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Directorate D: Government Finance Statistics (GFS) and quality

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Subject: Statistical Classification of the Fundação Luso-Americana para o Desenvolvimento (FLAD)

Ref.: Your request for advice of 11 March 2015

Dear Mr Oliveira,

Thank you for your letter dated 11 March 2015 requesting Eurostat's advice on the sector classification of the Fundação Luso-Americana para o Desenvolvimento (FLAD). Eurostat has closely examined the dossier provided by Statistics Portugal and is now in a position to express its view on this matter.

1. THE ACCOUNTING ISSUE FOR WHICH A CLARIFICATION IS REQUESTED

The issue to be analysed is the sector classification of FLAD, a non-profit institution resident in Portugal, created to contribute to the economic and social development of the country through scientific, technical, cultural, educational, commercial and business cooperation between Portugal and the United States (US).

Following the changes introduced by ESA 2010¹ in the delimitation of the General Government sector, and, in particular, in the rules for the classification of non-profit institutions, Statistics Portugal included the FLAD in the General Government sector in September 2014 in the first data transmission under ESA 2010.

¹And by Eurostat's Manual on Government Deficit and Debt implementation of ESA 2010, published in August 2014.

FLAD has contested this classification based on legal aspects and has questioned the application of ESA 2010 rules by Statistics Portugal. Based on paragraph 1 of Article 10° of the Council Regulation (EC) N° 479/2009, as amended, Statistics Portugal has asked Eurostat for its advice, in order to confirm the correct statistical classification of FLAD.

Documentation provided

Statistics Portugal has provided a methodological analysis confirming their view that the FLAD is to be classified in the General Government sector following national accounts rules. The following documents have also been provided to Eurostat:

- Letter from FLAD to Statistics Portugal contesting its classification in the General Government sector
- Decree law n° 168/85 establishing the creation and the original statutes of the unit
- Decree law n° 107/2013 establishing the latest version of the statute of FLAD
- Exchange of letters between the government of Portugal and the Government of the United States preceding the creation of FLAD.

Description of the case

Origin and aim of the unit

The Fundação Luso-Americana para o Desenvolvimento (FLAD) was formally created in 1985, by agreement of the governments of Portugal and the US, by the publication of Decree Law n°168/85. The most recent version of the statutes, agreed unilaterally by the Portuguese government, was published with Decree Law n°107/2013.

FLAD is an institution resident in Portugal. Its mission is to contribute to the development of Portugal through the financial and strategic support for innovative projects and encouraging the cooperation between Portuguese and American civil society.

Throughout its existence, FLAD has supported numerous projects involving scientific institutions, universities, associations, companies and civil society institutions of Portugal and the US.

The action of the foundation develops under the following four strategic areas:

- economic and business cooperation between Portugal and the US;
- scientific and business cooperation between Portugal and the US;
- development program for the Azores;
- promotion of language and Portuguese culture in the US.

As concerns the origin of the unit, between 1975 and 1985 the US government provided financial support to the Portuguese government under various forms (more than USD 850 mn were received by Portugal during that period). In 1985, with the forthcoming accession of Portugal to the UE, such financial support to the Portuguese government had to be decreased and the private sector was called to play a leading role.

In order to continue receiving financial support from the US, both governments agreed on the creation of a foundation, the FLAD, which would be financed with funds provided by the US to the Portuguese government for this purpose.

Financing

The initial funding of the FLAD was set at USD 38 mn. These funds were provided by the US to Portugal and were kept in an account of the Portuguese State until they were transferred to the FLAD after its creation. Subsequently, between 1985 and 1991 the Portuguese government increased the capital of the FLAD with endowments from specific donations made by the US government to the Portuguese government in the framework of different agreements between the two countries up to an amount of USD 112 mn.

No further capital increases or financial support under any form have occurred after 1991. Since then, the FLAD has obtained financing for its activities exclusively from the return obtained by managing and investing its equity.

Governance

The FLAD has the following organisation:

- the Board of Administrators, which takes the main decisions.
- the Executive Board, which is in charge of the daily management of the unit.
- the Curators Council, whose main function is to choose the members of the Board of Administrators (except the President)
- the Auditor

According to the latest version of the statutes of FLAD, the Board of Administrators is formed by 3 up to 5 members (the current board is integrated by 5 members). The President of the Board is appointed by the Portuguese Prime Minister and the remaining members of the Board are appointed by the Curators Council.

The Executive Board is formed by 3 members appointed by the Portuguese Prime Minister among the members of the Board of Administrators. The President of the Board of Administrators is the President of the Executive Board.

Both in the Board of Administrators and in the Executive Board, decisions are taken by simple majority and the President has a casting vote.

The Curators Council is formed by 5 up to 7 members, nominated by the Portuguese Prime Minister. Out of these members, only two are proposed by the Ambassador of the US in Portugal. The current composition of the Curators Council is 6 members (out of which two are proposed by the Ambassador of the US in Portugal). The President of the Curators Council is elected among its members by absolute majority (the current President of the Curators Council has held different positions in previous governments, always with the party that is currently in government). The remaining decisions are taken by simple majority and the President of the Curators Council has a casting vote.

