Value-for-Money Audit regarding the enforcement of the Cooperation Agreement between the

Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., and Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A.

File No. 01/2009

Report No. 11/2011 2nd Chamber

Approved by the Plenary Sitting of the 2nd Chamber on 14 April 2011

I. Summary

In fulfilment with the Audit Plan, which was approved by the Tribunal de Contas[1] for 2009, by the Plenary Sitting of its 2nd Chamber, through Resolution No. 7/08, of 11 December, a Value for Money audit was conducted regarding the enforcement of the Cooperation Agreement between the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P.[2], and Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A.[3].

Held on 25 November 2009, the 2nd Chamber of the Tribunal de Contas decided to request an opinion from the Advisory Board of the Public Prosecutor Service regarding legal issues set out in the audit report, namely on the legal nature of the Cruz Vermelha Portuguesa[4], on the automatic extension to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., of the statute and the specific benefits of the Cruz Vermelha Portuguesa, and whether the Cooperation Agreements are subject to the public procurement legal framework. The previously mentioned opinion was approved at the Advisory Board session, which was held on 3 March 2011, and its conclusions will be highlighted in this Report.

Conducted in 2009, the audit was carried forward to the 2010 Audit Plan, approved by Resolution No. 6/09, of 3 December, of the 2nd Chamber of the Tribunal de Contas, and, subsequently, to the 2011 Audit Plan[5], of this Chamber, through the approval of a proposed amendment to it, by the Plenary Sitting that took place on 10 February 2011.

The Cooperation Agreement celebrated between the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P. and Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., is aimed at ensuring, **complementarily** with the National Healthcare Service units, the provision of healthcare services to patients that are exclusively covered by the Lisbon and Tagus Valley Health Region.

The main audit objective was to assess the physical and financial enforcement of the Cooperation Agreement, the measures implemented by the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., to follow up and monitor compliance with the aforesaid Agreement, the comparative analysis between *ex-post* and *ex-ante* economic and financial data, in the period 1998-2008, and finally the business development perspectives, set out not only in the Cruz Vermelha Portuguesa Restructuring Project, for the same period, which was elaborated by an advisory bank, but also in the Audit Report drawn up by an auditing/consulting company.

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[1] Portuguese Court of Auditors.

[2] Lisbon and Tagus Valley Health Region Administration.

[3] Portuguese Red Cross – Hospital Management Company, PLC (Public Limited Company).

[4] Portuguese Red Cross.

[5] Approved by Resolution No. 8/10, of 2 December, of the 2nd Chamber.

The audit was conducted in strict compliance with the Audit and Procedures Manual of the Tribunal de Contas and with the auditing standards of INTOSAI, of which the Portuguese Tribunal de Contas is a member.

1. CONCLUSIONS

The State's intervention in the Cruz Vermelha Portuguesa – see points 9, 9.1 and 9.5

- In 1997, given the **financial status** of the Cruz Vermelha Portuguesa's Hospital, the State was requested to bail it out. To that purpose, the Line Ministry[6] (through an auditing/consulting company) and the Cruz Vermelha Portuguesa (through an advisory bank and an auditing/consulting company) ordered audits and studies to measure the hospital's economic-financial feasibility and, concomitantly, to carry out an assessment to it.

- At the origin of this situation was an inappropriate human resource management policy. Through it, the hospital's assets were depleted, as emerges from the allegations presented by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., itself, in February 2001, within the adversarial procedure of the "***Audit of State's Securities Portfolio Management Operations***"[7]. As a matter of fact, according to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., the human resource management policy was at the origin not only of its accumulated net losses, but also of the wear and obsolescence of its medical equipment, its infrastructure and, inclusive, the decrease in the value of its intangible assets, such as image and prestige[8].

  The seriousness of the company's economic and financial status was so great that, according to points 33 to 42 of the said adversarial procedure, the Cruz Vermelha Portuguesa's Hospital's value was estimated to be negative. In other words, there was a buyer for the Hospital, but the Cruz Vermelha Portuguesa had to spend huge sums of money to assume 155 existing labour contracts, i.e., it should not only *"compensate 155 surplus labourers for rescission of their labour contracts, who earned "huge salaries (…) and possessed low levels of qualification"* (nearly 1/3 of the labour strength), but also pay current liabilities (see point 34).

  It should be noted that the early Cruz Vermelha Portuguesa's initiatives, leading to a solution for the situation into which the Cruz Vermelha Portuguesa's Hospital had been led, dealt with IMPÉRIO and MUNDIAL CONFIANÇA, two Portuguese insurance companies, in order *"to find out whether they were interested in purchasing or operating the Hospital, and what criteria needed to*

[6] Portuguese Ministry of Defense.

[7] File No. 25/00 – Audit and Audit Report No. 08/2001 – 2nd Chamber, published on the Tribunal de Contas's website.

[8] See point 49 of the allegations of February 2001 of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A..

be satisfied" (see point 31 of the Cruz Vermelha Portuguesa's adversarial procedure of 2001 – Audit Report No. 08/2001 – 2nd Chamber).

In short, the Cruz Vermelha Portuguesa's Hospital's situation had become critical because of the financial burden with excess staff and because of staff's insufficient qualifications to adequately perform the activity required. In addition, and because of that, the Cruz Vermelha Portuguesa did not manage to generate cash flow (despite the State's recurrent subsidies)[9] to *"invest in equipment replacement and update or in infrastructure maintenance works"* – see point 18 – and to pay current debts.

Although to a great extent the situation was due to the way the Cruz Vermelha Portuguesa managed its Hospital, notably because of the admitted organizational human resource policies, the State was forced to find a solution for this problem. In fact, according to the Cruz Vermelha Portuguesa, this was foreseeable. The main and most effective intervention tool was the Cooperation Agreement with the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., the subject of this audit.

As we shall see later on, after subscribing to a Shareholders Agreement in 1998 and celebrating, in that same year, a protocol with the Line Ministry[10], in which clear objectives were defined for the restructuring of its human resources, the Cruz Vermelha Portuguesa failed to comply with them, despite some significant efforts from PARPÚBLICA seeking its observance.

- The report elaborated by the advisory bank, in 1998, (entitled "**Restructuring Project"**)[11], included 10-year economic and financial forecasts (1998 to 2008) for the Cruz Vermelha Portuguesa's Hospital's activity, whose value was estimated at € 25,937,490,64 (or 500,000 shares), corresponding to a unit value of € 51.87, through the yield method. This study assumed[12]**:**

  - **The independence of the Cruz Vermelha Portuguesa's Hospital's activity** from the Cruz Vermelha Portuguesa, in legal, patrimonial and financial terms, which was materialized into the **incorporation of the commercial**

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[9] "*The most recent contributions totalled PTE 65 million, in 1985, PTE 10 million, in 1989, PTE 25 million, in 1993, PTE 29.5 million, in 1995 and 180 million, in 1998*", although the State's aid was spent on operating costs and, basically, on costs with excess staff, who *"earned huge salaries (…) and possessed low levels of qualification (…)"* as Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., said (point 24 of the 2001 adversarial procedure, Audit Report No. 08/2001 – 2nd Chamber) and not on any humanitarian activities.

