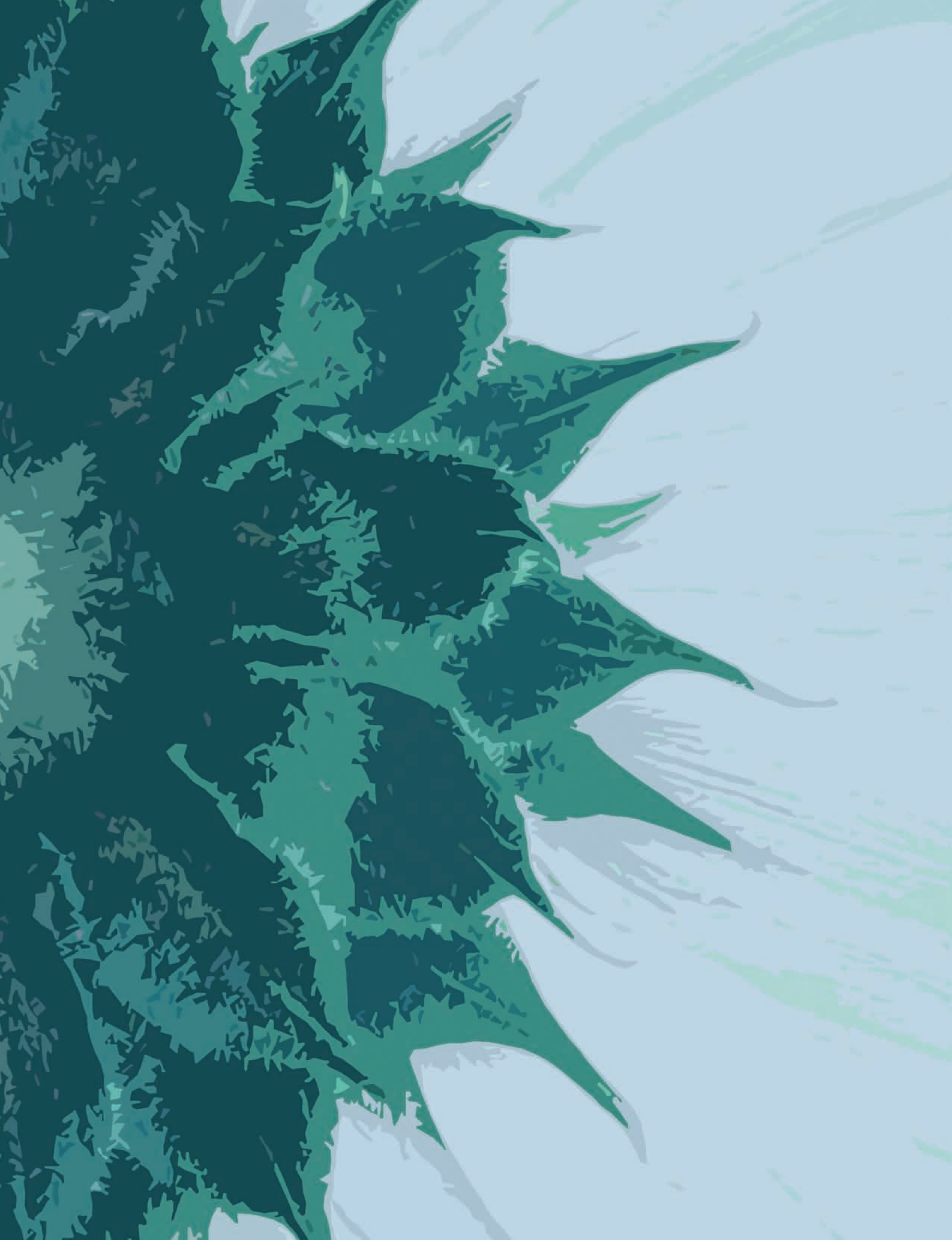
It is possible to ensure a successful co-operation, the basis of which is a mutual understanding, by carrying out the information circulation of full value between the Treasury and the society.

One of the main priorities of the Treasury's Operational strategy is the orientation towards the client, his needs and interests. The satisfaction of the client is found out by the Treasury with the help of public polls: in 2005, the opinion of the users of *eKase* system and the opinion of the local governments' accountants about the Treasury's operation has been found out.

Since 2003 the Treasury has maintained the Internet homepage (www.kase.gov.lv) in which the information about the Treasury and its functions is available. Information about the topical issues of the Treasury is regularly entered in the homepage, the possibility to ask questions electronically, to submit applications, proposals and complaints is also provided. It is an opportunity for the visitors of the homepage to receive an operative answer to their question, but for the Treasury – the possibility to identify the potential problems concerning the co-operation with the clients and to prevent them.

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

In March 17, 2005, the Treasury organised a press conference in which the Treasurer Mrs. Irēna Krūmane informed the public about the performance results of the year under her management.



The Treasury's development priorities for 2006

Central government budget execution

Ensure implementation of the project of the Ministry of Finance and the Treasury "On widening of the SAP system for the provision of the support for the central government budget planning and execution control functions", in the framework of which the replacement of the current central government budget execution system will be carried out.

Continue work on development of the Central government budget information system's sub-system *eKase*, which is meant for the provision of the Treasury's services on the Internet. Continue distribution of *eKase* to the clients of the Treasury's units.

Ensure correspondence of the financial reports of the central government budget and local governments for 2006 to the accounting records of the budget institutions, which is provided as of January 1, 2006 by the Regulations of the Cabinet of Ministers No.867, dated as of November 15, 2005 "Procedure under which the budget institutions arrange the accounting records".

