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Unit D.4: GFS Quality Management and Government Accounting



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## **Technical and Upstream Dialogue Visits to Spain, 24 May and 18-22 June 2012**

### **Main conclusions and recommendations**

#### **0. Introduction**

Eurostat carried out a short technical visit to INE on 24 May 2012 and an Upstream Dialogue Visit (UDV) to Spain from 18-22 June 2012 to clarify in particular the issue of previously unreported arrears by Autonomous Communities (AC) and local governments.

Eurostat met representatives of Instituto Nacional de Estadística (INE), Intervención General de la Administración del Estado (IGAE), Banco de España (BdE), Tribunal de Cuentas (Supreme Audit Office), regional Courts of Audit, ACs, Municipalities, Instituto Nacional de la Seguridad Social (National Social Security Institute), Intervención General de la Seguridad Social (Inspectorate General of Social Security) and the Consejo de Política fiscal y Financiera de la Comunidades Autónomas (Fiscal and Financial Policy Council –FFPC). Eurostat received full cooperation from all these authorities.

The objectives of the missions were three fold:

- The first objective was to assess the recent revisions to the Spanish 2011 general government deficit,
- The second objective was to review the reporting of expenditure by ACs and municipalities and the system of public accounts at national, regional and municipal levels, and discuss the necessity for future improvements of these systems in order to avoid for 2012 and future years what has happened for 2011.
- The third objective was to review the capacity of the Spanish statistical authorities to ensure the quality of the statistical reporting by ACs and local authorities.

The present report is organised alongside these three objectives.

Eurostat concluded that some expenditure which took place in 2011 and in prior years was not reported at the time it incurred and consequently was not recorded according to the accrual principle of recording. Eurostat considers that this is a consequence of serious weaknesses of the statistical reporting chain.

Eurostat considers that significant improvements are necessary in order to achieve a robust statistical reporting system.

## 1. Recent revisions to the Spanish general government deficit

Eurostat concluded that revisions to the deficit for 2011 (and to earlier years) are primarily the consequence of two distinct deficiencies in the public accounting and in the statistical reporting of the expenditure of ACs.

- Not all arrears of ACs in 2011 were reported to INE in a timely manner
- Specific accounting rules in the AC of Valencia allowed the delayed reporting of a part of health expenditure over a longer period.

This situation was highlighted by the implementation of the Supplier Payment Mechanism (SPM) for the payment of AC arrears by Central Government. Thereby, the data sources used for the compilation of the deficit for the March 2012 notification for the Excessive Deficit Procedure (EDP) were compared with the data on arrears resulting from the Suppliers Payment Mechanism based on declarations from Autonomous Communities and local governments of unpaid bills at the end of 2011. It was found that some expenditures incurred before the end of 2011 had not been reported in the March 2012 EDP notification. This more exhaustive collection of data on arrears put in evidence some drawbacks of the accounting systems, reporting and compilation procedures.

The majority of the unreported arrears relate to health expenditure and the arrears are concentrated in two regions – Madrid and Valencia. In the first AC there was essentially a problem of timeliness and in the second one the use of specific accounting rules, which led to expenditures not being reported in line with EDP requirements<sup>1</sup>.

### *Global estimation of the unpaid bills reported in 2012*

INE announced on 18 May 2012 an estimated increase of 0.4% of GDP of the 2011 government deficit for the Autonomous Communities, compared to what was reported to Eurostat on 30 March 2012. The special suppliers payment mechanism for the arrears of ACs and regional governments revealed higher unpaid bills than reported to Eurostat in the context of the April 2012 EDP notification.

The total amount of the unreported unpaid bills reported in 2012 amounts to about 4.5 billion euro. A major part of these unreported unpaid bills were attributed to the year 2011 and about 40 % of the expenditure occurred in 2010, or in the case of the

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<sup>1</sup> In **Valencia** the problem related to the existence of a special accounting law which allowed that not all extra-budgetary expenditure would be included in the Accounts 409/413, as would be the case in other Autonomous Communities. This special system of accounting for financing health care had existed for many years, and led to some delays in the reporting of expenditures in past years, but the amounts concerned by the delayed reporting increased significantly in recent years. For **Madrid** data on expenditure and arrears was reported to IGAE in January 2012 for the March 2012 notification. At that time the amounts to be imputed to account 409/413 "Creditors pending allocation to budget" were still under scrutiny and not reported in full. There was a problem of timeliness but also of reporting procedures, since there was no obligation to report the revised amounts to IGAE although by the end of February the revised amounts were already known by Intervencion General de La Comunidad de Madrid.