[10] The Portuguese Ministry of Defence is responsible for the Cruz Vermelha Portuguesa. The previously mentioned Protocol was also celebrated with a representative from the Ministry of Finance, which also represents the State as its shareholder.

[11] It was based on the Audit Report and on the Cruz Vermelha Portuguesa's Hospital's economic and financial situation, elaborated by an auditing/consulting company.

[12]
$$\textit{share price} = f(\textit{cooperaton agreement}_t, \overline{\textit{restructuring}}, \ \ldots)$$
$$\wedge$$
$$\textit{cooperation agreement} = f(\textit{installed capacity of the Portuguese Healthcare System}_t)$$
$$\therefore \ \textit{share price} = f\left[f(\textit{installed capacity of the Portuguese Healthcare System}_t), \overline{\textit{reestructuring}}, \ \ldots \right]$$

partnership known as Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A..

- **The restructuring of the Cruz Vermelha Portuguesa's Hospital**, with particular emphasis on the restructuring of its human resources (which was a constant factor when calculating the share price).

  Let's take a quick look at what Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., said, in point 24 of the adversarial procedure, of 1 February 2001:

  "*By the end of 1997, (…) among nursing, administrative and operating services, there were 470 people working at the Hospital, in old age (…) earning huge salaries (…), and possessing low levels of qualification (…)*".

  Point 27 states that, despite its excess staff with low qualifications, the Cruz Vermelha Portuguesa's Hospital lacked "*its own clinical staff*"[13].

- **The State intervened through:**
  - a **Cooperation Agreement** between the Ministry of Health (represented by the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P.) and Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., which was valid for five years and automatically renewable for two-year periods, aiming to provide the users of the National Healthcare System with clinical care;
  - the purchase by PARTEST (currently PARPÚBLICA) of the following portfolio:

    (i) 225.000 shares (45%), with a face value of € 5.00, purchased at € 51.87 each, totalling a global investment of € 11,671,870.79; and

    (ii) An American put option over the Cruz Vermelha Portuguesa (which was subscribed) of 10% of the purchased shares, with a 5-year maturity and whose strike price is described in point 2 of clause 9 of the Shareholders Agreement;

    (iii) In addition to these two assets, the contingent-claim described in point 4 of the aforesaid clause should also be considered.

    The Cruz Vermelha Portuguesa remained with 54.97% (274.850) of the shares in its portfolio and an American call option, with a 10-year maturity, over the shares purchased by PARTEST[14], whose strike price is described in point 2 of clause 8 of the Shareholders Agreement.

[13] On 3 August 1998, the Cruz Vermelha Portuguesa's Hospital's Transfer of Exploration Contract stated in point iii of the recitals that *"(…) the Cruz Vermelha Portuguesa's Hospital's staff is oversized in relation to its activity requirements, for now and for the future (…)"*. In the annex to the letter of 7 March 2001, PARPÚBLICA quotes Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., agreeing, *vis-à-vis* its arguments, to "acknowledge" "*the existence of an excessive cost*" in comparison with the objectives for breach of the terms and conditions set out the Shareholders Agreement and in the Transfer of Exploration Contract made towards PARPÚBLICA.

[14] Which subscribed this call option.

The Clinical and Management Team[15] kept in its portfolio 0.03% (150) of the number of shares, and the possibility of buying a stake in Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., within the call option set out in clause 8, for the strike price established "in the Shareholders Agreement" on condition that the number of shares in the Clinical and Management Team's portfolio does not exceed 150.000 shares, i.e., 30% of the share capital. This portfolio also includes an equally significant right to 50% profit sharing, should profits beat economic and financial forecasts.
The *sine qua non* condition for this "deal" was and still is, however, the Cooperation Agreement of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., with the State (represented by the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P.). In fact, although not *de jure* classified as such[16], this agreement has been interpreted, in practice, by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., as something assimilable to a real option, known as a "*Partially-Guaranteed Production Placement Option*". And, just as an option has a subscriber, it seems clear that the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., has played a passive role in that potential understanding.

This real option (asset), which underlies the whole "deal", is, for sure and by far, the most valuable asset within it.
In light of the foregoing, two important questions should be asked: the first, is whether the State should intervene in such entities as shareholder and, concomitantly, as insurer of its own investment, and of the Cruz Vermelha Portuguesa's and the Clinical and Management Team's investment, therefore assuming possible errors, omissions and noncompliances on the part of the Management of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., over which it has little control, with serious consequences to the treasury.

The other question concerns the portfolio evaluation. Among the various assets contained in the respective portfolios, only shares were evaluated. The contingent-claims were disregarded. And so, as it seems to have happened, the State's financing procedure, besides lacking prudence, needs some transparency, to say the least.
Besides, it appeared that this Agreement was carried out at the expense of a likely sub-use of the installed capacity of the NHS hospitals, - waste of State's fixed capital investment – in the terms stated by the Management Boards of the North, Central and Western Lisbon Hospital Centres.

[15] Composed by 11 natural persons.
[16] Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., shares the same views, *vide* point 43 of the 2001 adversarial procedure, Audit Report No. 08/2001 – 2nd Chamber.

> The Restructuring Process assumed staff cuts, from 480 people to 355, in 1998, or nearly 30%. Nevertheless, PARPÚBLICA, on 7 March 2001, quoting the Management Board of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., draws attention to the fact that, in 2000, 510 people were employed. In other words, staff had increased by 43.66% instead of being reduced by 30%, in relation to the objective (nearly € 5 million). It should be noted that, in the Restructuring Project a sum of PTE 1,000 billion was consigned to defray the costs of excess staff reduction, in addition to studies and projects. In the *ex-ante* Balance Sheet, a sum of PTE 1,013.6 billion was entered as intangible fixed assets, from 1999. Attention should be drawn to the fact that the restructuring of human resources was fundamental to create value for Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., and was one of the conditions set in the Protocol and in the Shareholders Agreement, accounting for a very significant percentage of the share "intrinsic value".

Based on the value of business ascertained, in 1998, in the Restructuring Project elaborated by an advisory bank, and in the Audit Report carried out by an auditing/consulting company, the State materialized its intervention by **purchasing a 45% stake in the share capital** of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., having spent **€ 51.87** on each share. This price adds **€ 46.87** to the share face value (€ 5.00), or a valuation of nearly 937.40%, totalling **€ 11,671,870.79[17].**

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[17] Fundamentally, the share pricing is backed by the Cooperation Agreement for Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A.. Thus, the share price derives from or is determined by the value of the aforesaid Agreement – which, in this case, replaces the real asset – and not the Cruz Vermelha Portuguesa's Hospital's fair value, *per se*. A significant part of the share price of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., incorporates or is made up by the value of the Cooperation Agreement (the restructuring value of the human resources ended up, for noncompliance reasons, being very relevant, as well) and this is of course independent from Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A..

Thus, the Cruz Vermelha Portuguesa's and the Clinical and Management Team's contingent-claims, as well as those of the State (represented by PARPÚBLICA), which were included in the Protocol and in the Shareholders Agreement have as its underlying asset the "intrinsic value" of the Cooperation Agreement, the subject of this Audit.

