

## **Application of Accrual Principles to Debt Arrears**

An Issue Paper Prepared for the December 2004  
Meeting of the Advisory Expert Group on National Accounts

### **The Statistics Department International Monetary Fund**

#### (1) Recommendations by BOPTTEG:

- (i) The group agreed unanimously to harmonize the time of recording, and treatment of, arrears in various macroeconomic statistics.
- (ii) The group unanimously recommended that when arrears occur, no transactions should be imputed, but the arrears should continue to be shown in the same instrument until the liability is extinguished.
- (iii) If the terms and characteristics of financial instruments change when a liability goes into arrears, the majority of the group favored the treatment of this change as reclassification/other volume change but several supported its treatment as a transaction.
- (iv) The group reinforced the view that data on arrears are important. There was a general consensus that data on arrears should be presented as memorandum or supplementary items rather than as subheadings under relevant instruments of the international investment position. Although it is useful to identify some commonly important arrears (such as arrears on public and publicly guaranteed debt), most members favored flexibility in determining which items of arrears are important to disseminate depending on each country's circumstances.
- (v) The group noted that, in the accrual system, the accrual of interest is a separate event from payments and both are recorded. The arrears refer to payment arrears. The payments could be related to interest and/or principal. The group suggested that appropriate and consistent terminologies be used in drafting the manual.

#### (2) Alternatives rejected by BOPTTEG:

The group rejected the imputation to account for the liability being repaid and its replacement by a new short-term debt (representing the arrears) when a liability goes into arrears.

(3) The Committee's decisions

The Committee supported the recommendations. However, it was concerned about how the proposals for arrears and non-performing loans could be reconciled and asked for worked examples. The attached paper on "Debt Arrears and Nonperforming Loans" serves this purpose and concludes that (i) memorandum or supplementary information on arrears may be needed only for positions (balance sheets) but not for the balance of payments (flows account), and (ii) a distinction between arrears on nonperforming loans and others arrears is not needed.

(4) Implications for SNA

1(i) Harmonization

1(ii) Harmonization for BOP and clarification for SNA

1(iii) Clarification

(5) Questions for the AEG:

- (i) *Does the AEG agree that the time of recording and treatment of arrears be harmonized in various macroeconomic statistics? See 1(i) above.*
- (ii) *Does the AEG agree with the recommendation that no transactions should be imputed when a liability goes into arrears? See 1(ii) above.*
- (iii) *Which of the two alternative treatments -- transactions or reclassification/other changes -- is appropriate if the terms and characteristics of financial instruments change when a liability goes into arrears? See 1(iii) above.*

**IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS  
BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTTEG)**

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**ISSUES PAPER (BOPTTEG) # 3**

**APPLICATION OF ACCRUAL PRINCIPLES TO DEBT ARREARS**

**Prepared by Manik Shrestha, IMF Statistics Department**

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## BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP

### ISSUES PAPER (BOPTTEG) # 3

#### APPLICATION OF ACCRUAL PRINCIPLES TO DEBT ARREARS

Debt arrears occur when scheduled payments (repayment of principal or coupons) are not made by their due-for-payment date. The current statistical manuals seem to follow two separate bases for time of recording for repayments of debts.

#### I. Current international standards for the statistical treatment of the issue

In general, all macroeconomic statistics use the accrual basis for determining time of recording. However, the treatment differs for arrears. The *External Debt Statistics: Guide for Compilers and Users (External Debt Guide)* defines arrears as amounts that are past due-for-payment and unpaid (paras. 3.36, 3.37).

The time of recording basis followed in the *BPM5* (paras. 123, 528), *External Debt Guide* (paras. 2.29, 3.36), and *Government Finance Statistics Manual 2001 (GFSM 2001)*; para. 9.19) is that when a debt liability goes into arrears, transactions are imputed as if the repayment of debt liability had been made and a new short-term liability created. This time of recording basis conforms with the due-for-payment basis as repayments are recorded at the time they are due.