Autonomous Community of Valencia, even before. The Spanish statistical authorities confirmed that no 2012 expenditure have been included in the 2011 deficit figure.

The Spanish authorities are currently finalising the cross checking of the amounts reported by suppliers in the context of the SPM with the updated information received directly from the ACs in May 2012, in order to ensure that the amounts of unpaid bills are exhaustive. The first results have shown that the recent past situation is now being clarified for the Autonomous Communities as regards the recording of unpaid bills.

The situation of the municipalities (local governments) has also been assessed. As the final data from the SPM, as well as updated data on the statistical reporting of the municipalities to the Spanish statistical authorities were not available at the time of Eurostat visits in May and June 2012, Eurostat asked the Spanish statistical authorities to provide data on the unreported unpaid bills as soon as the necessary information was processed and assessed by the Spanish statistical authorities.

INE confirmed that the final updated data on the government deficit for the Autonomous Communities, as well as for the municipalities, as will be reported to Eurostat in the October EDP notification data, was expected to be available during the summer 2012<sup>2</sup>.

Overall, Eurostat has received assurances by the Spanish statistical authorities that the essential part of the 2011 and pre-2011 unpaid bills have now been accounted for as expenditure in the government deficit of ACs and municipalities.

***Action point 1:*** Eurostat recommended to the Spanish statistical authorities to finalise the cross-checking of the unpaid bills reported in the SPM with their own statistical data, in particular in the case of municipalities, and inform Eurostat about the final results as soon as available (end-July 2012)<sup>3</sup>.

### ***Split of global amount between 2011 and previous years***

The largest part of the unreported unpaid bills reported in 2012 in Autonomous Communities was generated in 2011, but some unpaid bills also refer to the years prior to 2011. The amount of 2.8 billion euro, or 0.26 % of GDP, was attributed to the year 2011 while 1.7 billion euro or 0.16 % of GDP was attributed to the years prior to 2011 as follows: 28 million euro refer to the year 2008, 378 million euro (around 0.035% of GDP) to 2009 and 1, 3 billion euro (around 0.12% of GDP) to 2010.

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<sup>2</sup> Note that the 2011 data to be reported in the October EDP notification will still be half-finalised and may be subject to further revisions.

<sup>3</sup> The note on the impact on government deficit due to the unregistered unpaid bills for municipalities was provided to Eurostat on 2 August 2012. The total amount of the unreported unpaid bills in municipalities reported in 2012 amounts to about 946 million euro, of which about 50 % were attributed to the year 2011.

*According to the ESA95, flows are recorded on an accrual basis when economic value is created, transformed or extinguished, or when claims and obligations arise, are transformed or are cancelled.*

On the basis of the ESA95 definition of the time of recording, the unreported unpaid bills should be recorded as expenditure with impact on government deficit in the year when obligations arose, i.e. in 2011, 2010, 2009 and 2008. The Spanish statistical authorities informed Eurostat that expenditure related to the years before 2010 will be recorded in 2010, due to practical reasons.

Therefore, the estimated impact on government deficit due to the unreported unpaid bills in the Autonomous Communities is estimated to be 2.8 billion euro (0.26 % of GDP) in 2011 and 1.7 billion euro (0.16 % of GDP) in 2010.

As regards the municipalities, 493 million of unrecorded unpaid bills (0.05 % of GDP) was attributed to the year 2011 and 453 million euro (0.04 % of GDP) of unrecorded bills was attributed to the year 2010.

Thus, on the basis of the information provided by the Spanish statistical authorities and to be in line with the ESA95 rules on the time of recording, Eurostat estimates that the impact on general government deficit due to the unrecorded unpaid bills is estimated to be about 3.3 billion euro (0.31 % of GDP) in 2011 and 2.1 billion euro (0.21 % of GDP) in 2010<sup>4</sup>.

***Action point 2:*** Eurostat requested the Spanish statistical authorities to record the unreported unpaid bills in the year in which obligations arose in order to follow the accrual principle of recording. Eurostat also advised the Spanish statistical authorities that in case 2009 and previous years cannot be reopened for practical reasons, then expenditure related to years before 2010, could exceptionally also be recorded in 2010.

## **2. Changes in the public accounting system needed to ensure that this will not happen in 2012 and onwards**

Eurostat concluded that substantial improvements to public accounting and statistical reporting, for both ACs and Municipalities, are needed to ensure this situation or similar issues will not arise in 2012 or later years. The Spanish Central Government and ACs have already designed and begun implementing a series of improvements, which must be followed by other initiatives in order to achieve a robust statistical reporting system.