Given the random character and the volatility of the Cooperation Agreement value, notably as regards it renewal, these contingent-claims had their value, which was far greater to the Cruz Vermelha Portuguesa than to the State (in the legal person of PARPÚBLICA). These real options embedded in the reorganization plan (or the restructuring plan) should, unless otherwise convincingly explained, be considered by the advisory bank and by the auditing/consulting company in the Cruz Vermelha Portuguesa's Hospital's evaluation. In fact, PARPÚBLICA itself was manifestly interested in the fact that the Cruz Vermelha Portuguesa and, possibly, the Clinical and Management Team would exercise the respective call options. This was, besides, PARPÚBLICA's expectation, as can easily be interpreted from the Shareholders Agreement review proposal, which is attached to the adversarial procedure of September 2009.

Thus, in the addendum proposal to the Shareholders Agreement, of 3 August 1998, attached to PARTEST's letter of 10 May 2000, in points 1 and 4 of Clause 8, PARTEST proposes that the Cruz Vermelha Portuguesa's call option over PARTEST be "converted" into a put option of PARTEST over the Cruz Vermelha Portuguesa, in order to ensure that the shares held by PARTEST be held by the Cruz Vermelha Portuguesa until the end of the first 10 years and keep the value invested.

This pricing has important faults. The advisory bank assumed that the concession was deemed to have an infinite life ($n = \infty$) whereas the concession life is 25 years. This "mistake" is not negligible, once, *per se*, it overvalued the shares more than 20%[18]. As everyone knows, concessions have a finite lifetime, which is defined in the concession contract. Therefore, this negligence on the part of the advisory bank cannot be understood. This possible fault is even more

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Besides, if the strike price of PARTEST's put option over the Cruz Vermelha Portuguesa is analysed, it is easy to understand that there is no intention to obtain any profit from that. In truth, the strike price defined in No. 2 of Clause 9 of the Shareholders Agreement is the same as the purchase price plus the "time value", majorated by a small 0.5% risk premium deducted from dividends and other benefits, which may have been received. This means, *grosso modo*, that the State met its needs with the financial equivalent of the share purchase price when exercising the put option or, in other words, upon the pay-back of the investment *stricto sensu,* thus being unclear what Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., intended by demonizing the public shareholder (PARTEST) in the allegations set out in points 67 to 70 of the 2001 adversarial procedure – Audit Report No. 08/2001, 2nd Chamber.

Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., does not ignore that the money spent by the State on the bailout of the Cruz Vermelha Portuguesa's Hospital has an opportunity cost. In order to obtain funds, the State must sell public debt on the market, which is subscribed by national and international investors and bear, in a conclusive manner, the burdens of the internal and external debt. It does not therefore make any sense alleging that the State has any profit-making purpose (or value-added purpose), even because the Cruz Vermelha Portuguesa's call option over PARTEST hindered any chance of achieving that. This addendum proposal would place the Shareholders Agreement on the right track (but, at the same time, it was not at all a proposal to be submitted to the Cruz Vermelha Portuguesa), and its only fault was its untimeliness, being understandable that the Cruz Vermelha Portuguesa would not have wanted to "exchange" a contingent-claim (asset) for an obligation (liability).

The difficulty of the Portuguese State in negotiating agreements with derivatives is clear, both in the Shareholders Agreement, and in the addendum proposal thereto.

If the Cruz Vermelha Portuguesa had exercised its call option over PARPÚBLICA both the Cruz Vermelha Portuguesa and the Clinical and Management Team would benefit, and PARPÚBLICA would recover the investment, with zero or near zero added-value or profit.

Failure to comply with the Shareholders' Agreement by CVP frustrated efforts to which the parties had committed (see letter and annexes of PARPÚBLICA, of 07 March 2001).

It is a fact that the "shielding", which was made available to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., by the Protocol and by the Shareholders Agreement, through contingent-claims, together with the decision-making power that was "offered" within the terms of the contract, did not foresee the margin of intervention needed to keep the value of the State's stake in this Hospital. This fact had already been mentioned in the Audit of the State's Securities Portfolio Management Operations (Audit Report No. 08/2001 – 2nd Chamber). Nevertheless, the most valuable asset was, and still is, the so-called Cooperation Agreement of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., with the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., which has been acting, in practice, - although not *de jure* –, as a "life insurance". In fact, in terms of real derivatives, it may be called a "*Partially-Guaranteed Production Placement Option*", whose value is analogous to the American put option. It is in this real option where almost all the "deal" value source lies. The remaining part concerns the excess staff reduction and the recruitment of qualified staff. As can be clearly seen, the "life insurances" such as real options (put options) come at a high price and it is hard to believe that the alleged 10% "bonus", even if it was real (economic efficiency price), which has not been proved, was sufficient to pay the "insurance premium", i.e., the aforementioned option price.

Regarding the other main value generation source – the restructuring of human resources – Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., clearly failed to comply with the provisions of the Protocol and the Shareholders Agreement, pretending to be unaware that jobs cannot be made up and that it is not because there is "fresh" money that jobs are created out of the blue.

Besides, Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., insists to continue to depend on the State. Therefore, its statute in the healthcare system should probably be re-equated.

[18] The Continuing Value, also known as Terminal Value was inexcusably overestimated by 34.242%, that is to say, the Continuing Value measured in 2008, decreased from PTE 10,648 million to PTE 7,001.92 million (to n=25 years)

serious, given the fact that all valuation professionals know that a substantial part of a company/corporation is attached to its Continuing Value[19].

Besides, and in spite of identifying the Cruz Vermelha Portuguesa's and the Clinical and Management Team's call options and PARPÚBLICA's put option, the advisory bank did not take them into account to determine the value of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., being aware that these options change the respective portfolio values, which shows excessive and non-negligible lapses and gaps.

If more accurate and mindful studies had been done, it would be found that the parties were treated unevenly and that the State lost out. Besides, if the core part of this "deal"[20] is taken into account, which constituted and still constitutes the Cooperation Agreement, it can be deducted that the State played recklessly with its own interests.

If the "intrinsic value" was € 51.87 per share, this value would certainly be different for the Cruz Vermelha Portuguesa and PARPÚBLICA and, consequently, for the value of the respective portfolios. This was not taken into consideration by the advisory bank, and PARPÚBLICA only expressed its views in March 2001.

Even if this price had been a great estimate of the fair price to pay for the shares of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., it contained clearly mystifying elements in terms of their fair value to PARTEST.

In fact, regardless of any other considerations, the advisory bank and the auditing/consulting company have ignored, without any explanation, the remaining contingent-claims (assets) acquired by the parties over the same real asset. It is therefore surprising that PARPÚBLICA, even if it has not been asked to participate in the pricing procedure, says, uncritically, that the pricing was fixed on the basis of "*studies carried out by credible entities and that this corresponds to the actual value of the Project, as had been calculated by the consultants"* after stating that "PARTEST *will hardly lose money in this business*". This type of statements of course justifies the price calculated by the consultants and defined by the Government. It is hard to believe that PARTEST/PARPÚBLICA had made this type of statements without knowing the substance of the work made by the consultants.

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[19] Tom Copeland/Tim Koller/Jack Murrin – *Valuation,* Chap.12; 3rd Edition, 2000, Chap.12; John Niley & Sons, 2000.