The treatment followed, in principle, in the *1993 SNA* (paras. 3.94 and 11.101) and *Monetary and Financial Statistics Manual (MFSM 2000)*; paras. 225, 238) is that repayments of debts are recorded when they are extinguished (such as when they are paid, or rescheduled, or forgiven by the creditor). This time of recording basis conforms with the accrual basis. Under this approach, arrears will continue to be shown in the same instrument until the liability is extinguished. When a liability goes into arrears, the terms and characteristics of the entire liability or only the portion in arrears may change. If the terms and conditions change with respect to any part of the liability, that part is to be treated as a separate instrument. However, the *1993 SNA* does not discuss this issue specifically (for example, whether to treat such events as transactions similar to debt reorganizations or as other changes due to reclassification of instruments).

Amounts rescheduled or forgiven by the creditors are treated the same way by both approaches.

The existing statistical manuals also emphasize the usefulness of data on arrears for various types of policy analysis and solvency assessments.

- The *External Debt Guide* (para. 4.4) explicitly distinguishes arrears under other debt liabilities and intercompany lending.

- The *GFSM 2001* (para. 7.144) suggests that each classification be divided into the amount not in arrears and the amount in arrears as well as that total amounts in arrears be shown as a memorandum item.
- The *BPM5* table on Selected Supplementary Information (Table 8) includes various categories of arrears on exceptional financing that are needed to derive an analytic presentation, as published in the IMF's *International Financial Statistics (IFS)*. It does not discuss arrears in cases other than exceptional financing.
- The *MFSM 2000* (para. 239) requires that data on interest arrears be presented as a memorandum items in sectoral balance sheets.
- The *1993 SNA* (para. 11.101) also notes that it may be useful to group all arrears of interest and repayment under a memorandum item.

## **II. Concerns/shortcomings of the current treatment**

The existing international statistical manuals seem to follow different treatment of arrears. While *BPM5*, *GFSM 2001*, and the *External Debt Guide* record transactions when arrears arise, the *1993 SNA* and *MFSM 2000* record transactions only when the liability is extinguished. The time of recording for debt arrears could be harmonized in various macroeconomic statistics.

Under the *BPM5* approach, all arrears are classified under short-term liabilities. This has the consequence that arrears are no more linked to associated instruments, rather they are treated as separate financial instruments. This requires separate recording of arrears in statistical systems. However, the *GFSM 2001* (para. 3.49) notes that arrears arising from failure to repay debt obligations as scheduled will not be apparent without supplemental information in the due-for-payment recording basis. Further, to derive an analytic presentation, as published in the IMF's *IFS*, separate identification is needed of various categories of arrears on exceptional financing (as in the *BPM5* Table 8). The imputation of transactions also gives the impression that the debtor has made the repayment and obtained a new source of financing.

The *1993 SNA* approach does not record arrears as transactions. It distinguishes arrears between those where terms and conditions change and those that do not. For the latter, to identify amounts of arrears included in the stock of each instrument, either a separate sub-heading would be needed for each instrument having arrears or arrears would need to be shown as memorandum items. Presentation of arrears as a separate subheading under each instrument, when terms and conditions do not change, has the advantage that arrears are linked to associated instruments. For countries that do not compile international investment position statistics, separate information on various categories of arrears on exceptional financing would be needed if an analytic presentation of balance of payments is to be derived.

Under the *1993 SNA* approach, the existing guidelines are not clear as to the treatment of arrears if the terms and characteristics of financial instruments change when a liability goes into arrears (as transactions or changes in classification).

A related issue is the treatment of non-performing loans. Generally, loans are defined as non-performing when payments are overdue by more than a specified time period. In that sense, all non-performing loans include arrears (unless they are written off). Under the *BPM5* approach, non-performing loans would not include arrears because a new liability is created when arrears arise. Valuation and other issues related to non-performing loans will be dealt with in a separate issues paper.

### **III. Possible alternative treatments**

Two possible alternative treatments are presented in the *Annotated Outline* (para. 3.11) for recording of arrears that do not change the terms and conditions of the instrument. They are:

- (1) imputation of transactions that the liability had been repaid and then replaced by a new short-term debt (representing the arrears), or
- (2) no imputation of transactions but continuing to show arrears in the same instrument until the liability is extinguished, but either requiring arrears to be shown in the balance sheets as a sub-group under relevant instrument or to be shown as memorandum or supplementary items<sup>1</sup>.

