REPORT

Third Meeting of the Advisory Expert Group on National Accounts

18 – 22 July 2005

at ESCAP, Bangkok

Cost of capital services 1

Issue 15; Paper SNA/M1.05/04; for decision 1

Government and non-market producers: cost of capital of own assets 4

Issue 16 ; Paper SNA/M1.05/05; for decision 4

Obsolescence and depreciation 7

Issue 23; Paper SNA.M1.05/06; for decision 7

Overview of comments on decisions of the second AEG meeting 10

Paper SNA/M1.05/03; for information 10

Financial services 11

Issue 6(a); Paper SNA/M1.05/26: for information 11

Employers' pension schemes 13

Issue 2: Paper SNA/M1.05/28; for information 13

General government and public sectors: Chapter and Annex outline 15

Issue C15; Paper SNA/M1.05/9.2; for information 15

Public/private/government sectors delineation 18

Issue 36; Paper SNA/M1.05/9.1; for decision 18

Non-resident SPEs linked to government 23

Issue 25e; Paper SNA/M1.05/31; for information 23

Research and development 24

Issue 9; Paper SNA/M1.05.20; for decision 24

Originals and copies 30

Issue 11; Papers SNA/M1.05/18.1 and 18.2; for decision following e-discussion 30

Databases 32

Issue 12; Papers SNA/M1.05/19.1 and 19.2; for decision after e-discussion 32

Land improvements and structures 33

Issue 20; Papers SNA/M1.05/22.1 and 22.2; for decision after e-discussion 33

Water as an asset 34
Issue 31; Papers SNA/M1.0523.1 and 23.2: for decision after e-discussion.................................. 34
Purchased goodwill and marketing assets 36
Issue 22; Papers SNA/M1.05/24.1 and 24.2; for decision after e-discussion 36
Tax revenues, uncollectible taxes and tax credits 38
Issue 35; Papers SNA/M1.05/07; for decision 38
Granting of guarantees 45
Issue 37: Papers SNA/M1.05/08; for decision 45
Merchanting 48
Issue 41: Paper SNA/M1.05.14; for information 48
Goods sent abroad for processing 51
Issue 40: Paper SNA/M1.05/16; for decision.. 51
Migrants' transfers 53
Issue 38b: Papers SNA/M1.05/13.1 and 13.2; for decision after e-discussion 53
Residence of households: non-permanent workers 55
Issue 39c: Papers SNA/M1.05/15.1 and 15.2; for decision after e-discussion................................ 55
Residence of households: ships' crew and patients.. 56
Issue 39c: Papers SNA/M1.05/15.3 and 15.4; for decision after e-discussion................................ 56
Multi-territory enterprises - basis for allocation... 57
Issue 25e: Papers SNA/M1.05/27.1 and 27.2; for decision after e-discussion............................... 57
Reverse transactions... 58
Issue 1: Papers SNA/M1.05/25.1 and 25.2; for decision after e-discussion 58
Non-performing loans 59
Issues 4a, 4b, 38c: Papers SNA.M1.05/21; for decision 59
Distinction between loans and deposits.. 65
Issue 44c: Paper SNA/M1.05/10.2; For decision 65
Fees on securities lending and reversible gold transactions 67

Issue 43c: Paper SNA/M1.05/12; for decision ... 67

Retained earnings on mutual funds and other collective investment schemes ... 69

Issue 42: Papers SNA/M1.05/17.1 and 17.2; for decision ... 69

Government transactions with public corporations: super-dividends, capital injections and reinvested earnings ... 73

Issue 34: Paper SNA.M1.05/29; for information ... 73

Measurement of non-market output in volume terms ... 74

Issue C10: Paper SNA.M1.05/30; for information ... 74

Valuation of equity ... 76

Issue C9: Paper SNA/M1.05/32; for information ... 76

Interest on index-linked debt instruments ... 78

Issue 43a: Paper SNA.M1.05/11.1; for decision ... 78

Debt instruments indexed to a foreign currency ... 81

Issue 43a: Paper SNA.M1.05/11.2; for decision ... 81

Traded loans (borderline between securities and other financial instruments) ... 83

Issue 44d: Paper SNA/M1.05/10.3; for decision ... 83

Classification of financial instruments ... 85

Issue 44: Paper SNA/M1.05/10.1; for information ... 85

Wrap-up ... 89

Cost of capital services

Issue 15; Paper SNA/M1.05/04; for decision

Description of the issue

Capital services provided by fixed assets to the production process are not explicitly defined by the 1993 SNA. The OECD's Measuring Capital defines capital inputs as the actual or estimated pure economic rent payable; that is, by the sum of depreciation and the capital, or interest, costs. The capital services of rented produced fixed assets are only part of the rental paid by the user to the owner, the remainder being the costs incurred by the renter in providing the service. For own-use fixed assets, capital services appear implicitly as part of the gross operating surplus.

Presentation

1. Anne Harrison presented this paper (document number SNA/M1.05/04; Issue 15). It was written by Paul Schreyer, W. Erwin Diewert and Anne Harrison. The session was chaired by Barbro Hexeberg.

2. The major reasons for having capital stock estimates are for accounting purposes (balance sheets and consumption of fixed capital) and for analysis (examining changes in productivity is the most important analytical use). A major problem with estimating capital stock is that the values in each period cannot be directly observed and aggregated as is the case with gross fixed capital formation because there are seldom well developed markets for second hand capital goods. In practice, it is necessary to make an estimate of the current value of capital stock purchased in earlier periods. Two alternative questions which may be used to determine the value of capital stock are (i) how much would be paid for an item of capital and (ii) how much can it contribute to production. This leads to two different, but interdependent , notions of capital stock.

3. Anne presented a set of examples that illustrated the questions associated with valuing capital stock and in estimating capital services and consumption of fixed capital.[1] The first two examples used exactly the same values. The first example started with the contribution by an asset to output, and derived asset prices (and consumption of fixed capital). The second example started with the price decline of the asset and derived the contribution to output (and consumption of fixed capital). Both examples gave exactly the same values for the balance sheets and for consumption of fixed capital. However, small variations in the assumptions of how the price of an asset declines over time can give radically different estimates of the contribution to production, sometimes with a highly implausible pattern. Thus although starting from a pattern of price declines theoretically gives the same result as starting from a pattern of declines in the contribution to output, using existing price declines may give implausible results. Starting from more plausible contributions to output may give better estimates of the value of capital and consumption of fixed capital at the expense of changing the estimates of price decline by a relatively small amount.

[1] The numerical examples can be found in the power point slides for the presentation, available on the UN web site.

4. One problem is how to reconcile the estimated figure for capital services with gross operating surplus determined as a balancing item? The answer lies in the interest rate which can either be determined endogenously or predetermined exogeneously. If the latter, there will be a difference between estimated capital services and gross operating surplus. This difference may be indicative of wrongly estimated or omitted capital.

5. The "user cost" is a price index associated with capital services which is applied to a volume of capital stock. It depends on a rate of return to capital (either exogenous or endogenous), the depreciation rate, a discount factor, and the expected real price of the asset relative to the general price level.

6. If the general principle of capital services is accepted as part of the SNA, this leads to a means of explaining and estimating the contribution of capital to mixed income, the imputed rent of owner-occupied housing, non-market production and to the valuation of land and other natural resources.

7. Some arguments presented against including capital services in the SNA are that they require modelling (but so does the PIM approach currently adopted), a rate of return has to be selected/estimated (but options are given in the paper), and the resource cost for offices implementing the approach.

Recommendations/questions

8. Several questions were set out for discussion by the AEG:

(a) should capital services be introduced into the SNA? If so, then:

(b) should they appear in the main accounts or in supplementary accounts?

(c) should capital services, depreciation and capital stock measures be compiled in an integrated and consistent manner?

(d) should a comprehensive description be included in the SNA?

(e) does the AEG agree with the proposed formulae for the estimation of capital services and the options given for the rate of return?

Discussion

9. It was confirmed that a description of the principles of capital services should be included in the 1993 SNA update. However, there was a lengthy debate about whether estimates of capital services should be included in the core accounts or in supplementary accounts. The proponents of including them in the core accounts argued that they provide a more useful measure of a major factor underlying production and it would improve the consistency of the accounts for uses such as productivity analysis. Opponents claimed they are not likely to be sufficiently robust to include in the core accounts and so the initial way forward should be to include them in supplementary accounts.

10. Some participants felt that land may be a problem when estimating capital services because, unlike other assets, it has an infinite life and so land (and perhaps other non-produced assets) may have to be treated differently from other assets. Although rent on land is a claim on operating surplus, property income is not payment for a service, which attributing capital services to land seems to imply. In response, others argued land has always been recognised as a factor of production and as such there is an associated opportunity cost. The estimate of capital services can be considered as a measure of opportunity cost, because land is not used up in the course of

production. The proposal to measure capital services on land does not change how rent on land is recorded in the SNA. It simply identifies that part of gross operating surplus which may be redistributed to the owner of the land as property income in the distribution of primary income account. It was agreed a more explicit description of the application to non-produced assets is needed to allay concerns expressed.

11. Other main questions arising during the discussion were:

- capital services pervade more of the system than was apparent at the time of the last meeting;
- including estimates of capital services in the accounts does not change any of the balances;
- some key conceptual questions still have to be resolved (e.g. whether the rate of return should be determined exogenously or endogenously);
- it is possible to decompose the estimate of capital services into the consumption of fixed capital component and the return to capital component;
- capital services can be associated with gross operating surplus and the return to capital with net operating surplus, though these relationships will be identities only when an endogenous rate of return is estimated;
- capital services are provided by inventories and should be calculated on them, although the question of whether they are applicable to inventories of work in progress is still to be settled;
- the new SNA should refer to capital services in conjunction with valuing capital stock, estimating consumption of fixed capital and productivity Modelling is involved in all these areas whether or not using the capital service approach. A detailed description of the methods should be set out in an updated version of the OECD manual on "Measuring Capital".

12. At the conclusion of this session, the Chair summed up the discussion by saying the importance of including capital services in the SNA had been confirmed. They should be presented in supplementary tables but it is important that they are integrated with other estimates in the accounts and are compiled consistently with them. Details should be presented in the updated SNA, with a balance between providing sufficient detail, but not overwhelming the SNA presentation on capital. The formulae underlying the estimation were agreed to by the meeting, subject to detailed checking.

Summary conclusion

Decisions

13. The AEG:

(a) confirmed the importance of including the concept of capital services in the updated SNA

(b) strongly supported including the estimates of capital services in supplementary tables rather than in the core accounts of the SNA

(c) confirmed that capital services (comprising depreciation and return to capital) and capital stock measures should be compiled in an integrated and consistent manner

(d) agreed that the basic concepts of the capital services approach be presented in the SNA and that the detailed recommendations would be elaborated in an updated version of the OECD manual on “Measuring Capital”[2]

(e) agreed that the concepts underlying the formulae presented in the paper (“Cost of capital services”, document number SNA/M1.05/04; Issue 15) are appropriate, subject to detailed checking.

Government and non-market producers: cost of capital of own assets

Issue 16 ; Paper SNA/M1.05/05; for decision

Description of the issue

Services from assets used in non-market production are reflected in output only as consumption of fixed capital. This means that neither return on capital to these assets nor opportunity cost of capital is recognized. Should the SNA treatment of imputed output of non-market activity remain the same or should the full value of capital services be included?

Presentation

14. The paper for this session (document number SNA/M1.05/05; Issue 16) was written and presented by Anne Harrison. The session was chaired by Barbro Hexeberg.

15. At the December 2004 AEG meeting, there was strong support in principle for including a return to capital, viewed as opportunity cost, in the measurement of non-market output. Some concerns were expressed about the appropriate measure of the rate of return and the availability of data for capital stock.

16. Global consultation on this topic resulted in 44 responses including 13 from “AEG” countries and 31 others. It is clear that opinions are still divided, with both conceptual and practical difficulties being mentioned by those responding[3].

17. A concern expressed by several respondents about the concepts is along the lines that non-market equals non-profit, so why should the accounts include “profit” for government. In response it was stated that since in practice the measure of non-market output is calculated as the sum of costs, and capital services (user cost times volume of services) is a better measure of the costs incurred than is provided by the decline in asset value.

18. In practice, assets should be measured the same way for both the market and non-market sectors. This means including a return to capital for a similar asset whether used in market or non-market production. This also has productivity implications.

---

2 It was agreed in later discussion related to the manual that it is important that it should give due consideration to the position of countries with less developed statistical systems.

3 Full details of the consultation and responses are available on the UN web site.

19. Including a return to capital for assets used in non-market production means that GDP and NDP would increase and a question sometimes asked is what then would happen to the resulting government operating surplus. The answer is that government consumption expenditure would increase by the same amount.

20. The same model is used for estimating capital services as for estimating consumption of fixed capital via a PIM and the data requirements are similar as well. The proposal is not to change the method of measuring non-market production at cost but simply to extend the range of costs covered. There are several possible ways of estimating the rate of return viewed as the opportunity cost of money

- government bond rate
- interest on government bonds divided by the face value of the bonds (which reflects the maturity structure of all bonds outstanding and not just those newly issued).

21. The question is still the same as that posed last December, that is in principle, should we estimate a return to capital for government and other non-market producers? This time though, we should proceed by looking at some specific items for which a return to capital could be estimated.

Recommendations/questions

22. The questions presented for discussion were:

(a) Should a return to capital be estimated for non-financial capital used in non-market production and, if so, on which of the following asset groups:

(b) assets used by civil servants in the normal course of their work (e.g. computers, vehicles, offices)

(c) assets of benefit to the economy generally (e.g. roads)

(d) assets of benefit to the community at large (e.g. city parks)

(e) inventories

(f) land and other natural resources?

Discussion

23. Most speakers supported the proposal but some participants expressed reservations on practical grounds. The conclusion of the global consultation is disagreement with the current AEG position and so the initial proposition needs to be re-examined. There was some support for restricting the coverage of assets involved; for example by including assets that are involved in production (computers, vehicles and roads) but excluding community assets. If such a decision were made, then buildings should also be included and allocated to category (a) above. It was suggested that the Canberra II Group should be asked to take a closer look at the implementation questions, because they appear to be the major problem. However, it was pointed out that the Canberra II Group has set out the methodology and details to be incorporated in the update of the OECD's "Measuring Capital" manual.

24. Other points raised in the discussion were:

- the AEG should be identifying the best conceptual treatment, and even though practical questions such as data availability need to be taken into account, they should not override the underlying principles

- a consistency problem arises because some countries could make the imputation and a number of others cannot, which would imply that GDP would not be comparable between these countries
- there are strong conceptual arguments for including such returns and the practical problems are no greater for this question than those for some other parts of the existing accounts such as consumption of fixed capital for government
- setting out an appropriate rate of return could be problematical in practice (although it was suggested the appropriate rate of return to be used would be the implicit rate on government bonds, which is available in all countries)
- taking the average of government bond rates as the rate of return could be a problem because countries with high risks would have a higher rate, which would imply recording higher output for the government sector than for countries with lower bond rates
- in response to the previous point, it was argued that, because the value of government output is measured as the sum of costs, those governments which have high risks and have to pay a higher rate of return will typically be paying lower wages
- if some rate of interest other than the government bond rate is used to reflect the rate of return then we will not be reflecting the true cost of capital to those governments
- if developed countries have reservations about the practicality of implementation then the question is even more problematical for developing countries
- developing countries look to the 1993 SNA for guidance so including a question such as this in the SNA provides a vision of where they should be aiming with their economic statistics
- excluding the returns on the cost of capital by government distorts international comparisons (given that there are significant differences in the extent to which governments own or lease buildings)
- Europe is the only region world wide that is opposed to the proposal and it appears to be because the European statisticians do not like the idea of increasing GDP and GNI which will potentially have an impact on their countries' contributions to the EU budget
- these estimates could be presented in supplementary accounts so that EU-sensitive aggregates are not affected.

25. A suggestion was made that a possible way forward would be to look to the underlying messages in the comments from the global consultation and the comments on the recommendations of the AEG meeting held in December 2004. AEG members were asked to check the relevant part of the website and read all the comments because analysing them could provide a potential way forward. A revised proposal, more restricted in scope than the current one, will be produced for an e-discussion.

26. The OECD plans to update the "Measuring Capital" manual in the next couple of years. The aim is to have it available about the same time as the updated SNA, and it will take into account questions relating to developed and developing countries. It is necessary to have capital stock estimates as a starting point, and so it would be necessary to look at ways of making estimates if there are no capital stock estimates available within a country.

27. The Chair summed up that the AEG supports the proposal in principle. The ISWGNA will examine all comments arising from this and the previous AEG meeting and from the global consultation and will report back to the next AEG meeting.

Summary conclusion

Decisions

28. The AEG reaffirmed the principle to include a return to capital on non-financial assets used in non-market production.

29. It was agreed to follow-up on a one-on-one basis the comments from the global and country consultations, including those comments on the scope, and report back to the next AEG Meeting in early 2006.

Obsolescence and depreciation

Issue 23; Paper SNA.M1.05/06; for decision

Description of the issue

Consumption of fixed capital (depreciation) is defined in the 1993 SNA in general terms as the decline, during the course of the accounting period, in the current value of the stock of fixed assets owned and used by a producer as a result of physical deterioration, normal obsolescence or normal accidental damage. This decline is expressed in the average prices of the period but the 1993 SNA does not state whether the prices to be used should relate to the general price level or whether they should be asset specific.

Presentation

30. Charles Aspden presented the paper for this session (document number SNA/M1.05/06; Issue 23). It was written by Nadim Ahmad, Charles Aspden and Paul Schreyer. The session was chaired by Carol Carson.

31. The question of obsolescence arose from the preparation of the OECD manual "Measuring Capital". Different views arose concerning the treatment of obsolescence and the measurement of depreciation and they were not resolved at the time. The question does not concern what the SNA says; rather, it is a matter of differing interpretations being given to the existing text of the current SNA.

32. Paragraph 10.118 of SNA93 states:

> "….consumption of fixed capital must be measured with reference to a given set of prices, i.e. the average prices of the period. It may then be defined as the decline, between the beginning and end of the accounting period….., as a result of their physical deterioration and normal rates of obsolescence and accidental damage."

33. The dispute centres on what is meant by "the average prices of the period". The view advocated in "Measuring Capital" is that it should be with respect to a constant-quality price index of the asset concerned, which is the method underpinning the estimation of depreciation by many OECD member countries. It implies valuing depreciation at the average replacement cost of the

period. Hill and Diewert have argued that depreciation should be valued with respect to a general price index as long as it rises faster than the asset-specific, constant-quality price index.

34. Factors contributing to price change include:

(a) deterioration (i.e. wear and tear)

(b) exhaustion (as remaining service life declines)

(c) foreseen obsolescence

(d) other changes that bear on supply and demand

(e) changes in the overall price level.

35. There is broad agreement that depreciation should include (a), (b) and (c) and there is also agreement that depreciation should not include changes in the general price level. However, there are different views on how (c) should be measured and they have an impact on (d).

36. The opposing views are held by Erwin Diewert and Peter Hill (DH), who consider foreseen obsolescence should be equated with any expected real holding loss, and Nadim Ahmad, Charles Aspden and Paul Schreyer (AAS) who consider depreciation should not include any holding gains and losses.

37. The assumptions underlying Diewert's and Hill's views are that depreciation corresponds to a notion of income that measures maximum consumption in a period, provided that the purchasing power of the capital stock is kept intact. In such a case, the purchasing power of the capital stock is measured in terms of an overall bundle of goods and services. A real holding loss marks a reduction in purchasing power. In their view, "foreseen obsolescence" can be equated with expected real holding losses. Their estimate of depreciation includes expected real holding losses, but not any expected real holding gains, which makes it more difficult to rationalise. On the other hand, Ahmad, Aspden and Schreyer consider that depreciation corresponds to a notion of income which measures the maximum consumption possible in a given period, provided that the capital stock and its productive capacity are kept intact. To preserve productive capacity, replacement investment is required only to match the capital used up in production This is the measure of depreciation typically calculated at the present time, using a PIM-type approach. If the price of capital is expected to rise more slowly than the general price index, the DH measure of consumption of fixed capital will be higher, and the corresponding net operating surplus (income) figure lower than those proposed by AAS. This question is important in practical terms only when the rates of change of asset prices and the general price level are expected to be significantly different, but this is a common position in respect of IT equipment.

38. There are some practical considerations, particularly which general price index should be used and whether it matters if this price index reflects the effects of the obsolescence of other goods and services.

39. An example was presented to illustrate the different outcomes from the two different approaches.

Recommendations/questions

40. The recommendations set out for discussion by the AEG were:

(a) no change of substance is required to the SNA text, but a clarification should be made that average prices should be measured with respect to a constant-quality price index

(a) additional text should be included in the SNA explaining the concepts underlying the SNA measure of depreciation and its relationship to the concept of income

(b) more guidance should be provided on the implementation of depreciation measures and such guidance should be integrated into the broader setting of the revised manual on capital measurement, to be prepared in conjunction with the revision of the SNA.

Discussion

41. Most of the discussion centred around the specific differences between the Diewert and Hill (DH) proposal and that put forward by Ahmad, Aspden and Schreyer (AAS). The point was made that the DH approach results in an asymmetric outcome with expected capital losses being included in income but with expected capital gains not being included in income. The debate concluded that the DH views and AAS views are both correct because, in effect, they are answering different questions. The DH approach is concerned with maintaining the purchasing power of capital (i.e. holding losses are considered in the context of general price change) whereas the AAS proposal provides a measure relating to maintaining the productive capacity intact (i.e. in the context of specific price indexes for different assets). In practice, the choice of measure depends on what is being analysed and the AAS approach seems most appropriate for most common uses of the accounts. However, Peter Hill has confirmed that when he drafted the text in question he was referring explicitly to a general price level, rather than asset-specific prices. He has very firm views on this question and considers that the national accounts framework will be fundamentally damaged by adopting the AAS proposal.

