

*Unofficial rough translation from Portuguese by La'ó Hamutuk.*



**NATIONAL PARLIAMENT OF TIMOR-LESTE  
Secretariat**

**FORWARDING NOTE**

From: SEC - GENERAL

TO: PRESIDENT OF THE NATIONAL PARLIAMENT

DATE: 20 / 10 / 2011

FOR CONSIDERATION

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**COURT OF APPEAL**

Dili, 20 October 2011

Excellency,

I hereby submit to the National Parliament the Opinion on the General State Accounts for fiscal year 2010 approved by the Court of Appeal, pursuant to Article 42.7 of the Budget and Financial Management Law.

Accept, Excellency, Yours sincerely

/ s /

Cláudio de Jesus Ximenes  
President of the Court of Appeal

H.E. the President of the National Parliament

c / c

H.E. the Prime Minister



## COURT OF APPEAL

*Proc. 01/CGE/2011/TR*

### **OPINION OF THE GENERAL STATE ACCOUNTS FOR 2010**

#### **I. INITIAL CONSIDERATIONS**

Under Article 129.3 of the Constitution, it is the mandate of the High Administrative, Tax and Audit Court, as a single instance, *to monitor the lawfulness of public expenditure and to audit State accounts.*

This mandate is temporarily exercised by the Court of Appeal, pursuant to Articles 164.1 and 164.2 of the Constitution.

In turn, it is the responsibility of the National Parliament to *monitor the execution of the State Budget and To deliberate on the State Plan and Budget and the execution report thereof*, as provided in Article 95.3(d) and (e) of the Constitution. The monitoring and evaluation activities of the Government in executing the budget, as in all areas, belong to the National Parliament. The Report is intended to technically clarify to Parliament so that it can exercise effective political control and inform citizens, to enable them to exercise social control, and submit to the competent authorities the opinion of any financial or criminal responsibility (Article 48 of Law 13/2009 of 21 October).

Thus, this report and opinion of the Court must examine the State's financial activity in 2010 in the areas of revenue, expenditure, the treasury, public funding and asset resources, including the following: a) Compliance with the State Budget framework law, as well as other complementary legislation regarding financial administration; b) Comparison between budgeted and actual revenue and expenses; c) Inventory and assessment of state assets, as well as changes in property; d) Execution of multiannual programs in the state budget, with special reference to their annual installment; e) Movement of funds for treasury operations, broken down by type of operation; f) direct or indirect State responsibilities, under the assumption of liabilities or to obtain public funding, including the granting of guarantees; g) support given directly or indirectly by the state, including grants, subsidies, tax breaks, credits, subsidies and financial guarantees; h) with foreign financial flows, as well as the degree of compliance with commitments made with it (see Article 29 of Law 9/2011).

It is in compliance with these constitutional and legal precepts to present this Opinion of the Court of Appeal on the General State Accounts (CGE) for fiscal year 2010, received on July 4, 2011.

Before this opinion the Court of Appeal has just ruled on the General State Account for the year 2009.

In the report and opinion on the General State Accounts, the Court should issue an opinion on the legality and correctness of the examined financial transactions, and may rule on the economy, efficiency and effectiveness of management and, as well as on the reliability of their internal control systems. It can also make recommendations to the National Parliament or the Government for the removal of deficiencies in budget management, treasury, debt and assets, as well as organization and operation of services.<sup>4</sup>

It remains to assess the limitations of the General State Accounts by this Court in judicial review of legality of public expenditure as provided for in Article 42 of Law No.13/2009 of 21 October (Budget and Financial Management Law) already identified in the advice provided on the CGE 2009. Only with the full installation and operation of technical support that is provided by Law 9/2011 of 17 August, the Court of Appeal will have the means to oversee budget execution, either concurrently or in place of examining the

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<sup>4</sup> Judgment in case no. 01/C.G.E./2011/TR.

