



EUROPEAN COMMISSION  
EUROSTAT

Directorate D: Government Finance Statistics  
Unit D3: Excessive Deficit Procedure II



Luxembourg, 28 March 2012

## **FINAL FINDINGS**

### **EDP ad-hoc visit to Portugal**

**19-20 September 2011**

## **Executive summary**

An ad-hoc Eurostat visit to Portugal took place on 19 and 20 September 2011. This visit was conducted immediately after the publication of the joint News released by INE and Banco de Portugal on Friday 16 September, which pointed to significant underestimation of expenditures and liabilities in recent years in the Autonomous Region of Madeira. The corresponding impact on EDP data has been at the origin of almost the whole data revision for Portugal within the EDP notification transmitted on 30 September 2011.

During this ad-hoc visit, Eurostat appreciated the diligence demonstrated by the Portuguese statistical authorities, to provide the needed information during and after the meeting.

As far as the issue of the misreporting of expenditures in Madeira was concerned, Eurostat obtained full explanations of the events which took place in the region and on the conditions in which “deliberate misreporting” had been detected by the Court of Auditors. A detailed description was also provided to Eurostat of the investigations that had been undertaken in recent weeks by INE, Banco de Portugal, the Ministry of Finance and the Court of Auditors.

It appeared that the misreporting did not result from a default in the statistical system but from deliberate action and that it had not been possible for the Portuguese statistical authorities to report on the issue already in the April 2011 EDP notification.

It was agreed that there should be in the future more cooperation between the Court of Auditors and the national Statistical Authorities so that the possible impact of remarks by the Court might be taken into account for the purpose of EDP statistics with a shorter delay.

Moreover, Eurostat asked to be informed about the measures, whatever their nature, that will be implemented in order to avoid any possible future misreporting in the Portuguese public accounts, especially in the case of autonomous regions.

During the visit a minor part of the agenda was also devoted to some other issues, at the request of Eurostat.

# **I/ Misreporting in the Autonomous Region of Madeira**

## **Introduction**

This mission was carried out following the publication by INE and Banco de Portugal of a press release on 16 September 2011 that pointed to significant underestimation of expenditures and liabilities in recent years in the Autonomous Region of Madeira.

## **Discussion**

### **1) Meeting with INE/Banco de Portugal (19 September)**

Eurostat specified the main objectives of the mission as understanding exactly what happened as regards the data related to Madeira, making sure that it could be really considered as an isolated case, and to discuss what could be done in future to ensure the quality of Government deficit and debt data following this case.

Eurostat praised the Portuguese statistical authorities for having unearthed this issue despite the difficult circumstances and for having made it public through the joint news release by INE and Banco de Portugal (BdP) on Friday 16 September 2011. Eurostat however regretted that the April 2011 EDP notification could not have already taken into account the impact on debt and deficit and asked for a precise chronology of the issue. Eurostat underlined that revisions such as these can deeply negatively impact the credibility of statistics.

INE explained that it had already expressed doubts on the reliability of data related to the Autonomous Region of Madeira, notably because of persistent discrepancy between its deficit and change in debt. However, the amounts were not sufficiently significant to trigger specific action. As a matter of fact, BdP noted that this discrepancy cancelled out over time when considering the loan recorded in the accounts of 2008, from Central Government to the Autonomous Region of Madeira, under a special financing programme "*Programa Pagar a Tempo e Horas*". Moreover, trade credit figures were in line with figures published in the Court of Auditors reports. In April 2011 the Court of Auditors had adopted and released a report (which had been prepared in February) in which the absence of any records for some expenditures had been detected, notably through Debt Repayment Agreements ("DRAs") between the regional authorities and the corporations which had taken part in different public works contracts (roads, schools, etc.).

This is the event that triggered the action of INE, which stressed that the significance of the misreporting has been a surprise for them, considering that they were not in a position to assume such a level of misreporting for which the Regional Statistical Office was also not aware. Due to the autonomy of the region, the Regional Statistical Office depends on the regional administration, although is linked to INE for technical matters. In the context of the EDP notification, INE has the role of validating regional government accounts and EDP data and may ask for clarifications to the regional authorities.

INE added that the reasons why the issue could not be raised for the April 2011 notification was the release date of the Court of Auditors report and the fact that the report presented 2009 and 2008 data that INE – in cooperation with the Regional Statistical Office and BdP - had to check. Moreover, the information from the Regional Statistical Office on 2008 and 2009 was only sent to INE in May 2011.

It was only at the end of August 2011 that INE knew about the new agreements signed in 2010 and which resulted in a significantly higher amount of unrecorded expenditure than in the case of the 2008-2009 agreements. It was then that INE reached a more complete picture of the impact on deficit and debt. In addition the report of the Court did not mention the precise accounting consequences of their observations, mentioning only the infringements to legal and regularity provisions.