[20] As far as the Partially-Guaranteed Production Placement Option is concerned, the forecasts made by the advisory bank highlighted that *"(…) the Hospital's financial evolution, notably its ability to refund the financial debt and to distribute dividends, depends on the celebration, in the short run, of a Protocol between the Cruz Vermelha Portuguesa's Hospital and the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P.. As a matter of fact, only at an activity rate set out in the forecasts will the Hospital stabilize its financial liabilities in the first five years of activity, which is the minimum deadline during which the aforesaid Protocol is in force.*" See page 40.

- Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., **distributed dividends in** 2003, 2004, 2005, 2007 and 2008, i.e., 5 dividends in 10 possible.
- Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., remunerated the Cruz Vermelha Portuguesa for the exploration transfer in 2004, 2005, 2006, 2007 and 2008, notwithstanding its losses in 2006.
- It should be noted that, notwithstanding the increase in the **share book value**[21] throughout the same period, it is substantially lower than the price at which PARTEST (currently PARPÚBLICA) purchased the shares.
- The standard *ex-post* **Net Present Value (NPV)**, from the point of view of the shareholders, calculated from the dividends discounted by the opportunity cost of equity capital, **i.e. 13.27%, corresponds to € - 24,412,349.78.**
- The *ex-post* **Internal Rate of Return (IRR)**, from the point of view of the shareholders, measured from the dividends distributed throughout the period under analysis, achieved nearly -23.5%[22].
- The **Shareholders Agreement**, celebrated between PARTEST (currently PARPÚBLICA) and the **Cruz Vermelha Portuguesa**, on 3 August 1998, included a **call option** of the latter over all or part of the shares acquired by the public shareholder. The call option could be exercised during the first ten years, which never happened. In truth, the call option is only exercised if the share value is higher than the strike price. Thus, it can be said that the understanding, certainly reasoned, of the Cruz Vermelha Portuguesa itself, was that the fair price of the shares of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., was lower than expected and/or the shares had been sold by the Cruz Vermelha Portuguesa to PARPÚBLICA for an excessive price, even assuming the State's zero-profit. Besides, this is confirmed by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., in the adversarial procedure dated 22 September 2009, stating that the State acquired "*a relevant stake in the company (…) above market price* (…)".

  After having stated, on 24 January 2001, that unlike other financial investments in other companies, in Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., "PARTEST *will hardly lose money in this business*", in its letter of 7 March 2001, attached to the adversarial procedure allegations, PARPÚBLICA acknowledges the obvious. In fact, PARPUBLICA says that the call option has effective value if its value is higher than the strike price and that will only happen if the Cruz Vermelha Portuguesa complies with the provisions of the Shareholders Agreement, basically regarding the "*restructuring project of the Cruz Vermelha Portuguesa's Hospital, which includes the restructuring of human resources*", since "*the Cruz Vermelha Portuguesa is responsible for*

[21] See Table No. 4-point 9.

[22] IRP calculated from the Continuing Value or the Terminal Value as a Cash inflow, which assumes that the financial flows, between 2008 and 2022, are updated and/or reinvested at the opportunity cost of the applicable capital.

managing the hospital (…)"and PARPÚBLICA lacked the instruments to make the Cruz Vermelha Portuguesa enforce compliance with the "*objectives defined in 1998 and to which the parties – the State (through PARPÚBLICA) and the Cruz Vermelha Portuguesa – have committed themselves*".

In fact, "*the assumptions contained in the Protocol celebrated between the State and in the Shareholders Agreement, celebrated with PARTEST/PARPÚBLICA, have failed to be complied with*", and the Cruz Vermelha Portuguesa intends to justify this through its statute and nature, which, in the case in point, cannot be accepted – quite the opposite.

In turn, during the first five years of the Shareholders Agreement, the **public shareholder** had the right to exercise the **put option** up to 10% of the shares to the Cruz Vermelha Portuguesa, or to whom the latter indicated, at the entry price, **capitalized** at the one-year LISBOR rate, plus half a percentage point, deducted from the sum of potential dividends and distributed reserves, discounted at the same rate.

Within the time limit allowed, the put option entitled the State to decide whether to sell those shares, falling upon the Cruz Vermelha Portuguesa (if the State exercised its put option) the obligation to buy them within the conditions agreed. There is no evidence, however, that the public shareholder has considered **to effectively exercise its put option.** That course of action, not open to refusal by the Cruz Vermelha Portuguesa, **would constitute an act of good management of public money**, since the shares were purchased for a higher price than that of their expected value throughout the period in which PARPÚBLICA could (and should) have exercised the put option. Thus, one can consider that the State (represented by PARPÚBLICA) did not consider the opportunity cost involved in this put option.

- Although it is certain that PARPÚBLICA has always monitored the value of its stake in this company, by failing both the renegotiation of the Shareholders Agreement and the partial divestiture of the shares, it has neglected the public interest regarding the investment in Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., as it should have done. In fact, PARPÚBLICA bought and paid this put option with a five-year maturity (it is irrelevant how it was done) and forfeited this asset, which should even be registered in its accounting records, because, in spite of possessing all the information to do it, it has not timely exercised its put option – a PARTEST's asset (currently PARPÚBLICA) as any other.
- The shares of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., were evaluated in 2001, for the purposes of the IPE's share capital increase, at **€ 8.39**[23], **that is to say, a price that suggests a potential loss of € 43.48 (nearly 83.8%),** and, in 2003, for the purpose of restoring the

[23] 225,000 x € 8.39 = € 1,887,750.

shareholding portfolio held by PARPÚBLICA, at **€ 35.56**, which represents a potential loss of **€ 16.31 (-31.5%)**.

- From the tenth year-end (August 2008), the State can freely sell its stake through PARTEST (currently PARPÚBLICA), within the terms and conditions of the Shareholders Agreement, but it is now impossible (in rational terms) given the high price at which it bought the shares from the Cruz Vermelha Portuguesa. PARPÚBLICA has, for sure, realised this was happening, because a proposal for revision of the Shareholders Agreement was submitted to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., in May 2000.
- The company's *ex-post* operating costs, in the period 1999 - 2008, always exceeded its *ex-ante* operating costs.
- From 1998 to 2008, within the Cooperation Agreements with Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., the **Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., paid a total sum of € 198,508,992.00 for the healthcare services provided to the NHS users.**
- The **payments** made in this period, within **the Cooperation Agreements**, account for 52% of the total operating income of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., on average. These Agreements were crucial to save the Cruz Vermelha Portuguesa's Hospital from insolvency into which it had been led.
- From 2004, regardless of reporting profit or loss, Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., paid to the Cruz Vermelha Portuguesa the sum corresponding to 1.5% (which represents a compensation for the transfer of exploration contract) of the annual turnover in compliance with the clauses of the Shareholders Agreement, totalling € 2,897,137.30, between 2004 and 2009. These payments started to be made, despite PARPÚBLICA, in its letter of 9 March 2001, attached to the adversarial procedure, proposing that "*the Cruz Vermelha Portuguesa should dispense with its remuneration for the transfer of exploration (…) until a new shareholders agreement is negotiated.*" The PARPÚBLICA's proposal was based on the failure to comply with the restructuring of human resources by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., which was accepted by the latter, "*and which defined the price paid for the shareholding*", as endorsed in the letter of 7 March 2001, attached to the adversarial procedure and addressed to the relevant Ministry. It should be noted that the aforesaid payments were made against PARPÚBLICA's will in view of the breach of the Agreement in terms of reducing excess staff and of the weak economic and financial performance, as compared with the forecasts on the basis of which the shares sold to PARTEST/PARPÚBLICA had been evaluated. In fact, a significant portion of the value of the shares sold by the Cruz Vermelha Portuguesa to PARTEST/PARPÚBLICA had been dilapidated due to failure to fulfil the Shareholders Agreement.