General State Accounts, from the technical accounting point of view. Indeed, a capable analysis of budget execution imposes the outset that the Court may, by monitoring concomitant to go following the quality and level of execution of the General State Budget (OGE) with the various departments of the state, becoming at once more enabled to issue a technical opinion on the adjusted final account of budget execution.<sup>6</sup>

Once again this Court has chosen not to appoint an auditor for the purpose of examining the audited accounts for the same reasons stated above in the opinion submitted last year on the 2009 General State Accounts: a) Article 42.3 of Law 13/2009 allows only the auditor to “examine the audited accounts”, which means he would only issue a new opinion similar to the one already attached to the audit process; b) this Court sees no gap or deficiency that could raise suspicion about the quality of the audit submitted with the CGE, which was carried out by an international business of recognized merit; c) in these terms, the realization of a new audit, would delay the process, with substantial political and financial costs without clear advantage.

For this reason, and once again, this Court decided to issue this opinion on the 2010 General State Accounts, based only on a formal legal analysis, based on information provided by the Government, aware of the pointed out limitations, which are expressed according to their best understanding.

## II. REPORT

### A. BUDGET PROCESS

The Proposed Budget was admitted to the National Parliament on 15 October 2009, in accordance with the provisions of Article 30.1, of Law No. 13/2009 of 21 October (Budget and Financial Management Law).

The State Budget was approved by the National Parliament on 3 December 2009 and was published in the Official Gazette of December 23.

As regards the preparation of the budget it appears that

1. The budget basically observed the provisions of the Budget and Financial Management Law;
2. However, it did not considered funds received from donor countries (in violation of Article 33 of the Budget and Financial Management Law), a situation already noted in the 2009 budget, but which is understandable given the difficulty resulting from the lack of information from individual donors;
3. Prior to the rectification of the budget it has already been noted that, “in general government expenditures increased more than twofold compared to fiscal year 2007”;<sup>8</sup>
4. There was need for amendment of the budget, reviewing the high budget expenditures which exceeded financing from the Petroleum Fund, above the Estimated Sustainable Income from the Fund, which had been depleted with the original budget proposal, which increased the anticipated expenditures by 27%;
5. The proposed amendment complied with the legal formalism and was approved by the National Parliament (Law No. 8/2010 of July 14), according to the proposed rectification under the terms of Article 35 of the Law of Budget and Financial Management.

There is no executing document, other than the State Budget Law itself.

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<sup>6</sup> “The budgetary control of public bodies should be done systematically and successively and will include the supervision of the regularity and financial analysis of the efficiency and effectiveness of services and agencies” (Telmo Rebola Pascoal HV and Jorge Ribeiro, “Management Report Private and Public Entities Portuguese - information and control the activity,” Bulletin of OROC, Oct. / Dec. 2001, Lisbon, p. 51), quoted in the aforementioned opinion on the CGE 2009.

<sup>8</sup> Speech of the Prime Minister presenting the 2010 General State Budget.

According to the COE the following budget was executed (thousands of US \$):

	Original Budget Estimates	Rectified Budget Estimates	Final Budget Estimates	Actual Income / Expenditure	Variation
<b>REVENUE</b>					
<b>1. Domestic Revenue (2 +3)</b>	<b>87,200</b>	<b>94,700</b>	<b>94,700</b>	<b>96,591</b>	<b>102%</b>
2. Tax Revenues	60,480	47,600	47,600	50,097	105%
3. Non-tax revenues	26,720	47,100	47,100	46,494	99%
4. Capital Receipts from the Petroleum Fund	502,000	811,000	811,000	811,000	100%
<b>5. Total Revenue of the State Budget (1 +4)</b>	<b>589,200</b>	<b>905,700</b>	<b>905,700</b>	<b>907,591</b>	<b>100%</b>
<b>EXPENDITURES</b>					
<b>6. Recurrent Expenditure (7 +8 +9 +10)</b>	<b>443,188</b>	<b>585,198</b>	<b>584,131</b>	<b>543,083</b>	<b>93%</b>
7. Salaries and Wages	97,708	99,099	99,378	91,494	92%
8. Goods and Services	210,280	266,998	259,020	245,101	95%
9. Minor Capital	29,809	34,469	41,469	38,106	92%
10. Transfers	105,390	184,632	184,493	168,382	91%
11. Capital and Development	<b>216,808</b>	<b>252,783</b>	<b>253,851</b>	<b>215,644</b>	<b>85%</b>
<b>12. Total Recurrent + Capital Expenditure (6 +11)</b>	<b>659,996</b>	<b>837,981</b>	<b>837,981</b>	<b>758,729</b>	<b>91%</b>
<b>SURPLUS / DEFICIT</b>					
13. Recurrent Surplus / (Deficit) (1-6)	- 355,988	- 490,498		- 446,492	
14. Tax Surplus / (Deficit) (1-12)	- 572,796	- 743,281		- 662,138	
15. Fiscal deficit financed through:					
a. Petroleum Fund Capital Receipts	502,000	811,000		811,000	
b. Withdrawal of Reserve Funds	70,796	- 67,719		148,862	