Eurostat also confirmed that there had been a total absence of recording in the usual data sources, i.e. the public accounts. The Ministry of Finance had not received any information on the contracts, their execution and the DRAs, as should have been the case.

Both INE and the BdP confirmed that this was a case of deliberate misreporting from the Regional authorities, and in breach, of at least two Portuguese laws, one (2008) on the information to be included in public accounts, the other (2007) on the obligations of declaration for statistical purposes. The difficulty of control was due to the fact that there were no flows of payments. As the accounts of Madeira are still on a pure cash basis (not the case for example for other government units, including municipalities), the current arrangements allow the capturing of any expenditure in the public accounts only when a payment occurs, if a list of expenditures not yet paid for is not reported correctly, which was the case in Madeira. INE and the BdP considered that the issue did not show shortcomings in the statistical system as such.

During the investigations carried out in recent months, the level of unrecorded expenditure was determined on the basis of the amounts mentioned in the DRAs. These amounts would also include interest charged by government contractors because of the delays in payment.

As far as the debt was concerned, BdP mentioned that if the original debt of the region took the form of trade credit (F71) – not part of the EDP debt – there had already been some refinancing by banks in the factoring operations, without recourse (if the corporation fails to meet its obligations, the bank holds a direct claim on the government) which are recorded in the Portuguese money and banking statistics as a claim on government (the corporation is thus ignored) and therefore in General Government Debt. Following analysis, BdP classified the unrecorded liabilities in public accounts as EDP debt. Eurostat stated its full agreement with this treatment which is intended to be confirmed by the next specific Task Force on Trade credits. Eurostat welcomed an issue note from BdP to be addressed to the Task Force.

Concerning the revision of deficit data for the year 2008-2010, INE considered that the final EDP revisions to the notification were expected to be very close to the amounts announced in the press release of 15 September. As far as the increase in government debt is concerned (roughly half of the amounts mentioned in the DRAs have been already recorded in the debt) INE and the BdP pointed out that the definitive figures could still change more than for the deficit, as all the checks had not been achieved.

Eurostat agreed that the impact on deficit and debt would be recorded in the years that the DRAs were signed, which is the treatment mentioned in the INE/BdP press release. Through these agreements, there is an official recognition of the expenditures which were not recognised previously. There would also be an entry in the public accounts of the Region at this point of time. Eurostat was also assured that the impact of expenditures in previous years was incorporated in GDP production/expenditure, as work in progress of the construction

companies. So there is a reclassification of GFCF in 2010 (lower GFCF of the private sector, higher of the Regional government).

For the impact on the year 2011, at this stage, the statistical authorities expressed more uncertainty. The DRAs should involve lower amounts but this would still have to be confirmed. INE specified that they will use a survey of construction companies with the purpose to detect any agreement with government on debt.

Eurostat was informed on the work being carried out by the Technical Working Group organised by the Ministry of Finance, including INE, which was examining in detail the issues in Madeira, both in quantitative terms (misreporting) and as concerns the shortcomings in the reporting system that led to the situation. Its mission is to fully resolve the issue. The group should report at the end of September 2011 to the Minister of Finance. It was agreed that the report would be sent to Eurostat when it is available. The group should confirm that the totality of the misreporting has been detected, in particular for 2010.

Eurostat requested the Portuguese statistical authorities to provide a guarantee that there would not be further revisions (of any significance), notably for the years 2010, in the April 2012 notification due to the Madeira case. Eurostat insisted on the fact that there should be no uncertainty on this point, at the latest at next mid-October, before Eurostat's October 2011 EDP News Release is issued. Otherwise, there might need to be a reservation expressed by Eurostat.

The Portuguese statistical authorities replied by saying that the bulk of the issue had been captured and that no significant revisions are expected to occur.

Regarding the crucial point raised by Eurostat about the risk that similar misreporting could happen for other government units, INE and the BdP pointed out the very specific situation of Madeira and on the exceptional aspect of the deliberate misreporting.

For all government units using accrual system (from 2010 onwards for local government) the risk of such misreporting is expected to be negligible. As far as the other autonomous region (Azores) is concerned, INE has carried out specific investigations with the Regional Statistical Office and the regional government. Nothing that could indicate a similar misreporting has been noted and the statistical authorities considered that for the Azores there was no risk.

## **2) Meeting with representatives of the Budget General Directorate of the Ministry of Finance (20 September)**

At its request, Eurostat met representatives of the Budget General Directorate (DGO), with INE and BdP.

Eurostat invited the DGO to confirm that this was indeed a case of deliberate misreporting. The DGO explained that it had been confirmed by the representatives of the Government of Madeira that the expenditures incurred had not been reported, and that the MoF agreed it was a very serious matter. Concerning possible sanctions, the DGO was aware that the General Prosecutor had opened a case, and the DGO agreed to provide a written note following the meeting on the procedures that, according to the law, can be followed.