42. Some concern was expressed about the implications for the definition of income because the notion of income appears to be the key to the differences. The definition of income in the SNA is contained in paragraph 1.63:

> "…..-the concept of disposable income used in the System is based on the underlying idea that it represents the maximum amount available to a household for purposes of consumption after maintaining its net worth intact, i.e. its assets minus its liabilities valued at current prices".

43. It was pointed out that the notion of income does not relate to maintaining the purchasing power of the capital stock intact. However, expected and realised holding gains and losses are different and the debate on this topic is confused by switching from one to the other without making the switch explicit. The discussion on income concluded with a request for the implications for income under each approach to be explicitly set out because it is not clear that everyone fully understands the implications for the definition of income of adopting one or the other of the DH and AAS approaches.

44. Other points arising in the discussion were:

- a strength of the AAS approach is that it handles holding losses which the DH alternative does not
- the outcome of the debate has an impact on the core accounts
- the DH method requires a different age/price profile
- computers provide an example where large differences in outcomes will occur between the DH and AAS approaches

- the concept of obsolescence should be broadened to cover questions other than a product going out of favour
- more practical guidance should be provided in the SNA on the measurement of depreciation.

45. There was broad agreement that the text of the SNA concerning depreciation needs to be clarified to identify there are two different ways of looking at average price level (general and asset-specific). Most countries use the latter and it is necessary to follow this question through and identify the implications for income. Details underlying the clarifications will be formally presented in the update of the OECD manual on "Measuring Capital".

46. Anne Harrison volunteered to put together a note on how the definition of depreciation could be changed and the potential implications for income. She will circulate it to AEG members for comment.

Summary conclusion

Decisions

47. The AEG agreed with the recommendations but with the following qualifications:

(a) the current text of the 1993 SNA (Para. 10.118) relating to depreciation should reflect the accepted practice that "average prices" refers to the average price of an asset at constant quality

(b) the relationship of this recommendation to the concept of income needs to be considered

(c) the detailed practical guidance on measuring depreciation should be provided in an updated version of the OECD manual on "Measuring Capital"

(d) it is important that the above-mentioned manual should give due consideration to the aspects of countries with less developed statistical systems.

Overview of comments on decisions of the second AEG meeting

Paper SNA/M1.05/03; for information

Description of the issue

The United Nations Statistical Commission emphasised the need for transparency and the broadest possible involvement of the global statistical community in the updating process of the 1993 SNA. In line with this emphasis, the recommendations made by the Advisory Expert Group (AEG) in its meeting held in December 2004 were referred to the national statistical offices of the UN member States and the national banks for their comments.

Presentation

48. The paper for this session (document number SNA/M1.05/03) was written by the secretariat of the ISWGNA and presented by Ivo Havinga. The session was chaired by Carol Carson.

49. The questions considered were:

(a) non-performing loans (item 4(a))

(b) originals and copies (item 11)

(c) databases (item 12)

(d) cost of ownership transfers of assets (item 14)

(e) government owned assets – cost of capital services (item 16)

(f) mineral exploration (item 17)

(g) land improvements (item 20)

(h) holding companies, special purpose entities (SPEs) and trusts (item 25(b)(i))

(i) treatment of multi-territory enterprises (item 25(b)(ii))

(j) recognition of branches (item 25(b)(iii))

(k) change of economic ownership (as term) (item 38(a))

(l) application of accrual principles to debt arrears (item 38(c))

(m) predominant centre of economic interest (item 39(b)).

50. A majority of the countries supported the AEG recommendations on all the above questions except for item 16 (government owned assets – cost of capital services). This item is on the agenda of the AEG meeting.

Discussion

51. There was no discussion on this information. The Chair suggested that anyone who wished to make comments or seek clarifications should do so directly to Ivo Havinga.

Summary conclusion

Observation

52. The meeting noted the successful outcome of the consultations.

Financial services

Issue 6(a); Paper SNA/M1.05/26: for information

Description of the issue

The output of financial intermediation services and portfolio management by financial corporations has undergone a structural transformation towards a rising importance of the portfolio management of financial assets.

The AEG considered a paper listing the provisional recommendations of a task force on financial services. A final paper is being produced for consideration and decision in January 2006.

Presentation

53. The paper for this session (document number SNA/M1.05/26; Issue 6a) was written by Anders Nordin and presented by Charles Aspden. The session was chaired by Carol Carson.

54. The last meeting of the Financial Services Task Force was on 10-12 May 2005. The final paper is being prepared and will be ready during September 2005. The issue will be submitted for decision to the January 2006 AEG meeting.

55. As requested by the February 2004 AEG, the paper covers the volume/price split. The recommendations will include:

(a) new definition of financial corporations to reflect all financial services

(b) do not exclude own funds as a source of financial services

(c) allow the recording of production of financial services for units using exclusively own funds or those which have only one client

(d) specify that FISIM always be allocated to users

(e) specify the calculation of FISIM based on a formula using a reference rate

(f) recommend limiting the application of this formula to loans and deposits

(g) exclude holding gains from the calculation of FISIM

(h) allow for the recording of an output of "market makers".

56. The volume of FISIM is to be calculated either by extrapolation using the changes in the stock of loans and deposits deflated by a general price index or by building an indicator based on weighted quantity indicators (number of loans, number of accounts, money transfers, etc).

57. The volume of non-life insurance is to be calculated either by extrapolation using gross premiums deflated by premium price indices or by building an indicator using the weighted number of policies, by class of policy.

Discussion

58. The first question discussed related to the factors underlying the choice of interest rate in calculating FISIM. In the paper it is referred to as "the risk-free interest rate" but, in practice, this could lead to negative interest in some circumstances. One view is that the reference rate should be selected on the basis of each institution having a separate rate. Also, the price/volume measurement of financial services is still not settled properly. Extrapolating volumes from the base year benchmark can give some odd results if FISIM is treated independently of the direct charges. However, it was noted that such problems arise when exogenous interest rates are used. Using endogenous rates (the average of loan/deposit rates by institution) leads to fewer practical questions and the changing mix of FISIM versus directly-charged bank services can be taken into account by chaining the volumes.

59. Other questions that were raised included:

- FISIM may be able to be deflated directly as countries move to include FISIM prices in their CPIs and this should be taken into account in writing on this question;
- concepts should not be set out too precisely in this area because it could stifle developments, so the SNA should include the concepts in broad detail only with the

detailed practice being set out in manuals that are more amenable to being changed in the short term;

- the question of including own funds needs to be debated further;
- the output measure of pension funds and life insurance companies has not been addressed (it is possible to obtain negative output in practice using the current definition and suitable alternatives should be investigated);
- in practice, some of the new recommendations are being included in the accounts already, because of the data sources;
- in practice, it is often impossible to separate own funds and intermediated funds;
- it is essential to have consistency of treatment with that for life insurance and pension funds.

60. The Chair summarised by noting that the AEG had reservations with some of the recommendations (e.g. a single reference rate, the redefinition of financial corporations, inclusion of own funds), and each of these should be looked at more closely. The problem of the output of life insurance will be borne in mind by the Pensions Task Force. A report from the Financial Services Task Force will be available in September for the OECD National Accounts meeting, which will give AEG members an opportunity to examine the questions set out in the paper and to provide comments before the next AEG meeting.

Summary conclusions

Observations

61. The AEG expressed concern that none of the specialised task forces on financial questions had addressed the questions concerning the outputs of life insurance; this aspect should be considered explicitly by the Task Force on Pensions.

62. Some reservations were expressed with some of the provisional recommendations (e.g. using a single reference rate, the redefinition of financial corporations, inclusion of own funds in the calculation of FISIM).

63. A report of the Financial Services Task Force will be available in September 2005 for international discussion including at the OECD/UNECE National Accounts Meeting in October. This timing will give AEG members a chance to examine the questions and provide comments on them before the next AEG meeting.

Employers' pension schemes

Issue 2: Paper SNA/M1.05/28; for information

Description of the issue

In the 1993 SNA, promises to pay future pension benefits are not recognized as liabilities of unfunded employer schemes and social security schemes. The review will investigate the analytical relevance of recording these liabilities in the national accounts and, if appropriate, formulate recommendations regarding their valuation and measurement. The review will also formulate proposals to reconcile the recommendations of the 1993 SNA and the IMF

Government Finance Statistics Manual regarding the treatment of unfunded employer pension schemes.

Presentation

64. The paper for this session (document number SNA/M1.05/28; Issue 2) was written by Adriaan Bloem and John Ruser and presented by Adriaan Bloem. The session was chaired by Carol Carson.

65. Various experts are writing papers on different topics for the Task Force on Pensions. The two main questions to be covered are the principles of the treatment of defined benefit employers' pension schemes and the borderline between employers' pension schemes and social security.

66. The key questions being considered in the treatment of defined benefit employers' pension schemes are:

- the actuarial treatment of defined benefit employers' retirement pension schemes (both funded and unfunded)
- where and how the system of national accounts should record defined benefit retirement schemes
- the implications of other questions that bear on the treatment of defined benefit retirement schemes.

67. The main steps in identifying the borderline between employers' pension schemes and social security are to:

- review existing borderline cases between employers' pension schemes and social security
- examine questions such as the treatment of transactions between employers' schemes and social security setting out principles on how to deal with structural changes in schemes.

68. There are several ways of presenting data relating to defined benefit retirement schemes. They include satellite accounts, supplementary accounts, supplementary tables and memorandum items. Authors for some of the topics have already been identified. They will look closely at questions that impact on developing countries in setting out their recommendations. Apart from the important question of identifying the borderline between employers' pension schemes and social security schemes, another question that needs to be settled is to identify the sector to which defined benefit retirement schemes will be allocated.

Discussion

69. It was noted that the EU's CMFB Committee and the ECB Statistics Committee have discussed these questions in relation to the EU. A consensus has been reached on how to treat unfunded schemes and to record them in supplementary accounts rather than in the core accounts.

70. The Chair suggested that the work on defined contribution schemes should be compared with the work on defined benefit schemes to ensure consistency of treatment. She noted the EU view about using supplementary accounts rather than core accounts to record details relating to unfunded schemes.

Summary conclusions

Observations

71. The AEG noted there will be a Task Force meeting in September to discuss this question.

72. The AEG suggested the accounting for defined contribution schemes should be a starting point for considering the treatment of defined benefit schemes.

General government and public sectors: Chapter and Annex outline

Issue C15; Paper SNA/M1.05/9.2; for information

Description of the issue

The public sector is mentioned only briefly in Chapter 19 of the 1993 SNA.. It has become an important analytical construct that complements the currently more prominent general government sector. The Task Force on Harmonization of Public Sector Accounting is clarifying several questions that are unique or particularly important for government, and for the public sector. It is proposed that a chapter (or annex) clarify the identification of institutional units, the meaning of control, the meaning of economically significant prices, the definition of the public sector and its various possible subsectors, accounting rules peculiar to the public sector (e.g. loans at concessional interest rates, transactions between general government and controlled public corporations, public-private partnerships, privatisation, and securitisation), and propose an alternative set of accounts useful for fiscal analysis (similar to the accounts in Government Finance Statistics Manual 2001).

Presentation

73. The paper for this session (document number SNA/M1.05/09.2; Issue C15) was written by the Task Force on the Harmonization of Public Sector Accounting (TFHPSA) and was presented by Lucie Laliberté. The session was chaired by Charles Aspden.

74. The reason for proposing to have a chapter on the government and public sectors is that government presents special problems that are only alluded to rather than being fully set out in the sequence of accounts. Consistency will be maintained with other relevant standards and links will be provided to other, more detailed documents such as the ESA Manual on Government Deficit and Debt (EMGDD) and GFSM 2001.

75. The major topics to be included in the proposed chapter would be:

(a) Purpose of the chapter

(b) SNA institutional units and sectors

(c) general government

- composition
- accounts
- specific activities

(a) public sector

– composition

– accounts

– relations with both public and private corporations

(b) relations between government and corporations.

76. In addition to a description of the general government sector and the public sector overall, the following public sector/government accounts would be described:

(a) revenue

(b) expenditure

(c) balances

(d) financial account

(e) other changes in assets account

(f) balance sheets.

77. The discussion on transactions between government and public corporations would include:

(a) earnings from equity investment

(b) taxes versus withdrawal of equity

(c) dividends versus withdrawal of equity.

78. The discussion on other transactions with corporations would include:

(a) public/private partnership

(b) licences and concessions

(c) securitisation.

79. The proposed chapter will relate to the five topics of the TFHPSA in the following ways:

(a) delineation (institutional units)

(b) taxes (accounts of government)

(c) earnings and capital (relations with public corporations)

(d) restructuring (relations with public and private corporations)

(e) guarantees (relations with corporations).

80. In addition to the chapter, it is proposed to have an annex would include details of links with related datasets and provide detailed correspondences between the SNA sequence of accounts and the public finance accounts. Links will be described with GFSM 2001, the ESA95 Manual of Government Debt and Deficit, OECD Revenue Statistics, and possibly IPSAS.

Discussion

81. The relative importance of a number of pros and cons with the proposal were raised. There was fairly general agreement that the government sector is sufficiently different from the rest of the economy to require some elaboration in the accounts. However, there was less agreement on

whether this should be in a separate chapter or spread through the relevant parts of the SNA. One argument against having a separate chapter is that it indicates the government is fundamentally different from the rest of the economy, which is not the case in reality. Government is an integral part of any economy and government-specific balances (e.g. the government deficit) should be included in manuals relating to government finance statistics rather than in the SNA. On the other hand, it was argued that it is very constructive to have close links between national accountants and public sector statisticians. Therefore, it is necessary to have sufficient detail in the SNA for it to be self contained and, in addition, provide links to more detailed documentation elsewhere, such as in the GFSM.

82. Several speakers were in favour of having a chapter on the public sector, plus a more detailed annex, because it is important for developing countries to be able to see the public sector in the overall context of the national accounts and to identify the links to assist in their statistical development. However, contrasting opinions were advanced on this topic. Those opposing too much detail argued along the lines that having both a chapter and an annex on government accounts will add too much to the SNA, which is designed to describe the system of national accounts, not a system of government accounts. Some questions are country specific, which limits the amount of detail that is relevant and developments in fields such as government accounting could make the SNA outdated fairly quickly if too much detail is included. On the other hand, it was felt the size of the new SNA does not matter, because it will be presented on a CD-ROM or some other similar medium, so it is technically possible to include everything in a high degree of detail. The government sector is sufficiently important, particularly in developing countries, to justify this detail.

83. At its most recent meeting, the TFHPSA did not really consider whether or not an annex was required because that had been decided at last December's AEG meeting; rather, it discussed the detailed content of the chapter. At the TFHPSA meeting there was a debate about the relative merits of focussing on the public sector as a whole or the general government component in particular with the conclusion being it is essential to include details on both, given governments can shift things so readily from the general government sector to public corporations.

84. Other points made during the discussion were:

- the updated SNA should be written bearing in mind that national accountants in developing countries may be more dependent on the written text than those in OECD countries
- material that describes the links between the SNA and the public sector needs to be included as an annex in both the SNA and in other related manuals to provide a means of enabling others to understand national accounting principles
- the ESA government debt and deficit manual should not automatically provide the basis of material for the SNA, because it includes considerations which are not relevant to most countries
- the public sector accounts used to be quite different from the national accounts in the past, but now they are moving closer to private sector accounting principles internationally.

85. The Chair summed up by saying that there is general support for including both a chapter and an annex but there needs to be a balance regarding what is included. It is essential to cross reference extensively to other international manuals and to avoid duplication to the extent possible, by not incorporating too much detail in the SNA.

Summary conclusions

Observations

86. The AEG supported including in the updated SNA both a chapter and an annex covering general government and public sector questions.

87. The AEG considered a balance needs to be struck between the amount of detail that is included in the SNA and the risk of overburdening the SNA by duplicating detail that is already set out in other international manuals.

88. Sufficient detail should be included in the SNA to provide guidance to national accountants in countries which have less-developed statistical systems, with cross references to more detailed documentation embodied in other relevant standards, such as the Government Finance Statistics Manual 2001.

Public/private/government sectors delineation

Issue 36; Paper SNA/M1.05/9.1; for decision

Description of the issue

In the1993 SNA, the notion of control by government, which defines the public sector boundary, is defined only in general terms. Ambiguous areas include special purpose vehicles (SPV), notably created in the context of public-private partnerships (PPP) or securitisation. Other areas relate to how control is determined, including the link with the "mainly financed" concept for non-profit institutions. Another question relates to the market versus non-market distinction. The distinction between government and public corporations is on whether production takes place at economically significant prices. The ESA 1995 has established a rigid rule of 50 percent of the production costs to be covered by sales. Should sales and production costs and the relationship between them be introduced in the updated SN ?

Presentation

89. The paper for this session (document number SNA/M1.05/09.1; Issue 36) was written by The Task Force on the Harmonization of Public Sector Accounting (TFHPSA) and presented by Lucie Laliberté and Jean-Pierre Dupuis. The session was chaired by Charles Aspden.

90. The delineation of public and private sector units is based on the criterion of control. The delineation of non-market (government) versus market units (corporations) within the public sector is based on the criterion of whether the prices charged for the unit's output are economically significant prices (ESP). An important question was to set out what control and ESP entail.

91. The **first recommendation** was to use a decision tree to identify the public sector boundary. The path followed is to first determine whether the entity is an institutional unit. The next step is to determine whether the institutional unit is controlled by government, that is forms part of the public sector and, if so, is this unit a market or non-market unit.

92. The **second recommendation** was to set out nine indicators to assess whether or not the government is actually controlling a corporation:

(a) ownership of the majority of voting interest

(b) control of the board or other governing body

(c) control of the appointment and removal of key personnel

(d) control of key committees of the entity

(e) golden shares and options

(f) regulation and control

(g) control by a dominant customer

(h) control attached to borrowing from the government

(i) other controls associated with the constraints that apply to the ways in which the entity can acquire or dispose of fixed assets.

93. The **third recommendation** was to set out five indicators which can be used to determine if government controls a non-profit institution:

(a) appointment of officers

(b) other provisions of enabling instrument

(c) existence of contractual agreements

(d) degree of financing by government

(e) level of risk exposure.

94. The **fourth recommendation** was to establish the criteria to be used in classifying producers as "market" or "non-market" if government controls a non-profit institution. The device used is to identify whether or not a producer's output is sold at "economically significant prices". If so, then the producer is classified as "market" and, if not, the producer is classified as "non-market". In practice, the output of non-market producers is often provided free or at heavily subsidised prices.

95. The public sector comprises government units, corporations controlled by government units, and non-profit institutions (NPIs) controlled by government units. The current definition of control of a corporation is "the ability to determine the general corporate policy and largely financed by government". The proposed definition is "the ability to determine the general corporate policy". Similarly, the current definition of control of an NPI is "the ability to determine the general corporate policy and largely financed by government", while the proposed definition is "the ability to determine the general corporate policy".

96. The definition of economically significant prices is that they "are prices that have a significant influence on the amounts the producers are willing to supply and on the amounts purchasers wish to buy". It is a critical definition in determining the market status of producers. The 1993 SNA deliberately avoided using a fifty per cent criterion on the amount of costs to be covered by sales, although this was subsequently adopted by the ESA95. Market producers are identified by their production being offered for sale (on the market) at economically significant prices. Non-market producers appear only in the government or NPISH sectors.

97. Recommendation 4 sets out a rule of thumb that could be used as part of the process for determining whether a unit is a market producer: "although there is no prescriptive numerical relationship between the value of output and the production costs, one would normally expect the value of output to average at least half of the production costs over a sustained multi-year period."

98. Several special cases can occur in trying to apply the fourth recommendation (e.g. if a unit's output is sold only to government). In such a case, if a public producer is the only supplier, then it is non-market unless it competes with a private producer in tendering for the contract. If it is one of several producers,then it is a market producer provided it competes with those other producers on the market.

99. The **fifth and six recommendations** concerned defining sales and production costs. It is necessary to have a definition of sales if the above recommendations are to be applied in practice. Output is measured as being equal to the business notion of sales (plus change in inventories), excluding taxes on products and subsidies on products (except for subsidies granted to all private producers) for this particular type of activity and excluding own account production. Production costs are measured as the sum of intermediate consumption, the cost of wages and salaries, the cost of capital services, plus other taxes on production (but note that other subsidies on production are not deducted).

Recommendations/questions

100. The following recommendations were presented to the AEG:

(a) use a decision tree to distinguish units controlled by government from others then distinguish market from non-market on the basis of the economically significant criterion

(b) eight major indicators of government control on corporations were proposed

(c) five major indicators of government control on NPI were proposed

(d) no major changes to the definition of economically significant prices were proposed but elaborations were suggested concerning a supplementary criterion for producers involving the proportion of production costs to be covered by sales

(e) arising from this proposal a suggestion was made concerning the definition of sales

(f) and similarly a proposed definition of production costs.

Discussion

Recommendation (a) - decision tree

101. The discussion opened with several participants querying what the TFHPSA is trying to achieve by setting out such detailed criteria. There was a feeling that, in practice, the criteria are open to being manipulated if they are too specific. In addition, introducing too much legalism can result in the recommendations becoming outdated quickly. To ensure its continued relevance, the SNA should provide guidelines rather than prescriptive detail.