We verify, therefore, that the budget estimates were close to the rectified budget, sometimes with pronounced variations but on average a more acceptable level of expenditure, and budget execution was always lower than predicted for expenses and higher than predicted for revenue streams.

## B. CONCLUSIONS AND RECOMMENDATIONS

1. The system of accounting and control of State Revenues continues to reveal an inability to produce reliable information in a timely manner. It remains, therefore, the need for a reconciliation procedure and to provide aggregate data which can be reviewed in order to ensure their reliability.<sup>10</sup>

In this context, the Court reaffirms the need for the existence of reliable information on budget execution to allow it to properly perform its duties with regard to the monitoring and preparation and issuance of the Opinion on the General State Accounts.

2. The General State Account that is now being analyzed shows no improvement in budget execution and control of revenue and expenditure relative to 2009. Evidence shows that there is still much for the Democratic Republic of Timor-Leste to do for its public accounts to be properly ordered and controlled.<sup>11</sup>

<sup>10</sup> Manuela Ferreira Leite, loc. cit. ("Transparency in public management is one of the key components of good governance and is of enormous importance in fighting corruption. This being the case, for countries that need foreign investment to accelerate their development, having a high level of good management is a comparatively important advantage, not only to mobilize resources for development but mainly to attract and promote investment").

<sup>11</sup> "A modern public administration requires more accounting information useful for decision making and budgetary control, greater accuracy and transparency in the use of public money, the pair joined modernization of procedures to facilitate the consolidation of accounts of the state" ( Jose Manuel Pereira de Araujo, in "The Official Plan of Implementation of Accounting and Public Sector Plans of Autonomous Central Administration: Study and Analysis", University of Minho, Braga, 2005, p. 22, quoted in the opinion of the CGE, 2009).

“The absence of information on expectations of medium term financing limits the Government’s ability to conduct planning long-term macro-economic analysis on a consolidated basis.”<sup>12</sup>

3. The objection presented in the Opinion on the 2009 General State Accounts<sup>13</sup> was duly rectified having been duly considered the State receipts and expenditure actually collected or disbursed through 28 February 2010, although disaggregation of respective income and expenditure is still missing, making it impossible to determine whether there was violation of Article 43.1 of the Budget and Financial Management Law.<sup>14</sup>

In fact, “the guidelines of the Manual on Public Finance Statistics of the International Monetary Fund (MEFP 2001) are directed to public finance statistics and not specifically for public sector accounting, while exercising some influence over the financial information.”<sup>15</sup>

4. Despite the lack of inclusion of foreign aid in the budget, it has been duly discriminated in the General State Accounts, which is enhanced as a positive fact, without prejudice to reaffirm the need to pursue the necessary prediction of such aid in the State Budget.

5. The issue of budget deficit and surplus also raises considerations.

The execution showed a surplus of \$148,862,000.<sup>16</sup>

As stated in the State Budget itself, the budget deficit is supported by transfers from the Petroleum Fund.

