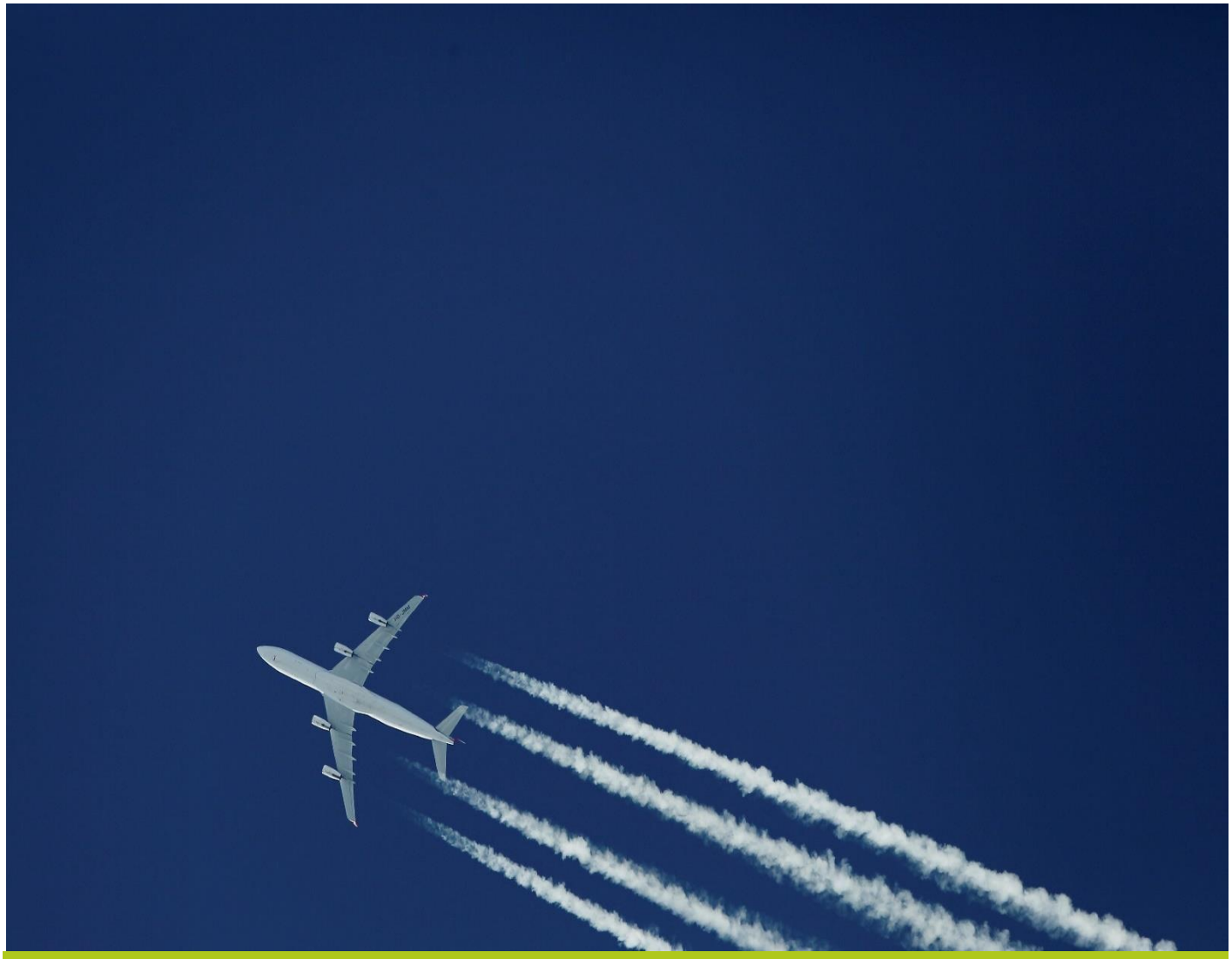


How did the state supervise the investment made in airBaltic during COVID-19 pandemic?