At the central level, the Organic Law 2/2012 of 27 April 2012, Financial Stability and Sustainability Budget (LOEP), whose scope is the general government sector according to ESA, provides for a series of improvements in the provision of information and transparency.

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<sup>4</sup> Note that the 2011 data reported by the Spanish statistical authorities in the April 2012 EDP notification are only provisional. For example, the Spanish statistical authorities noted an increase of investment expenditure by 405 million (0.04 % of GDP) for ACs, due to source data updates while the 2011 local government deficit is expected to increase by a further 219 million euro (0.02 % of GDP) due to source data updates.

Moreover the law on the State Budget for 2012 requires government departments and managing bodies and the common services of social security to ascertain, by audit techniques, that the data and information provided with economic importance fairly reflect the operations arising from their activity.

In the area of the ACs, the Council of Fiscal and Financial Policy plans to adopt an agreement to ensure that the governments of the ACs enact the policy measures necessary to include that the internal auditors of the financial and economic management carry out annual controls to entities not otherwise subject to accounting audits, allowing to check any obligations or expenditures for goods and services received which have not been covered in budget allocations.

Further improvement actions planned from 2013 include the continuation of the initiatives on transparency, on reinforced reporting requirements and on measures to be applied in the case of infringements.

Within the ACs a series of initiatives were reported, including the following taking effect in 2012:

**Autonomous Community of Madrid:** Resolution from the Interventor General de la Comunidad de Madrid, concerning instructions for the handling of evidence of expenditure. All documents are received through a general register (in the E-REG system) and no more than a week elapses from registration to the issuance of the "justifying document for the expense" in the system. Also an Instruction of the Interventor General de la Comunidad de Madrid is being prepared to enter in force in July 2012 to control expenditure not charged to the budget. These controls will provide reinforced quality and exhaustiveness of the data and a strict application of accrual principles.

**Autonomous Community of Valencia:** As a consequence of the Law of budgetary stability and sustainability, an interdepartmental commission has been created to pursue the follow-up of the policies of rationalisation and austerity in expenditure.

Some legislative measures are also being prepared such as:

- A decree by the Council creating and regulating the centralised general registry of invoices of the AC. This registry is connected with the accounting system and will allow a better knowledge and control over expense and unpaid bills;
- An amendment of the Council Agreement from 27 June 2008, to extend some of the measures to verify the proper control of some expenditure records such as PPPs and public procurements through administrative concessions;
- The revision of Decree 40/1992, from 16 March by another Decree of the Council, reinforcing guarantees on the management of public resources, increasing the content and scope of the investments to be made by the Intervention to the wording of the provisions of article 57<sup>o</sup> of the revised Law of Public Finances for *Generalitat Valenciana*.

From 2013 the Spanish statistical authorities as well as the Autonomous Communities (Madrid, Valencia and some other ACs) explained that measures were already taken to

improve the current system, such as, a new budgetary law; compulsory quarterly auditing of the accounts (including the extra-budgetary accounts such as Account 409, 411, 413), a single point of registration of all the bills at the level of the Autonomous Communities, etc. These are the improvements being prepared by the central government and are foreseen to be applied from 2013 onwards. Regarding Madrid and Valencia, the following measures were reported:

**Autonomous Community of Madrid:** A new financial accounting IT system will be implemented progressively from 2013 onwards, starting with some health care institutions. In terms of controls, it was highlighted that all invoices must be registered through the portal registration system of the Autonomous Community, providing more reliable and accurate information on bills pending application to the budget.

Moreover, the implementation of the logistics module for all purchases of hospitals and centralized purchasing for the rest of the Autonomous Community will reflect directly in financial accounting the delivery of goods and services.

**Autonomous Community of Valencia:** Changes will be made to the legal text of the Law of Public Finances with the purpose of incorporating the same required instruments and procedures to guarantee the appliance of the Law of budgetary stability and sustainability, including expressly a liability regime eligible to those responsible for the various departments and entities for the breach of such rules and principles.

Moreover an expansion of the Annual Permanent Plan of Financial Control will cover the verification of the information recorded in the general registry of invoices, including cross-checking data directly with providers.