Economic and financial analysis – see point 9.2

- In the **Cruz Vermelha Portuguesa's Hospital's Restructuring Project,** the evaluation of its activity totals **€ 25,937,490.64**, based on a **10.46% WACC, or, in other words, € 51.87 per share.**
- The *ex-ante* **Internal Rate of Return (IRR),** obtained from the Free Cash Flow forecast is **37.39%**.
- The ***ex-post*** **Free Cash Flow did not accompany the forecast values**, and the evaluation value of the **Cruz Vermelha Portuguesa's Hospital**'s activity was found to correspond to **€ -14,448,658.48** and to **€-28.90** per share.
- Because it proved impossible to calculate the ***ex-post*** **Internal Rate of Return** (IRR) of the Free Cash Flow, given that it is a series of non-conventional Cash Flows, **the Teichroew's approach,** often referred to by Copeland (2005)[24] was used, and a **– 82.3%** ***ex-post*** **rate of return** was obtained.
- The **annual** ***ex-ante*** **economic profitability**[25]**,** for the ten-year period[26], which gave rise to the Internal Rate of Return (IRR), obtained through the Free Cash Flow from the Restructuring Project of the advisory bank, was found to be substantially higher than the *ex-post* rate of return in the same period.

Indicators	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Ex-ante economic profitability	16.2%	36.3%	30.3%	39.4%	41.0%	38.1%	35.6%	33.1%	31.5%	30.0%	28.3%
Ex-post economic profitability	0.6%	4.1%	18.8%	12.6%	10.3%	7.9%	7.7%	5.8%	-2.3%	6.9%	10.6%

Thus, the simple arithmetic mean of the said estimated annual economic profitability for the period under analysis totalled 33.16%, whereas the average of the current annual economic profitability achieved 7.24%. Such difference in the rates of return can only result from the breach of the Shareholders Agreement, a possibility raised by PARPÚBLICA, and from a careless economic and financial management, because the Cooperation Agreement between the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., and Cruz

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24 *Vide*, Copeland, Weston and Shasti, 2005, "Financial Theory and Corporate Policy", Pearson Education, Fourth Edition (International Edition).

25 The calculation method of the IRR from the accounting rates of return was based on J. Barreau's PhD thesis, defended in 1974 at the University of Panthéon – Sorbonne, " Relation entre le taux de rentibilité interne et le rendement contable",Vide, also, Brealy & Myers.

26

$$IRR = \sum_{t=1}^{n} \pi_t \times c_t$$

$$\pi_t = \frac{I_{t-1} \times (1 + IRR)^{-(t-1)}}{\sum_{t=1}^{n} I_{t-1} \times (1 + IRR)^{-(t-1)}}$$

$$c_t = \frac{EBIT_t}{I_{t-1}}$$

$$t = 1,2,\ldots n$$

Ct= Economic profitability

I= Investment in Fixed Capital (IFC) + Investment in Net Working Capital (INWC)

EBIT= Earnings Before Interest and Taxes

IRR= Internal Rate of Return.

Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., has always been in force.

- The solvency and financial leverage ratios reflect the mediocre financial balance of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., whose debt ratio achieves nearly 74%, in 2008. This shows some financial problems and its unmistakable immaturity, to say the least.
- It should be noted that the debt ratios of the State-Owned Enterprise hospitals, in 2008, reached 63%, and 66% with regard to all NHS hospitals (Administrative Public Sector + State-Owned Enterprises).

In fact, the financial autonomy still fell short of what is desirable. Besides, it is recommended that efforts should be made so that the State will not be asked again to bailout Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A.. In fact, in the adversarial procedure, Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., claims that the State must cover its deficits irrespective of their origin. It should be remembered that the situation of insolvency into which the Cruz Vermelha Portuguesa's Hospital had been led, arose from declared mistakes in terms of human resource management. In fact, they led the former Cruz Vermelha Portuguesa's Hospital to make debts during consecutive years with suppliers and other creditors and to squander the State's subsidies, in order to pay the "huge salaries" for excess staff, according to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., and to postpone *ad eternum* the replacement investments and other investments necessary to the hospital's proper functioning. The indebtedness level, significantly higher than that of the NHS hospitals, must be monitored with greater rigueur. In addition, the State should effectively monitor Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., so that the levels of indebtedness do not require another intervention, leading to outcomes of questionable effectiveness, to say the least.

Likewise, the board of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., should not invoke the nature of the Cruz Vermelha Portuguesa's statute [27] and demonize the profit and the market to obtain advantages. A for-profit organization, as such, does not necessarily manufacture and commercialize products at higher prices than those practised by a not-for-profit institution, or any other similar entity. There is evidence that the market, when it works (or is allowed to work), is more rigorous than any supervising entity. In this case, the former Cruz Vermelha Portuguesa's Hospital, precisely

[27] Regarding *"(…) the possible automatic extension to* Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., *of the statute and the specific benefits of the private welfare institutions, a privilege granted by law to the Cruz Vermelha Portuguesa, for the pursual of humanitarian purposes, in particular in the healthcare area*", the opinion of the Advisory Board of the Public Prosecutor's Service, requested by deliberation of the 2nd Chamber of the Tribunal de Contas, on 25 November 2009 (see point 7 of this Report), concludes that "*The specific benefits of the private welfare institutions legally granted to the Cruz Vermelha Portuguesa cannot be extended to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., a company whose share capital is mostly held by the former*".

because it thought, and still thinks, to be immune to the risk of bankruptcy (see adversarial procedure of 2001 – Report No. 8/2001- 2nd Chamber), allowed itself the "luxury" of incurring extra costs, year after year, which were ultimately paid by the State. The minimum one can ask in these cases – involving public money – is the same transparency that is required from all organizations.

Besides, in 2001, PARPÚBLICA[28] stated the need to cut excessive costs in order to counterbalance the results, which, for noncompliance reasons attributable to the Cruz Vermelha Portuguesa, achieved a "*reduction of more than PTE 200 million* [29] *(one third) per year of the sums in the project*", as per the letter of 9 March 2001, attached to the adversarial procedure. It should be remembered that, as stated by PARTEST, "*results forecasts" "defined the price paid for the shareholding*", which "*will not be met*". Because the costs have not been reduced, there is therefore a loss of the share "intrinsic value" of nearly 37% (€ 19.2 per share), as compared with the projections made.