They also described the specific situation of the autonomous region that has a separate budget but must transmit precise information of the execution of the budget to the DGO on a monthly basis. However, they explained that the control of the data was rather formal and could not be considered as a real auditing process<sup>1</sup>; there is no similar control system, as for local government units. Concerning the data supply process from Madeira, Government accounting data for Madeira is provided directly from the Regional Directorate of Planning and Accounting of Madeira to the DGO. The data supply is a responsibility of the Government of Madeira under law. The data is verified within the DGO by checking that it is consistent with data for previous periods. The data for Madeira is not audited by DGO. Auditing is carried out only by the Court of Auditors.

In Eurostat's view there was a clear weakness in the control of data from the autonomous regions. The DGO explained that this weakness had already been raised by the EC/IMF/ECB and a revision of the law with respect to regional finances was under discussion.

The DGO confirmed that the unreported amounts had not yet been totally assessed for Madeira. As far as Azores was concerned, they explained that various responsible persons had been contacted. They concluded that the quality of data seemed to be satisfactory.

Eurostat asked which actions would be taken in order to avoid a repetition of such misreporting and to correct the shortcomings in the procedures that were at its origin. It was specified that there would be some adjustments to the current legislation. The report of the Technical Working Group (within which INE, BdP, DGO and other agencies of the MoF are represented), benefiting from the contributions of the IMF during some meeting days, is due to be completed by end September 2011. At that point the MoF would send to Eurostat the results of the work, in particular focussing on the revisions needed to the 2010 EDP data and the data for other years, and the measures that would be taken.

INE will also inform Eurostat of the use by it of certain data sources, such as business surveys, which could reinforce the quality and reliability of the data.

### **3) Meeting with the Court of Auditors (20 September)**

After having praised the work of the Court which found the mechanism for hidden expenditures in the accounts of Madeira, Eurostat explained the seriousness of the issue of the misreporting for Madeira in the context of the support programme for Portugal and of the reporting for Portugal in the EDP notification to be released by Eurostat on 21 October 2011. The Court of Auditors (CoA) explained the principles underlying its work, in particular its full independence and integrity, and its own mandate. The results from all of the CoA's audits were issued in its published reports.

In its report dated February 2011, and adopted and made public in April 2011, the CoA had noted some important charges incurred but not paid by the Government of Madeira, which had been the subject of Debt Repayment Arrangements (DRAs) concluded between the Government of Madeira and construction companies in 2008 and 2009. Within its audit of the 2009 accounts, the CoA had collected information from the construction companies concerning the amounts involved. The DRAs concluded in 2008 and 2009 relate to

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<sup>1</sup> The DGO has no powers to apply auditing processes.

construction work dating back as far as 2003. The Court of Auditors had not identified the misreporting before its report on the 2009 accounts of Madeira. The Court had concluded that the legal obligations related to reporting had not been met and that expenditure had not been shown as it should have been.

Nevertheless it should be stated that since 2007, in the annual Court opinion on the regional accounts of 2005, the Court report drew attention to operations to postpone payments due (debt renegotiation agreements with suppliers, credit subrogation agreements, interest debt agreements with suppliers).

INE acknowledge that the opinion was indeed important and that the mentioned operations were incorporated in National Accounts compilation.

Concerning the follow-up of the report the Court stressed that its responsibility to detect anomalies in the accounting reporting and that other instances, namely the General Prosecutor deputy assigned to the Court, had their own tasks, such as sanctions or measures to ensure a correct reporting. For instance, the report findings were included in the 2009 annual Court opinion on the regional accounts that has been sent to the Parliament of Madeira which can decide to engage prosecution. The Court has not the power to correct itself the accounts but the Court makes a follow-up of its own recommendations that would ensure that the accounts would give an exact picture of the level of the expenditure and liabilities of the region.

The Court pointed out that the Madeira issue was quite exceptional and had not been observed in other cases. Notably the Court specified that nothing similar had been detected in the other autonomous region (Azores).

Eurostat explained that it regretted that the CoA had not been able to provide any information about their audit work on the Madeira case at the previous meeting between the two institutions held in April 2011. If that information had been made available it might have been used to improve the EDP reporting made by Portugal in April 2011. The CoA explained that its report was internal at that stage and the information it contained could not be shared in February 2011. Eurostat stressed the importance of the EDP notification schedule, which foresees notifications at the end of March and September each year, and proposed that this could be taken into account in the planning of the CoA's work.

The CoA had not yet received the annual accounts for 2010 from the Government of Madeira. In the previous three years, the annual accounts had been received by July of the following year. However, according to the regional law of Madeira, the deadline for providing the accounts is the end of December the following year. The CoA expects to receive the 2010 accounts before the end of the year. The CoA's report on the 2010 accounts would be issued, as usual, in the first part of 2012. The CoA had therefore not yet been able to assess the amounts of unreported expenditure at stake in 2010.