Eurostat considers that these improvements are fully necessary and seem sufficient for the expenditure covered by the Suppliers Payment Mechanism. However, in order to ensure that all arrears are reported in a timely and complete manner already in the October 2012 and April 2013 notifications, Eurostat recommends that:

**Action Point 3:** *An independent assessment or audit be carried out to establish the completeness of reporting deficits by ACs by September 2012. An external audit is ongoing in the AC of Valencia and Eurostat recommends that this should also be done for all ACs with significant amounts of previously unreported arrears.*

**Action point 4:** *An analysis be provided by INE for those types of entities not covered by the Suppliers Payment Mechanism by September 2012, such as government controlled entities which are less than 100% owned.*

In the case that evidence is found of any further unreported expenditure, the corresponding amounts *will* be included *without unnecessary delay*.

**Action point 5:** *A review be undertaken by INE, in cooperation with IGAE and FFPC by November 2012, of the data reporting arrangements for ACs and municipalities during the first quarter of each year (period of preparation for April notification) to ensure that deadlines set better reflect availability and completeness of data and moreover to verify during February and March that the amounts of expenditure notified reflect latest available information.*

**Action point 6:** *A review be undertaken in cooperation between the FFPC, IGAE and INE to mitigate any residual risks which may derive from a potential lack of consistency between corrective measures being implemented in various AC to fix the issue of late reported or unreported arrears, in that different approaches may be taken to the same or similar problems pending decisions at central level. Eurostat welcomes the fact that the FFPC plans to look into this issue and requests a report by INE by November 2012.*

**Action point 7:** *Eurostat recommends a review by INE in cooperation with IGAE (who are the setters of public sector accounting standards) and the FFPC on the differences between the accounting standards implemented in the ACs and the standards of the new General Government Accounting Plan, implemented from Jan 2011, in order to:*

*(a) achieve a harmonised treatment of extra-budgetary accounts such as accounts 409, 411 and 413, and;*

*(b) assess the potential scope for inaccuracies and incomparability and their impact of EDP data so as to propose amendments to accounting plans and standards.*

*Eurostat also recommends that the new set-up discussed below ensures that INE's views and needs are taken into account with respect to amending existing or developing new public sector and business accounting standards. Eurostat requests that a progress report on this matter be provided by INE by December 2012.*

### **3. The system of statistical reporting<sup>5</sup>**

Eurostat noted the progress made this year with the first publication of ESA 95 based quarterly deficit/surplus data for ACs. This is a significant step forward in terms of transparency and should allow a better quality control of the data of ACs.

Notwithstanding the progress mentioned above, significant shortcomings remain in the governance of the chain of statistical reporting.

Eurostat's UDV visit confirmed the findings of the 2007 peer review, notably the major concern expressed therein resulting from the complex institutional and administrative structure within which INE operates and noted the important role of the internal audit offices at all level of government (central, ACs and local level) which are not subject to any direct control by INE with respect to statistical reporting for GFS/EDP purposes. The UDV visit also confirmed that in practice GFS/EDP statistics are not within the responsibility of INE nor, from a legal perspective, does INE have the necessary methodological and coordination responsibility for these statistics.

Cooperation between the three key players involved in data collection, compilation and notification of GFS and EDP data, INE, central IGAE and BdE, is informal and the GFS Working Group that coordinates EDP work is an important body but it operates in

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<sup>5</sup> The Spanish statistical authorities requested to comment on this section. Those comments appear in the annex to this report.

practice on an informal basis. Eurostat also notes that under the current set-up, central IGAE and the IGAEs of ACs are not subject to the statistical legislation forming the European Statistical System.

**Action point 8:** *Eurostat recommends that a platform under the leadership of INE is put in place in order to carry out a review of the institutional set-up on which GFS/EDP statistics are based which should be linked to the planned reform of the European and Spanish Statistical Laws. The review should design a new data collection and compilation system for GFS/EDP statistics that is compliant with the European Statistical Law, the EDP regulation, the European Statistics Code of Practice, and COM 211(2011). It should ensure a clear definition of responsibilities, both at institutional and operational levels, between INE, IGAE and BdE. In particular, it should give to INE the right of access to, and to collect, data of all primary sources, including for Autonomous Communities. The GFS Working Group needs to be put under the lead of INE, be given a formal and clear mandate, and efficient rules of procedure. Eurostat requests that a progress report on this matter be provided by INE by December 2012.*

**Action point 9:** *Eurostat also recommends redesigning the procedures for GFS data collection, in particular for Autonomous Regions, as the current GFS reporting system is based on partly voluntary or non-binding data reporting arrangements. To this end the Fiscal and Financial Policy Council should adopt common and binding agreements following the guidelines set up by the GFS Working Group. Eurostat requests that a progress report on this matter be provided by INE by December 2012.*

**Action point 10:** *The new set-up should also ensure that upstream data suppliers are aware of their duties and responsibilities with respect to quality, in particular the reliability of the data they supply. Eurostat notes that this is not the case for all suppliers and sees a significant risk therein that may affect the quality of the reported data. Eurostat therefore recommends that INE take effective action to mitigate this risk both in the short term under the existing set-up and in the medium term in context of future developments. Eurostat requests that a progress report on this matter be provided by INE by December 2012.*

The GFS/EDP data collection and reporting system currently in place seems unnecessarily complex and seems to reflect the structural complexity of the institutional set-up mentioned above.