102. There was broad agreement within the AEG that the approach of using a decision tree is a sensible one. However, a couple of participants queried whether the ordering within the decision tree was the best possible. For example, a better starting point could be the market/non-market aspect followed by the institutional question (public/government). In response to this query, it was pointed out that the decision paths are set out specifically for public sector units, so government control is a critical determining factor.

103. Other points raised during the discussion were:

- will specific references to accounting rules be set out (e.g. parent/subsidiary relationships)

- it may be necessary to set out clear definitions of non-profit institutions (NPIs) within the decision-tree framework
- by definition, institutional units classified using this process will be resident.

104. The AEG broadly agreed with the first recommendation (use a decision-tree approach) but some questions raised during the discussion need to be clarified.

Recommendation (b) - eight major indicators of government control on corporations

105. There was some debate about the importance of the indicators because all the points that were listed can be very important in different circumstances. However, it is likely that different combinations of them will be useful in different circumstances. In particular, concern was expressed that the list could be too broad, because it could classify some units as government under the control aspect (e.g. if the dominant customer is government). An alternative view was that the dominant customer being government is one indicator rather than being conclusive evidence.

106. A further point made was that an additional useful criterion would be to identify who takes control of the remaining assets if the unit is liquidated, which could be particularly important for NPIs.

107. There was broad support within the AEG for this recommendation (indicators of government control on corporations).

Recommendation (c) - five major indicators of government control on NPIs

108. The discussion opened with a concern being expressed that the definition of control of NPIs is not tight enough. Other points raised during the discussion were:

- the borderline between market and non-market NPIs is not defined clearly enough
- the order involved in the decision tree should be about government control of the unit first, followed by whether it is an NPI, and then whether it is market or non-market
- finance and control can be quite separate questions
- doubts were expressed about always being able to identify a market NPI by following the proposed decision tree
- the 1993 SNA uses the term "corporations" in two different contexts - one relating to units and the other relating to a sector, and this creates confusion
- the updated SNA will refer to the "Handbook on NPIs".

109. The AEG did not agree on this recommendation and the Chair requested participants to send their detailed comments to Lucie Laliberté (IMF) or Jean-Pierre Dupuis (OECD) by the end of August.

Recommendation (d) – definition of economically significant prices

110. Most of the debate on this question was around the question of whether the 50% rule is too prescriptive or whether it is ambiguous in practice. The main points raised were:

- in practice, the 50% rule is not applied consistently because it is interpreted differently in different countries

- the 50% rule is a rule of thumb and should not be a prescriptive rule
- the Task Force has tried to introduce some flexibility, but defining sales is not always straightforward
- a distinction needs to be made clearly between output and sales
- a single supplier with a single customer is not an uncommon occurrence in practice and so the guidelines should be aimed at determining whether or not there is a genuine market in operation
- there is a problem with the scope, particularly in defining market or non-market (e.g. a unit with a lot of own-account production could be problematical, because it is "other non-market production").

111. One of the presenters (Jean-Pierre Dupuis) pointed out that recommendation (d) is effectively in two parts. Identifying whether prices are economically significant or not is the first step in the process with the relationship between sales and the cost of production as an extra test.

112. The Chair summarised by saying the proposal had broad support within the AEG but there are still questions on some of the details. Detailed comments should be sent to Lucie Laliberté (IMF) or Jean-Pierre Dupuis (OECD) by the end of August.

Recommendation (e) – definition of sales; and recommendation (f) – definition of production costs

113. There was not a lot of discussion on these recommendations. The main theme was a concern that the definitions do not quite get to the root of the question because they do not necessarily cover the more difficult cases, which have provided most problems in classifying sales and production costs. A suggestion was made that reference could be made to recommendation (d) in trying to define sales by specifying a set of guidelines. A further suggestion was that it would be possible to start with the definition of output, and then add and subtract elements to get to a final definition.

114. The Chair suggested that any comments should be supplied in writing to the authors (Lucie Laliberté (IMF) or Jean-Pierre Dupuis (OECD)) by the end of August.

115. The Chair asked the authors to arrange with the TFHPSA to revise the paper in the light of any comments received.

Summary conclusions

Decisions

116. Following detailed discussions on the above recommendations and a broad level of support, the AEG decided that there are still a number of questions requiring further clarification before final decisions can be made. Therefore, the AEG chair requested members to send detailed comments to Lucie Laliberté and to Jean-Pierre Dupuis by the end of August. The authors should take into account these comments in conjunction with the comments made during the meeting to produce a revised version of the paper for e-discussion with the aim of finalising this question at the next AEG meeting.

Non-resident SPEs linked to government

Issue 25e; Paper SNA/M1.05/31; for information

Description of the issue

The question is whether a special purpose entity (SPE), incorporated in the economic territory separately from its owners, should be treated as a separate institutional unit and be treated as resident in its territory of incorporation. Should an exception be made for SPEs created by government? The TFHPSA would like an exception made; BOPCOM suggest no exceptions.

Presentation

117. The paper for this session (document number SNA/M1.05/31; Issue25e) was written by the TFHPSA and presented by Jean-Pierre Dupuis. The session was chaired by Charles Aspden.

118. Governments may create SPEs abroad for specific activities such as privatisation, defeasance or the securitisation of assets. A key question being examined is the classification of the SPE as resident (on the economic territory) or non-resident. In principle, in the 1993 SNA, the concept and coverage of residence are identical to those in the IMF's BPM5. The questions to be answered are whether the SPE is an institutional unit and, if so, where does its centre of economic interest lie.

119. The relevant parts of the 1993 SNA are paragraph 14.7: "the concept of residence is not based on nationality or legal criteria" and paragraph 14.12 which covers the primacy of the "centre of economic interest" over "a long period of time". In addition, general government has agencies abroad (embassies), considered to be extra-territorial in the economy in which they are physically located (see paragraph 14.30).

120. The TFHPSA recommendation for the SNA update is to classify those SPEs created by government for its financial convenience inside the general government sector, and not as corporations (financial or non-financial). However, the BOPCOM has a different view.

121. The TFHPSA rationale is that these types of units act under the direct control, financing and management of the general government, and usually for a limited period of time. They cannot be financial intermediaries because "they do not put themselves at risk" (SNA, paragraph 4.78).

122. More research is to be conducted in the case of SPEs created by general government. The TFHPSA will explore alternatives for the treatment of government SPEs and/or their transactions.

123. The TFHPSA will circulate proposals to an informal working group including BoP representatives during the Summer 2005.

Discussion

124. The discussion on this topic was fairly brief. A couple of participants pointed out that the questions outlined also apply to the private sector and there is a need to be careful not to create another problem in the SNA in the process of solving an existing problem. A suggestion was made that one way forward could be to look at an extended public sector that would cover these SPEs, SPVs and some other special financial enterprises.

125. The only other point made was that if the government sets up an SPE abroad then its operations could be included in foreign direct investment statistics, although a query was raised about whether governments would set up SPEs abroad in practice.

Summary conclusions

Observation

126. The AEG considers that this issue is an important one and it should be taken forward not only in the TFHPSA but also in other relevant forums such as the UNSD meeting on institutional units being held in September. The AEG expressed concern that consistency problems with BPM could arise from the recommendation by the TFHPSA that these non-resident units be treated as part of general government.

Research and development

Issue 9; Paper SNA/M1.05.20; for decision

Description of the issue

The SNA currently does not recognize the output of R&D as capital formation. If all R&D covered by the Frascati Manual were included in the asset boundary, the practical difficulties of deriving satisfactory estimates would have to be addressed, such as using expenditure data collected as per the Frascati Manual, and obtaining appropriate deflators and service lives.

Presentation

127. The paper for this session (document number SNA/M1.05/20; Issue 9) was written and presented by Charles Aspden. The session was chaired by Carol Carson.

128. The Canberra II Group has discussed this issue at every one of its five meetings in close cooperation with the NESTI Group. Comprehensive consideration has been given to both conceptual and practical questions. Further cooperation with NESTI will be required if the proposals to capitalise R&D are accepted.

129. The current situation in the 1993 SNA is that expenditures on R&D are not classified as gross fixed capital formation (GFCF), despite the recognition in the SNA that they are inherently investment in nature. Instead, the SNA recognises "patented entities", which are non-produced and come into existence in the "other changes in assets account". In effect, the SNA recognises those assets created by R&D which generate an income flow between units but denies their connection with R&D production, and does not recognise R&D assets whose services are consumed by their owners. The 1993 SNA differs from the 1968 SNA in that income flows associated with patented entities are recorded as income from sales and the use of a service, rather than as property income. Allowing patented entities to be classified as non-produced but having income flows associated with them as if they were produced was a deliberate compromise introduced into the 1993 SNA when it was decided not to extend the asset boundary to include R&D.

130. The explanation as to why the 1993 SNA treats R&D in this way is set out in para 6.163. R&D is first explained in terms of its purpose,

> "…..research and development are undertaken with the objective of improving efficiency or productivity or deriving other future benefits so that they are inherently investment – rather than consumption – type activities".

and then it is explained that by convention, R&D along with activities such as staff training and market research are all treated as intermediate consumption even though they may bring future benefits.

131. It is necessary to have clear criteria for delineating R&D from other activities, to be able to identify and classify the assets produced and to be able to value the assets and depreciate them.

132. The Canberra II Group has carefully investigated the questions associated with R&D, focussing on the following questions:

(a) the scope of R&D GFCF

(b) definition of R&D

(c) measurement and valuation of R&D

(d) constant price estimation

(e) the feasibility of measurement of capital stock, capital services and consumption of fixed capital.

133. A question that has been debated in detail in the Canberra II Group relates to the **scope of R&D** to be included as GFCF. The possibilities of excluding some R&D according to the nature of the research, whether it is undertaken in the public sector and whether it is made freely available have all been discussed. Nearly all Canberra II Group members think expenditures on R&D should be recorded as GFCF. The majority favour including all of it either for conceptual reasons, or because the parts they think should be excluded (e.g. esoteric R&D) are so small that it is not practical to try to exclude them. A minority would like to exclude R&D output made freely available.

134. The logic behind proposals for including all R&D is that R&D is thought to be one of the principal drivers of output growth. It is important for productivity analysis across time and across countries that R&D data be fully integrated in the national accounts. From an economic theory point of view, all R&D expenditure qualifies as capital formation because consumption is foregone for the sake of future benefits.

135. It is important to include all forms of R&D, including basic research, some of which may be undertaken without any specific goal in mind. Without such research, technological progress would be restricted to improving existing technologies and technological leaps would occur only by chance. Clearly, those who finance basic research do so in the belief that there will be future benefits. If we exclude it, we could be excluding an important factor influencing economic performance.

136. Units that make their R&D output freely available often undertake the R&D with the expectation of gaining future benefits, e.g. medical research to provide more cost-effective medical treatments or studies of genetics to identify people at risk of illness or prone to criminality. Both private and public sectors make some R&D output freely available and protect the rest, although the proportions and means of protection differ. Government institutions, such as universities, often take out patents. Defence R&D is generally kept secret.

137. In practice it would be very difficult to exclude R&D made freely available accurately, and attempting to do so could add substantially to the estimation costs. One could expect reduced comparability over time and across countries. It would be very crude and misleading to try to exclude R&D made freely available by excluding all general government R&D.

138. The Frascati Manual **defines R&D** as “research and experimental development to comprise creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society, and use of this stock of knowledge to devise new applications”. The 1993 SNA does not provide an explicit definition of R&D and the closest it comes to doing so is in paragraph 6.163 quoted above. However, various paragraphs in the 1993 SNA that mention R&D imply a definition that is somewhat broader and more akin to the Frascati Manual’s definition and coverage of market and non-market activities, including, for example, R&D activities that are mixed with education (paragraph 9.89).

139. **Measurement and valuation of R&D.** The SNA recommends that non-market output should not be valued by the amount of income received. This extends to the freely available services of public roads, whose asset values are determined on the basis of cost. The Canberra II Group believes this recommendation should include the services of R&D assets made freely available. The definition of an asset should be clarified to cover such assets.

140. As most R&D is conducted on own account, it is proposed to use expenditure data collected according to the guidelines in the Frascati Manual as the principal data source. Eighty-nine countries have Frascati-based R&D data on the UNESCO database, mostly time series. A request has been submitted to NESTI for changes to the Frascati Manual to better accommodate SNA needs.

141. As far as **constant price estimation** is concerned, research is being undertaken to develop output price indexes for R&D, but well-constructed input price indexes will suffice, at least in the short term. Much work has been done to estimate asset lives and depreciation rates to enable capital stock estimates to be produced, but more work is needed.

142. To assess **the feasibility of implementation** a number of Canberra II Group members have compiled R&D accounts in order to determine the practicality of doing so and to identify problem areas. This work has shown that it is feasible to compile R&D estimates of adequate quality in the national accounts. Further work is planned, aimed at improving the quality.

143. The next steps required if the recommendations are accepted are:

(a) The Canberra II Group is to work with NESTI to change or augment R&D surveys to better meet SNA needs; the first meeting is tentatively set for early 2006

(b) The Canberra II Group also needs to work on improving the measurement of international trade in R&D

(c) The Canberra II Group is to undertake further research on asset lives and depreciation rates for R&D

(d) the NESTI Group is working on the development of output price indexes for R&D.

Recommendations/questions

144. The recommendations presented for the AEG’s consideration were:

(a) The 1993 SNA should be changed to recognise the outputs of R&D as assets, and the acquisition, disposal and depreciation of R&D fixed assets should be treated in the same way as other fixed assets.

(b) All R&D output should be treated as an asset, irrespective of its nature or whether it is made freely available. In the latter case, the asset should be recorded on the balance sheet of the owner of the original and be regarded as providing a free service until it becomes obsolete.

(c) The definition of an asset should be reviewed to ensure it covers the assets of non-market producers adequately.

(d) The definition of R&D given in the Frascati Manual (FM) should be adopted in the SNA.

(e) The Frascati system provides the best means of deriving estimates of R&D statistics, principally gross fixed capital formation (GFCF). However, there are shortcomings in the Frascati data and the FM should be amended to better support the needs of the SNA. (NESTI has indicated a willingness to do this.)

(f) Most R&D output is produced over several periods and the SNA recommendations for the production of other assets should apply. Most R&D production is on own account, which implies recording it as GFCF as it occurs under the current recommendations.

(g) Patented entities should no longer be recognised as assets in the system.

Discussion

Recommendations (a) – treat R&D as assets; (b) – include freely-available R&D as an asset; and (c) – review the definition of an asset

145. The discussion opened with several participants expressing strong support for the first recommendation (that the SNA should be changed to recognise the outputs of R&D as assets), with their arguments being along the lines that R&D clearly meets the criteria needed to be classified as an asset, particularly relating to consumption foregone. A couple of participants were opposed to the first recommendation. One argument was that staff training and related costs are not capitalised yet they lead to future benefits, so why should R&D be treated differently from other knowledge assets. A counter to this argument was that some knowledge assets are already included in the accounts (e.g. software, including open-source software which is freely available, and mineral exploration). It was noted that, under the 1993 SNA, R&D can already be treated as assets in satellite accounts but few countries have done so, which seems to indicate little demand for R&D to be capitalised.

146. One AEG member expressed a strong view in favour of capitalising R&D in the core accounts on the grounds that any concerns about depreciating and deflating R&D can be handled by having a long implementation period, say five years.

147. On balance, there was strong support within the AEG for this recommendation. However the AEG was split on the second recommendation (that all R&D output should be treated as an asset, irrespective of its nature or whether it is made freely available). The key question being disputed was whether or not R&D made freely available should be included in R&D assets. Those arguing in favour of including freely available R&D as part of assets generally did so on the grounds that unless it is included the SNA will miss recording something that contributes to economic growth because all research does affect economic growth whether or not a specific payment has to be made by its users. Some participants felt that capitalising freely-available R&D

opens the door to arguments against capitalising it. R&D assets should be restricted to those that are subject to actual transactions with payments.

148. Other comments made included:

- esoteric research (e.g. into ancient languages) should be excluded from the scope, at least in concept, even though there will be practical difficulties in doing so;
- capitalising R&D meets the needs of the national accounts in the 21st century, given that business and economic growth are so dependent on research, so not including R&D would make the accounts less relevant;
- the accounts do not recognise assets for other components underlying growth, particularly in productivity, such as free and transparent government;
- comparing R&D with public roads is misleading, because once R&D is made freely available there is no way of charging in future, which is not the case for roads;
- capitalising R&D might imply a change in the definition of assets (e.g. ownership rights);
- the Canberra II Group has closely examined both conceptual and practical questions relating to R&D; these questions have been investigated more thoroughly than many other parts of the SNA although work is still required on an updated definition of an asset;
- there will be practical difficulties in estimating R&D assets;
- specific guidance will be required on how to depreciate and deflate the new assets;
- the updated OECD manual on "Measuring Capital" should provide practical advice on measuring R&D.

149. The outcome of the debate on the second recommendation was a split within the AEG. A compromise was suggested. It involves excluding freely-available R&D in concept, but to note that all R&D would probably be included in practice for the sake of simplicity (in practice, freely-available R&D is likely to be small and it will not be worth trying to measure it so that it can be excluded from the total assets). Also, this proposal would not change the definition of an asset. There was some explicit support for this proposal and no-one opposed it.

150. The Chair summarised by saying that the majority of the AEG appear to be able to accept the proposed compromise. In addition ,the definition of an asset is being reviewed for other reasons.

Recommendation (d) – adopt the Frascati Manual definition in the SNA

151. The discussion opened with a point being made that the implication of using the Frascati Manual definition would be that all knowledge would have to be capitalised in the SNA. One reading of this would include human capital also. Several proposals were considered on ways in which the Frascati Manual definition could be modified to fit in better with SNA concepts. The final decision of the AEG was to retain the Frascati Manual definition in its entirety but explain in the updated SNA text that it does not include human capital.

Recommendation (e) – the Frascati Manual should be amended to better support the needs of the SNA

152. The AEG accepted this recommendation.

Recommendation (f) – SNA recommendations for the production of other assets should apply to R&D

153. The background to this question was clarified. Most R&D on own account is work in progress and should be classified as capital formation in a similar manner to the construction of buildings, ships etc. The AEG accepted this recommendation.

Recommendation (g) – patented entities should no longer be recognised as assets in the system.

154. The folllowing amendment to recommendation (g) was proposed and accepted.

> "Patented entities will no longer be separately identified as such in the system, but they will be subsumed into R&D assets."

Summary conclusions

Decisions

155. A large majority of AEG members supported recommendation (a), that the 1993 SNA should be changed to recognise the outputs of R&D as assets.

156. A number of AEG members expressed concern about some aspects of recommendation (b). In particular, the proposed inclusion as assets of R&D made freely available would potentially change the current SNA definition of an asset. It was agreed that theoretically these should not be treated as assets. However, because the amount of R&D made freely available is likely to be small and difficult to identify, in practice they might not be excluded.

157. The definition of an asset (recommendation (c)) is being re-examined by the Canberra II Group.

158. The AEG agreed to use the Frascati Manual definition of R&D with the clarifying explanation that this does not imply that human capital is treated as an asset in the SNA.

159. Recommendations (e) and (f) were accepted.

160. The following amended version of recommendation (g) was accepted:

> "Patented entities will no longer be separately identified as such in the system, but they will be subsumed into R&D assets."

Originals and copies

Issue 11; Papers SNA/M1.05/18.1 and 18.2; for decision following e-discussion[4]

Description of the issue

The part of the issue not previously resolved concerned the treatment of annual licences to use proprietary software.

Presentation

161. The substantive paper for this session (document number SNA/M1.05/18.1) was written by Nadim Ahmad and the result of the e-discussion presented by Ivo Havinga. The session was chaired by Carol Carson.

162. The AEG in Dec 2004 requested Canberra II Group to recommend which cases represent the acquisition of an asset when payments for a license-to-use are made over several years.

Recommendations/questions

163. The Canberra II Group made the following recommendations to the AEG for its consideration and comments were received on these questions via an e-discussion:

(a) If a copy (licence-to-use) is acquired via regular annual payments, the payments should be recorded as finance lease transactions if it can be established that the purchaser intends to use the copy repeatedly in production until the end of its economic life. Intent can be determined if significant associated costs are incurred on acquisition (e.g. for software, the costs involved in training or developing new systems based on the software). For other copies, however, establishing intent is likely to be more difficult.

(b) The full value of the software reproduction should be recorded as fixed capital formation at the time of acquisition, with annual license payments corresponding to interest payments thereafter, following the usual national accounts rules for financial leases. When this is not practical it is acceptable to capitalise the annual licence payments as and when they occur and record consumption of fixed capital in the same year.

164. Regarding question (a), a small majority of those participating disagreed. Question (b) was strongly supported.

Discussion

165. The main question discussed was whether or not software "purchased" via annual payments should be capitalised.

166. The following points were advanced by those proposing to include such software as assets:

[4] For all issues reviewed following e-discussion, the first mentioned paper discusses the substance under discussion; the second gives a summary of the e-discussion.

- in some cases (e.g. SAS), you can obtain the software only by obtaining a licence for a year and making payments on an annual basis
- building application systems using such software shows a long-term commitment to use the software and it should be treated as an asset despite the policy of the licensor that it can only be leased annually and not purchased outright
- unless the recommendation is accepted, software leases repeatedly renewed annually on a long term basis would have to be treated as consumption.