Appraisal of the decision-making process underlying the celebration of Cooperation Agreements – see points 9.3 and 9.4

- **Prior to the Cooperation Agreements** with Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., the NHS's needs should have been identified, the healthcare targets desired by the State should have been set and a Cost-Benefit Analysis should have been made, from the macroeconomic/social/community point of view. Alternatively, this cost-benefit analysis should ensure a rational management of public money.
- The Healthcare Service Contract System Agency has not conducted economic and financial sustainability studies for the celebration of the aforesaid Agreements, notably in terms of the use of the installed capacity (supply) in the public sector and of compliance with the principles of economy, efficiency and effectiveness of expenditure. In addition, **no comparative analyses have been made** between the costs resulting from those agreements and the costs of the contract system with NHS hospitals (programme-contracts).
- Because this is the only way of introducing the issue of scarcity of resources in the decisions, the lack of such studies and analyses presupposes that the resources to be allocated to Health are unlimited. Such procedure is always unjustified and unjustifiable, in particular considering the economic situation of the country.

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[28] In March 2001, a letter addressed to the Vice-Chairman of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A..

[29] € 997,595.80.

Monitoring of the Cooperation Agreement – see point 12

- The Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., has periodically **monitored the Cooperation Agreement** celebrated in 2008 with regard to the whole outsourced activity and the sums involved in the contract in cardio-thoracic surgery, ophthalmology, orthopaedics, vascular surgery and urology, the latter from November 2008. The Cooperation Agreement is designed to provide surgery healthcare services, outpatient surgery services, patient appointment services, and other medical acts set out in the annexes attached to the said Agreement.
- The Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., **has performed its duties** within the follow-up and control of the Cooperation Agreement, through the **monthly analysis of invoices** from Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., and **clinical audits** regarding healthcare service provision.
- In 2008, the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., did not conduct any **audit or inspection** on the **Hospital's working conditions**, failing to perform one of the powers set out in the Cooperation Agreement.

Conduction of clinical audits in 2008 – see point 12.2

- In 2008, the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., conducted **clinical audits** regarding the Cruz Vermelha Portuguesa's Hospital's activity with the purpose of checking whether the **contractual obligations were met**, whether there were any differences between the computer records and the medical records regarding the origin of referred patients, and whether the acts invoiced and carried out and the respective coding, matched, among others.
- The **noncompliances** found essentially concern appointments without medical record, supplementary diagnostic and therapeutic tests and procedures with no information in the medical records, appointments without the doctor's signature, situations where the DRG has been changed and coding mistakes. **After being cross-checked by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., the previously mentioned noncompliances were corrected, with implications in invoicing.**

Assessment of compliance with the clauses of the Cooperation Agreement celebrated between the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., and Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A. – see points 12.3. and 12.4.

- In the period 2007-2008, users made no claims regarding the services provided within the Cooperation Agreement.

- The provisions of paragraph b) of No. 11 of article 8 (verification of the response capacity of the NHS hospitals) were not observed in the clinical processes referred by Primary Healthcare Units, selected in the sample, with regard to orthopaedics, vascular surgery, ophthalmology and urology. This can therefore result in a source of waste of resources, which is difficult to quantify. In fact, if the installed capacity in the NHS hospital units had been confirmed, it would have rendered the referral for the Cruz Vermelha Portuguesa's Hospital impossible.

Besides, this concern underlies the three Circulars[30] which, in 2010[31], the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., sent to the Executive Directors of the Primary Healthcare Centre Groups of the respective geographical area, in which restate the user referral criteria for the Cruz Vermelha Portuguesa's Hospital ("*Existence of a presumption of surgical need*"; "*The lack of adequate response capacity in the NHS hospitals*"[32]), and update the referral procedures to comply with, namely regarding the NHS response capacity verification process.[33].

These Circulars[34] even mention that:

> *"(…) the power given to the Primary Healthcare Units for patients to be sent directly to the Cruz Vermelha Portuguesa's Hospital within this Cooperation Agreement lends it* ***not to take the most of the NHS installed capacity and, concomitantly, not to comply with the assumption of resorting only to external entities when there are in fact no timely response conditions****, namely, within the deadlines fixed in the SIGIC Regulation (Order No. 45/2008, of 15 January) and in Order No. 1529/2008, of 26 December, in which the maximum guaranteed response time is set for access to healthcare units."*

And that:

> *"(…) without prejudice to obvious concerns in* ***guaranteeing the rational use of the NHS existing resources*** *and the equity of access, an array of guidelines are disseminated with regard to patient referral for the Cruz Vermelha Portuguesa's Hospital by the Primary Healthcare Units:*
>
> *a) (….)*

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[30] Circulars No. 10924/DC/2010, of 10 May, 17665/DC/2010, of 2 August, and 21481/DC/2010, of 25 September. The latter two are updates/amendments to the former.

[31] After exercising the adversarial principle of this audit. The Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P.'s Circulars meet the recommendations proposed in the audit report, in order for the Governing Board *"To make efforts, with the referring entities to improve control over patients' routing and referral to avoid bearing costs within the Agreement, when there is proper installed capacity in the hospitals of the National Healthcare System"* and *"To prevent any patient from referral for the Cruz Vermelha Portuguesa's Hospital, without prior assessment of the National Healthcare System capacity to address the health problem*".

[32] See point 1 of Circular No. 10924/DC/2010, of 10 May.

[33] *See*, in particular, Circular No. 17665/DC/2010, of 2 August (which changed the procedure established by Circular No. 10924/DC/2010, of 10 May).

[34] Circular No. 10924/DC/2010, of 10 May.

b) ***Patient routing should only occur when the NHS shows an effective lack of response time****, i.e., where it is not possible to provide healthcare services within the maximum guaranteed response times for surgery.*

(…)

Compliance with this premise is crucial ***to safeguard proper use of available resources*** *in the NHS hospital units and* ***to avoid possible waste of the installed capacity****.*

c) (…)

d) (…)".

- Unlike the provisions of the Agreement, it was also found in the selected sample that fifteen patients were referred by the North Lisbon Hospital Centre[35], Western Lisbon Hospital Centre [36] and Hospital de Garcia de Orta, for cardiothoracic surgery of the Cruz Vermelha Portuguesa's Hospital (paediatric cardiology and adult cardiac surgery), **because there was no timely response capacity to carry out those surgeries and because some of them had a high medical risk,** without prior assessment of the response time of the other hospitals that are part of the Referral Network of the Lisbon and Tagus Valley Health Region.

- **Hospital do Espírito Santo de Évora, E.P.E.,** referred a patient of the National Healthcare Service to the Cruz Vermelha Portuguesa's Hospital, after **having confirmed the response incapacity of the reference hospital** for paediatric cardiology (Hospital de Santa Cruz), as well as the Hospital de São Francisco de Xavier which provides Hospital de Santa Cruz with neonatal support services.

- The lack of timely response capacity in the **Central and North Lisbon Hospital Centres** in cardiothoracic surgery, used as justification for the referral of patients to the Cruz Vermelha Portuguesa's Hospital, is not in line with the information that was previously sent to the "Direcção-Geral do Tribunal de Contas"[37], by those hospital units, within the Financial Audit of the Hospital Curry Cabral (Report No. 8/2009- 2nd Chamber), because it was stated **that there was an installed capacity, in 2007 and 2008, to carry out more than 390 cardiothoracic surgeries/year.**

- Thus, as there is available installed capacity in the NHS hospitals (Central and North Lisbon Hospital Centres) one could infer, unless proven otherwise, that, with a high degree of likelihood, the NHS has been wasting the available installed capacity (supply) of these hospitals in carrying out more cardiothoracic surgeries in the Lisbon and Tagus Valley Health Region. The prices paid to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., bear therefore the opportunity cost of the wasted/idle installed capacity.