Ensure submission of the information determined by the European Council Regulation of November 23, 1993 (EC) No.3650/93 necessary for the preparation of the central government budget deficit and central government debt notification and the information within the Treasury's competence to the Central Statistics' Bureau according to the requirements of the legislative acts.

Ensure maintenance, improvement of the Treasury's central government budget accounting book-keeping policy, by taking into account changes and additions to the book-keeping account plan as well as development of new governing legislative acts.

Arrange the legislative basis of the central government budget execution concerning the granting and execution of the assignments.

Apply the S.W.I.F.T. (an international organisation which supplies standardised and secure inter-bank financial messaging services by using the telecommunications network) system – to define and implement the necessary changes in the system for automatic generation of S.W.I.F.T. messages and for the use of new S.W.I.F.T. messages, as well as for the automatic processing of the S.W.I.F.T. messages received.

Initiate issuing of credit cards to the state budget institutions, by concluding a contract with the bank on servicing the credit cards attached to the Treasury's accounts and by providing the operative information for the state budget institutions about the accounting of the turnover of the credit cards accounts.

Determine the necessary changes in the current transactions accounting (making book-keeping records) in accordance with the changes in the revenue and expenditure classifications and to make the corresponding changes in the central government budget accounting records system.

Central government debt and assets management

Perform the central government debt management in accordance with the Latvian Central Government Debt Management Strategy updated in 2006.

Prepare the analytical report on the central government debt management so that the Treasury's clients, the financial market members, including the Treasury's current and potential co-operation partners and the investors in government securities are provided with the updated information about the topical issues of the central government debt management, indicators of the results and the future tendencies.

Continue the work initiated on the implementation of the new models of the debt portfolio analysis — to implement *Cost-at-risk* model, the use of which would allow to evaluate different borrowing scenarios. The attraction of the resources within the framework of the plan, to forecast the central government debt servicing payments for medium term and to determine the optimal indicators of the Latvia's central government debt portfolio structure.

For the purposes of the government securities market development to work out development conception for the securities market within the framework of the central government debt management, by taking into account the possible terms for the euro implementation and the future perspectives of the financial market.

Plan issues of the short-term bills, as well as the medium term notes and the long-term bonds in the internal financial market. Taking into account that the interest rates are still not far from the historically lowest levels, to offer investors five-year and 10-year issues of the bonds. Evaluate the possibilities for the implementation of the programmes for the re-purchase and exchange of the domestic debt securities prior term.

Evaluate the possibilities to implement in the primary placement of the debt securities of the Republic of Latvia the primary dealers' institution that is used for the provision of the issue of the securities in several countries of the world, as well as for the purposes of widening the scope of investors to evaluate the possibilities of the issues of the securities potentially to be carried out in different financial markets.

To continue work on reduction of the servicing expenditure of the central government foreign debt, it is planned to re-evaluate regularly the conditions of the current central government debts in order to consider the possibilities of making premature payment of the debts, as well as to re-evaluate regularly the necessity of the planned central government borrowings, by taking into account the indicators of the central government budget execution, the macro-economical risks, as well as the situation in the financial markets.

In the area of the assets management improve the current procedure of the central government assets management, by developing the strategic basic principles of the assets management, as well as improve the co-operation with transaction partners of the Treasury, by widening the scope of the transaction partners and by ensuring the conclusion of the internationally accepted standard contracts.

In order to determine the total financing necessity for 2007-2009, evaluate the liquidity and risks of financial market and choose the most proper financial instruments for the financing of the fiscal deficit of the central government budget and for the re-financing of the central government debt within medium term, as well as develop the Resources' attraction plan for 2007-2009.

Develop the Treasury's plan for the euro implementation measures and commence its implementation.

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

In order to declare to the European Commission the expenditure until the end of 2006 corresponding to the grant of the structural funds of 2004, follow the fulfilment of N+2 principle determined by the legislative acts of the European Commission and, if necessary, make a timely proposal to prepare and submit an additional expenditure declaration to the European Commission.

Participate in the development of the legislative basis for the implementation and administration of the financial instrument of the European Economic Zone and of the bilateral financial instrument of the government of Norway, prepare the quality management documents and after the acceptance of the mentioned documents start making the first payments within the framework of the financial instrument of Norway.

Develop the legislative basis for making payments of the EU Cohesion fund and the financial management of the means of the EU structural funds by developing the rules of the Cabinet of Ministers corresponding to the delegation of the EU structural funds' management law and the EU Cohesion fund projects' management law.

State funded pension scheme assets management

Develop the amendments to the State funded pensions law and to the legislative acts for the execution of the Order No.715, dated as of November 7, 2005 of the Cabinet of Ministers "On Conception "On Future Action of the Treasury in the State Funded Pension Scheme Assets Management"".

Management of the Treasury as a public administration institution

Develop the Treasury's Operational strategy for 2007-2009 in accordance with the implementation of the planning system commenced in the public administration and corresponding to the requirements set in the Rules of procedure of the Cabinet of Ministers.

Carry out the planned measures in order to provide the certification of the Treasury's Quality management system corresponding to the requirements of the international standard ISO 9001:2000 "Quality management system. Requirements". After the certification, ensure elimination of the minor discrepancies found during the audit and, by taking into account the resources available in the Treasury, ensure the implementation of the proposals indicated during the audit. Organise carrying out of the supervision audits nine months after the certificate was obtained.

Develop the clients' policy of the Treasury in order to improve the client service culture.

Continue make effective use of information technologies in the servicing of the clients.

Organise control self-evaluation in the Treasury.