



Mr Eduardo Barredo Capelot
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European Commission, Eurostat
BECH F4/933, L-2920 Luxembourg

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Dear Mr Barredo Capelot

Re: Sector classification of Irish Water

I refer to your letter of 24 July 2015 and your assessment of the sector classification of Irish Water. The CSO notes the decision of Eurostat and further confirms that this decision will not result in any revision to government finance statistics, including government deficit and debt, previously published by CSO and provided to Eurostat.

As set out in your letter of 24 July the classification of Irish Water is a complex case and is perhaps the first complex case in the circumstance of establishing a new utility to be assessed under the new ESA 2010 regulation.

Based on our collective experience during this classification process it has become evident that there is scope for broad interpretation of some elements of ESA 2010. This potential for different interpretation of ESA 2010 creates difficulties for National Statistical Institutes (NSIs) such as the CSO in making a preliminary sector allocation decision. It is important for the European Statistical System that the lessons learned from this process lead to improved clarity in the official guidance for all future classification decisions.

To this end, we have identified a number of technical issues based on the conclusions reached by Eurostat in respect of this classification where we would appreciate clarification on the interpretation of ESA 2010 for future reference. We have also identified some points in the Eurostat decision on uncertainty of estimates and we would welcome a discussion in the statistical community on *ex ante* classifications given the difficulties that arise with making these decisions on the basis of forecast data such as that contained in a business plan. Our key points where we would appreciate further clarification or discussion of existing guidance are set out below.

Market nature of Irish Water output and consequent impact on the child allowance classification

We note the segmentation of output of Irish Water on the basis of customer groups as applied by Eurostat in assessing the quantitative market criterion and your conclusion that sales revenue of Irish Water should be decomposed on this basis into market output (P.11) for the non-domestic customer group and payment for non-market output (P.131) for the domestic customer group. We further note your conclusion that the impact of this segmentation is that the child allowance for households, being part of domestic consumption of Irish Water's output, should be classified as a *social transfer in kind – general government and NPISHs non-market production* (D.631) as per ESA 2010 paragraph 4.109.



Our reading of paragraph 20.20 of ESA 2010 is that any such segmentation should be done at the level of the individual outputs of an entity – i.e. the goods and services produced. We have regarded Irish Water as essentially providing a single type of good – i.e. the provision of clean water and treated waste water. We envisage the conditions of ESA2010 paragraph 20.20 as applying to corporations where a more diverse portfolio of activities are undertaken by an entity, e.g. provision of gas and electricity supply by a single entity would be regarded as separate outputs.

On the classification of the child allowance, as we had assessed Irish Water as having the status of a market operator our categorisation of this allowance as D.632 (social transfers in kind – market production purchased by general government and non-profit institutions serving households) was the more logical classification for us to apply (again as per ESA 2010 para 4.109) and thus was a valid inclusion in our calculation of sales of Irish Water. If we had assessed the entity to be non-market, then we agree that these allowances should be treated as D.631, and thus not part of sales revenue.

The issue of segmentation of output is key to the classification of the child allowance and thus to the quantitative market/non-market criterion. On this issue we find the rationale for your interpretation of ESA 2010 paragraph 20.20, which applies such segmentation on the basis of customer groups rather than the nature of the output, difficult to understand. Consequently we would welcome the opportunity to discuss this point in greater detail in the appropriate technical forums in the very near future as we are of the view that this issue will be of broader interest to other Member States.

Household conservation grant

On the issue of the household conservation grant, as set out in previous correspondence and outlined at our meeting in June it was, and remains, CSO's view that we could assess the conservation grant only on the basis of the official criteria for receipt of the grant. To do otherwise would have introduced an element of subjectivity around intentions etc. that we did not feel would be appropriate to make during the preliminary classification process.

In our review of the official documentation available on the grant we have noted there is no official linkage between receipt of the grant and payment of water charges to the relevant provider. It remains the case that this grant will be paid to all households and is not restricted to customers of Irish Water or related to payments to Irish Water. Therefore it has been, and continues to be, our assessment the grant represents a cash transfer to households and is unrelated, based on the formal official criteria for receipt of the grant, to the financing of any water provider. We have not identified any guidance in the legal text of ESA 2010 and the related manuals that would change our interpretation. Clarification on the Eurostat interpretation, and reference to the appropriate parts of ESA 2010, would be very welcome for future reference.

We have already proposed a recording of this grant in the government expenditure of D.759 (h) – *current transfers from general government to households in their capacity as consumers if not recorded as social benefits* as per paragraph 4.138 (h) of ESA 2010 and continue to regard this as the appropriate recording of this payment given our interpretation of ESA 2010.

On this basis we feel that the suggestion by Eurostat that this grant should be netted from the revenues of Irish Water could potentially introduce an unnecessary complication into the statistical recording of this payment, given that a quite considerable proportion of households (at least 20% based on current Census estimates) will not be customers of Irish Water. These households will, however, be in receipt of the grant. As we understand it the treatment proposed by Eurostat would suggest that the part of the grant that is payable to Irish Water customers should be treated as a reduction in government non-market revenue (P.131) rather than an expenditure item, while the payments to other households should be treated as expenditure – whether of D.759 payable or other expenditure item remains to be determined. It remains the CSO's view, given our interpretation, that a recording of the entire cost of the grant as expenditure of government is more appropriate than any partitioning of the payment. We would welcome Eurostat's clarification both on our interpretation of your advice and on the

implications of this recommendation for our data compilation, with reference to the relevant sections of ESA 2010.