167. The points made against including such software as assets were:

- an implication of accepting the recommendation is that it will be necessary to measure intent, which is an impossible thing to do
- in effect the business owning the software is not allowing anyone to invest in the software
- in practice, it would not be possible to identify leased software from purchased software
- the 12 month rule should be followed for consistency with the rest of the system
- annual licences for software are similar to making annual rent payments on a building, where upfront fixed costs are also incurred, thus there is a parallel with annual rent, which is a good example of it being necessary to look at the nature of the contract rather than the relationship between the provider and the user.

168. The AEG accepted that the implication of not adopting this recommendation is that the annual payment is a rental payment. In effect, it means that an annual payment without any firm indication of a long-term agreement implies that an asset is not being acquired. The SAS-type arrangement is not similar to a financial lease because the user does not take over ownership of the asset at the end of the lease. However software, like other assets, can be subject to financial leasing arrangements and, if such a situation is identified, then it should be treated as a financial lease.

169. The Chair summed up that the AEG does not accept recommendation (a), which implies that no exceptions will be made to the way that annual payments are treated.

170. The AEG confirmed the outcome of the e-discussion on recommendation (b).

Summary conclusions

171. Two questions were put to the AEG for e-discussion:

Decisions

172. The AEG did not accept that annual licence fees for software without a long-term contract should be treated as fixed capital; the payments should be treated as rentals.

173. In general, software should be treated in a similar way to any other asset. As a result, a long-term lease of software can be treated as a financial lease.

174. If a large initial payment is followed by a series of smaller annual fees, the initial payment is treated as fixed capital formation and the annual fees as a service charge.

Databases

Issue 12; Papers SNA/M1.05/19.1 and 19.2; for decision after e-discussion

Description of the issue

The 1993 SNA recommends that large databases should be capitalized. Should SNA provide a clear definition of databases to be capitalized covering characteristics such as size and marketability of the data as well as the database itself?

Presentation

175. The substantive paper for this session (document number SNA/M1.05/19.1) was written by Nadim Ahmad and the result of the e-discussin presented by Ivo Havinga. The session was chaired by Carol Carson.

176. At the December 2004 meeting, the AEG has asked for clarification on exactly what should be included in the concept of 'database' and further refinement of the proposed method of valuation. The Canberra II Group made the following recommendations to the AEG for its consideration:

(a) the value of the database reflects the value of the DBMS, plus the cost of converting data from one medium/format to the medium/format required for access by the DBMS; the value of the database does not include the value of the information in it

(b) all databases holding data with a useful life of more than one year are fixed assets

(c) no maintenance is entailed with the database

(d) the value of own-account database capital formation can be estimated as:
(number of employees x average remuneration x time spent in developing database) + (other intermediate costs, excluding the value of the software supporting the database). + (costs of capital services for items such as scanning machines and computers)

177. The conclusions of the e-discussion were:

(a) the value of the database should only include the costs of developing the database excluding the value of the DBMS software used which is treated separately as a software asset

(b) databases holding data with a useful life of more than one year are fixed assets

(c) no maintenance is entailed with databases and all set-up and updating costs should be recorded as capital formation

(d) the input-costs method is proposed for deriving macro-based estimates of own-account production of databases.

Recommendations/questions

178. As a result of the e-discussion, a slightly revised set of questions were put to the AEG.

179. The part of the question not previously resolved was formulated in terms of the following questions put to the AEG.

(a) Do you agree that the valuation of a database should include only the loading costs for data and metadata but exclude the value of the DBMS, which should continue to be recorded as a software asset?

(b) Do you agree with the recommended method for deriving estimates of own account database capital formation?

Discussion

180. The discussion focussed mainly on how and where the value of the data in databases should be recorded – as part of the databases themselves or somewhere else in the accounts. If a database is sold then a value is available to record in the accounts. However it is not possible to separate out the value of the information component and generally a value of the production of the information content of the database is not directly recorded. In effect, the information embodied in a database "suddenly appears" if the database is sold after being built up. It is somewhat similar to goodwill, which is not recognised until the asset to which it is attached is sold.

Summary conclusions

Decisions

181. Arising from the e-discussion and the follow-up discussion in the meeting, the AEG agreed the following in respect of own-account databases:

(a) databases holding data with a useful life of more than one year are fixed assets

(b) the value of the software component of databases, the DBMS, would normally be recorded elsewhere as a software asset

(c) the remaining value of the database should only include the costs involved in converting data from one medium/format to that required by the DBMS, including the application costs (adapting the software for a particular application, setting up the structure of the database, loading metadata, etc.), but should exclude the costs of acquiring the data themselves

(d) no maintenance is entailed with databases and all updating costs should be recorded as capital formation

(e) the value of databases should be estimated using a sum-of-costs approach, in the absence of a more satisfactory alternative.

182. The value of databases for sale includes the value of the information content.

Land improvements and structures

Issue 20; Papers SNA/M1.05/22.1 and 22.2; for decision after e-discussion

Description of the issue

The SNA currently records improvements to land as gross fixed capital formation, but in the balance sheet such improvements are included with land itself – a non-produced asset. Should land be split into two, with one part recorded as a fixed asset and the other part recorded as a non-produced asset? If so, how should the separation be made? One option is to distinguish

between land that is in, or nearly in, its natural state as a non-produced asset and the remainder as a fixed asset. Another option is to separate land from the improvements made to it, and record the former as a non-produced asset and the latter as a fixed asset.

Presentation

183. The substantive paper (document number SNA/M1.05/22.1) was written by Anne Harrison. The results of the e-discussiion were presented by Ivo Havinga. The session was chaired by Carol Carson.

184. At its meeting in December 2004, the AEG agreed that land improvement should be treated as a separate produced asset. The Canberra II Group was requested to clarify which structures should remain as part of land improvements and which should be classified as structures.

Recommendations/questions

185. The Canberra II Group set out the following question for AEG consideration:

(a) Do you agree with the following proposal:

Activities such as land clearance, land contouring, creation of wells and watering holes which are integral to the land in question and which are carried out by the landowner are to be treated as part of land improvements. Activities such as the creation of sea walls, dykes, dams and major irrigation systems which are in the vicinity of the land but not integral to it, often affect land belonging to several owners and which are often carried out by government, are to be classified as structures.

(b) If you answered NO to question 1, is there another division which you prefer? If so, please describe it.

(c) Or, do you think the SNA should be left unchanged in this respect?

Discussion

186. There was no discussion on the details underlying the proposals for land.

Summary conclusions

Decisions

187. The proposals in question 1 of the e-discussion were overwhelmingly supported.

Water as an asset

Issue 31; Papers SNA/M1.0523.1 and 23.2: for decision after e-discussion

Description of the issue

When water is no longer free, how should the charge for it be treated? Should it be treated in a similar way to land or mineral resources giving rise to rent? It is complicated by the fact a large share of the charges represents distribution costs.

Presentation

188. . The substantive paper (document number SNA/M1.05/23.1) was written by Anne Harrison. The results of the e-discussion were presented by Ivo Havinga. The session was chaired by Carol Carson

189. The treatment of water in the SNA needs amplification to allow for the greater recognition of the value of water as an increasingly scarce resource. To meet this need, the Canberra II Group has made the proposals contained in the following questions, which were circulated to AEG members soliciting their opinion in the matter.

Recommendations/questions

190. The following questions were set out by the Canberra II Group for e-discussion:

(a) It is proposed that the definition of water resources be extended to cover rivers, lakes, artificial reservoirs as well as other surface catchments in addition to aquifers and other groundwater resources. The intent of the proviso "to the extent that their scarcity leads to the enforcement of ownership and/or use rights, market valuation and some measure of economic control" would stand though some changing of this wording will be needed arising from other discussions on the interpretation of ownership and control.

(b) It is recommended that the SNA include guidance that water bodies should in principle be valued in a manner parallel to the valuation of mineral resources but with an indication that more pragmatic alternatives may have to be used such as estimates based on access fees.

(c) The phrase "and associated surface water" should be added to land under cultivation.

(d) It may be that the surface land associated with a water body is relatively small and of little value separately from the water body. In keeping with the recommendation on buildings and land under buildings, land and associated surface water should be allocated to either a category of land or to water resources depending on which element has the greater value.

(e) The value of an artificial reservoir full of water may exceed the cost of building and maintaining the reservoir but this addition represents the value of the water per se. In principle this addition should be recognised as the value of the non-produced water resource but as noted in connection with land, it may not be possible to separate these in practice and in that case the allocation should be made between the reservoir and the water resource according to which has the greater value.

(f) By extension of the treatment of carrying water as the production of a good and similar treatment of bottling and branding water, distribution of mains water should be treated as the production of a good (water) and not just a service of moving water from one place to another. This is also consistent with the move to charge for mains water on a volumetric basis.

(g) Where fees are levied for permission to deposit waste water into a body of water the fees should be treated in the same way as other fees to use natural resources, noting that the exact modalities for this are yet to be agreed by the Canberra II Group.

Discussion

191. The main question raised in the discussion was that the transport of water is treated as part of a service industry and so bringing it in as a good conflicts with ISIC (it was later pointed out it also conflicts with the CPC).

192. Anne Harrison volunteered to discuss this particular point offline with classification experts.

Summary conclusions

Decisions

193. Proposals (a) to (e) were overwhelmingly agreed in the e-discussion.

194. Proposal (f) could have implications for the proposed CPC classification of distribution of water (as a service). The SNA editor agreed to discuss the implications with classification experts and report back to the next AEG meeting.

195. Proposal (g) in the e-discussion was supported but some reservations were expressed by the AEG and they will be investigated further.

196. An update on the situation following the next Canberra II Group meeting will be presented to the next AEG meeting.

Purchased goodwill and marketing assets

Issue 22; Papers SNA/M1.05/24.1 and 24.2; for decision after e-discussion

Description of the issue

The 1993 SNA only records purchased goodwill and it treats purchased goodwill for corporations and unincorporated enterprises differently. Should goodwill continue to be recognized only when purchased or should internally generated goodwill be recognized? Should purchased goodwill be treated the same way for corporate and unincorporated enterprises? Should the balance sheet recognize assets such as brand names, trademarks, franchises, etc.?

Presentation

197. The substantive paper for this session (document number SNA/M1.05/24.1 Issue 22) was written by Tony Johnson. The results of the e-discussion were presented by Ivo Havinga. The session was chaired by Carol Carson.

198. The Canberra II Group identified a number of questions for the AEG's consideration:

(a) the nature of purchased goodwill needs to be clarified in the updated SNA

(b) although marketing assets are separately identifiable, they should be included in the same category as purchased goodwill

(c) valuation principles for purchased goodwill and marketing assets should be applied consistently (listed or unlisted corporation, quasi-corporation or unincorporated)

(d) internally generated goodwill and marketing assets should be excluded except where evidenced by a sale

(e) purchased goodwill and marketing assets should continue to be treated as non-produced

(f) purchased goodwill should not be amortized at a predetermined rate but made subject to an impairment test.

199. These questions were used as the basis for a series of questions (see below under "Summary conclusions") presented for resolution via an e-discussion. The result of the consultation shows that the AEG members participating in the e-discussion overwhelmingly supported the proposals of the Canberra II Group on "Purchased goodwill and marketing assets".

Recommendations/questions

200. The Canberra II Group set out the following questions for AEG consideration:

(a) Do you agree that an asset class 'Purchased goodwill and marketing assets' should replace the existing 'purchased goodwill'?

(b) Do you agree that the economic nature of purchased goodwill and marketing assets should be clarified along the lines presented in this paper?

(c) Do you agree that the valuation principles for purchased goodwill and marketing assets should be applied consistently, irrespective of whether the entity is a listed or unlisted corporation, a quasi-corporation or is unincorporated. They should be calculated as the excess of the purchase (or takeover) value of a business over the value of the other assets and liabilities otherwise identified in the SNA system for that business?

(d) Do you agree that internally generated goodwill and marketing assets should continue to be excluded, except when their value is evidenced by a sale? In the case of internally generated goodwill, this occurs only with the sale of a business. In the case of marketing assets it can also occur with their independent sale.

(e) Do you agree that the assets should continue to be classified as non-produced assets, even though their value is often driven by a productive activity. However, further consideration will be given by the Canberra II Group to whether a term can be found that better reflects the nature of these assets. This will be addressed in the issues paper concerning Classification and terminology of assets (Issue 27)?

(f) Do you agree that the assets should not be amortised at a predetermined rate but made subject to an impairment test consistent with the international accounting standards for these assets?

Discussion

201. AEG partipants were satisfied with the e-discussion; there was no further discussion in the meeting.

Summary conclusions

Decisions

202. All proposals in the e-discussion were overwhelmingly agreed to.

Tax revenues, uncollectible taxes and tax credits

Issue 35; Papers SNA/M1.05/07; for decision

Description of the issue

It is necessary to clarify the definition of taxes and the distinction between the payment of taxes and the payment for services. Moreover, uncollectible taxes should not be recorded as accruing. An estimated uncollectible amount based on experience could be deducted either from the gross amount under the accrual principle ("net recording") or alternatively recorded as a capital transfer ("gross recording"). Another alternative treatment would record unpaid taxes via the other change in volume accounts. Time of recording is an issue for income and wealth tax. For instance, for households it might be preferred to record the taxes at the time of assessment because it affects behaviour at that time. This treatment would be a deviation from the accrual principle that calls for recording taxes when the taxable event occurs. Expensing tax credit separately from tax revenue is increasingly hampered by the fact that source data may not allow separate recording of expenses, reducing international comparability.

Presentation

203. The paper for this session (document number SNA/M1.05/07; Issue 35) was written by the Task Force on the Harmonisation of Public Sector Accounts (TFHPSA) and presented by Jean-Pierre Dupuis. The session was chaired by Charles Aspden.

204. Accruals accounting is now an international norm, even for public accounts. International comparisons (including of tax burden) are increasingly based on national accounts. It is necessary to clarify the SNA principles and provide more guidance on the coverage of tax, the acceptable methods for implementing accruals and the recording of tax credits, in particular, the case of payable tax credits.

Definition and coverage of taxes

205. SNA93 defines taxes as "compulsory, unrequited payments to government" (paras 7.48 and 8.43). GFSM 2001 defines them as "compulsory transfers received by the government sector" (see para 4.21).

206. **Recommendation (a)** is that no major change is required to the definition or the present classification (D2, D5, D91). The TFHPSA suggested some clarifications relating to the meaning of "unrequited".

207. Borderline issues concerning the definition and coverage of tax particularly relate to making a distinction between taxes and fees. The current rationale was confirmed, but the TFHPSA considered more guidance is needed. In the case of licences and permits, the flow is to be analysed either as an unrequited transaction (usually a tax), or as a requited transaction when the purchaser receives a service or an asset in return.

208. **Recommendation (b)** (concerning borderline issues) is to record as a tax "any payment which is a mandatory condition to perform an activity or to acquire an asset and without a government unit rendering a specific service other than a minimum control of the legal capacity". In such cases, the licence/permit is automatically granted on payment by the user. On the other hand, a payment should be recorded as the purchase of service "if the issuance of the licence/permit implies the exercise of a proper regulatory function of the government, and when a service is

provided in return to the payment, unless the payment is clearly out of proportion to the costs of producing the service for all or any of the entities benefiting from the services".

209. **Recommendation (c)** (concerning borderline issues) covers the case of certain fees. Some key examples are admission fees to public museums, library fees, public television and radio fees, waste collection and garbage disposal fees and road tolls. They usually correspond to sale of services (by the government or a public sector unit). There is not a well-defined borderline between the provision of a service and a tax in these cases. A further issue to be considered is the market/non-market delineation of such services.

Accrual recording of taxes

210. The present guidelines regarding accrual recording of taxes are consistent in the various international standards, with the underlying basic principle being "when the taxable event occurs". Some practical flexibility is provided by the SNA and GFSM covering income tax deducted at source and regular prepayments when they are assessed or paid. The general principle set out in the SNA, ESA and GFSM2001 is that the amounts due should be recorded. However, the SNA allows some flexibility in making the estimates of "amounts due". Paragraph 7.60 of the SNA indicates cash is allowed in some cases and paragraph 3.57 of the GFSM2001 recommends recording "amounts realistically expected to be collected".

211. It should be made clear that implementing the accrual principle for recording taxes raises not only the question of time of recording, but also the amount to be recorded. Instead of two paragraphs in the present SNA (paras 7.59 and 7.60), three paragraphs are necessary setting out the general principle, the time of recording and the amounts to be recorded.

212. **Recommendation (d)** sets out the general principle underlying the accrual recording of taxes. "Accrual recording means that flows are recorded when economic value is created, transformed, exchanged or extinguished and not when cash payments are made. If this principle would be understood as requiring to record due amounts of taxes (as the consequence of the underlying economic event, and under the existing law), this should not in any case lead to the recording of uncollectible taxes in the total revenue of the general government."

213. **Recommendation (e)** covers the time of recording, which is defined as the time "when the activities, transactions or other events occur which create the liability to pay taxes – in other words, when the taxable event occurs – and not when the payments are actually made. This time is usually when income is earned or when a transaction (such as the purchase of goods and services etc.) generating the liability occurs, to the extent that the tax liability can reliably be measured."

214. **Recommendation (f)** outlines the situations in which flexibility is permitted in practice. Two cases for which accruals assessments cannot be made reliably before the time of assessment relate to the parallel economy and to taxes on income for which the moment of the tax assessment is considered to be the time when the tax liability is measured and known in a reliable way, taking into account possible changes to the tax rates and the final settlements.

215. **Recommendation (g)** defines the two basic methods of valuing accrued amounts of taxes. The first is the ***time-adjusted cash method*** in which the amounts are initially recorded on a cash basis when the taxes are actually paid. The time of recording is then adjusted to the time when the tax liability was incurred rather than the time the payment was actually made. The second method is based on an ***assessment of due taxes***. There are two statistical methods which may be used to eliminate the effect on these assessments of taxes unlikely to be collected – net recording and gross recording. Under the ***net recording of taxes***, the amounts assessed as due are adjusted by a

coefficient reflecting the proportions of assessments in recent periods that were never collected. The amounts of accrued tax are then written down according to this adjustment. ***Gross recording of taxes*** records as tax the amounts assessed as due – based on realistic assessments - but the difference between this due amount of tax and the actual cash receipts is treated as a capital transfer (in favour of the defaulting payers).

Tax credits

216. The 1993 SNA and ESA95 do not contain any recommendations on the treatment of tax credits. In chapters 5 and 6 of the GFSM2001 reference is made to amounts deductible from tax due being recorded as reducing taxes (i.e. as negative taxes) while net payments by general government are considered as expenditure. The OECD publication "Revenue Statistics" defines as expenditure "any amount exceeding tax liability and paid by general government". IPSAS distinguishes "tax expenditure" and "expenses paid through the tax system".

217. **Recommendation (h)** sets out the characteristics of tax relief to form the basis of a definition: "Most tax systems include elements of social redistribution, through the tax schedule (increasing tax rate), the choice of tax unit (individual or family taxation) and tax relief. Tax relief aimed at redistribution may be designed to reduce the amount of tax that households pay according to certain characteristics, such as the number of children. Moreover, tax relief may also be designed to encourage certain activities, such as participation in the labour force or investment in R&D."

218. **Recommendation (i)** describes the characteristics of tax credits: "A tax relief that is embedded in the tax system should be recorded as reducing tax revenue. This is the case of tax allowances, exemptions and deductions, as they enter directly into the calculation of the tax liability. This is also the case for non-payable tax credits, as their value to the taxpayer is limited to the size of their tax liability." However, a tax credit can result in the government making a net payment to the taxpayer. This the case of a payable tax credit.

219. **Recommendation (j)** covers the special case of payable tax credits, which are defined as: "Payable tax credits occur in cases where the total amount of the credit exceeds the amount of tax liability (otherwise due) and so the element of the credit in excess is paid by the government to the taxpayer. The amount actually paid by the government is to be recorded as government expenditure (subsidy or social benefit) while the rest reduces the tax liability. Actual government payments will not in any case be deducted from the reporting of global tax revenue."

220. **Recommendation (k)** refers to the recording of a tax credit as a negative tax in the national accounts under certain conditions. The criteria basically reflect the fact that the tax credit is embedded in the tax system and that there is a close relation between the subject of the tax credit and the category of tax. In particular (i) the tax credit measure must appear as part of the tax law, of tax calculation and of tax statements (tax consistency); (ii) the tax credit can be deducted only from a given tax liability (otherwise due); and (iii) the amount recorded as negative tax cannot exceed the amount of tax due by the beneficiaries on an individual basis. Thus, individual tax information must be used in order to calculate the amount of credit to be expensed. The element due in excess is an expenditure of government, and will not be deducted in the reporting of global tax revenue (individual character of tax credits)."

221. **Recommendation (l)** clarifies the situation in the case of certain social benefits: "To draw the line between tax credits and social benefits paid through the tax administration, it is made clear that social benefits that come in full replacement of labour income (income substitutes) should systematically be recorded as government expenditure, even if granted through the tax

administration. Old age pensions, disability pensions or unemployment allowances would be always recorded this way". The rationale is that these benefits are not embedded in the tax system. Recording them as reducing tax would distort the assessment of relevant aggregates (tax burden, public expenditure) and international comparisons.

