

AUDIT REPORT

Riga

02.12.2011

No. 5.1-2-7-1/2011

Compliance of the Greenhouse Gas Emission Allowances Administration with Legal Requirements and Effectiveness of the System in Latvia

Legal Justification of the Audit

1. According to the Section 2 of the State Audit Office Law and Audit Assignment No. 5.1-2-7/2011 of 2 May 2011 and Audit Sub-Assignment No. 5.1-2-7-1/2011 of the Fourth Audit Department of the State Audit Office, the legality audit “Compliance of the Greenhouse Gas Emission Allowances Administration with Legal Requirements and Effectiveness of the System in Latvia” was conducted.
2. The audit was conducted by Senior State Auditor Janis Salenieks (head of the audit group) and State Auditor Linda Mikanovska.

Objective of the Audit

3. The objective of the audit is to gain assurance whether
 - 3.1. the administration of the emission quotas of greenhouse gases (hereinafter: “GHG”) is realized in compliance with the requirements of regulatory enactments; and
 - 3.2. the European Union emissions trading scheme has been implemented in Latvia in the way that motivates enterprises to lower emission with minimum impact on the enterprises economical development.

Accountability of the State Audit Office

4. The State Audit Office is responsible for issuing an audit report that is based on appropriate, sufficient and credible audit evidence obtained during the audit.

Accountability of the Public Utilities Commission

5. The Public Utilities Commission is responsible for compliance with regulatory enactments and the truthfulness of the information provided to the auditors.

Scope of the Audit

6. The audit has been conducted in accordance with international auditing standards recognised in the Republic of Latvia. The audit was planned and conducted in a way to gain sufficient assurance regarding the compliance with the regulatory enactments of the inclusion of the expenses for purchase GHG emission allowances in the operators’ tariffs in the energy sector and use of revenues from the sale of emission allowances.
7. Due to the fact that the audit was conducted in an area involving a number of responsible institutions, two audit reports have been prepared as a result of the audit:
 - 7.1. to the Ministry of Environmental Protection and Regional Development: on the implementation of climate change reduction policy and compliance of the supervision of operators with regulatory enactments;

- 7.2. to the Public Utilities Commission: on the compliance with the regulatory enactments of the inclusion of expenses for purchase GHG allowances in the operators' tariffs in the energy sector and use of revenues from the sale of emission allowances.
8. This report has been prepared for the Public Utilities Commission regarding the compliance with the regulatory enactments of the inclusion of expenses for purchase GHG allowances in the operators' tariffs in the energy sector and use of revenues from the sale of emission allowances. 31 heat energy and co-generation tariffs approved for producers were selectively audited at the Public Utilities Commission.
9. The audit was conducted regarding the time from 1 January 2005 to 30 June 2011.

Summary

10. Neither local government regulators¹ nor the Public Utilities Commission have realized sufficient actions to ensure that the tariff payments made by heat energy users cover only economically justified costs of public utilities², thus increasing the tariffs, and they have failed to supervise the use of the revenues from the sale of GHG emission quotas, as the following is the case:
 - 10.1. by not observing the requirements of the regulatory enactments, the inclusion of the expenses for purchase GHG emission allowances in the tariffs of the operators in the energy sector has not been evaluated, creating the situation where
 - 10.1.1. of the nine tariffs in which the cost of purchase of emission allowances has been included, the emissions allowance expenses included in two tariffs approved by local government regulators and one tariff approved by the Public Utilities Commission, or 33% of the tariffs of the operators inspected, were unjustified;
 - 10.1.2. the heat tariffs have been increased by LVL 0.08 to LVL 0.42 per megawatt hour.
 - 10.2. the possibility to initiate tariff revisions for five public utility providers whose heat tariffs include the cost of GHG emission allowances but which had no expenses associated with GHG emissions allowances in 2011 was not used, thus:
 - 10.2.1. in one case, the heat tariff was increased by 0.7%, or LVL 0.19 per megawatt hour, as of 1 January 2011;
 - 10.2.2. in four cases, the heat tariffs have been increased by LVL 0.34 to LVL 1.03 per megawatt hour as of 1 August 2011.
 - 10.3. by not observing the requirements of the regulatory enactments, no assurance was gained that the revenues from the sale of GHG emission allowances are used towards measures to reduce GHG emission, as a result of which,
 - 10.3.1. in two cases, a risk of double funding exists; i.e., the expenses included in the tariff possibly may have been paid for from the revenues from

¹By 31 October 2009.

²Section 20 of the Law on Regulators of Public Utilities.

the sale of GHG emission allowances in the amount of up to LVL 492,781;

10.3.2. the tariff includes depreciation of LVL 3,475 for fixed assets purchased from revenues from the sale of emission allowances, accordingly increasing the tariff by LVL 0.02.

11. Following the audit, four recommendations were issued to the Public Utilities Commission, which, if implemented, would ensure the following:

11.1. inclusion of the cost for purchase of GHG emission allowances in the heat energy and co-generation tariffs in a way that is economically justified;

11.2. use of revenues from the sale of GHG emission allowances by public utility providers towards the reduction of GHG emission, and the non-inclusion of such costs in the tariffs.