Latvijas Republikas
Valsts kontrole

RIGA 2025

Interim audit report

The date can be viewed in the document signature timestamp and the document number can be viewed in the text file.

"How did the state supervise the investment made in airBaltic during COVID-19 pandemic?"

Financial audit "On the accuracy of the annual financial statement for 2024 of the Ministry of Transport"

The implementation of the recommendations was audited and this interim audit report was drafted by Senior State Auditor, Lawyer Baiba Amoliņa, Senior State Auditor Alda Smoļenska, State Auditor Inga Briede, Head of the Responsible Sector Larisa Reine and Department Director Mārtiņš Āboliņš based on audit schedule No. 2.4.1-70/2024 of the First Audit Department of the State Audit Office of Latvia of 4 November 2024.

The interim audit report takes effect on the day of adoption of the decision of the Council of the State Audit Office of Latvia on the reasoned complaints of the audited entity and individuals.

The interim audit report includes clarifications approved by the decision of the Council of the State Audit Office of Latvia (Minutes No 32, § 1 of 28 May 2025).

Some information in the public version of the interim audit report has been classified based on the request of JSC "Air Baltic Corporation" to assign this information restricted access status to protect commercially sensitive information.

The cover design uses an image from *Microsoft Word Stock Images*.

Why have we drafted this interim audit report?

The total investment of the Republic of Latvia in the share capital of JSC "Air Baltic Corporation" (hereinafter referred to as airBaltic) already amounts to 545 million euros, of which a total of 340 million euros was invested by the state during the COVID-19 pandemic. At the end of 2024, the state's shareholding in the share capital of airBaltic reached 97.97%.

One of the largest state investments in airBaltic was made in 2020 by allocating 250 million euros in financing to mitigate the consequences of the COVID-19 crisis. In its financial audits of the 2020 annual reports of ministries and central institutions, the State Audit Office of Latvia examined the validity of requests for COVID-19 funds and the actual use of them. Accordingly, the financial audit[1] was conducted and an interim audit report was drafted in 2021 on the financing allocated to the Ministry of Transport for increasing the share capital in aviation companies, including the contribution of 250 million euros to the share capital of airBaltic (hereinafter referred to as the 2021 audit report).

The State Audit Office of Latvia concluded that the state, represented by the Ministry of Transport, was not implementing effective governance of its capital shares. To facilitate the recovery of the state investment, it is essential to eliminate the irregularities identified in the audit. Until the crisis caused by COVID-19, the Ministry of Transport and the Coordination Institution (*An entity stipulated in the Law on Management of Capital Shares of Public Entities and State-owned Enterprises. Currently the State Chancellery performs this function.)* did not assess and coordinate airBaltic's business plans and achievable performance indicators at their development stage, as the Coordination Institution did not provide opinions, because, contrary to the law[2], the Council of airBaltic did not submit their business plans to the Coordination Institution. In turn, the Ministry of Transport expressed the opinion that the Ministry did not need to assess the aforementioned plans and indicators and did not need to provide an opinion because the state had not delegated the tasks to airBaltic to perform. This reduced the ability of the state as a shareholder to implement its strategic goals, for the achievement of which investments were made in the state-owned enterprise. It was found that the Ministry of Transport did not participate fully in the process of determining the results to be achieved by airBaltic by relying only on the information provided by airBaltic itself. As a result, it was concluded that the airBaltic monitoring system established by the Ministry of Transport should be improved.

The 2021 audit report by the State Audit Office of Latvia provided a proposal to the Cabinet of Ministers and two recommendations to the Ministry of Transport. One recommendation to the Ministry of Transport was recognised as implemented[3] in 2023 – *When making investments in the share capital of state-owned enterprises, the Ministry of Transport should define the goals of investing state budget funds clearly and determine measurable achievable results and develop a specific plan of measures for monitoring the achievement of decisions, goals and results*. The State Audit Office of Latvia indicated that the implementation of the recommendation was recognised based on the information provided by the Ministry of Transport, without conducting a follow-up audit because there were no circumstances during the implementation period of the recommendation that met the conditions for applying such procedure. The second recommendation had not been implemented by November 2024 and its implementation deadline had been extended several times.