2. METHODOLOGICAL ANALYSIS

National accounts rules in force

Eurostat's analysis is carried out according to the rules of ESA2010 and the MGDD Implementation of ESA2010, the latter published in August 2014.

Control of non-profit institutions is defined in ESA 2010 2.39. However, it is to be recalled that this is a general definition for all institutional sectors and thus, to assess whether a non-profit institution is controlled by government, it is ESA 2010 chapter 20 for government accounts that should be used.

In ESA 2010, non-profit institutions classified into the general government sector are treated in paragraphs 20.13-20.16. ESA 2010 20.13 states that: "*Non-profit institutions (NPIs) that are non-market producers and are controlled by government units are units of the general government sector*".

ESA 2010 20.15 defines five indicators of control for non-profit institutions as follows: "*To determine whether a NPI is controlled by the government, the following five indicators of control should be considered:*

(a) the appointment of officers;

(b) the provisions of enabling instrument, such as the obligations in the statute of the NPI;

(c) contractual agreements;

(d) degree of financing;

(e) risk exposure.

(...)"

The above criteria are further elaborated on in paragraph 17 of section I.2.3 of the MGD. Part I of the MGDD covers the delimitation of the general government sector. In particular, the concept of government controlled institutional units is defined in part I.2.3.

Eurostat's analysis

From a National Accounts Perspective, the FLAD is a non-profit institutional unit resident in Portugal.

From the information provided in the annual reports it is concluded that the FLAD is a non-market unit, the result of the quantitative market test being well below 50%. The unit has no sales and positive entries in the profit and loss account correspond mainly to items not considered as sales (holding gains, reversal of provisions and revaluations).

Given that the FLAD is a non-profit institution and a non-market producer, following ESA 2010 20.13, it should be classified in the government sector if it is controlled by government. In order to determine the statistical classification of the FLAD, it is a key element to establish who is controlling the unit.

This represents a difference as compared to ESA 95, according to which a non-profit institution and non-market producer would be classified in the government sector if controlled and mainly financed by general government. As pointed out by Statistics Portugal, under ESA 2010 the degree of financing is no longer a necessary condition and it is only one of a set of criteria to be considered to assess government control. In addition, the degree of financing by itself would not normally be a decisive criterion in order to determine control.

The Portuguese Prime Minister appoints the majority of the members of the Curators Council, which, in turn, appoint all the members of the Board of Administrators with the exception of

the President, which is directly appointed by the Portuguese Prime Minister. In addition, the Portuguese Prime Minister appoints the members of the Executive Board among the members of the Board of Administrators.

Through the direct appointment of the majority of the members of the Curators Council (who appoint the members of the Board of Administrators), the direct appointment of the President of the Board of Administrators and the members of the Executive Board, the Portuguese Government exerts a significant degree of influence in the decisions and the daily management of the FLAD.

Following paragraph 13 of section I.2.3 in the MGDD, this criterion would be sufficient by itself to determine government control of the unit.

In addition, as pointed out in the letter by Statistics Portugal, according to article 14 of the statute, the Portuguese Government has the power to unilaterally change the statute of FLAD or decide over the transformation or extinction of the unit.

Following paragraph 17.b) of section I.2.3 in the MGDD, an NPI fulfilling one of the above (power to change of the statute or to extinct the unit), would be considered to be controlled by government.

Moreover, in case of extinction of FLAD, the remaining assets of the unit will revert to the Portuguese State. This fact points at government exerting control over the assets of the unit in case of extinction.

3. CONCLUSION

Eurostat considers that FLAD is controlled by the Portuguese Government because of the following reasons:

- The right of government to appoint the majority of the members of the Curators Council, the President of the Board of Administrators and the Executive board, which entails that the Portuguese Government exerts a significant influence in the decisions and daily management of the unit;
- The power of government to unilaterally change the statute;
- The power of government to decide unilaterally over the transformation or the extinction of the unit;
- The fact that in case of extinction, the remaining assets will revert to the Portuguese State.

It is to be recalled that each of these reasons would lead to the FLAD being controlled by the Portuguese Government if considered individually.

The FLAD is a non-market non-profit institution controlled by the Portuguese Government. Therefore, following ESA 2010 20.13, Eurostat concludes that FLAD is correctly classified in the general government sector for National Accounts Purposes.

4. PROCEDURE

This view of Eurostat is based on the information provided by the Portuguese authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009, as amended, and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC.

Eurostat is therefore publishing all official methodological advice (ex-ante and ex-post) given to Member States on its website. In case you have objections concerning the publication of this specific case, we would appreciate if you could let us know before 1st April 2015.

Yours sincerely,

(e-Signed)

Eduardo Barredo Capelot
Director