Recommendations/questions

222. The following table summarises the recommendations presented for discussion:

1 Definition and coverage of a tax

(a) Fine tuning of definition "nothing directly in exchange"

(b) Taxes versus services

(c) Fees for specific services

2 Accrual recording

(a) General accrual principle

(b) Time of recording: "taxable event"

- of which flexibility for time of assessment

(c) Amount to be recorded: Tax due

- time adjusted cash
- assessment of due taxes

  net recording (coefficient)

  gross recording (capital transfers)

3 Tax credits

(a) Tax relief, of which tax credits

(b) Non-payable tax credits

(c) Payable tax credits

(d) Conditions for tax credits

(e) Clarification for certain transactions, e.g. social benefits (income substitutes).

Discussion

Recommendations (a), (b) and (c) - definition and coverage of a tax

223. The AEG expressed some concerns about some of the examples give. One of these was a road toll, which was stated to be likely to be a fee for a service but road tolls can often be a tax in practice. It is difficult to generalise and details need to be looked at for each case. A question that needs to be asked in each case is "what do you get in exchange"? If it is simply permission to go through a barrier then it is probably a tax. The 1993 SNA sets out the basic principles well and the distinction between taxes and services should be based on those principles. It is not clear why some of these changes are being proposed; it seems like a step back. The SNA principles should not be compromised in this process.

224. It was pointed out that the GFSM 2001 is consistent with the 1993 SNA and there is a continuing commitment on the part of the IMF and other international organisations to maintain

consistency between the various economic standards such as those for the national accounts, the balance of payments, and government finance statistics.

225. The Canberra II Group considers licences or permits issued in unlimited quantities with little consequential activity by government as taxes; further the Group decided licences available in limited numbers are also taxes. There is some concern about licences that cover a proper regulatory function being treated (wrongly) as payment for a service. For example, a payment to a prudential agency for its financial regulatory functions is not a payment for a service because it fails the test of being of the direct benefit to the payers; in practice, the customers rather than the financial businesses benefit from this process. Providing examples is useful but only if they demonstrate the difference between taxes and payments for a service. The list of examples should not appear to be an exhaustive list of all the types of licences to be treated as taxes (or fees for a service).

226. Other points raised during the discussion were:

- inserting the term "sovereign powers" in definitions is undesirable because it may have some legal aspects in some countries that are inconsistent with statistical principles
- something needs to be included to explain why fines and penalties (other current transfers) are not taxes
- the purpose of providing examples should be only to help the understanding of the basic principles and not as an exhaustive list of treatments because examples can be used too selectively
- it would be useful to set out more precise meanings (e.g. to describe what "unrequited" means).

227. Jean-Pierre Dupuis said that the TFHPSA does not consider the wording in recommendation (c) to be final and the Task Force is prepared to consider any written proposal for change.

Recommendations (d), (e) (f) and (g) – accrual recording

228. The discussion on accrual recording revolved around the meanings of different terms and their implications for what is recorded in the accounts. In particular, a large part of the debate was on the proposal regarding the amount of taxes that are never likely to be collected being excluded from the tax revenues (referred to during the discussion as "net recording"). "Gross recording" refers to the practice of recording the total amount of taxes expected to be collected and then adjusting through capital transfers for the part that is not collected. It was pointed out that gross recording has some unfortunate impacts on the national accounts and is open to manipulation by overstating tax receipts. Businesses which do not on-pay VAT, for example, to government raise their gross operating surplus, while the receipts of government are lower than gross assessments suggest.

229. A number of participants argued against gross recording. One argument was that no flow should be recorded from government to the business any more than a flow should be recorded for shoplifting. No such flow exists so none should be recorded. If gross amounts were to be recorded, the adjustment should be recorded as an other change in volume, as if the non-payment were recognised as a bad debt. Those participants making these points favoured the time-adjusted and similar methods of recording taxes to provide a more realistic assessment of what is actually happening from the point of view of the government sector

230. Several other questions were debated on the accrual principle and the corresponding of recording; The main ones were:

- the expression “due for payment’ is ambiguous and should be avoided; the time when the amounts are o be recorded as well as the size of the amounts due should be spelled out separately;
- taxes on wages provide an example where an inconsistent recording occurs if taxes are not recorded on a gross basis, since households do receive wages net of all taxes even though government may not receive all the taxes deduced from wages
- some clarification is required about what constitutes a taxable event; for example, how should a tax on property paid in April each year be recorded in the quarterly accounts (is it the annual amount divided by 4 or something else?)

Recommendations (h), (i), (j), (k) and (l) – tax credits

231. Tax credits are not defined in the 1993 SNA. The key issues involved are whether certain deductions from the amount of tax payable should be recorded as a “tax credit” and therefore reduce the amount of tax revenue shown as being received by government or whether they should be included in total tax revenue and also in government expenditures (generally, they would be recorded as expenditure on a social benefit).

232. A Task Force paper was distributed setting out the case for gross recording. A key factor is the case of payable tax credits which are payable to taxpayers and non-taxpayers alike. They are thus a form of social benefit. There is a need to be able to analyse tax flows separately from a full set of social benefits data and gross recording provides the data necessary.

233. It was argued that data should be provided to see the true cost of social policies, which requires a gross basis. Hiding social benefits in a tax category distorts analysis. The ratio of tax revenue to GDP is politically sensitive so there is political pressure to record payable tax credits on a net basis. Recording actual transactions is preferable because it removes the need to impute unnecessarily. The issue of identifying payable tax credits can be based on whether the taxpayer’s liability is based on income or on social position (e.g. the number of children or the age of dependents).

234. Most participants agreed with the recommendations on payable tax credits but a couple of speakers disagreed. There was some concern that data availability may be a problem in developing countries.

235. The debate switched to identifying the differences between payable and non-payable tax credits that result in the former being regarded as social benefits while the latter are not. In some countries, a number of social benefits are embedded in the tax system. However, there was agreement that social benefits paid via the tax system for administrative convenience should not be included in tax revenue. No one disagreed with the proposal that principles should be set out in the updated SNA, with illustrative examples being provided rather than trying to produce a comprehensive list. The AEG agreed that tax credits should be presented on a gross basis to prevent government receipts being artificially inflated, and this should be explicitly set out in the SNA, but with sufficient details to reconcile with information presented on a net basis as is the case in other publications.

236. Much of the Task Force paper on this subject focuses on refining existing text rather than redefining principles and many of the proposals are drafting issues rather than real changes. It was

agreed that the Task Force should prepare some or all of a free-standing chapter taking account of this discussion and any written comments received as a result of it. This document will then be edited to fit it into the updated SNA. This will be done by the editor in consultation with the project manager and the ISWGNA.

Summary conclusions

Decisions

Definition and coverage of a tax

237. The AEG noted that the TFHPSA paper focussed mainly on refining existing SNA text rather than on redefining existing principles.

238. The AEG felt strongly that the definition and coverage of a tax should be set out clearly, with some examples. The examples should illustrate the underlying concepts but should not suggest that they are exhaustive or prescriptive. It is important not to try to produce a comprehensive list of treatments.

Accrual recording

239. Taxes are to be recorded on an accrual basis. The expression "due for payment" should be replaced by "accruals".

240. The discussion focussed almost exclusively on the question of whether amounts should be recorded on a net or a gross basis. The principle of not including taxes that are uncollectible and/or unlikely to be collected and so affect the government surplus/deficit was agreed. Because the AEG could not agree which of the three methods in the paper was preferred, it was decided to leave the SNA unchanged in this regard.

Tax credits

241. A clear majority of the AEG decided that payable tax credits should be recorded on a gross basis. The presentation should permit the derivation of tax credits on a net basis also.

242. It was decided that the best way forward would be for the TFHPSA to prepare the proposed free-standing chapter for the SNA covering all the questions on taxes[5.] This draft should include the rationale for the changes proposed and emphasise the underlying concepts and principles. The SNA Editor in consultation with the Project Manager and the ISWGNA will review the text to identify changes in substance and in drafting to the 1993 SNA. A report on this process will be submitted to the AEG.

---

[5] It was agreed retrospectively that this should apply to the recommendations on the issues concerning the delineation of the government and public sector also.

Granting and activation of guarantees

Issue 37: Papers SNA/M1.05/08; for decision

Description of the issue

This issue covers both the granting and activation of guarantees. For the granting of guarantees, specifically guarantees on loans, this issue address the recognition of constructive liabilities that are not legally enforceable liabilities but are nevertheless expected to result in outflows. The recognition of the latter would result in a change to the asset boundary. The issue affects the formulation of the treatment of flows between the original debtor and creditor and between the original debtor and guarantor when the guarantee is activated or between debtor and creditor when collateral is called by the creditor. While the 1993 SNA does not treat these flows, GFSM 2001 describes the treatment of debt assumption involving general government: either acquisition of a financial asset, acquisition of equity, a capital transfer, or other volume changes. In addition, this issue addresses the recognition of constructive obligations which are not legally enforceable liabilities but are nevertheless expected to result in outflows. The recognition of the latter would result in the relaxation of the economic asset boundary.

Presentation

243. The paper for this session (document number SNA/M1.05/08; Issue 37) was written by Reimund Mink and presented by Lucie Laliberté. The session was chaired by Charles Aspden.

244. Guarantees have a significant impact on the economic behaviour of transactors. They influence decisions on production, income, investment and saving and can modify lending and borrowing in financial markets. Guarantees are particularly significant for government and other public sector units.

245. The 1993 SNA views guarantees as contingent assets. ESA 95 recognises that the counterparts of insurance technical reserves and pension funds are contingent assets in most cases. The GFSM2001 recommendation is to record as memorandum items the possible revenues/expenses (gross amount of guarantees) and also the expected revenues/expenses, recognising that they can be quantified.

246. Experience suggests that memorandum items are often not reported. It is therefore proposed that to reflect the differences among economic events that give rise to guarantees of different sorts, a change to the System is needed.. In addition, the change proposed would lead to a convergence with accounting standards that distinguish guarantees from contingencies.

247. Maintaining the status quo would be criticised since economic behaviour is influenced at the time guarantees are given, creating potential costs/benefits for the units involved.

248. The solutions proposed are based on distinguishing three types of guarantees with different methods for recording each of these.

Recommendations/questions

249. **Recommendation (a)** is that guarantees should be viewed according to types. ***Standardised guarantees*** are those where there are very many similar guarantees, for relatively small amounts (e.g. export credits or student loans). Given their large number, it is very likely that some of them

will be called. Accordingly, it is possible to make a good estimate of the average loss by considering statistics on claims. ***One-off guarantees*** are individual guarantees, often for large amounts where it is difficult to predict the likelihood of the guarantee being called. However some of these may be ***tradable or offsettable guarantees***.

250. **Recommendation (b)** is that tradable or offsettable guarantees should be treated as financial derivatives. Tradable guarantees are similar to derivatives since the issuer takes over the risk of the deterioration in the credit worthiness of an entity. The conditions under which they can be identified are when there is a market for similar instruments and when there are observable market prices. This is a clarification of the 1993 SNA rather than a change. At present, only credit derivatives would meet the conditions for this treatment and they would be recorded as financial derivatives.

251. **Recommendation (c)** is that standardized guarantees should be treated in a manner similar to insurance because of their similarity in that both involve pooling risks. The liability of the guarantor is equal to the net present value of the expected payments to be made under the guarantees. The sector being protected by the guarantees records a corresponding asset.

252. **Recommendation (d)** is that a sub-category should be created under "insurance technical reserves" called "provisions for payments under standardized guarantees".

253. **Recommendation (e)** is that the sector of the counterpart asset is the sector receiving the guarantees (e.g. the lender for a guarantee on borrowing).

254. **Recommendation (f)** is that a subsidy/capital transfer to the lender should be imputed if the guarantor sells the guarantee for a premium that does not cover the expected loss and administration costs.

255. **Recommendation (g)** is that one-off guarantees should be recorded outside the core accounts (either as memorandum items or in supplementary accounts). One-off guarantees are usually not standardised and not tradable. Four possibilities have been considered:

(a) liability in the core accounts (for the expected loss)

(b) re-routing

(c) memorandum items

(d) supplementary system of accounts.

256. **Recommendation (h)** is that a sufficiently prominent status should be given to ensure that one-off guarantees are recorded in practice (as for non-performing loans).

Discussion

Recommendation (a) – guarantees characterised as standardised/one-off and tradable/offsettable

257. There was little enthusiasm for making any significant changes to the 1993 SNA, although it should explicitly recognise the contingent nature of guarantees. It was suggested it would be more helpful to characterise guarantees as being of only two types, standardised or one-off with a sub-division of the latter into tradable or non-tradable.

258. The recommendation was supported because it was considered desirable for the SNA to provide guidance since some guarantees are tradable.

Recommendation (b) – tradable/offsettable guarantees should be treated as financial derivatives

259. This recommendation was supported.

Recommendation (c-f)

260. There was general discussion about the treatment of standardised guarantees. The following points were raised:

- the views expressed are sensible but some of the details need to be clarified (e.g. in recommendation (f), a subsidy is shown as a capital transfer in one part and a current transfer – subsidy- in another)
- should the treatment apply only to government guarantees, or more generally, for example to include bankers' acceptances and manufacturers guarantees`? What does this imply for the parallel with insurance?
- guarantees involve three parties; the two originally contracted (say a lender and borrower) and the third making a contract with one of the original parties (eg the lender); the transactions to be recorded by all three parties needs to be described;
- the recommendation that the activation of a guarantee should be recorded as a capital transfer does not seem universally the best solution;
- how should the fee paid for the guarantee be treated?
- This is another instance which suggests a more comprehensive view of the role of provisions in the accounts would be useful.

261. Lucie Laliberté agreed the link to provisions is an important question and said that the Task Force will look at it.

Recommendation (g and h)

262. There was some discussion about whether supplementary accounts and memorandum items are satisfactory solutions. Those who spoke considered that they are not satisfactory and so it will be necessary to determine how pervasive one-off guarantees are because they potentially impact on the coherence and comprehensiveness of the accounts. Even though it is notionally easier to handle guarantees in the balance of payments because they have fewer knock-on effects, handling them via memorandum items is a problem there as well. "Activation" is an important question with guarantees and it needs to be discussed. A paper on activation could be based on an updated version of the December 2004 paper on this topic and handled through an e-discussion.

263. Despite the above sentiments on the undesirability of treating guarantees in supplementary accounts or as memorandum items no one argued against recording one-off guarantees outside the core accounts. However, one participant said he would like to see an option for including guarantees in the core accounts if data are available.

General discussion on all recommendations

264. A number of participants said they had no comments to offer on the topic of guarantees because they have not had sufficient experience with these questions. General comments were:

- some questions need further clarification

- it would be difficult to include one-off guarantees in the core accounts; it is impossible to record anything until the event happens because they are contingent
- concerns about the supplementary accounts or memorandum items because financial derivatives are more difficult than other parts of the accounts
- the AEG and ISWGNA may not have sufficient expertise to handle discussions on increasingly complex financial derivatives
- it is best to keep guarantees out of the core accounts because of some uncertainties in concepts/practice at this time but they should be treated consistently with transactions and stocks in the core accounts
- there are two sets of transactions, one connected with a loan and the other is a type of insurance contract
- it is not such a big question to handle in cases where market values are involved.

265. The Chair summed up by saying it is clear that the majority is in favour of accepting the recommendations in principle. There are a number of details that require clarification in practice particularly the question of consistency where treatment of activation of a guarantee being variously described as a subsidy and a capital transfer. Recording the various transactions concerning activation needs to be described in greater detail.

266. The Chair proposed that Anne Harrison, Rob Dippelsman and Ivo Havinga should work with Reimund Mink and Lucie Laliberté to produce a revised version of the paper for e-discussion.

Summary conclusions

Decisions

267. A clear majority of the AEG was in favour of accepting all the recommendations in principle. However, a number of details need to be clarified (e.g. a payment appears to be treated as a capital transfer in one part of the paper and as a current transfer in another, and the exact nature of the parallel with insurance).

268. The AEG agreed that a revised version of the paper combining the granting and activation of guarantees should be prepared for e-discussion.

Merchanting

Issue 41: Paper SNA/M1.05.14; for information

Description of the issue

"Merchanting" is a term used in BPM5 for the activity of trading in goods that do not enter the territory of the trader. In such a case, the treatment is to report only the margin earned as an inflow into the territory of the trader. In cases in which the trade is not concluded during the accounting period, changes in inventories are shown as imports (negative if inventories decrease). The issue is not covered in the 1993 SNA.

Presentation

269. The paper for this session (document number SNA/M1.05/14; Issue 41) was written by Hidetoshi Takeda and presented by Robert Dippelsman. The session was chaired by Adriaan Bloem.

270. The presentation started with an example to illustrate the questions underlying merchanting.

271. A wholesaler in Country A buys goods from Country B for 80 and then resells the goods in Country C for 100. The BPM5 treatment is that, if the goods pass through Country A, then A records imports of goods of 80 and exports of goods of 100.

272. An exception may arise when merchants or commodity dealers buy commodities or other goods from non-residents and then sell them again to non-residents within the same accounting period without the commodities actually entering the economy in which the merchants are resident. In this case, a change of ownership of the goods bought by A from B occurs but is ignored in the accounts. To continue the previous example, if the goods do not pass through A, then A records exports of merchanting services of 20. In both cases, Country B records an export of 80 and Country C records an import of goods of 100. In the first case, B exports 80 to A, in the second case B exports 80 to C directly.

273. The difference between the receipts and the sales of such dealers is treated as measuring the value of the services they provide and recorded under exports or imports of services. If, however, the goods are not resold within the same accounting period, the purchases have to be recorded as imports of goods which are temporarily held in inventory, and when they are sold abroad in a later period they should be treated as negative imports.

274. More complex cases arise in practice. One case is where the merchant is a pure speculator (e.g. on the oil or gold market) rather than a wholesaler so the difference is entirely holding gain, or a holding loss. Another case arises when the transactions straddle the reporting period and the three entities involved are all related.

275. In practice, the "merchant" may be managing a production and distribution process without physically holding the goods, or it may be a case of transfer pricing.

276. The following concerns arise about the treatment of merchanting:

(a) merchanting is a residual which includes the value of wholesaling services and it includes holding gains/losses

(b) commodity arbitrage and speculation are important components of merchanting

(c) ignoring a change in ownership which legally takes place gives inappropriate balance sheet entries

(d) it is not consistent with the treatment of other wholesale margins on exports, where the value of the export includes the wholesale margin

(e) merchanting is not shown for imports, so it is asymmetric

(f) the link between the margin and the associated goods flows is lost

(g) it results in a quite different treatment to that of goods that are delivered through the merchant's economy

(h) there is possibly a different treatment of the same transaction in national and currency union data

(i) changes in inventories as imports or negative imports are hard to interpret

(j) however, without the current BPM treatment of merchanting, goods flows would be larger and include even more of the "straight-in straight-out" goods flows

(k) services would be lower

(l) inexplicable results would arise, such as Hong Kong wheat exports, etc.

Questions

277. The following questions were posed for the AEG to consider:

(a) Should the change of ownership in goods subject to merchanting be recorded as imports and exports of goods in merchandise?

(b) Alternatively, should the change of ownership be ignored in this case and the difference in value between the selling price and buying price be treated as a service provided by the merchant to the purchaser of his goods?

(c) If (b), should the disposal of the goods in a subsequent period be recorded as negative imports at the original value (as now) or as exports at the original value (leaving an export of services)?

(d) If (a), should a new subcategory of goods under merchanting be introduced under the trade in goods category?

278. BOPCOM had considered these questions at its recent meeting. The Committee expressed its objective as being to properly reflect complex global production and marketing processes while taking into account concerns about both deviating from the change of ownership principle and avoiding excessive grossing up of export and import flows.

279. The Committee proposed that a working group be set up to investigate further. In the meantime, it suggested that the AEG discuss the questions now, but that a decision be delayed.

Discussion

280. The discussion focussed on the implications of the proposed change in treatment. For example, it would have a massive impact on the Netherlands' national accounts because, on a gross basis, the Netherlands would become the largest exporter of computers in the world (e.g. the "origin" of most computer imports into Germany is the Netherlands). The importance of international consistency was stressed and it will be necessary to look more closely at the implications.

281. There was no disagreement with a proposal that merchanting should be recorded on a strict change of ownership basis. However, it is clear that identifying ownership consistently is not straightforward. Merchanting is not being treated like other goods in the balance of payments (where they are treated at purchasers' prices), which gives rise to an anomalous outcome in a supply/use context.

282. The question of handling merchanting in the quarterly accounts also needs to be resolved because of the possibility of the outflows and the return inflows being in different quarters.

Summary conclusions

Observation

283. The AEG noted the potential implications for the national accounts of merchanting. A further issues paper is being prepared on the subject.

Goods sent abroad for processing

Issue 40: Paper SNA/M1.05/16; for decision

Description of the issue

The BPM5 and the 1993 SNA treat goods sent abroad for processing differently. The BPM5, as a practical matter, suggests a convention that all processing be assumed substantial and therefore gross flows are recorded as exports of goods (before processing) and imports of [other]goods after processing, both recorded at their full value. The 1993 SNA only records trade flows in this way when there is substantial processing (reclassification of the good at three-digit CPC). The problem is that no change in ownership of the original goods and thus no transaction covering these takes place. Can a distinction be made between the different levels of processing? It is mentioned that the current treatment of goods for processing in the 1993 SNA was to facilitate input-output analysis. Therefore, any change should take this issue into account.

Presentation

284. The paper for this session (document number SNA/M1.05/16; Issue 40) was presented by Anne Harrison. It was written by Anne Harrison, Rob Dippelsman and Ivo Havinga. The session was chaired by Adriaan Bloem.