The current reporting deadline was set until February 2025. The recommendation and proposal that has yet to be implemented is as follows:

- ✓ Recommendation to the Ministry of Transport: establish a management system for state-owned enterprises in which the state has a decisive influence, which ensures the opportunity for the state to implement the strategic objectives of the sector and to participate fully both in the process of setting goals and results, and in their assessment in accordance with the legal provisions to facilitate the effective management of the capital shares of the Ministry of Transport and state-owned enterprises, rational and economically justified use of resources, as well as to ensure compliance with the public entity shareholding conditions.
- ✓ Proposal to the Cabinet of Ministers: Taking into account the significant impact made on the state budget and the national economy by the state investment in the share capital of airBaltic, assess the possibility of establishing a special procedure in addition to the regular management processes of state-owned enterprises in order to manage the risk of recovery of the state investment in airBaltic by developing and implementing an action plan that would determine monitoring of the decisions taken, the achievement of goals and results, deadlines for implementation and responsible persons while at the same time not reducing the responsibility of the Board and Council of airBaltic.

In August 2024, the government decided to initiate a process to reduce airBaltic's share capital for losses from previous years, i.e., to reduce it by 571 million euros, which, according to airBaltic, was an essential prerequisite for the implementation of an initial public offer (hereinafter referred to as the IPO). Following this government decision, the Minister of Transport, representatives of the airBaltic Board and Council claimed in several public statements[4] that the recovery of the investment made during COVID-19 was never planned or emphasised that the state support was already repaid through airBaltic's tax payments and its contribution to the country's gross domestic product.

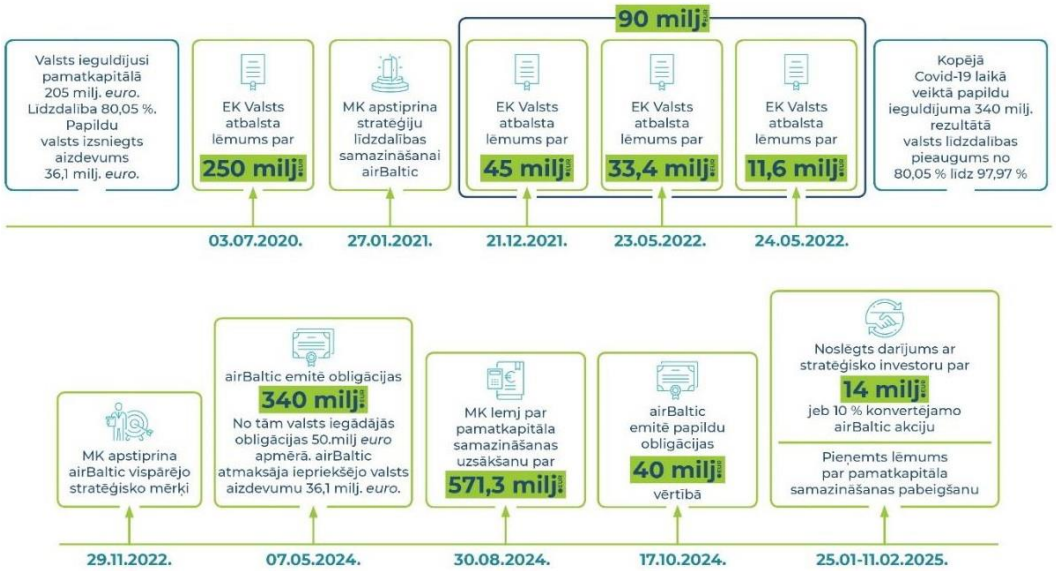
The state has invested 205 million euros into the share capital, share 80.05%. Additionally, issued state loan of 36.1 million euros	EC decision on state aid of **250 million euros**	Cabinet of Ministers approves strategy on reducing shareholding in airBaltic	EC decision on state aid of **45 million euros**	EC decision on state aid of **33.4 million euros**	EC decision on state aid of **11.6 million euros**	The total additional investment of 340 million euros during COVID-19 pandemic resulted in increased share of the state from 80.05% to 97.97%.
						