If the terms and characteristics of financial instruments change when a liability goes into arrears, the *1993 SNA* approach could be clarified as to whether the change in characteristics of financial instruments should be treated

- (1) as transactions (extinction of the old liability and creation of a new), or
- (2) as other changes in financial assets and liabilities due to reclassification of instruments.

### **IV. Points for discussion**

- (1) *Do the BOPTTEG members consider it essential that the time of recording for arrears be harmonized in various macroeconomic statistics?*
- (2) *Which of the two possible time of recording principles is appropriate for recording arrears and repayments of debts?*

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<sup>1</sup> In the new Balance of Payments Manual, a distinction will be made between memorandum and supplementary items. Memorandum items are considered as a part of the standard components whereas supplementary items are raised as options that may be considered when a particular issue is of interest to analysts and policy makers.

- (3) *If the 1993 SNA approach is followed,*
- (a) *Should the data on arrears be presented as subheadings or memorandum items?*
  - (b) *Are data needed on all arrears or on selected arrears?*
  - (c) *If data are needed only for selected items, which arrears are needed (for example, arrears on public and publicly guaranteed debt, technical arrears (External Debt Guide para. 3.37), etc.)?*
  - (d) *Which of the two alternative treatments -- transactions or reclassification/other changes -- is appropriate if the terms and characteristics of financial instruments change when a liability goes into arrears?*

### **References**

*Annotated Outline for the Revision of BPM5*, IMF, April 2004 (Chapter 3).

*1993 SNA* (paras. 3.94, 11.101).

*BPM5* (paras. 123, 528, Table 8).

*Government Finance Statistics Manual 2001* (paras. 3.49, 7.144, 9.19).

*Monetary and Financial Statistics Manual 2000* (paras. 225, 238, 2239).

*External Debt Statistics: Guide for Compilers and Users* (paras. 2.29, 3.36, 3.37, 4.4).

**Seventeenth Meeting of the  
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**Debt Arrears and Nonperforming Loans**

**Prepared by the Statistics Department  
International Monetary Fund**



## **Debt Arrears and Nonperforming Loans**

In discussing BOPTTEG outcome paper 3 on Accrual Principles on Debt Arrears (BOPCOM 04/19) and the outcome paper 4 and its attachment on the Treatment of Nonperforming Loans in the Macroeconomic statistics (BOPCOM 4/19A), the Committee was concerned about how the proposals in the two papers could be reconciled and asked for worked examples. These are attached. They cover both transaction and position data. The data are presented over four quarters. For ease of presentation, they are presented from the debtor's side (counterpart entries are to be made in the creditor's accounts).

BOPTTEG outcome paper 3 proposes that debt arrears are no longer treated as transactions with the creation of a new short-term debt instrument but rather remain in the original instrument. The Committee was asked for views on whether there could be memorandum or supplementary items for arrears in the international investment position statement. In the paper on the Treatment of Nonperforming Loans (NPLs) in the Macroeconomic statistics, four options were presented for recording NPLs, of which option 2 was the consensus choice of the Committee—this option measures loans at nominal value in the accounts but includes mandatory memorandum items on their market-equivalent value and on NPL interest arrears.

An issue arises as to whether the debt arrears data should cover NPLs only. As the definition of NPLs is converging on 90 days beyond the due date for payment, and given that most balance of payments data are compiled on a quarterly frequency at best, a distinction between NPL and non-NPLs debt might not be particularly revealing, although if Committee members so considered, a further split of the memorandum items into NPLs and non NPLs arrears could be considered.

### **Transaction data**

Both the proposed and present approaches are set out for the recording of debt arrears in the transaction data (Table 1). The recording in the current account is the same under both approaches. The main difference between the proposed (accrual) and present (due-for-payment) recording of arrears concerns the flows in the financial account. For debt arrears in general, memorandum or supplementary items are proposed only for position data as arrears could be on interest due or any other outstanding liability due for payment. The NPL paper proposed a memorandum item for interest arrears.