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[35] Includes the Hospital de Santa Maria and Hospital Pulido Valente.

[36] Includes the Hospital de Santa Cruz, Hospital São Francisco Xavier and Hospital Egas Moniz.

[37] Directorate-General for the Portuguese Court of Auditors.

- Broadly speaking, the price charged by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., should also bear the said opportunity cost. This is the only way the economic efficiency prices corresponding to the delivery prices of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A.[38], could be achieved, plus the opportunity cost of the investment in this entity, which is equal to the difference between the social rate of discount and the multi-period dividend yield[39] (which is negative).

  The "*10% bonus"* over listed prices, claimed by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., is hard to reach. For there to be any actual price reduction in relation to the NHS listed prices, it would be necessary that the said percentage was such that the total sum so obtained, covered (or paid) the idleness costs of the NHS hospitals and the costs of opportunity of the State's stake in Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A.. In addition to these two costs, other advantages given to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., should be included, such as the price/value of the market risk reduction associated with the Cooperation Agreement. This can be determined by calculating the "Partially-Guaranteed Production Placement Option" "embedded" in the Agreement[40]and[41].

- Some of the cardiothoracic surgery patients, who received healthcare services at the Central Lisbon Hospital Centre[42] by the medical/surgical team that is currently performing its activity at the Cruz Vermelha Portuguesa's Hospital, (this team of the Hospital de Santa Marta was headed by the then Chairman of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A.) continue to receive healthcare services in this hospital, **without any new referrals** by the **Central Lisbon Hospital Centre,** after **assessing, in subsequent situations**, its timely response capacity, and the timely response capacity of the other NHS

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[38] The additional premium to the delivery price of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., could be calculated as follows:

$$NHS\ hospital\ idle\ costs_i \approx Fixed\ Costs_i \times \frac{Q_{Full\ emplyment_i} - Q_{Underemplyment_i}}{Q_{Full\ emplyment_i} \times Q_{Underemplyment_i}}$$

[39] The multiperiod dividend yield is obtained by calculating the shares' IRR (share price *versus* dividends).

[40] One should probably consider the American call option over 100% of the shares held by PARPÚBLICA, with a 10-year maturity, which annulled the latter's chance of making any profit. This option allowed the Cruz Vermelha Portuguesa to take legitimate ownership of income generated by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A.. After all, it was enough for PARPÚBLICA to recover the investment made in shares (a financial equivalent of the purchase price when the option by the Cruz Vermelha Portuguesa is exercised). Another relevant aspect is the fact that the common practice of indexing procedures (100%-10% of the original DRG price) in this type of Agreements may carry, to the private sector, the inefficiencies of the State-Owned Enterprises and the Administrative Public Sector, with the resulting negative consequences. To have as a reference, administrative prices that are likely to incorporate, *a priori*, production inefficiencies, instead of adopting economy efficient prices, may be a way to early destroy the healthcare market. That's also why it is highly recommended to turn to the market without which it is hard to have an idea of which prices would promote efficiency (and competitiveness) in the Portuguese healthcare market.

[41]And, when Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., refers to hypothetical subsidies, it should be remembered that investment subsidies are returned to the State, phased over time, for the amount of the subsidy multiplied by the Corporate Tax rate in force.

[42] This refers to the Hospital de Santa Marta.

hospitals covered by the Lisbon and Tagus Valley Health Region[43]. The Central Lisbon Hospital Centre mentions that there is not technical justification for these services being rendered by the team that has previously provided them.

- It was found in the selected sample that **Hospital Professor Doutor Fernando da Fonseca[44] has also referred paediatric cardiology situations**, whose patients came from Hospital de São João - Porto and Hospital Maria Pia - Porto, without observing the Referral Network established in the Cooperation Agreement. These healthcare services were invoiced within the scope of the said Agreement and analysed in the clinical audit conducted by the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P.. Nevertheless, **the invoiced sum was taken into consideration to settle payments**, having been deducted in subsequent payments. This was still reported to and handled by the Inspectorate-General for Healthcare Activities, for all due purposes.
- **The Centro Hospitalar do Médio Tejo, E.P.E,** (Hospital de Torres Novas) referred some patients for **adult cardiac surgery** at the Cruz Vermelha Portuguesa's Hospital. Although the referral, made directly by that Hospital Centre, does not fall within the scope of the Agreement, it has previously evaluated the response capacity of the appropriate hospital within the Referral Network of the Lisbon Area, the Western Lisbon Hospital Centre (Hospital de Santa Cruz), failing to obtain any timely response.
- By **directly referring** patients for the Cruz Vermelha Portuguesa's Hospital, **with no integration in the Integrated System for Managing Patients Scheduled for Surgery**, the Hospital de Curry Cabral goes against the principles of equity, impartiality and universality.
- With regard to the referral for cardiac surgery, and following the recommendations formulated by the Tribunal de Contas within the Financial Audit of Hospital de Curry Cabral, the *"(…) Board of Directors of the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., commissioned a study to make a Cost-Benefit Analysis on the referral procedures for the Cruz Vermelha Portuguesa's Hospital*". As a result of the conclusions of that study, the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., states that *"(…)within the scope of cardiac surgery, the referral procedures will be re-evaluated, and the necessary measures implemented, in order not to waste resources, as a result of the sub-use of the NHS installed capacity (…)*".

[43] The information provided by the Cruz Vermelha Portuguesa's Hospital was that these patients need a continuous surgical correction until the treatment is concluded.
[44] Within the Cooperation Agreement the NHS hospitals covered by the Lisbon and Tagus Valley Health Region Administration may refer patients for the Cruz Vermelha Portuguesa's Hospital paediatric cardiology service, after confirming that the appropriate Regional Hospital of the referral network does not have response capacity in the first place, and only when the patients' accessibility to timely healthcare services is at stake. This accessibility is assessed according to the patient's clinical situation (see No. 7 of article 8 of the Cooperation Agreement).

- **The principle of equity** is not guaranteed in terms of user fee payment, owing to the fact that users that benefit from the healthcare services provided within the Cooperation Agreement are not subject to the payment of these fees unlike the NHS hospital users.
- Financially speaking, in 2008 the ceiling amount under contract, € 21,132,599.30, was not exceeded, and the surgery area took up the highest sum (€ 19,729,624.85).

Assessment of the quality of the healthcare services provided – see point 12.4

- **No mechanisms implemented** by the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., **have been identified** in 2008 in order to **determine the quality** of the services provided in assistance, human and technical areas covered by the Agreement.

Activity costs under contract – see point 13.2

- The specialties within the Cooperation Agreement, which, in 2008, showed less profitability margins for Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., are **cardiothoracic surgery**, 6%, and orthopaedic, 10%. **Ophthalmology** and **vascular** surgery showed profitability margins of 49% and 35%, respectively.