Cabinet of Ministers approves the general strategic goal of airBaltic	airBaltic issues bonds of **340 million euros** of which 50 million euros worth bought by the state. airBaltic repaid the previous state loan of 36.1 million euros.	Cabinet of Ministers decides to begin reduction of the share capital for **571.3 million euros**	airBaltic issues additional bonds worth **40 million euros**	Transaction with a strategic investor is concluded worth **14 million euros**, or 10% convertible shares. A decision made on the finalisation of the reduction of share capital.		

Figure 1. Key developments since the state's investment for mitigating the effects of the COVID-19 crisis

Considering that all recommendations provided in the 2021 audit report had not been implemented, the current reporting deadline was set until February 2025, the state had not recovered the investment yet, and it was clear from the statements made by representatives of public entities and the state-owned company that it was no longer planned to recover the investment, the State Audit Office of Latvia decided to conduct an in-depth review of the implementation of the recommendations by providing answers to three questions:

- ✓ Did the state plan to recover the investment made to airBaltic to mitigate the consequences of the COVID-19 crisis, and how?
- ✓ How did the state monitor airBaltic after the state investment was made to mitigate the consequences of the COVID-19 crisis?

Has the state clearly defined the national strategic vision and objectives which airBaltic must fulfill?

The introduction to the interim audit report is followed by a summary summing up the main conclusions and the opinion of the State Audit Office of Latvia on whether the recommendation and proposal provided in the 2021 audit report can be considered implemented.

The audit findings section is structured in three chapters in accordance with the above-mentioned review questions for the implementation of recommendations.

Summary

To mitigate the consequences of the COVID-19 crisis, the state invested a total of 340 million euros in airBaltic from 2020 to 2022, thus increasing the state's shares in the company from 80.05% to 97.97%. In the 2020 financial audit, the State Audit Office of Latvia audited the validity of the request for funding granted during COVID-19 and the actual spending of the first investment of 250 million euros made in airBaltic. The audit also assessed the management system of state-owned enterprises established by the Ministry of Transport, in which irregularities were identified. The State Audit Office of Latvia concluded that there were insufficient prerequisites for monitoring the implementation of the conditions for state support provided to airBaltic. The audit provided recommendations to improve the aforementioned management at various levels, thereby also facilitating the recovery of the investment made. A separate opinion of the Ministry of Transport on the recommendations provided by the State Audit Office of Latvia in 2021 is available on page 18 of the original Latvian version of the interim audit report.

In 2021, the State Audit Office of Latvia issued recommendations to improve the state-implemented governance of airBaltic, thereby facilitating the recovery of the 250 million euro investment made to mitigate the COVID-19 crisis. Taking into account the audit findings on the implementation of the recommendations regarding the state's supervision from 2021 to 2024, as well as the currently promoted scenario that the investment is no longer planned to be recovered in accordance with the original intention, the State Audit Office of Latvia closes the recommendation provided to the Ministry of Transport and the proposal provided to the Cabinet of Ministers with the status "not implemented". At the same time, the State Audit Office of Latvia will call on the Cabinet of Ministers to urgently strengthen the management of the state-owned shares in airBaltic, probably by involving other ministries or competent institutions in its supervision or transferring them to management by themselves, thus reducing risks to the state budget.

The following conclusions substantiate the above-mentioned opinion of the State Audit Office of Latvia.

- Although the state initially had a clear intention to recover the investment, there was no clear plan on how exactly this would happen and on what preconditions it depended on. Although the support was provided in accordance with the State Aid's Temporary Framework of the European Commission established at the time, it is the decision of the Republic of Latvia, as the aid provider, to determine what to do with its investment and how to actually recover it.

The initial intention of the government was to recover the investment made during COVID-19 in the amount of 250 million euros, possibly even with a return on the investment, and such a commitment was included both in documents and in public statements up to June 2023.