285. Previously, a question that has been considered is whether goods sent for processing should be recorded on a gross (i.e. impute a change of ownership) or a net (do not impute any change of ownership) basis. Opinions are divided both in BOPCOM and the AEG.

286. Goods sent from country A to country B for processing and then returned to the same unit in country A are recorded on a gross basis (i.e. a change of ownership is imputed). This means the value of the goods is recorded as an export from A to B and then the (increased) value is recorded as an export from B to A.

287. However, if goods are sent from country A for processing by unit 1 in country B and then sold to unit 2 in country B, the transaction between the unit in A and unit 1 in B would be recorded on a net basis and no change of ownership of the original goods is imputed. Instead, the processing fee is recorded as an export of a service from country B (unit 1) to country A. A similar outcome (of no change in ownership being recorded between the units in A and B) arises if the goods are sent from country A for processing in country B and then on to country C.

288. Exceptions to these rules occur if the unit in country B is an unincorporated subsidiary of that in country A or if the unit in country B is a direct investment enterprise of that in country A.

289. In summary, we have a hybrid system that is not transparent for either compilers or analysts.

290. The accounting implications are that goods out less goods in should be equal to the processing fee. In practice, this will not always be the case because of different data sources being used, different products being recorded, potentially at different times (e.g. goods sent for processing in period t are returned in period t+1after processing), and with holding gains possibly affecting the values recorded.

291. The analytical implications relate to what the processor is doing and who assumes the risk of production. Also, there is a major interaction with outsourcing and the ratio of imports to domestic production will be affected by the treatment (gross or net) adopted. A further question that needs to be considered is whether processing is a good or a service.

292. The most straightforward alternatives are to always impute a change of ownership or to never impute a change of ownership. Either alternative will result in a significant change, especially for input-output tables. Similar rules should apply for domestic processing as for international processing and changing the rules for domestic processing might have a more significant impact than that for international processing, particularly for supply-use analysis.

Recommendations/questions

293. The following questions were posed for AEG's consideration

(a) Should the national accounts always impute a change of ownership for goods going abroad?

(b) Should the national accounts never impute a change of ownership for goods going abroad?

(c) Should the national accounts retain the present situation?

(d) If the answer to questions (a) or (b) is "yes" should the national accounts make the same sorts of changes for domestic processing?

294. Questions to be asked of BOPCOM were:

(a) If AEG says to always impute change, would BOPCOM follow or opt for never?

(b) If the latter, would this apply to unincorporated establishments and to direct investment enterprises?

295. Questions to be asked of both groups were:

(a) However processing is recorded, robust valuation needs the values of goods in and out (from Customs) reconciled with processing fees (from business)

(b) Does BOPCOM support provision of these data?

Discussion

296. At the AEG meeting last December it seemed as though this was a fairly simple problem but it is now apparent the question is potentially major with changes required in the description of production and in the approach to input-output in the SNA. Several participants made the point that the present situation is not viable.

297. There was broad agreement with the proposition that processing should be treated in the same way whether it is carried out abroad or domestically. Arguments on practical grounds were presented both for and against showing a change of ownership.

298. Input-output statisticians generally favour imputing a change of ownership for all goods going abroad for processing but this is likely to become increasingly difficult. If goods are exported from A to B for processing and then exported to the C, they will be “lost” from the trade statistics unless a change of ownership is imputed. In addition, some participants favoured treating all exports and imports as involving a change of ownership for practical reasons. Even some countries with “free zones” only have data readily available on total exports and imports in a lot of cases and so it is impossible to identify the goods affected.

299. Other participants spoke against imputing a change in ownership. Problems with data sources can affect not only the split of the value into a service fee and the value of the good but the overall value which is affected by how the parent company dictates its prices (including the case of transfer pricing). This distorts the value flows so imputing a change of ownership does not solve the exports/imports problem. Transfer pricing is likely to lower GDP and distort any ratios involving exports.

300. The benefits to an economy of locating processing businesses in an economic “free zone” arise from the processing, which is treated as a service charge, and so a change of ownership of such goods should not be imputed.

301. In practice, it is difficult to obtain relevant information to impute a change of ownership for goods imported and exported in different periods. A lot of imputation would be required.

302. In principle, it would be desirable to have the data to support measuring all the flows. . However, there is a problem with data sources other than exports and imports because enterprise data may not reflect all the flows consistently with the trade flows.

303. The Chair summed up that there is general agreement that the current situation is undesirable. A clear majority of participants chose to never impute a change of ownership in this situation. There was general agreement about having a consistent treatment for processing such goods abroad and domestically.

Summary conclusions

Decisions

304. The AEG agreed that the current situation is undesirable. There was a clear majority for never imputing a change of ownership for goods being sent abroad for processing. The same approach of not imputing change of ownership for goods being processed domestically should be adopted in all cases even if it is between related enterprises.

Migrants’ transfers

Issue 38b: Papers SNA/M1.05/13.1 and 13.2; for decision after e-discussion

Description of the issue

The flows of goods and changes in the financial account arising from a change in residence of individuals are treated as imputed transactions in the BPM5, which are offset in the capital account by capital transfers called migrants’ transfers. The 1993 SNA is not explicit on this question. Because no change in ownership occurs, it is proposed that changes in financial

claims and liabilities due to a change in residence of individuals be treated as a reclassification in the other changes in volume account.

Presentation

305. The substantive paper for this session (document number SNA/M1.05/13.; Issue 38b) was written by Jens Reinke . The results of the e-discussion were presented by Ivo Havinga. The session was chaired by Adriaan Bloem.

306. The movement of personal effects and financial assets when individuals change residence from one country to another are treated as capital transfers in the balance of payments while migrants' effects are treated as exports and imports in the 1993 SNA. However, in reality no change of ownership takes place. It is proposed to remove migrant transfers from the flow accounts in both the BoP and the SNA.

307. Comments made as part of the e-discussion indicate strong support for the idea that corporations do not change residence the same way people do. For corporations, movement of fixed assets from one country to another should be recorded as divestment and exports in one country and imports and capital formation in the other country.

308. The e-discussion showed that most of the AEG members participating support the recommendations on migrant transfers, but that corporations should not necessarily be treated the same way.

Recommendations/questions

309. The following questions were presented for the AEG's consideration:

(a) Does the Group agree with the proposal not to record migrants' personal effects under imports and exports of goods (and to amend SNA paragraph 14.92 accordingly)?

(b) Would the Group like to clarify the recording of the changes in financial assets and liabilities due to changes in residence? If so, should the changes in assets and liabilities position of individuals who change their residence be recorded under "other changes in volume of assets"?

(c) Should the same principles apply to corporations that change their residence (either due to relocation or to boundary changes)?

(d) Should clarifying text be added to SNA chapters 11 and 12, so that the special nature of these economic events is explicitly outlined?

Discussion

310. It was pointed out that this question is relevant for corporations. Under EU law a company can be created which can move from country to country within the EU; in other words, a company can "migrate". However, what looks like a "company migration" is often simply a transaction between two corporations. It will be necessary to make sure the SNA wording covers the possibility of the migration of a corporation and to set out the circumstances in which this is possible.

Summary conclusions

Decisions

311. The AEG accepted the recommendations on migrant transfers as far as households are concerned.

312. It was confirmed that enterprises seldom change location; in general an enterprise in one location is dissolved and another is formed in another location. However, there were specific but limited examples (for example within the European Union) where an enterprise may change residence, in which case the same rules would apply as for households.

Residence of households: non-permanent workers

Issue 39c: Papers SNA/M1.05/15.1 and 15.2; for decision after e-discussion

Description of the issue

In the case of non-permanent workers with connections to two or more territories, it would be useful to prepare a supplementary presentation for countries where the number of non-permanent resident persons is significant, bringing together relevant components of contract services, compensation of employees, workers' remittances and migrants' transfers with short-term non-resident workers. Also harmonization of the residence concept with demographic, tourism, and migration statistics should be sought and any remaining differences spelled out.

Presentation

313. The substantive paper for this session (document number SNA/M1.05/15.; Issue 39c) was written by Alessandra Alfieri and Ivo Havinga. The results of the e-discussion were presented by Ivo Havinga. It was. The session was chaired by Adriaan Bloem.

314. Non-permanent workers are increasingly important in the globalised world. It is not possible to identify the universe satisfactorily so an e-discussion was held to obtain AEG Members' views on eliminating the concept of migrant and to replace the item "workers' remittances" with a wider concept of personal transfers.

Recommendations/questions

315. It was suggested that:

(a) There was no need for the concept of "migrant" in the SNA or BPM; non-resident was sufficient.

(b) The standard item "workers' remittances" should be replaced by "personal transfers". This would include all transfers from households in one country to households in another whether or not the source of the transfer was income from employment and whether or not the households were related.

(c) In addition there should be a supplementary item called "personal remittances" which comprised (on the receipts side) compensation of employees earned abroad, personal transfers, current transfers payable by other institutional units to households and current transfers from any institutional unit to NPISHs.

(d) Personal transfers and personal remittances could appear both including and excluding capital transfers between households and from other institutional units to households.

Discussion

316. The conclusion of the consultation was that all the AEG members participating supported the recommendations on non-permanent workers. This was accepted and there was no further discussion on this issue

Summary conclusions

Decisions

317. The AEG accepted the recommendations on non-permanent workers.

Residence of households: ships' crew and patients

Issue 39c: Papers SNA/M1.05/15.3 and 15.4; for decision after e-discussion

Description of the issue

There is an exception in both SNA and BPM to the general rule on residence for employees in the case of both ships' crew and patients. The question was raised about whether this exception should be continued.

Presentation

318. The substantive paper for this session (document number SNA/M1.05/15.3; Issue 39c) was written by Robert Dippelsman. The results of the e-dicussion were presented by Ivo Havinga. The session was chaired by Adriaan Bloem.

319. An e-discussion was held to determine the AEG members' opinions on the proposal to retain the current treatment of ships' crews as residents of the economy where they spend most of their time other than on board and patients as residents of their home country.

Recommendations/questions

320. The following questions were presented for the AEG's consideration:

(a) Does the Group agree with the continuation of the existing treatment of ships' crew and similar cases as residents of the economy where they spend the most time other than on board?

(b) Does the Group agree with the continuation of the existing treatment of patients as residents of the home country?

Discussion

321. The conclusion of the consultation was that all the AEG members participating supported the recommendations on ships' crews and patients. There was no further discussion on this issue

Summary conclusions

Decisions

322. The AEG accepted the recommendations on ships' crews and patients.

Multi-territory enterprises - basis for allocation

Issue 25e: Papers SNA/M1.05/27.1 and 27.2; for decision after e-discussion

Description of the issue

With the appearance of multi-territory enterprises that operate as a single legal entity in more than one territory, principles have to be adopted whether to allocate the unit to the predominant territory or to use pro rata splitting. Principles of recognizing these ancillary units as separate institutional units should take into account different residence and the institutional sector of the (ultimate beneficiary) owner, sources of information, etc. Moreover, the sectorisation of those units has to be determined.

Presentation

323. The substantive paper for this session (document number SNA/M1.05/27.; Issue 25c) was written by Neil Patterson. The results of he e-discussion were presented by Ivo Havinga. The session was chaired by Adriaan Bloem.

324. An e-discussion was held to determine the AEG's views on multi-territory enterprises, which are defined as single enterprises with substantial operations in more than one territory. The proposition considered in the e-discussion was to extend the general principles set out in BPM5 to all activities. If this was agreed, the complexities of practical implementation should be acknowledged and the need for cooperation between compilers in different countries should be explicitly mentioned.

325. The conclusion of the e-discussion was that all AEG members participating supported the recommendation to prorate multi-territory enterprises and enterprises in joint sovereignty zones, but did not make suggestions on possible criteria.

Recommendations/questions

326. The following questions were presented for the AEG's consideration:

(a) Do you agree with the prorating of multi-territory enterprises and enterprises in joint sovereignty zones?

(b) If so, would you prefer that the manuals suggest;

i. a range of possible criteria for prorating?

ii. a particular criterion? If so, which criterion?

(c) To cover the possibility that (i) might be chosen, other suggestions on possible criteria for inclusion in the list would be welcome.

Discussion

327. A suggestion was made that the term “joint jurisdiction” should be mentioned in addition to “joint sovereignty” because the latter could have specific legal implications in some countries.

Summary conclusions

Decisions

328. The AEG accepted the recommendation of the prorating of multi-territory enterprises and enterprises in joint sovereignty and joint jurisdiction zones, but did not make suggestions on additional possible criteria.

Reverse transactions

Issue 1: Papers SNA/M1.05/25.1 and 25.2; for decision after e-discussion

Description of the issue

A repurchase agreement (repo) involves the sale of securities or other assets with a commitment to repurchase equivalent assets at a specified price. The right to on-selling has become almost universal. The 1993 SNA and the BPM5 treatment of repos is similar to that of a collateralized loan or as other deposits if repos involve liabilities classified under national measures of broad money. Should the 1993 SNA treatment be revised?

Presentation

329. The substantive paper for this session (document number SNA/M1.05/22.1; Issue 1) was written by John Joisce. The results of the e-discussion were presented by Ivo Havinga. The session was chaired by Adriaan Bloem.

330. There was no consensus at the last AEG meeting over the treatment of reverse transactions.

Recommendations/questions

331. The AEG suggested an e-discussion to obtain reactions to the following proposals:

(a) there should be no change to the current SNA treatment

(b) the issue should remain on the research agenda

(c) the following clarifications should be added:

(i) added explanations on securities lending and gold loans

(ii) remove reference about not being able to on-sell

(iii) treating short positions as negative assets.

332. Comments made during the e-discussion were that securities lending and gold loans cannot be treated as collateral loans because no lending takes place and that the negative asset adjustment is not generally acceptable.

333. The outcome of the e-discussion was that most of the AEG members participating supported the recommendations on reverse transactions.

Discussion

334. One participant said that the issue cannot be satisfactorily resolved at the moment. The decision taken, which is to retain the current SNA treatment and then add entries for negative positions because of the problems with the current treatment, presupposes a conclusion which is premature. The SNA should recognise that this is an unresolved issue and, as such, should not be prescriptive about the treatment.

Summary conclusions

Decisions

335. The AEG accepted the recommendations on reverse transactions.

Non-performing loans

Issues 4a, 4b, 38c: Papers SNA.M1.05/21; for decision

Description of the issue

4a. Non-performing loans

The Thai authorities had asked the ISWGNA for clarification as to what extent unpaid interest on non-performing loans should be accrued (considering that the financial intermediation services indirectly measured on such interest may affect the GDP). The purpose of the review is to determine what criteria should be applied when writing-off non-performing loans and to make sure that they are consistent with the other major macroeconomic statistical systems (balance of payments, government finance, and money and banking statistics).

4b. Valuation of loans and deposits; Write-off and interest accrual on impaired loans

The valuation of loans and deposits positions is subject to alternative perspectives. Nominal or face value valuation might be misleading because of the risk of default and/or changes in interest rates. This difference becomes apparent when the loans are traded. However, these valuation issues are equally applicable to non-traded loans. Business accounting standards are considering using the concept of "fair value" for the valuation of loans as if they were traded.

38c. Application of accrual principles to debt in arrears

The time-of-recording principle for scheduled payment is different between BPM5, External Debt Guide, and GFSM2001 on the one hand and the 1993 SNA on the other hand. The former use the due-for-payment date basis involving imputation of transactions that the liability has been repaid and replaced by a short-term debt. The latter uses an accrual basis involving no imputation of transactions but continuing to show arrears in the same instrument until the liability is extinguished. If the accrual basis is followed, sub-headings or memorandum items for all or selected arrears might be introduced.

Presentation

336. The paper for this session (document number SNA/M1.05/21; Issues 4a, 4b, 38c) was written by Adriaan Bloem and Russell Freeman and presented by Adriaan Bloem. The session was chaired by Ivo Havinga.

337. The conclusions of the December 2004 AEG Meeting were that the updated 1993 SNA should:

(a) continue to measure loans at nominal value irrespective of their quality

(b) show mandatory memorandum items on both the market-equivalent value of loans, and interest arrears on non-performing loans (NPLs)

(c) record interest as continuing to accrue, even if no payments are made.

338. The following questions were raised for clarification after the discussion at the December 2004 AEG meeting:

(a) clarify the definition of NPLs

(b) specify the exact nature of the memorandum items

(c) provide a worked example of the accounts showing the memorandum items

(d) show the implications of the recommendations for the recording of FISIM

(e) discuss whether the treatment should be extended to other financial instruments such as trade credit.

339. The proposed definition of NPLs is as follows:

(a) A loan is nonperforming when payments of interest and/or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons - such as a debtor filing for bankruptcy - to doubt that payments will be made in full.

(b) After a loan is classified as non-performing, it (or any replacement loans) should remain classified as such until payments are received and/or the principle is written off on this or subsequent loans that replace the original.

340. The memorandum items recommended for inclusion are the market equivalent value of non-performing loans and interest arrears on NPLs. The closest approximation to market equivalent value is fair value which is “the value that approximates the value that would arise from a market transaction between two parties”. Fair value can be established using transactions in comparable instruments, or using the discounted present value of cash flows. In the absence of fair value data, the memorandum item will have to use a second-best approach and show nominal value less expected loan losses.

341. Arrears are defined as the amounts that are past due for payment and are unpaid. They include both principal and interest. The 90-day definition proposed to identify non-performing loans is reasonably generous. The potential for impairment may well be identified earlier, but possibly at the expense of identifying many minor and temporary cases. Once a loan is classified as an NPL, the memorandum item for the loan would relate to the whole value of the loan and not just to the amount of arrears.

342. The logic of the national accounts requires that FISIM should be calculated on interest arrears on NPLs. FISIM is a measure of output and all output is to be included whether paid for or not. NPLs may become performing again and loan and accrued interest may be paid.

343. The proposal presented in the paper is to make the memorandum items on NPLs compulsory for the financial corporations sector, with an extension to government (compulsory) and other sectors (not compulsory) and also with an extension to other instruments.

Recommendations/questions

344. At the end of the presentation AEG members were asked whether they agreed with:

(a) the proposed definition of NPLs

(b) the proposal for valuing NPLs

(c) the presentation of the memorandum items

(d) the treatment of FISIM on NPLs

(e) the extension to government (compulsory) and other sectors (not compulsory)

(f) the extension to other instruments.

Discussion

Recommendation (a) - definition of NPLs; and recommendation (b) – valuing NPLs

345. Several participants spoke in support of the definition but with some minor suggestions or clarifications. In particular, the AEG agreed that the definition is acceptable as a guideline but it should not be prescriptive.

Recommendation (b) – valuation of the memorandum items referring to NPLs

346. The AEG agreed that the market valuation for the memorandum items for NPLs should be a market equivalent value. If a fair value figure is not available, an acceptable alternative is nominal value less expected loan losses.

Recommendation (c) – presentation of memorandum items

347. The first view expressed in the discussion was that it is impossible to show the link from the opening balance to the closing balance if the value of NPLs is based on nominal value less expected loan losses. Therefore, they will have to be shown in supplementary accounts. The actual presentation depends on the data that are available. It is a very important with respect to the Paris Club rescheduling of debt and its implications for developing countries. The questions facing developed and developing countries are different but there should be no divergence in the underlying principles.

348. There was discussion about whether these memorandum items would appear in the core accounts, and thus be “mandatory” or whether they would simply appear in supplementary accounts. It was agreed the use of the term “mandatory” was not appropriate for the SNA and instead the distinction would be between standard items and supplementary items. The accounts should present as much information as possible on the stocks and flows associated with NPLs. The updated SNA should set out an optional presentation with some new standard elements so countries can choose how much detail they show.

349. Reimund Mink volunteered that the ECB will develop a presentation that reconciles stocks and flows.

Recommendation (d) – including FISIM on NPLs

350. Although the AEG appeared to be comfortable with the idea of imputing values for NPLs, some participants were less comfortable with including such imputations as memorandum items in the core accounts because they would have an impact on production. However, the question was first raised by Thailand during the late 1990s monetary crisis when GDP was growing artificially fast as a result of continuing to include interest and thus FISIM on NPLs. There are no balance sheets in developing countries, so they felt it important that the consequences of NPLs should not distort GDP.

351. The discussion commenced with the view that there is no sense in including FISIM on NPLs because when banks set their charges they take account of expected NPLs. An opposing view was that banks look at what the traffic can bear and not at what they expect will ultimately get paid. In any case, output is being generated and it is not relevant whether it is ultimately paid for or not. A question was raised about the period for which FISIM continues to accrue. For example, if a loan is non-performing for 15 years is the bank still providing banking services on that loan (Japan is an example where banks held NPLs for this long)?

352. An example was presented of a bank offering a loan at 8%, and this is split into 5% interest and 3% FISIM. If the borrower does not pay, there is unpaid FISIM of 3% but this cannot be seen in the accounts. The bank still accrues interest at 8% because banks are not interested in separately identifying FISIM, so they show interest arrears accruing at 8% and not 5%. The current explanation of arrears is wrong; it should include unpaid FISIM but it does not. The proposal to include FISIM and to explicitly show the element of FISIM related to NPLs in the accounts would need to be a clarification in the SNA.

353. Other points raised during this part of the discussion were:

- some service continues to be provided on NPLs but an alternative to recording this explicitly could be to show a higher level of FISIM on the performing loans
- exclude FISIM on NPLs and show it as unpaid interest
- there is a risk of having another inconsistency in the system if the SNA continues to show interest accruing on NPLs where the banks do not
- unpaid interest could be accrued into loans but it is not possible to have accounts payable for FISIM
- the liability for unpaid FISIM has to be reflected somewhere
- recording loans at their nominal value is not realistic so FISIM has to be estimated in conjunction with recording loans at market value
- interest should be accrued according to the loan contract; for example, if it is a 1-year loan then interest and FISIM should be calculated until the end of that 1-year period and then interest would stop accruing at that point.