Under Article 7.1 of the Petroleum Fund Law (Law No. 9/2005 of 3 August), “*Subject to Section 6.3, the only debits permitted to the Petroleum Fund are electronic transfers made in accordance with this present article, as well as Articles 8 to 10, to the credit of a single State Budget account.*” In other words, the law itself recognizes the need to finance the budget deficit from the Petroleum Fund, stipulating the limits of the same based on the estimated sustainable income for the year to which it relates (Article 8). This means that transfers from the Petroleum Fund should not be equivalent to the total amount of the expected sustainable income, but what is strictly necessary to cover the budget deficit, given that they shall never exceed the sustainable income.<sup>17</sup>

The existence of a current budget surplus is seen as a symptom of good budget execution, because the State managed to keep its recurrent expenses to a level below that of ordinary revenues.<sup>18</sup> However, such an assertion can only be upheld, relative to ordinary revenue (being the excess of ordinary revenue over current expenditure).

In the case of Timor-Leste, given the lack of sufficient current revenue, the general government budget always has a deficit, which is supported from the Petroleum Fund, and the law has a clear objective that transfers from this fund are only when strictly necessary to support such a deficit.

Consequently, the aforementioned surplus reveals, on one hand, lack of efficiency in forecasting expenditures and corresponding budget execution. Hence the need to improve technical and professional skills of State departments, because the problem is widespread, to ensure a more balanced budget that avoids the existence of the aforementioned surplus.

On the other hand, this imposes on the Government a clear definition of the destination of unspent budgetary allocations, given that nothing is mentioned in the General State Accounts under examination.

### III. EXECUTION OF THE REVENUE BUDGET

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<sup>12</sup> Speech of the Prime Minister presenting the 2010 General State Budget.

<sup>13</sup> Point 3 of general recommendations.

<sup>14</sup> One of the limitations of cash system is just that it cannot preview receive future income or expenses that the entity will incur. The entity can only record the fact in the accounts when the actual receipt or disbursement occurs, subject to surprises in the management of resources and hindering projections (Leonardo Nascimento Silveira, in “Budgets and Information Systems”, Public Finance - National Treasury Award XLII, Brazil, 2008, pg. 10, also quoted in the Opinion on the CGE 2009).

<sup>15</sup> Leonardo Silveira do Nascimento, op. cit., p. 8.

<sup>16</sup> Situations of surplus, or budget excess, still fit the framework of balanced budgets (Sousa Franco, in “Public Finance and Financial Law,” vol. I, 4th edition, 13th edition, Almedina, Coimbra, 2010, pg. 365).

<sup>17</sup> It follows, for example, that the use of money in “cash” surplus resulting from the previous year to support the budget deficit may involve a violation of the aforementioned limits of sustainable income, as occurred last year, which, for lapse, was not noted in the opinion delivered then, for reasons explained below.

<sup>18</sup> Although this idea begins to be strongly challenged (David Richardson, “Why the obsession with a budget surplus?”, in <http://www.abc.net.au>, and John Wanna, “Worshipping the debt-free mantra of surplus”, in <http://theconversation.edu.au>).

## A. SCOPE OF VERIFICATION

With regard to revenues, given the limitations mentioned above, we proceeded to the conference of the General State Account and the State Budget, together with the presented audit report, as well as the opinion of the 2009 General State Accounts, up to expose the concrete form of budget execution, although we cannot to ascertain the suitability of the information given.

## B. CONCLUSIONS AND RECOMMENDATIONS

1. Fiscal receipts were significantly lower than anticipated in the initial budget, revealing a value of about \$2,500,000 above the rectified budget amount, being approximately \$2,160,000 higher than expected value in the collection of other taxes. But, inexplicably, the value of the anticipated revenue from taxes on individuals was less than the amount raised in the previous year (a forecast was presented for employees of the Government of revenues of \$60,000, while in the previous year this had raised \$530,000), which resulted in a collection of 1125%. A similar situation happened to the Special Withholding Tax (which had an actual receipt of \$6,156,000, while what was budgeted for 2010 was only \$4,490,00), which obtained much higher than expected coverage (182%).