According to the exit strategy[5] approved by the Cabinet of Ministers in 2021, the state had planned to recover its investment in an IPO process, during which part of the state-owned shares would be sold by reducing the states shares to 51%, thus also exiting state aid. However, this strategy did not contain a clear plan and vision on how the state could recover its investment in the IPO process taking into account various circumstances that could affect the successful implementation of this process, as well as alternatives in the event of adverse market conditions. The lack of the aforementioned plan is also evidenced by the fact that this strategy, approved in 2021, has not been reviewed even once, despite the fact that the second wave of the COVID-19 pandemic followed with state investing another 90 million euros, airBaltic's route network was affected by the war launched by Russia in Ukraine, airBaltic operations were affected by aircraft engine problems, and despite changing its business plans several times.

(As amended by the decision of the Council of the State Audit Office of Latvia of 28 May 2025 (Minutes No 32, § 1))

Permission was granted by the European Commission to provide the aid, and the aid was provided in accordance with a special State Aid's Temporary Regulation of the European Commission established during COVID-19. The aforementioned regulation establishes the state's obligation to reduce the shares acquired during the state aid period and to receive compensation for the investment made. It also defines the ways in which an enterprise can exit from state aid. The main goal of exiting from state aid is not to recover the invested funds but to reduce the state's shareholding in the enterprise. It is the decision of Latvia, as the aid provider, to determine what to do with its investment and how to actually recover it.

Over time, the Temporary Regulation introduced options that exiting from state aid and reducing state shareholding could occur in a way that the state investment is not actually recovered. So far, the Cabinet of Ministers has not approved such a new strategy, although the Ministry of Transport provided information on this at the end of 2024.

There have been several cases[6] where airlines of other countries have actually repaid state aid, and even before the deadline. The State Audit Office of Latvia has not identified any cases to date where an airline that received state aid would exit state aid in a manner similar to the exit strategy currently being considered by airBaltic.

- In connection with the investment made during COVID-19, the State Audit Office of Latvia called for improved supervision of airBaltic in 2021 by providing both a proposal to the Cabinet of Ministers and recommendations to the Ministry of Transport. Although some improvements were made, they were not sufficient. At none of the supervisory levels such as the Cabinet of Ministers, the Ministry of Transport, or the airBaltic Council, were there sufficient actions taken that potentially contributed to the recovery of the state investment.

Since the state aid was provided in accordance with the EC Temporary Framework, both airBaltic as the recipient of the aid and Latvia as the provider of the aid had to comply with the restrictions, monitoring and reporting mechanism set out therein. The provisions of the Law on the Management of Capital Shares of Public Entities and State-owned Enterprises, as well as the monitoring procedures set out by the Ministry of Transport as the shareholder, also apply to airBaltic.

Since 2015, **the Cabinet of Ministers** has determined that it must submit information on the current situation of airBaltic twice a year. However, it was not defined what information should be provided, nor was there a requirement to submit reports on the goals set and results achieved by airBaltic until April 2024. This led to a situation whereby, except in cases related to additional investment needs, the informative reports submitted to the Cabinet of Ministers mostly highlighted the positive aspects of airBaltic's operations, without mentioning various risks related to the financial situation. This can be explained by the fact that, up until December 2024, these information reports were prepared by airBaltic itself.

Additionally, when approving the strategy for reducing the state shareholding and recovering the state investment within the framework of the state aid case in 2021, the Cabinet of Ministers stipulated that the Cabinet of Ministers should be informed about the progress of the IPO process every six months. However, this introduced mechanism also did not ensure timely identification of deviations and implementation of corrective measures or the consideration of alternatives, for example, at the time when the decision was made on the state's participation in the refinancing of bonds. Supervision of the recovery of the investment was left to the Ministry of Transport, its nominated Council and Board Members of the company.

The State Audit Office of Latvia draws attention to the fact that almost all informative reports reviewed by the Cabinet of Ministers have been assigned the status of restricted access and are being maintained as such for a long time, which prevents the public from obtaining information about airBaltic's activities, thus reducing public trust in the decisions made by the government and their justification.