Accruals vs cash recording

As previously indicated, we continue to be unclear about the rationale applied by Eurostat in your proposal to record revenues on a cash basis and, based on our interpretation of the manuals and related guidance, view this as being at variance with the general principles of accrual recording in ESA 2010 as stated in paragraph 1.101 “*Flows shall be recorded on an accruals basis; that is when economic value is created, transformed or extinguished, or when claims and obligations arise, are transformed or are cancelled*”. Paragraph 1.102 further clarifies that “*Output is recorded when produced and not when paid for by a purchaser*”.

In your letter of July 24 you have recommended a departure from the accruals approach given the “*high uncertainty on the proportion of bills which will never be paid*”. We cannot find any guidance in the legal text of ESA 2010 that provides latitude for this departure on these grounds from the recording of output on an accruals basis and it is not a decision we, the NSI, could have taken during the preliminary classification process.

While we continue to recognise concerns around non-collection of revenues we are of the view that this proposal to record revenues on a cash basis is inconsistent with the general rules applying to the calculation of the quantitative market/non-market criterion where output is clearly intended to be recorded on an accruals basis. The audited financial statements of Irish Water will be prepared on an accruals basis in accordance with international accounting standards and will contain a provision for bad debts. It is these figures that will ultimately be used to assess Irish Water’s performance in relation to the market/non-market criterion. This also relates to the issue of uncertainty of estimates which we address further below.

Autonomy of decision-making

We note Eurostat’s comments on the level of autonomy of decision enjoyed by Irish Water under the governing legislation. We acknowledge that there are complexities in this assessment, mainly due to the transition being undergone in the establishment of Irish Water. We further note that Eurostat acknowledge the difficulty in assessing the level of autonomy of a unit based solely on a review of the relevant statute.

In your letter you reference the requirements of paragraph 2.12 of ESA 2010 in determining whether an entity is an institutional unit. In our assessment of Irish Water we reviewed the provisions of its governing statutes and memorandum and articles of association against the criteria set out in paragraph 2.12 (a) – (d) and thus formed the view that Irish Water qualifies as an institutional unit according to these criteria and based on the evidence of the relevant documentation.

We would welcome the opportunity to engage further on the assessment of the criteria of paragraph 2.12 (a) – (d) and a further exploration of issues taken into account by Eurostat in your consideration of the extent of autonomy of decision available to Irish Water as well as a discussion in principle around the interaction between considerations of control and of autonomy of decision.

Uncertainty of estimates

We recognise that in the case of Irish Water, as with all *ex ante* classification decisions, a degree of uncertainty exists in relation to the business plan, and had acknowledged as much in our original submission earlier this year. The MGDD (Section I.2.4.3, paragraph 33) acknowledges the role of the business plan in the classification process.

We have formed our view of the Irish Water business plan, on the clear understanding that these estimates are forward-looking and based on certain assumptions. These forecasts have been provided by financial professionals drawn from a team of experts whose remit is to take a commercial approach to the oversight of certain State companies. In addition our assessment of the forecast revenues took

into account that there is a clearly stated strategy in place to ensure collection of these revenues which is now supported by legislation. Finally we note that these forecasts have been compiled in accordance with the relevant international accounting standards.

It is not clear to us on what basis we can make a determination that the information provided in one business case is sufficient for direct inclusion in the decision making process while in another case, such as that relating to the establishment of a new public utility, make a determination that the information is not robust enough for usage. Clarity on the usage of business cases and the criteria for assessing the robustness of business cases is needed. The criteria applied by Eurostat in the assessment of the Irish Water business case may be a useful starting point.

Given that we are still in a forward-looking situation and we have acknowledged the need for review of the classification as actual results become available, we feel that only at that stage will the impact of the different scenarios presented by Eurostat become apparent. The CSO took the view during the preliminary classification process that it was appropriate to base the classification decision on the business plan as presented.

In this regard we will, in the normal course of events, review the performance of Irish Water against their original business plan once full year audited accounts for 2015 (the first year referenced in our submission) become available. As discussed at our meeting in June, this will give an opportunity to review the market/non-market nature of Irish Water in the light of observed financial data.

Concluding comments

With the uncertainty that typically exists around business plan estimates, the CSO's opinion is that a discussion is needed in the statistical community on *ex ante* decision making. For instance, a more transparent approach could be that a new public body, which plans to operate ultimately as a market entity, is classified by default to government sector until sufficient observed data is available for a sector allocation decision. The CSO would welcome an engagement with Eurostat and the other Member States that examines the current approach and that discusses other possible approaches that would support improved transparency and clarity of classification decisions.

We wish to propose that the following items be included on the agenda of the standing Task Force on methodological issues (MGDD) for discussion as soon as possible:

- The application of the accruals principle, and exceptions where cash-based recording is deemed appropriate
- Segmentation of output for the purposes of assessing the market/non-market nature of an entity
- The interaction between the concepts of control of an entity and autonomy of decision making, as applied in the assessment of an entity as an institutional unit.

In conclusion, the issues set out in this letter are raised to improve our understanding of Eurostat's interpretation of ESA 2010. We look forward to further discussion and ultimate clarification of the issues raised above within the relevant technical forums, to assist all Member States in future classification decisions.

Yours sincerely



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