It was agreed to provide immediately to the CoA the data collected by the INE, BdP and MoF concerning unreported transactions in 2010. Eurostat regretted that the timing of the verification by the Court of the 2010 accounts of Madeira was not consistent with the timing of the October 2011 notification and stressed that it would value any contribution the CoA could make towards guaranteeing the data for 2010 for the October 2011 EDP notification. The Court of Auditors also explained that it has recommended the modification of the

regional law in order to introduce in Madeira the same timing of presentation of accounts as in the State and in Azores (30 June).

Finally the Court indicated that it was aware of the need to develop its cooperation with the statistical authorities in order to ensure a better quality of data on government debt and deficit. Therefore the Court agreed to examine any proposal that would be presented in this sense.

### **Final findings and action points**

**Action point 1.** Eurostat takes note that this is a case of deliberate misreporting from an entity of general government. Deliberate statistical reporting is grave and should be severely sanctioned. Eurostat welcomes the commitment of the Budget General Directorate to send to Eurostat a note explaining the measures that the government (or appropriate authorities) are taking to sanction and reform the system as to avoid such a case to be repeated.

**Action point 2.** Eurostat takes note that this case should be considered exceptional, and heard the convergence of all actors to consider that the other autonomous region is not affected by such misreporting. Eurostat is however not fully convinced that all misreporting for the past years, and in particular 2010, has been taken into account for the specific case of Madeira. In case all issues are not clarified, Eurostat could incorporate a reservation in its 21 October publication. Eurostat requests to receive a note from the Portuguese statistical authorities before mid-October clarifying the conclusions of the Working Group organised by the Ministry of Finance<sup>2</sup>. The report of this working group, with a special annex on 2010, is to be forwarded as soon as possible to Eurostat<sup>3</sup>. Any clarification from the Court of Auditors of its verification of 2010 data would also be welcome.

**Action point 3.** A meeting will be organised between Eurostat and the Portuguese statistical authorities before mid-October, with the objective of clarifying the last issues regarding the Madeira case.

**Action point 4.** Eurostat welcomes the wish of Portuguese statistical authorities for a stronger cooperation of all institutions, including the Court of Auditors, in particular taking into account the constraints of the timing of the European notification of deficit and debt. Eurostat would welcome that the Portuguese statistical authorities and the Court of Auditors participate in the new Working Group on GFS Quality Management and move forward a formal memorandum of understanding, based on best practices. Eurostat was also asked to provide examples of cooperation between Court of Auditors and statistical authorities that could be useful to develop this cooperation in Portugal.

## **II/ Other issues**

The remaining part of the meeting was dedicated to several issues, some being raised by information given by the press:

Hospitals: 14 public hospitals are in a critical situation and might not meet their debt obligations (no guarantees from government); INE stated that there was no plan for re-

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<sup>2</sup> This note has been received.

<sup>3</sup> This has been done.



classification within government sector as they pass the 50% test and that any capital injection for covering losses would be as usual treated as capital transfer;

BPN - Caixa: it is envisaged to discharge Caixa from its claims on BPN; INE will closely follow future developments and inform Eurostat;

Public corporations: Eurostat mentioned the cases of some companies; there are no new specific issues for INE;

New transfer of pension obligations (essentially from some financial institutions); INE specified that this possibility was effectively under discussion but there was still no decision;

Parpublica (transactions for buildings): INE declared that these transactions will continue to be checked. BdP noted that this issue had been discussed during some of the previous Eurostat EDP dialogue visits and a follow-up was provided after the missions.

## **Annex: list of Participants**

### **INE**

Carlos Coimbra, *Director of National Accounts Department*  
Pedro Oliveira, *Deputy Director National Accounts Department*  
Rute Dourado, *Head of GFS Unit*  
Patricia Semião, *GFS unit*

### **Banco de Portugal**

João Cadete de Matos, *Director of Statistics Department*  
Ana Almeida, *Deputy Director of Statistics Department* (only in the meeting of 19<sup>th</sup> September)  
José Sérgio Branco, *Head of General Government Statistics Unit*  
Paula Menezes, *Head of Methodological Development Unit*

### **Budget General Directorate of the Ministry of Finance**

Maria Teresa Ferreira, *Deputy Director of Budget General Directorate*  
Tiago Teixeira, *DSFP unit*

### **Court of Auditors**

José Tavares, *General Director*  
Ana Affonso, *Deputy General Director (Madeira)*  
Alberto Pestana, *Auditor-Coordinator (Madeira)*

### **Eurostat**

François Lequiller, *Director Directorate National and European Accounts*  
Luca Ascoli, *Head of Unit C3*  
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