The Ministry of Transport is both the shareholder of airBaltic and the ministry responsible for the aviation sector, and it was also designated as the responsible institution for Latvia in the European Commission's State aid cases.

The audit of the implementation of the recommendation concluded that the Ministry of Transport had still not established a corporate governance system that would enable the state to implement the strategic objectives of the sector, to promote rational and economically justified use of resources, as well as to ensure compliance with the conditions for the shareholding of a public entity.

The Ministry of Transport is still not obtaining information from airBaltic in the planned amount, for example, on employee remuneration. The Ministry has also not verified whether the restrictions set by the European Commission in the framework of the state aid case regarding the remuneration of the Board have been observed, as it has delegated supervision to the airBaltic Council.

The auditors assess that the supervision by the Ministry of Transport was generally insufficient and lacked a proactive approach, especially with regard to the adoption of strategically important decisions. The Ministry mainly relies on the work of the airBaltic Council. Even when the Ministry receives significant information from the Council about the transactions it has concluded, the Ministry does not assess whether and how the obligations arising from the transactions affect the shareholder's plans to recover its investment, as well as whether these obligations create potential risks in addition to the need for investments from the state budget. The separate opinion of the Ministry of Transport

on the aforementioned conclusion is available on page 22 of the original Latvian version of the interim audit report.

The Ministry of Transport still does not fully participate in determining the company's financial and non-financial goals, including in assessing how the goals are consistent with those set during the provision of state aid. Although the Ministry of Transport participates in the coordination of business plans, it does not show interest in the final decisions made or amendments made in their implementation. The Ministry of Transport requested the most current version of the business plan from the airBaltic Council only when it was due to be submitted to the State Audit Office of Latvia.

The Council must represent the interests of shareholders between general shareholder meetings and monitor the activities of the Board.

When auditing the implementation of the recommendation, it was concluded that, although the airBaltic Council had established an additional monitoring mechanism over the use of funds allocated for COVID-19, its actions regarding the monitoring of the Board's remuneration limits were insufficient not only to avoid violating the European Commission's restrictions but also to act in the best interests of the shareholder and taking into account the company's financial situation. As a result, in January 2022, a few months after airBaltic had requested an additional state investment of 90 million euros to mitigate the effects of the COVID-19 crisis, the company's Board was paid bonuses for its performance results in 2019. Also, in September 2022, contracts with the Board were renewed, with Restricted Access […] remaining in the contracts of two Board Members. In the opinion of the State Audit Office of Latvia, such actions were incompatible with airBaltic's financial position.

In turn, regarding the development and coordination of business plans, the State Audit Office of Latvia still finds deviations from the application of this regulation in accordance with its meaning although the process set out in the Law on the Management of Capital Shares of Public Entities and State-owned Enterprises was followed. For example, the responsible institutions evaluated and provided an opinion on airBaltic's business plan "IPO&BEYOND", which included two development scenarios, but the airBaltic Council did not provide them with information on which of the scenarios had been chosen and why.

- As of mid-2023, airBaltic's business plans are no longer related to the goal of the state recovering its investment, and the actions taken by the state with the reduction of the share capital, as well as the planned reduction of the shares held, show that the state no longer has such an intention. Although this justifies the need to also exit the state aid regulation set by the European Commission, the State Audit Office of Latvia draws attention to the fact that exiting state aid cannot be considered an end in itself and can occur in various ways. The state is responsible for making a decision whether it wants to recover its investment in this process.

When investing 250 million euros in 2020, the government set specific achievable operational and financial indicators for airBaltic which it had to achieve by 2025 to facilitate the recovery of the state investment. Although these goals were carried over into airBaltic's business plans, the business plans were often changed due to external circumstances (there have been four business plans), and deviations from achieving the target values set in 2020 began as early as 2022.

After the new business plan was approved in July 2023, airBaltic's main goal is one, to implement an IPO, but its implementation is not in any way related to the recovery of the state investment anymore since the financing planned to be mobilised is necessary for the implementation of the company's planned growth plans.