354. The discussion then focussed on the potential period for which FISIM should continue to be calculated. One suggestion was to accrue FISIM for 90 days after a loan becomes non-performing. However, this was considered to be too short, being only one quarter. Some of these loans could

become performing again and the question would then arise as to how would this be written this back into the production account.

355. Anne Harrison said there are three alternatives that need to be set out:

(a) continue to estimate FISIM on NPLs and allocate to the corresponding borrowers, but consider how unpaid FISIM is recorded in the accounts in such a way as to increment principal outstanding

(b) estimate FISIM on interest received (rather than receivable) and on interest payable so that FISIM is not attributed to NPLs

(c) estimate FISIM on a basis including NPLs but allocate the whole amount of FISIM only to those borrowers currently servicing their loans.

356. Anne volunteered to put together an example of these 3 scenarios up for an e-discussion. She said she wants to explore all the consequences of alterative treatments of NPLs on all parts or the system including balance sheets.

357. Several suggestions were made about the examples. They should take account of situations where the loan is unpaid but the collateral the borrower has provided (which is often less than the loan) is forfeited. It should be a worked example that will be designed show the impact of alternative proposals. Adriaan Bloem, Peter Harper and Reimund Mink will collaborate with Anne in producing the example.

Recommendation (e) – extension to government and other sectors

358. This recommendation was agreed at the AEG meeting in December 2004.

Recommendation (f) – extension to other instruments

359. The discussion commenced with the view that, conceptually, this recommendation should be accepted but there will be problems in practice. However, countries should be encouraged to do it if the data are available to do so.

Summary

360. The Chair summarised the discussion on all the recommendations

- the definition was accepted but it should be considered as a guideline rather than being prescriptive
- valuation of the memorandum item for loans should be on the basis of market-equivalent values
- details should be presented in memorandum items
- it would be useful to have an integrated example showing the links between stocks and flows
- the terms to be used in the SNA will refer to “standard items” and “supplementary items” rather than “mandatory”
- examples will be set up to demonstrate the impact of different treatments of FISIM
- the extension to government and other sectors was agreed at the last meeting

- the principle regarding the extension to other instruments will be set out for those countries that wish to do so
- FISIM will be recorded only until the loan expires.

361. Anne Harrison's worked examples will provide more information on which to base a firm decision on the outstanding points. Discussions will continue via an e-discussion with a view to reaching agreement before the next AEG meeting.

Summary conclusions

Decisions

362. The AEG agreed with the definition proposed[6]. The AEG considered that it should be used as an indicative guideline rather than being prescriptive.

363. The AEG agreed that the valuation basis for NPLs should be a market equivalent valuation. If a fair value figure is not available, an acceptable alternative is nominal value less expected loan losses.

364. The AEG agreed that it would be desirable to have an explanatory presentation in the SNA showing how the memorandum item for stocks of loans and that for flows of interest are connected, even if in practice the memorandum items were shown without the linking information.

365. A term such as "standard item" should be used in the SNA text rather than a more didactic term such as "mandatory" or "compulsory".

366. The discussion on the treatment of FISIM concluded that there are potential alternative methods that could be used and each of these needs to be documented. Anne Harrison with the help of others volunteered to put together an example for each of the following three scenarios and present them to the AEG for an e-discussion:

(a) continue to estimate FISIM on NPLs and allocate to the corresponding borrowers, but consider how unpaid FISIM is recorded in the accounts in such a way as to increment principal outstanding

(b) estimate FISIM on interest received (rather than receivable) and on interest payable so that FISIM is not attributed to NPLs

(c) estimate FISIM on a basis including NPLs but allocate the whole amount of FISIM only to those borrowers currently servicing their loans.

367. The AEG would like further consideration of how long interest accrues and for how long FISIM is calculated on an NPL.

---

6 Essentially that a loan is non-performing when payments of interest and /or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalised, refinanced or delayed by agreement, or payments are less than 90 days overdue but there are other good reasons to doubt that payments will be made in full. For greater elaboration, please refer to the issues paper.

368. The decision made at the December 2004 AEG meeting to show as standard items NPLs for financial institutions and government as creditors was reconfirmed. They may be shown for other sectors as supplementary items.

369. An extension of the treatment of non-performance on other instruments was considered to be conceptually correct and can be shown as supplementary items.

Distinction between loans and deposits

Issue 44c: Paper SNA/M1.05/10.2; For decision

Description of the issue

Current international statistical standards include a distinction between deposits and loans. However, the criteria to make the distinction are not very clear and may require additional guidance in practice. Recent financial innovations raise questions about the continuing analytical usefulness of the distinction. A particular problem is when a position between two parties, especially financial intermediaries, is seen as a deposit by one party and a loan by the other.

Presentation

370. The paper for this session (document number SNA/M1.05/10.2; Issue 44c) was written by Pierre Sola and Carlos Sánchez Muñoz and presented by Robert Dippelsman. The session was chaired by Ivo Havinga.

371. The 1993 SNA defines "Transferable deposits" and "other deposits", with the latter including "all claims, other than transferable deposits, on the central bank, other depository institutions, government units, and in some cases other institutional units that are represented by evidence of deposit" (para 11.72). In addition, the 1993 SNA defined loans as "Loans include all financial assets that (a) are created when creditors lend funds directly to debtors, (b) are evidenced by non-negotiable instruments, or (c) for which the lender receives no security evidencing the transaction" (para 11.83).

372. These definitions are not clear in practice. For example, when both parties are banks, it is particularly hard to classify loans and deposits consistently. Additional operational guidance is required. ESA95 recognises the problem and adds the criterion of who is taking the initiative in an attempt to distinguish loans from deposits. In addition, the convention is based on who the borrower is. Short-term liabilities of monetary and financial institutions are always deemed to be deposits.

Recommendations/questions

373. The following questions were posed for the AEG's consideration:

(a) What are the views of AEG members on the analytical use of the split between deposits and loans?

(b) If the continued usefulness of this split is confirmed, do AEG members agree that current international standards do not provide clear criteria to perform such a distinction?

(c) Do AEG members have any preference for any of the criteria mentioned in the note:

(i) looking at who takes the initiative (and whether or not a distinction should be made between short-term and long-term instruments);

(ii) taking into account the nature of the borrower (banks ≈ deposits / non-banks ≈ loans);

(iii) defining in a very precise way which instruments meet the definition of "transferable" and "other deposits";

(iv) considering the representation in the documents that evidence loans or deposits; etc.?

Discussion

Question (a)

374. There was support to maintain the distinction on the grounds that the distinction between loans and deposits needs to be made for calculating FISIM. Retaining the distinction also would maintain consistency with the IMF's Monetary and Financial Manual. In addition, users find deposits and loans analytically useful in the balance sheets.

375. Some participants expressed the view that the distinction between loans and deposits is not required in their countries because their accounts are based around identifying assets/liabilities, which are more clearly definable.

376. The Chair summed up the outcome as a decision to maintain the distinction between loans and deposits for a number of reasons, including calculating FISIM and the analytical requirements of national accounts users.

Question (b)

377. There was little discussion on this question because most AEG members felt the question is one that is primarily of concern to financial accountants. It may be useful to present it at the OECD financial accounts meeting.

378. The only points arising from the discussion were that some more precise operational guidelines are required. It was noted that ESA95 provides more detailed information than the 1993 SNA.

Question (c)

379. The discussion opened with a suggestion being made about the criteria that could be used to identify a deposit. For example, a deposit could potentially be identified on the basis of whether a creditor can unilaterally terminate an arrangement. There was some discussion as to whether a long-term deposit would meet this criterion and whether, in practice, a long-term deposit is really a loan. It was suggested it would be better to distinguish deposits and loans on the basis of who is doing the depositing/lending. It may be necessary to look at the central bank's role in deposits/loans and the interaction with the government.

380. Several participants supported a suggestion to ask financial accountants for further guidance prior to making a decision. In the past, financial accountants have suggested a list of indicators to assist in making a decision. However, it is not an easy task to identify where, when and how to get the financial accountants involved. The same question arose at BOPCOM. The OECD Financial Accounts Meeting is one possible forum to take this forward. Perhaps a better approach would be

for the AEG to take a decision and ask the ISWGNA to get the financial accountants to check it. The ISWGNA should also obtain input from users as to why they think such distinctions are analytically useful.

381. The Chair summarised the outcome as the ISWGNA should prepare a proposal in conjunction with some financial accountants, with the final decision to be made via an e-discussion.

Summary conclusions

Decisions

382. The AEG agreed that the updated SNA should maintain a distinction between loans and deposits.

383. The AEG agreed that current international standards do not provide sufficiently clear criteria to make a distinction between loans and deposits. Therefore there should be further consultation with experts to formulate improved operational guidelines to be set out in the updated SNA.

Fees on securities lending and reversible gold transactions

Issue 43c: Paper SNA/M1.05/12; for decision

Description of the issue

Neither the 1993 SNA nor BPM5 discuss the question of fees payable on securities lending and gold loans. The fee for securities lending is for putting a financial instrument at the disposal of another unit. However, it does not fit with the definition of interest when the legal ownership is transferred but the economic risks and rewards of the ownership remain with the original owner. The fee payable on gold loans appears to be a payment for services as long as gold is not treated as a financial asset.

Presentation

384. The paper for this session (document number SNA/M1.05/12; Issue 43c) was written by Manik Shrestha and presented by Robert Dippelsman. The session was chaired by Ivo Havinga.

Fees on securities lending

385. Fees on securities lending and reversible gold transactions are not covered in the 1993 SNA.

386. Securities lending relates to the delivery of securities, to be returned after a given period. In effect, it is a type of reverse transaction. The provider of the securities receives a fee. It is a process often used by pension funds etc. to boost returns. The receiver of the securities is typically a dealer who has a short position, so the securities are on-sold. The receiver of the securities often will provide other securities as collateral. The same sort of process can be carried out with monetary and non-monetary gold.

387. One concern is that no specific guidelines are set out in the 1993 SNA on the nature of the fee. It seems to be property income because a financial asset is being put at the disposal of another entity. However, it is the legal title to the security, rather than funds, that is provided.

388. Another concern is that the process does not fit into existing property income categories. (Property incomes accrue when the owners of financial assets put financial resources at the disposal of other institutional units, but interest is the return of the creditor from the debtor; and dividends are the return from the share issuer to the party that supplies equity funds.)

389. There are three possible alternatives for treating these transactions:

(a) to create a new property income category

(b) to classify according to the instrument loaned (dividends for shares; interest for debt instrument), but it is different to interest and dividends

(c) to treat as entirely interest, (although not strictly interest this would be simple to implement).

Fees on reversible gold transactions

390. Similar arrangements can arise involving gold (reversible gold transactions). Gold can either be a financial asset (monetary gold) or a non-financial asset, depending on who the owner is. A fee on financial assets is property income, while a fee on produced assets is a service. A paper on the classification of non-monetary gold will be submitted to the January 2006 AEG meeting.

391. The proposed treatment is that allocated gold accounts can be considered as being ownership of specific gold and are non-financial assets. On the other hand, unallocated gold accounts are financial assets (an obligation of the dealer) rather than ownership of gold.

Recommendations/questions

392. The following questions were posed for the AEG's consideration:

(a) What are the views of AEG members concerning the three alternatives for the treatment of the fees associated with securities lending and reversible gold transactions, namely:

(i) investment (property) income

(ii) financial service

(iii) a blended approach whereby it would be treated as financial services if the "lender" were a financial intermediary, and as investment (property) income in all other cases?

(b) If treated as investment (property) income, under which category should securities and gold lending fees be included:

(i) interest

(ii) dividends, or

(iii) some other category?

Discussion

Fees on securities lending

393. As background , the AEG was informed that a proposal presented to BOPCOM was that these fees should be treated as financial services, if they were produced by a financial intermediary

but BOPCOM did not accept this proposal. In practice, a custodian keeps records and communicates with the user and owner, which implies it is a service.

394. There was little support within the AEG for this treatment with most members considering that treating it as property income would be the "least worst" of the possible alternatives. The AEG did not consider it to be a hugely important question. It is not a service, the blended approach is unattractive so that leaves the only possibility being to include the fees in property income. One participant suggested that setting up a new property income category could be the best alternative.

395. The Chair summed up the discussion as that treating such fees as interest in all cases is the preferred AEG option.

Fees on reversible gold transactions

396. There was little discussion on this question. The pragmatic solution is to include it all in interest despite some fees effectively being paid for a service because it would be too difficult identify the split in practice. In effect it is a security denominated in gold. The AEG also concluded there is no FISIM involved.

397. Robert Dippelsman said that the paper on financial gold, which has already been written, will be updated to reflect this decision.

Summary conclusions

Decisions

398. The AEG agreed that fees associated with securities lending and reversible gold transactions should be treated as property income. The AEG also noted the value of the fees involved is likely to be very small compared with other property income items.

399. The AEG agreed that fees on securities lending and reversible gold transactions should be recorded entirely as interest, including amounts paid on loans of allocated [non-financial] gold.

400. The AEG noted that there is no FISIM associated with the interest recorded for these fees.

Retained earnings on mutual funds and other collective investment schemes

Issue 42: Papers SNA/M1.05/17.1 and 17.2; for decision

Description of the issue

In the 1993 SNA retained earnings of an entity are generally treated as the income and saving of the entity, rather than the owner. However, exceptions are made for life insurance companies, pension funds and foreign direct investment companies, where there is an imputed flow to the policyholders, beneficiaries, and owners, with an equal financial account flow. The ESA 95 introduces an imputed transaction for the retained earnings of mutual funds where income is attributed to the investors and then reinvested in the fund. That treatment brings about consistency with the treatment of life insurance and pension funds which are other types of collective investment schemes.

Presentation

401. Two papers were presented for this session (document number SNA/M1.05/17.1 and 17.2; Issue 42). One was written by John Joisce and one by ECB and Eurostat. They were presented by Reimund Mink. The session was chaired by Adriaan Bloem.

402. The 1993 SNA and BPM5 treatment is for interest on loans, deposits and bonds to be accrued, as if paid out and reinvested. For insurance, interest is treated as property income attributed to policy holders which is returned as premium supplements. For pension funds, interest is also reinvested in the fund. The 1993 SNA and BPM5 do not provide recommendations about mutual funds.

403. The IMF has identified five options:

(a) the status quo as in 1993 SNA and BPM5

(b) the ESA95 approach which distributes part of the property income as interest and part as dividends

(c) a modified ESA approach which would use a new category of property income covering the retained earnings of mutual funds.

(d) change the treatment of the retained earnings of pension funds to be the same as that for mutual funds in 1993 SNA and BPM5, but leave technical reserves of life insurance as they are in 1993 SNA.

(e) treat the retained earnings of life insurance and pension funds in the same manner as mutual funds in 1993 SNA.

404. The EU proposal is to distribute the investment income of mutual funds to owners of shares as "Property income attributed to holders of investment funds" and then record reinvestment in financial accounts as "Equity". The definition of investment funds and their sectoring is:

> "Investment funds are collective investment undertakings investing in financial and non-financial assets to the extent that their sole objective is the investment of capital being raised from the public. Pension funds are excluded and also investment funds issuing highly liquid liabilities of a monetary nature. The latter institutions, known as money market funds are classified in Other depository corporations".

405. The justifications are to align their treatment with other forms of collective investment and to provide the best possible estimates of household income and saving. It is also the simplest solution.

Recommendations/questions

406. The following questions were posed for the AEG's consideration. Does the AEG

(a) Agree on the principle of recording retained earnings of investment funds in a similar way to income attributed to policy holders?

(b) Agree to record it as anew component called 'property income attributed to holders of investment funds"?

(c) Agree to the proposed definition of "investment funds"?

(d) Agree to separately identify funds issuing monetary liabilities within "other depository corporations"?

Discussion

Question (a)

407. The balance of payments has one treatment for pension funds and life insurance but a different one for the rest of mutual funds. There was no agreement in BOPCOM on the best way forward on this question. Within the AEG, the Chair declared there was clear and overwhelming agreement with the proposal with the only comments being:

- this treatment would provide better information on saving and investment flows than the existing treatment
- more explanation is required about why mutual funds are different from other financial corporations
- the criteria to separate mutual funds from other financial institutions should be set out.

Question (b)

408. The discussion started with some questions about the proposal. In particular, why is a new flow created in ESA and what is its purpose? Participants from the IMF and the ECB confirmed that it is simply to identify the imputed flow by showing the investment attributable to investors and then recording how it is reinvested.

409. Mutual funds distribute from three sources: interest, dividends, holding gains. Even if it is possible to split the earnings into these three components, it is difficult to separate the allocation to holders in the same way. That is a good reason to introduce a new item under property income.

410. Some participants argued that someone can buy a share in a mutual fund, which generates investment opportunities, but with the implication that it can only issue dividends and it would be better to include it in dividends rather than in an entirely new category. Thus even if the money market fund invests in something that pays interest to the mutual fund the payments to the holders should still be regarded as dividends.

411. The distinction between what is paid out by mutual funds and what is retained was discussed. Should the allocation under property income include all the funds' earnings or just the allocated part?

412. The discussion then became more focussed on some specifics about the treatment of holding gains. The key problem is that pension and investment funds receive holding gains which are paid out, but SNA rules on holding gains preclude income from this source being considered to be paid out. The value of mutual funds can increase because of holding gains, but these would not then be included in property income flows. However, it was pointed out that companies can fund dividends from holding gains, so effectively there is a different treatment. Part of the problem is that it is difficult to eliminate the holding gains in this situation. Under the GFSM, even if dividends are paid out of holding gains, they are still included in property income. In ESA95, property income only covers interest and dividends received by investment funds and holding gains are excluded. An example was given of a mutual fund which earns 8, with 5 being distributed to shareholders, which implies 3 is reinvested. However, if the mutual fund earns 5 and has holding gains of 3, do we pick this up in the accounts? In practice, pension funds may look under funded on an annual basis in the national accounts because holding gains are excluded.

413. At this point the Chair pointed out there was a lot of confusion associated with this part of the accounts. There is no agreement on question (b) and some specifics need to be investigated further, particularly regarding where holding gains come in.

414. A couple of final points were made. From a practical point of view, it is always difficult to split the holding gains from other parts of income; it is not just linked to the mutual funds question. There was some concern about what is done in practice under ESA95, which seems to focus mainly on retained earnings.

415. Peter Harper and Reimund Mink volunteered to develop a proposal for an e-discussion, with the key questions being where the retained earnings are presented in the accounts and the role of holding gains.

416. It was also suggested that the ISWGNA will look at all questions slated for e-discussion and decide if some will be better covered at the next meeting.

Question (c)

417. There was little discussion on this question. One participant pointed out there is the potential for confusion with the same term being used for an instrument and a unit.

418. The AEG agreed to include this definition in the scope of the e-discussion being set up for question (b).

Question (d)

419. The AEG noted that paragraphs 27 and 28 of the paper indicate this question is relevant only to countries with very sophisticated financial markets.

420. The AEG agreed to also include this question in the scope of the e-discussion being set up for question (b).

Summary conclusions

Decisions

421. The AEG agreed unanimously to accept recommendation (a).

422. The AEG requested further clarification on the exact recording of the property income flow, the definition of retained earnings and an elaboration of the parallel with insurance transactions. This clarification should also consider the role of holding gains in the attribution of income to share holders. Some of these questions will be dealt with by e-discussion before the next AEG meeting.

423. The AEG considered the definition of investment funds needs to be further refined and the terminology to be adopted for the unit and the instrument to be re-examined. The e-discussion forum covering questions associated with recommendation (b) should cover these aspects also.

Government transactions with public corporations: super-dividends, capital injections and reinvested earnings

Issue 34: Paper SNA.M1.05/29; for information

Description of the issue

The accrued earnings of all public corporations could be treated on similar lines as the reinvested earnings of the resident foreign direct investment enterprises with non-resident shareholders. This might be preferable to having flows from government to public corporations (capital injections) or flows from public corporations to government (super-dividends) determined on bases other than current profitability and thus affecting the level of government debt and deficit inappropriately.

Presentation

424. The paper for this session (document number SNA/M1.05/29; Issue 34) was written by The Task Force on the Harmonization of Public Sector Accounts (TFHPSA) and presented by Jean-Pierre Dupuis. The session was chaired by Adriaan Bloem.

425. Recording transactions between the government and public corporations is a challenge for the SNA. In practice, the recommendations in the 1993 SNA appear to be not sufficiently precise. In particular, there are no criteria to record capital injections or super-dividends which are one-off transactions. They may be for very significant amounts, subject to manipulation (regarding timing etc.), and have a potentially large impact on government deficit and debt.

426. New manuals have attempted to clarify the notions of income, revenue, equity, and the related flows, for the specific case of government. The manuals involved include the GFS Manual 2001, the ESA95 Manual on Government Deficit and Debt (EMGDD, part II, 2002), and the IPSAS Handbook (2003).

427. The TFHPSA has explored the possibility of developing a parallel with the item “Reinvested earnings,” which is currently reserved in the 1993 SNA for foreign direct investment (see SNA paragraphs 7.120 and 14.152). An alternative approach will also be proposed, based on GFSM2001 and EMGDD recommendations.