For illustrative purposes a memorandum item on interest arrears is included under the proposed approach. We do not recommend including such a memorandum item for a number of reasons. First, arrears are a payments concept, while interest is measured on an accrual basis in the current account. As can be seen from the table, a memorandum item on a payments basis could mislead the analyst with regard to the current account position—interest accrues in all periods but payments are missed only in the period when due.

Second, the user could exclude such interest as it accrues, arguably giving a “truer” measure of the current account revenues for the creditor. However, the Committee rejected this idea at its meeting in Pretoria, not least because of the problems of symmetry of approach—the current account expenses of the debtor should not be reduced simply because interest is not

paid. Third, if users were to make an adjustment to the current account on the basis of the memorandum item, they should also make an adjustment in the financial account, which would give a misleading outcome as the claim exists until written off or forgiven.

The related issue of the treatment of interest (and principal) arrears in exceptional financing is to be addressed at a later date (for reference see page 49 of *BPM5*).

### **Position data**

In the position data (Table 2), as interest is not paid, the liability continues to increase as a result of interest currently accrued, and on arrears. A memorandum item for debt arrears is proposed with a possible break down into principal arrears, interest arrears, and interest on arrears. The figure on total arrears indicates the amount of overdue payments. The breakdown is consistent with the approach in the *External Debt Guide*, and for interest arrears, consistent with the proposal in BOPCOM 4/19A, as well as being of analytical use—in looking at sustainability issues, analysts typically draw a distinction between interest (on-going) and principal payments.

Table 3 presents data for one period on a nominal and market value basis. The same memorandum items for arrears as in Table 2 are presented. This table shows the data on both nominal value and market-equivalent values as called for under option 2.

### **Questions to the Committee**

*Do Committee members agree that there should not be a memorandum or supplementary item on interest arrears in the balance of payments (leaving aside at this time the related issue of the treatment of interest (and principal) arrears in exceptional financing)?*

*Do Committee members agree with the inclusion of memorandum or supplementary items on arrears, as set out above, in the positions data? Should a distinction be made between arrears as on NPLs and other arrears?*

*Do Committee members have any comments on Table 3?*

## ACCRUAL PRINCIPLES ON DEBT ARREARS

Interest arrears on a long-term debt (assume the interest of 5 accrues each period, with 10 due semi-annually but never paid. Interest also accrues (1 in this case) on arrears; this interest falls into arrears when not paid.

**Table 1: Balance of Payments Data for the Debtor Economy**

Proposed Treatment	Q1		Q2		Q3		Q4	
	CR	DR	CR	DR	CR	DR	CR	DR
Current A/c Interest		5		5		6		6
Financial A/c Long-term loans	5		5		6		6	
<b>Memorandum Item</b>								
Interest Arrears			10		1		11	
<b>Current treatment</b>								
Current A/c Interest		5		5		6		6
Financial A/c Long-term loans - Increase - Repayment (imputed)	5		5		5		5	
Short-term loans <sup>2</sup>			10	10	1		11	10

<sup>2</sup> Included in “exceptional financing-arrears” (i.e. below the line in the analytical presentation) if it results from BOP difficulties.

**Table 2: Position Statement: proposed treatment**

	<b>Q1</b>	<b>Q2</b>	<b>Q3</b>	<b>Q4</b>
Opening Position	100	105	110	116
Transactions Accrued interest	5	5	6	6
Other changes Prices				
Closing Position	105	110	116	122
Memorandum item: Closing position				
Arrears				
Interest arrears	0	10	10	20
Principal arrears				
Interest on arrears			1	2

**Table 3: Positions statement — proposed treatment with memorandum items on market equivalent value: Q2**

	Nominal value	Market value <sup>3</sup>
Opening position	105	100
Transactions		
- accrued interest	5	5
Other changes		
-prices		-10
Closing position	110	95
Memorandum item		
Debt Arrears		
Interest arrears	10	10
Principal arrears	0	0
Interest on arrears	0	0

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Assumptions:

Interest = 5

Price decline = 10. No other changes in market conditions.

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<sup>3</sup> The market value column is a memorandum item under option 2