Although the Ministry of Transport and the Coordination Institution assess airBaltic's performance indicators annually, this is done against indicators selected by the company and certain target values, thus airBaltic received a good assessment in 2022 and 2023. However, according to airBaltic's annual financial statement, its financial situation has not stabilized in recent years, which is also one of the reasons why the state decided to recognise losses and reduce the share capital in 2024.

- The state has not clearly defined the national strategic vision and goals which airBaltic must fulfill. Promoting Latvia's accessibility is used more as a "slogan", rather than a clear vision of the state or the Ministry of Transport as a shareholder by what and how often we should be accessible and under what profitability conditions. As a result, airBaltic does not sufficiently take into account potential risks in its growth plans that may affect the preservation of the value of the state's investment, and the state does not require it.

The state may establish or acquire a stake in a state-owned enterprise if one of the conditions included in the State Administration Structure Law is met. Latvia has defined that it needs its own airline, as this creates services that are crucial for the development of the state.

In 2022, the Cabinet of Ministers set the general strategic goal of airBaltic. However, the Ministry of Transport has not yet developed a document that would detail this goal and provide an explanation of the intentions the state seeks to meet with the aforementioned shareholding within a certain period, that is, a Letter of Intent.

Although promoting Latvia's international reach is one of the state-defined goals of airBaltic, the auditors of the implementation of the recommendation did not identify a clear vision on what that would actually mean. In the opinion of the State Audit Office of Latvia, such uncertainty allows the "slogan" of Latvia's reach to be used in cases where the need for a new investment from the state as the largest shareholder needs to be justified. It also indicates the risk that the state cannot assess whether and how airBaltic's business decisions are consistent with the state's goal, including recovering or benefiting from the state's investment.

The state's lack of vision is also evidenced by the latest business plan developed by the company to move towards the implementation of the IPO and foreseeing significant growth of the company by doubling the size of the fleet for this purpose. The development of this business plan is not based on the defined need or interest of the state as a shareholder, including in relation to recovering its investment because, contrary to the state's strategy approved in 2021, the sale of state-owned shares is no longer planned as a result of the IPO – it is only planned in order to issue new shares to finance airBaltic's growth plans.

From the above, it can be concluded that, although the state owned 97.97% of the share capital of airBaltic after the 340 million euro investment made during COVID-19, the state has so far acted more like a 'wallet to draw from' than a sufficiently qualified and demanding owner of a state-owned enterprise.

References

[1] Audit No 2.4.1-36/2020 by the State Audit Office of Latvia, interim audit report "Investments in state-owned enterprises of the aviation sector of the Ministry of Transport to curb the consequences of the COVID-19 crisis". Available: https://www.lrvk.gov.lv/lv/getrevisionfile/29569-ZIYN4tzL94W87f9rsq-_QZrt_Qira4Qw.pdf

[2] Part Two and Three, Section 26 of the Law on the Management of Capital Shares of Public Entities and State-owned Enterprises.

[3] Letter No 7-2.3.1e/490 of the State Audit Office of Latvia dated 6 June 2023 "On the updated timeframe for reporting on the implementation of recommendations by the Ministry of Transport".

[4] See, for example: 1) Vai valsts savus ieguldījumus "airBaltic" norakstījusi zaudējumos? Ministri beidzot sākuši skaidrot lēmuma būtību | tv3.lv; 2) LETA: The CEO of airBaltic explained that the COVID-19 support granted across Europe, in the case of airBaltic, is conditional on the state proving that the company has positive value. Value, not cash. Available: https://www.leta.lv/archive/browse/?_=1&s=gauss&t%5B0%5D=news&cs=0&rs=01.01.1995&re=16.02.2025&fl=&id=C8EE58A0-751E-4023-9417-6B54A8A10C48 (accessed on 6 February 2025).

[5] (Restricted Access) Informative report "On the strategy for the termination of the state shareholding obtained as a result of the recapitalization of airBaltic" TA-198-IP (reviewed by the Cabinet of Ministers on 11 February 2021).

[6] See the examples of airlines Finnair, KLM and Lufthansa included in Chapter 1.2 of the Interim Audit Report.