**Action point 11:** *Eurostat recommends a review of the rather complex GFS/EDP data supply chain to ensure the integrity, robustness, transparency and timeliness of that data supply at all stages before it is delivered to INE. Eurostat requests that progress report on this matter be provided by INE by December 2012.*

Eurostat also notes that data supply for the first EDP notification is done informally by e-mail, outside and parallel to the formal GFS data supply chain.

**Action point 12:** *Eurostat recommends to document and formalise this process with effect from the September 2012 EDP notification if it should not be possible to integrate it into the established formal reporting chain.*

More specifically, the data clarification process for the EDP notification between

upstream suppliers and IGAE is fully informal and lacks documentation.

**Action point 13:** *Eurostat recommends devising and documenting a clarification procedure that registers the exchanges and documents explanations and changes made to the supplied data during notification periods, with effect from September 2012.*

#### **4. External audit arrangements**

From a GFS/EDP data quality point of view, against the background of the late reporting of arrears, Eurostat notes that the budgetary frameworks directive (Council Directive 2011/85/EU) requests that all general government public accounting systems are subject to internal control and independent audits. Against this background Eurostat is of the opinion that, with a view of transposing the said Directive into national law, a review of the audit system may be necessary.

## **Annex: Comments of the Spanish statistical authorities on section 3 of the report**

During the necessary exchanges with the Spanish statistical authorities in the process of finalising this report, the Spanish statistical authorities proposed several amendments. Eurostat took utmost account of those proposals. Nevertheless at their request the following comments by the Spanish statistical authorities are annexed to this report:

*INE and the GFS/EDP Working Group are aware of the need of improvement in the collection chain. Therefore, Spain assumes Eurostat's recommendation to improve the working methods for the EDP data collection. However, there is one main limit that cannot be crossed (even changing the Spanish Statistical Law), which is the distribution of competences sets up in the Spanish Constitution. Bearing this in mind, Spain wants to make the following comments for clarification:*

*1. The ACs have budgetary autonomy recognised in articles 156 and 157 of the Spanish Constitution and this competence is ruled by the principles of instrumentality and coordination. The mechanism set up in order to follow these principles and to comply with the EU stability pact and EDP rules is the FFPC. This Council has been established in 1980 in an Organic Law and all the "harmonised" measures related to this competence of the ACs have to be adopted in this forum, which can just give orientations and adopt agreements. This is why we propose the binding nature of those agreements linking them with the new Spanish Organic Law on Budgetary Stability and Financial Sustainability.*

*2. The statistical competence is a shared competence defined in article 338 of the Treaty (TFEU), therefore, the EDP regulation, the statistical law and the CoP must be followed according with the specific idiosyncrasy of each MS and its own administrative organisation. In the name of the respect of the subsidiarity principle, we accept criticism and recognise some gaps in our statistical reporting chain, but we have to solve these issues respecting our National Constitution.*

*3. The Spanish statistical law will be probably amended in a near future. Nevertheless, we have to analyse in deep if this is the correct place to develop national rules for EDP purposes (as well as Regulation 223/2009 is the general framework for European statistics but it does not go into the details for each specific sectorial statistic). As a consequence Spain will take all the measures needed to address these shortcomings.*

*4. It seems that the responsibilities of the GFS/EDP Working Group and those of the three institutions participating in it have been misunderstood by Eurostat team. These responsibilities are laid down in the National Statistical Plans. These legal acts state clearly that Non-financial National Accounts are responsibility of INE, Financial Accounts and EDP Debt compilation are responsibility of Banco de España, General Government Accounts are responsibility of Ministry of Finance (IGAE). Therefore, the role of the GFS/EDP Working Group in this issue is limited to classification of units, clarification on the implementation of methodological rules, coordination among the above mentioned statistics, special transactions and other horizontal issues.*

As a result and taking into account these comments, Spain thinks that, first, it is very difficult to follow action points 8 and 10 and second, more time is needed to address the action points 9 and 11. In the latter case, December 2013 could be a better deadline to report on the improvements reached.