2. There are clearly errors in preparing the state budget, which are recommended to be avoided.

3. Compared with the previous year, there was a significant increase in direct taxes, which may indicate an increase in economic activity foreseen by the Government; but, in the opposite direction, there was a marked decrease of non-tax revenues for 2009, around \$4,000,000 less (which had also been budgeted at well below 2009 revenues).

4. Thus, although verifying the improvement of fiscal collection relative to the budgeted amount (and measuring this only according to the rectified budget), one cannot fail to point out the reductions from the previous year, while fiscal revenues have allowed a final increase in domestic revenues of approximately \$2,500,000.<sup>19</sup>

5. On the other hand, there is a lack of final information for various receipts, such as the Courts, Vehicle Inspection Fees, Driving License Fees and Other Transport Fees.

6. The Court recommends, once again, that the accounting model for revenue should be supported by a computer system capable of recording revenue control through the full reconciliation of information concerning the issuance and cancellation of billing and reimbursement documents with corresponding information on receipts and payments.

7. On the other hand, as mentioned in the previous Opinion, it is necessary to significantly improve efficiency in fiscal policy and revenue collection in order to reduce the use of capital transfers as a form of State funding (capital revenues by definition imply a change in the active situation of state assets, which thus becomes poorer) in compliance with the constitutional imperative of Article 144.1 of the Constitution of RDTL.<sup>20</sup>

8. Revenues from foreign aid appropriations from third parties (a "significant amount," according to the audit report, this is not different from the report on 2009 Accounts) were again not properly considered in State Budget, but were included in the General State Account, thereby to determine the exact amount of revenues received.

9. The Court stressed the recommendation to find a budget mechanism that allows accounting of foreign aid receipts as rigorously as possible.

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<sup>19</sup> It should be remembered that in his speech presenting the State Budget, the Prime Minister stated that "government spending will continue to be a strong stimulus, enhanced by a better budget execution."

<sup>20</sup> In order to narrow the gap between expenditure and domestic revenue in the medium term the Government intends to intensify efforts to increase tax revenues by broadening the base and significantly improving tax administration. Two specific reforms that will contribute much to such programs to improve cross-referencing tax identification numbers between Customs and business income taxes, and the capacity and compliance audit of fiscal institutions (Prime Minister's speech at the presentation of proposed rectification budget).

10. The “Consolidated Fund” received a significant amount of money (audit report). Although it has initiated a process of control of receipts for cash payments made before recording the accounting, specifically in relation to bank accounts,<sup>21</sup> “any money received, including sales of rice and university fees, was used to make payments prior to their entry into the financial records.”<sup>22</sup>

11. It is essential to be able to exercise effective control over cash receipts deposited in banks, the only way to ensure that deposits correspond with collected amounts.

12. Therefore, the Court recommends strengthening the already initiated control mechanism for such operations.

13. It is recommended, again, to exercise a more rigorous projection of revenues, in order to avoid significant discrepancies between budgeted projections and final execution.

14. The lack of a more detailed breakdown of the revenue line prevents an analysis of budget execution in this area, emphasizing the already mentioned limitations of the Court in the preparation of this opinion.

15. It is recommended, therefore, that the CGE be more thorough in presenting disaggregated revenues, to enable the Court and to the general public to better analyze the level of budget execution.

#### IV. EXECUTION OF THE EXPENDITURE BUDGET

##### A. SCOPE OF VERIFICATION

Also with regard to expenditure, proceed to the conference of CGE and OGE, together with the presented audit report and CGE 2009 and its opinion, to expose the actual form of budget execution, although being unable to assess the suitability of information given.

##### B. CONCLUSIONS AND RECOMMENDATIONS

1. Payments made through February 28, 2010 should be properly broken down in order to prove the correspondence with the outstanding obligations at 31 December of the previous year. The ability to execute the budget after the end of the fiscal year, by the cash method, makes it possible to tamper with the truth of budget execution.