Delivery prices of the "Misericórdias" (Charities) and other Private Welfare Institutions - see point 14.3

- By the time the audit was conducted (2009), the **prices paid** by the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., to Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., **were higher** than those in the social and private sectors. Nevertheless, it should be mentioned that the lowest prices were those fixed in the agreements/protocols celebrated with the "Misericórdias", bearing in mind that those prices date back to 1997.
- Having maintained the agreement with Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., over time, the Ministry of Health, through the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., did not investigate the existence of other **entities**, which may provide part or even all of healthcare services, with the same (or better) **quality and, perhaps, at lower prices**, neglecting, in this case, the **proper management of public money** and, concomitantly, **the sustainability of the National Healthcare Service**.

2. Recommendations

In light of the foregoing, we recommend that:

2.1. The Minister of State and Finance

- Should endeavour to implement the monitoring tools and/or mechanisms, in order to ensure an effective follow-up of the Protocols and Shareholders Agreements and make timely decisions, in order to minimize potential capital losses.
- Should make efforts to preserve the value of State's investment (profit=0) in Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A. through the reinforcement of the decision-making weight of PARPÚBLICA[45] in the company's internal bodies.

2.2. The Minister of Health

- Should raise awareness among the Administrações Regionais de Saúde and other entities that financial resources allocated to Health are, not only scarce, but also finite, and that the only way to bring in this restriction is through a Cost-Benefit Analysis[46].
- Should determine – as a cost reduction mechanism to be considered in future budgetary constriction measures – that the Protocols and/or Agreements to be celebrated with entities that are outside the NHS consolidation perimeter, be previously subject to a rigorous Cost-Benefit Analysis[47] from the macroeconomic/social/community point of view.
- Should reassess the Cooperation Agreement with Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., in view of the installed capacity in NHS hospitals.

[45] On 4 March 2011, Standard & Poor downgraded Parpública's rating, from «BBB/Watch Negative» to «BB+/Watch Negative». This decision was based on the high likelihood of it receiving exceptional State aid. On 18 March 2011, Moody's Investors Service also downgraded Parpública's rating, from «A1/Stable» to «Baa1/Negative Outlook».

[46] This is a method that allows adequate selection between alternative choices, in a budgetary constriction context.

[47] On 29 October 2010, a new Cooperation Protocol was celebrated between the Ministry of Health and the Cruz Vermelha Portuguesa with a view to regulating "*the terms and conditions in which the Ministry of Health and the Cruz Vermelha Portuguesa (…), articulate the access of the National Healthcare System patients to healthcare services in institutions and services belonging to the Cruz Vermelha Portuguesa*". The said Protocol states that "*This type of healthcare services cannot put at risk the rational use of the installed capacity in the public sector, assessed by the regional health administration and duly substantiated, namely through cost-benefit analyses and activity records developed by the institutions and services of the Cruz Vermelha Portuguesa on this matter*". To date, no agreement or studies are known as a result of the new Protocol. The aforementioned recommendations can be extended to other protocols/agreements that are celebrated with entities outside the NHS consolidation perimeter.

- Should reconsider the role played by Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., in the healthcare system, taking into consideration the State's significant financial engagement, operationally speaking or in terms of share capital outlay, for sustainability reasons of the National Healthcare Service.
- Should endeavour so that the NHS users, who benefit from the healthcare services within the Cooperation Agreement with Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., pay the user fees that the NHS users do.
- When celebrating future Protocols and/or Agreements for the provision of healthcare services with entities outside the NHS consolidation perimeter, should make efforts to launch a survey with social or private entities, aiming at the proper management of public money and the NHS sustainability.
- Should not adopt "administrative" prices as reference prices or as *a priori* benchmarking prices when negotiating with entities that are not part of the NHS.
- Should establish a systemic approach of Protocols and/or Agreements celebrated with entities supervised by other ministries.

2.3. The Board of Directors of the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P.

- When celebrating future Protocols and/or Agreements, with the purpose of providing healthcare services with entities outside the NHS consolidation perimeter, should survey other social and/or private entities, aiming at the proper management of public money and the NHS sustainability.
- Should back up the celebration of future Agreements/Protocols with private entities or with entities with contract for the provision of healthcare services, on cost-benefit analyses from the macroeconomic/social/community point of view.
- Should ensure compliance with principles of equity, impartiality and universality with regard to patients' referral by the Hospital de Curry Cabral.
- Should ensure a more efficient monitoring, in order to prevent patients excluded from the scope of the referral Agreement (Lisbon and Tagus Valley Health Region) from being provided with healthcare services by the Cruz Vermelha Portuguesa's Hospital.
- Should implement measures allowing the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., to assess the quality of services provided by the Cruz Vermelha Portuguesa's Hospital in the clinical, human and technical fields.

- Should endeavour, with referring entities, to improve the control over the patient routing and referral system, in order to avoid bearing costs within the Agreement, when there is installed capacity in the NHS hospitals.
- Should reassess the current Cooperation Agreement with Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., in view of the installed capacity of the NHS hospitals.
- Should monitor and make operational the application of patient referral procedures for the Cruz Vermelha Portuguesa's Hospital[48] and ensure effective compliance with the respective assumptions - "*existence of presumption of surgical need*" and "*lack of timely response capacity in the NHS hospitals*"[49].
- Should implement procedures to ensure that the Primary Healthcare Centre Groups only refer patients within the Agreement after confirmation of express lack of timely response capacity, in the NHS hospitals covered by the Lisbon and Tagus Valley Health Region.
- Should make efforts so that the NHS patients, who benefit from healthcare services within the Cooperation Agreement with Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., pay the same user fees that the NHS users do.

2.4. The Chairman of PARPÚBLICA – Participações Públicas SGPS – S.A.

- Should reassess its stake in the share capital of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A..
- Should monitor, timely and systematically, the performance of the financial shareholdings entrusted to it.
- Should promote a review of the Shareholders Agreement with Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., with a view to obtaining guarantees to preserve the value of public investment with the acquisition of a 45% stake in the share capital of Cruz Vermelha Portuguesa – Sociedade de Gestão Hospitalar, S.A., namely through the reinforcement of the decision-making weight in the management bodies of this company.
- In similar situations, should recognize derivative assets in accounting records.

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[48] Addressed by three Circulars from the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P., in 2010, which are in line with the recommendations proposed in the audit report, in order for the Board of Directors of the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P. *"To endeavour, with the referring entities, to improve control over the patient routing and referral system, in order to avoid bearing costs within the Agreement when there is installed capacity in the NHS hospitals"* and *"Not to allow any user to be referred to the Cruz Vermelha Portuguesa's Hospital, without prior assessment of the NHS installed capacity to address the patient's health problem*".

[49] See point 1 of Circular No. 10924/DC/2010, of 10 May, of the Administração Regional de Saúde de Lisboa e Vale do Tejo, I.P..

ABBREVIATIONS

Abbreviation	*Designation*
DRG	Diagnosis-Related Group
INTOSAI	International Organisation of Supreme Audit Institutions
IPE	Investimento e Participações Empresariais, S.A.
PARTEST	Partest - Participações do Estado, SGPS, S.A.
SIGIC	Sistema Integrado de Gestão de Inscritos em Cirurgia Integrated System for Managing Patients Scheduled for Surgery
NHS	National Healthcare Service
IRR	Internal Rate of Return
NPV	Net Present Value
WACC	Weighted Average Cost Of Capital