3. (*Sic*) The Court therefore recommends complying with the objective that was already outlined in the Proposed State Budget for 2009.

4. As reading the audit notes of the available evidence (or made available for auditing the accounts) relating to cash payments was limited, making it difficult to verify them.

5. It remained, therefore, to limit the audit analysis to the amounts deposited and withdrawn from bank accounts, with no possibility of proving their accuracy.

6. The audit found the payment by some institutions to non-existent employees on staff. This is a serious situation which could indicate criminal and / or civil liability.

7. The Court recommends, once more, the rapid implementation of a current, absolutely reliable database and the strict control of payments.

8. The General State Account does not contain any breakdown of expenditure by ministry or other institutions carrying out payments, which does not allow a minimal check on their legality. Thus, for example, investments have been made of “17.5 million for the purchase, storage and distribution of rice throughout the country.”<sup>24</sup> However, analyzing the account for expenditure of the Ministry of Tourism, Commerce and Industry, we have only the submission of an overall amount for “Goods and Services” of the

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<sup>21</sup> This is a clear improvement compared to the situation in 2009 where there was “no prior control (considering only the amounts actually deposited in banks)” (Opinion on the CGE, 2009).

<sup>22</sup> Audit report (page 14).

<sup>24</sup> Prime Minister’s speech presenting the proposed State Budget Rectification Law.

Food Security Fund in the overall value of \$39,068,837, which does not allow determination of how much was spent on purchasing rice and how much is spent on and what other items.

This is a situation common to the whole Account in terms of expenses, except for salary payments to employees, but here the situation is still referred to in 6.<sup>25</sup>

9. It is therefore essential that the General State Account disaggregate the expenses made by the state as much as possible, in a single form so that we can minimally prove them. Otherwise it would be impossible for this Court and, consequently, for the National Parliament, to perform its function of monitoring and supervising the activities of the state and budget execution.<sup>26</sup>

10. Similarly, as noted by this Court, the constitutionality of budgetary reserves and funds always depends on precise knowledge of their intended purposes and detailed knowledge of the expenses paid using the same, on penalty of violating Article 145.2 of the Constitution.<sup>27</sup>

11. Thus, the Court recommends that once again, as mentioned in 9, that the expenses paid using such funds or reserves (Food Security Fund, Contingency Reserve and government funds) be disaggregated in order to have a fundamental understand of the need for their use.<sup>28</sup>

## V. OPINION

Given the above, in accordance with Article 42.6 of Law 13/2009 (Budget and Financial Management), 129.3 and 164 of the Constitution, and with the limitations set forth in its recommendations, the Court of Appeal judges that the provided accounts of the state are valid, and adopts this Opinion on the General State Account for fiscal year 2010, to be submitted to the National Parliament, under Article 42.7 of the Budget and Financial Management Law.

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- To arrange to publish the Opinion in the Official Gazette.
- To arrange to send a certified copy of the Opinion to Parliament, under Article 42.7 of the Budget and Financial Management Law, with knowledge of the Government.
- Timely, to file.

Dili, 20 October 2011

OS Juizes do Tribunal de Recurso

  
Cláudio de Jesus Kimenes – Presidente e Relator

  
Maria Natércia Gusmão Pereira

  
José Luís da Goia

<sup>25</sup> The specification rule is addresses the need to clarify the budget institution's own objectives, which would be defrauded without this requirement (Sousa Franco, op. Cit, p. 353).

<sup>26</sup> The breakdown of expenditure is essential to fulfilling the constitutional prohibition of Article 145.2 of the Constitution. The constitutional function requires the specification of the budget revenue and expenditure sufficiently detailed to allow the decision of the National Parliament and the public control to be effective (Gomes Canotilho and vital Moreira, op. Cit, p. 1109).

<sup>27</sup> Opinion on CGE 2009.

<sup>28</sup> The express inclusion of autonomous funds and services is an important factor in streamlining and budget transparency of public finances, given the volume of expenditure and revenue involved in them (Gomes Canotilho and Vital Moreira, op. Cit, p. 1105).