428. A paper will be submitted to January 2006 AEG meeting.

Discussion

429. The importance of this issue stems from governments being able to manipulate public corporations to pay dividends to general government in such a way as to artificially reduce the level of government deficits and debt.

430. There was little discussion on the topic, with the Chair asking for the paper to be prepared for the January 2006 AEG meeting to present the pros and cons of both options and not concentrate on the option of treatment as reinvested earnings. It should also clearly indicate the Task Force’s preferred option.

Summary conclusions

Observation

431. The AEG welcomed the prospect of the paper for discussion in January but the AEG emphasised that it was important that this paper should be even-handed in setting out the pros and cons of the two possible alternative approaches.

Measurement of non-market output in volume terms

Issue C10: Paper SNA.M1.05/30; for information

Description of the issue

The recent report of the Atkinson review in the United Kingdom and the Eurostat Handbook on Volume and Prices have confirmed the desirability of measuring the volume of output of the general government using direct output indicators. They propose principles for the measurement that it would be useful to include in the new SNA, as they clarify the conditions for good measurement of non market output.

Presentation

432. The paper for this session (document number SNA/M1.05/30; Issue C10) was written by François Lequiller and presented by Charles Aspden. The session was chaired by Adriaan Bloem.

433. The ISWGNA accepted a proposal to clarify the measurement of the volume of non-market output. The objective is to incorporate in the SNA to the extent possible the recommendations about measurement in the Atkinson report and the Eurostat Handbook on Price and Volume Measurement. No conceptual change is proposed to the SNA.

434. The idea is to recommend output measures for individual services but to accept input methods as a second best for collective services. Reference is made to "willingness-to-pay" as a quality effect, which will affect volume measures but not current price measures.

435. The proposal is presented as a set of new or amended paragraphs.

436. The general conditions of market prices do not apply to non-market activities. In theory, the price relative of non-market services should reflect the marginal benefit, which is equivalent to "willingness to pay". There is evidence to suggest that the change in value of many non-market services is linked to the general prosperity of a country.

437. A change in the marginal benefit for the consumer is to be treated as a change in the volume measure of the services but it does not affect the current price value of government output, which is based on the sum of costs (including capital services). The rationale is that this price change corresponds to a change in the content of the service. Therefore it is treated as a change in quality, and so a change in volume. An important objective is to identify that part of the overall change in outcome directly attributable to the non-market services.

438. Estimates would be compiled using cost weights, reflecting the full range of services and making allowances for quality change. It is planned to test output methods and the implied

productivity measures with experts in the relevant domain. If the outcomes are not satisfactory then input methods should continue to be used.

439. The method proposed for health is to use a cost-weighted number of treatments, taking into account quality adjustments to the extent possible (e.g. using details on the number of treatments by category of the medical procedure adjusted, if possible, for quality changes).

440. The proposal for education is to use detailed cost-weighted quantity indicators. The stratification should at least distinguish pre-school, primary, lower secondary, higher education and other education, with the proposed indicator being the number of hours of pupil attendance. Estimates should be adjusted for quality change (e.g. school inspection, exam success).

441. For collective services, it is proposed to leave the current SNA paragraph unchanged because it may not be feasible to avoid using the input method.

Discussion

442. Although there was agreement on the more general proposals, there was some concern about the potential impact on the long-term relevance of the updated SNA of some of the proposals. In particular, active research on these difficult-to-measure outputs could lead to best practice overtaking the SNA, which is undesirable. The current SNA already does a good job in setting out principles on which volumes should be based and it is not necessary to be too specific in the updated SNA. Details such as those presented for the stratification for education are too prescriptive for the SNA because they are unlikely to be able to be followed by many countries.

443. Several participants expressed concerns about introducing the concept of "willingness to pay" into the SNA because it is problematical on both conceptual and practical grounds. Concerns were also raised about recommendations in the presentation and in the Atkinson report concerning volumes of collective services being measured through output indicators. It was re-emphasised that the SNA should only include details about robust methods that will stand the test of time.

444. The Chair asked that the paper be updated by more specifically setting out the underlying principles and proposals for any changes in them. The text should not be overly prescriptive. There was sufficient concern amongst the AEG members about the concept of "willingness to pay" that it should be dropped from the updated paper.

Summary conclusions

Observations

445. The AEG was supportive of the recognition of recent developments in this field. However, it considered that some parts of the paper were overly prescriptive and did not strike the right balance between established and innovative techniques.

446. Several AEG members expressed reservations with including in the SNA methods based on a "willingness to pay" approach.

447. The AEG requested that an alternative document be prepared which simply identified the areas for clarification and the corresponding proposals.

Valuation of equity

Issue C9: Paper SNA/M1.05/32; for information

Description of the issue

Paragraph 13.73 of SNA 93 just says that ''the value of shares that are not quoted on stock exchanges or otherwise regularly traded should be estimated using the prices of quoted shares that are comparable in earnings and dividend history and prospects, adjusting downward, if necessary, to allow for the inferior marketability or liquidity of unquoted shares'', but without making reference to specific issues or methods. The issue is, however, very relevant, as unquoted shares in many countries are far more important than quoted shares. Nonetheless, little progress was formerly made in producing harmonized data on unquoted shares. There are two questions for clarifications to help harmonize the valuation of equity:

(a) *the breakdown of the item shares and other equity into quoted shares, unquoted shares and other equity as done in the ESA95;*

(b) *recommendation of methods of valuation of different types of equity. This is not a substantive change question but one that will discuss equity from both the asset and liability side, considering both inter-company and portfolio investment in relation to listed and unlisted equity. Expansion and clarification of text about equity in the SNA will pave the way for better harmonization with other standards, in particular BPM5 (which does deal very closely with portfolio and direct investment).*

Presentation

448. The paper for this session (document number SNA/M1.05/32; Issue C9) was written by Patrick O'Hagan from the Task Force on the Valuation and Measurement of Equity (TFVME) and presented by Charles Aspden. The session was chaired by Adriaan Bloem.

449. The first meeting of the TFVME was at Statistics Canada in April 2005, and it focussed on measurement-valuation questions, in particular

(a) measurement questions/options for unquoted equity

(b) measurement questions/options for inter-company (direct) investment equity.

450. Equity is a complex instrument that specifies some degree of ownership in a firm and it is an investment. In some cases, it is a marketable security for portfolio and direct investors and it is a liability of firms to shareholders in the SNA model. It also provides a measure of the underlying value (net worth) of corporations. Equity can take on different valuations, including underlying book value, acquisition cost, current value, market value.

451. Equity is a major asset (and liability) category and figures prominently in measures of sector net worth (including the international investment position) in the balance sheets. The 1993 SNA is the principal international reference document, but it includes only a minimal discussion of equity. There is a need to expand, integrate and clarify measures of equity.

452. According to the SNA, when they are regularly traded on stock exchanges or other organised financial markets, shares and other equities should be valued in the balance sheets at their current prices. The value of shares in corporations that are not quoted on stock exchanges or otherwise traded regularly should be estimated using the prices of quoted shares that are comparable in earnings and dividend history and prospects, adjusting downward, if necessary, to allow for the

inferior marketability or liquidity of unquoted shares. Equity in quasi-corporations should be valued as equal to the value of the quasi-corporations' assets less the value of their liabilities (see 1993 SNA, para 13.73). In addition, paragraph 13.83 refers to net asset value and residual corporate net worth.

453. Components of equity include:

(a) listed portfolio investment

(b) listed inter-company (direct) investment

(c) unlisted inter-company (direct) investment

(d) other unlisted equity.

454. Practical and analytical considerations would dictate similar detail, valuation and measurement of equity asset and liability components. The estimation of unquoted equity is currently under study; direct investment is also under discussion. The integrated nature of the SNA implies a need to harmonise the concepts of all related equity components.

455. The TFVME is in the process of reviewing conceptual and methodological questions, for assets and liabilities, including portfolio and inter-company investment, in the context of the sequence of accounts.

456. A second and final meeting of the TFVME is scheduled for October 2005 at the OECD. This meeting will review the initial redraft of the equity sections of the 1993 SNA as well as consider other questions, such as links to other chapters, links to the work on intangible assets and equity stock-flow considerations.

457. The expanded redraft of relevant sections on equity will focus on:

(a) a detailed discussion of equity types to reflect its complex nature

(b) an expanded discussion of practical questions and alternatives in the current/market valuation of corporate equity, in particular for the difficult area of unlisted equity

(c) an improved link of assets and liabilities to the discussion of equity

(d) an interpretation of residual corporate net worth, as well as its link to firm's equity liabilities

(e) an improvement in the integration among the SNA chapters that deal with equity (chapters 11, 12, 13, 14).

458. It remains to be determined whether the draft should follow a less prescriptive approach than in the current standard (e.g. paragraph 13.73 of the 1993 SNA).

459. A final report (including a re-draft of the sections on equity in the 1993 SNA) will be prepared for the January 2006 AEG meeting.

Discussion

460. The following points were raised during the discussion:

- the TFVME should ensure it uses national accounting terminology in its reports

- work of the TFVME should be coordinated with work in similar fields undertaken in Europe by the ECB, and by the Canberra II Group
- outputs from the TFVME that are potentially going to be used in the updated SNA should focus on the underlying concepts and not be too prescriptive.

Summary conclusions

Observation

461. The AEG suggested that the Task Force should take into account the work already undertaken on this topic in Europe and related work by the Canberra II Group and, as suggested for the clarification question on non-market output, should document reasons for changes and proposals rather than simply present redrafted text.

Interest on index-linked debt instruments

Issue 43a: Paper SNA.M1.05/11.1; for decision

Description of the issue

For index-linked debt instruments, changes in principal arising from indexation are recorded as interest. However, should the recording of interests for index-linked debt instruments be clarified? Moreover, the 1993 SNA, BPM5 and other manuals mention exchange rates as one of various indicators to which indexation can be linked. However, they are not explicit on whether debt instruments with both principal and interest indexed to a foreign currency should be treated similarly to index-linked instruments or to foreign currency debt instruments.

Presentation

462. The paper for this session (document number SNA/M1.05/11.1; Issue 43a) was written by Manik Shrestha and presented by Robert Dippelsman. The session was chaired by Ivo Havinga.

463. The questions in this and the following paper are fairly similar. This presentation focussed on instruments indexed to an indicator of price change (e.g. CPI, share prices, oil price). The questions in this paper are how the indexation amounts are classified (as interest or as a revaluation) and how they are allocated over the life of the instrument.

464. Index-linked securities are defined in para 7.104 of the SNA as "… financial instruments for which the amounts of the coupon payments (interest) and/or the principal outstanding are linked to a general price index, a specific price index or an exchange rate index".

465. When the coupon payments are index linked, the full amounts of such payments are treated as interest receivable or payable, in the same way as the interest receivable and payable on any other security paying a contractually agreed variable income.

466. When the value of the principal is index linked, the difference between the eventual redemption price and the issue price is treated as interest accruing over the life of the asset in the same way as for a security whose redemption price is fixed in advance. In practice, the change in the value of the principal outstanding between the beginning and end of a particular accounting period due to the movement in the relevant index may be treated as interest accruing in that period, in addition to any interest due for payment in that period.

467. There are several questions associated with these processes. To start with, the redemption value is not known, with the implication being that the value of interest before redemption is unclear. Also, it is argued that some indexation arrangements (such as indexing to stock prices, oil prices, gold prices) are predicated on the basis of receiving both interest income and holding gains. In this context, interest is the return for putting financial resources at the disposal of another entity while holding gains/losses are the effect of index value fluctuations. Negative values of interest payable/receivable are possible outcomes from this process. Are they acceptable or meaningful, when general interest rates are positive, or are such fluctuations an indication that the value is driven by revaluation factors rather than being a return for supplying financial resources? Finally, it should be noted that business accounting does not make the interest/holding gain distinction in this case.

468. Under the 1993 SNA concept of interest, and without allowing any revisions to the estimates of interest in prior periods, the movement in the relevant index during the period is used to determine interest accruing in that period. The interest recorded can be volatile due to movements in the index. Revaluations are due to changes in market expectations about the future path of the index. They could arise also from changes in market interest rate or credit ratings. Revaluations cancel out over the life of instrument.

469. The situation under the 1993 SNA concepts, if revisions of interest accruals are allowed, is slightly different. The revisions of interest accruals will be determined in each accounting period either by:

(a) using the movement in the relevant index in each accounting period but revising these figures when actual redemption value is known, or

(b) in each period using the most recent observation of the relevant index and revising interest in all periods since issue up to the current period.

470. Points to note are that the total interest accrued over the life of the instrument under (a) or (b) is the same as that if no revisions are allowed. However, the allocation over the life of the instrument is different. Revaluations still cancel out over the life of the instrument. The question is whether it is desirable to revise interest in all periods once only when actual cash flows are known at redemption or to revise interest in all previous periods on a regular basis using the latest information (on the index).

471. An alternative described as the “modified debtor approach” was presented. This would mean changing the 1993 SNA for defining interest on index-linked instruments by fixing the rate of interest at the time of issue, and treating any deviation of the index from the expected path as holding gains/losses. This option had previously been ruled out of consideration. Under this approach, interest accruals are calculated using the expected yield-to-maturity at issue. Interest for the life of the instrument may not be equal to the difference between the issue price and redemption value. Further, revaluations may not cancel out over the life of the instrument (with the discrepancy being equal to the difference between expected and actual redemption value).

472. Another approach that could be used is the “embedded derivative approach”. It would involve changing the 1993 SNA principle for defining interest by regarding indexed-linked instruments as effectively including derivative contracts. This is similar to the previous approach, but interest is imputed based on a similar instrument that is not indexed and the value of the embedded derivative reflects the deviation (of the imputed interest) from actual movements in the relevant index. The standard bond component may also be revalued if the market interest rate

changes. If this occurs, it becomes difficult to work out how to disentangle revaluations due to changes in the index from those due to variations in market interest rates[7].

Recommendations/questions

473. The question presented was which alternative do AEG members prefer?

(a) 1993 SNA approach whereby the difference between the eventual redemption price and the issue price is treated as interest accruing over the life of the instrument. Each period, the movement in the relevant index during the period is used to determine interest in the period and is never revised.

(b) 1993 SNA with revisions:

- a single set of revisions made when actual redemption value is known
- continuous revisions made each period using the most recent observation

(c) the modified debtor approach whereby interest is defined for the life of the instrument as the difference between the redemption value expected at the time of issue and the issue price? The revaluation term then reflects the difference between actual and expected redemption values.

(d) an embedded derivative approach, which has the same net effect as the previous option but treats the instruments as separable into a standardised bond and a financial derivative?

474. (Note: the BOPCOM was evenly divided between (a) and (c). The BOPCOM conclusion was to keep the status quo – i.e. option (a) – in the absence of a consensus for change.)

Discussion

475. The discussion opened by considering the pros and cons of the 1993 SNA treatment. The points raised were:

- the 1993 SNA works well for things indexed to broad-based inflation measures (e.g. the CPI) that move relatively smoothly
- the 1993 SNA recommendations work poorly if the index used relates to commodities that have large price fluctuations and the modified debtor approach would be preferable in such cases
- the embedded-derivative approach provides the most comprehensive information on what is happening but it is difficult to implement in practice
- the 1993 SNA treatment means that an instrument indexed to commodities has an element of holding gains becoming involved in the indexation, so the second alternative would be preferred
- the 1993 SNA approach is not ideal but should be retained because it sticks most closely to other SNA principles

[7] Numerical examples of the four alternatives appear in the background paper which can be found on the UN web site.

- no single approach handles all situations satisfactorily so a split approach is required with a combination of the current SNA approach and the modified debtor approach being preferred in such cases.

476. The discussion then concentrated on two questions – the potential for holding gains to be included in some circumstances and how to distinguish when one or the other alternative approaches should be used if a dual-approach option were used. A lot of these indexed instruments are designed to obtain holding gains not just interest. For example, a mutual fund indexed to the stock market clearly results in a holding gain if the stock index doubles. On the other hand, CPI-indexed bonds have no holding gains associated with them. When using indices, it is not possible to know in advance the amount of indexation over time. The 1993 SNA treatment works well e when indexed to a "well-behaved" index. However it is not always easy to determine in advance whether the chosen index will be volatile. It is difficult to draw the line with the distinction between smooth and volatile indices. For example, where on the continuum of CPI, CPI goods, PPI, PPI metals, PPI steel would the distinction be made between smooth and volatile? Essentially the difference between smooth and volatile indices determines how much holding gain is acceptable and what is deemed to be too much, If we want to be pure we should change the SNA to reflect real rather than nominal interest, which would have major ramifications.

477. The Chair summed up. BOPCOM opted for the status quo in the absence of a satisfactory alternative. In the AEG discussion, there has been a slight majority for a dual approach. The impact of the risk element is reflected in holding gains/losses. Under a dual approach, the updated SNA would have to set out rules for making a decision on which option to adopt.

Summary conclusions

Decisions

478. By a slight majority the AEG opted for a dual approach of using option (a) or option (c) depending on the circumstances. In so doing, the AEG recommended that guidance be provided in the updated SNA on the situations in which one or the other of these options would be preferred. Broadly, option (a) would be recommended in situations in which a broad index is used, one expected to change relatively smoothly over time (such as when the CPI is involved) while option (c) would be used when a narrow index is used with the possibility of volatile movements (e.g. when the index relates to commodities).

479. The AEG recognised that option (c) requires a change to be made to the SNA.

Debt instruments indexed to a foreign currency

Issue 43a: Paper SNA.M1.05/11.2; for decision

Description of the issue

The 1993 SNA, BPM5 and other manuals mention exchange rates as one of various indicators by which debt instruments can be indexed. However, they are not explicit on whether debt instruments with both principal and interest indexed to a foreign currency should be treated similarly to index-linked instruments or to foreign currency debt instruments.

Presentation

480. The paper for this session (document number SNA/M1.05/11.2; Issue 43a) was written by Carlos Sánches Muñoz and presented by Robert Dippelsman. The session was chaired by Ivo Havinga.

481. The questions in this session related to instruments indexed to a foreign currency. As was the case in the previous presentation (on instruments indexed to an indicator of price change), the key questions covered are how the indexation amounts are classified (as interest or a revaluation) and how they should be allocated over the life of the instrument.

482. Paragraph 7.104 of the 1993 SNA defines index-linked securities as "financial instruments for which the amounts of the coupon payments (interest) and/or the principal outstanding are linked to a general price index, a specific price index or an exchange rate index."

483. There are some borderline questions with the existing treatment. For example, if the principal is denominated in a foreign currency, any changes in its value due to exchange rate changes are classified as revaluations. However, if the principal is indexed to a foreign currency then any change in its value due to exchange rate changes is classified as interest. It was noted that business accounting practice is not helpful in making a distinction between interest and a revaluation.

484. Questions that need to be resolved are whether negative values of interest payable/receivable are acceptable or meaningful when general interest rates are positive or whether such fluctuations are an indication that the value is driven by revaluation factors rather than being a return for supplying financial resources.

Recommendations/questions

485. The question for discussion by the AEG was whether AEG members agree that debt instruments with both principal and coupons indexed to a foreign currency should be classified and treated in the national accounts as though they are denominated in that foreign currency. This is similar to the question discussed at the December 2004 AEG meeting. At that time several participants expressed sympathy with the proposal.

486. The BOPCOM concluded that debt instruments with both principal and coupons indexed to a foreign currency should be classified and treated as being denominated in that foreign currency, and recommended that the currency of account and currency of settlement should be clearly distinguished in the new manuals.

Discussion

487. There was little discussion on this issue. The AEG agreed with the BOPCOM conclusions.

Summary conclusions

Decisions

488. The AEG agreed with the BOPCOM conclusions that:

(a) debt instruments with both principal and coupons indexed to a foreign currency should be classified and treated as being denominated in that foreign currency; and

(b) the currency of account and currency of settlement should be clearly distinguished in the new manuals.

Traded loans (borderline between securities and other financial instruments)

Issue 44d: Paper SNA/M1.05/10.3; for decision

Description of the issue

When and under what circumstances do loans that are traded become securities? This is important because virtually all loans are tradable and trading has increased. Further, it affects valuation since securities are valued at market price and loans at nominal values.

Presentation

489. The paper for this session (document number SNA/M1.05/10.3; Issue 44) was written by Manik Shrestha and presented by Robert Dippelsman. The session was chaired by Ivo Havinga.

490. In the 1993 SNA, loans are defined as "Financial assets that are created when creditors lend funds directly to debtors, that are evidenced by non-negotiable documents ... " (1993 SNA, annex to chapter 13). Securities other than shares are financial instruments that are "... normally traded in the financial markets ..." (1993 SNA, annex to chapter 13).

491. The question is whether traded loans should be reclassified as debt securities or should they remain loans? If they are reclassified, under what circumstances would traded loans become securities? Also, should untraded securities be reclassified as debt securities or should they remain securities?

492. The existing treatment for loans is that if they become negotiable they are classified in "Securities other than shares". The 1993 SNA is not specific but the following requirements appear in the External Debt Guide (para 3.29) and in ESA95 (para 5.79).

(a) a loan must be tradable and is, or has been, traded in the secondary market

(b) there must be evidence of secondary market trading

(c) these are fairly strict requirements and exclude one-off sales.

493. In recording the resulting flows, ESA95 imputes financial transactions while the 1993 SNA, External Debt Guide, GFSM and BPM5 all imply recording as other changes due to reclassification.

494. There is no mention of reclassification in the existing treatment for securities.

Recommendations/questions

495. The following questions were posed for the AEG's consideration:

(a) Do members agree that traded loans are to be reclassified as securities if a loan becomes tradable and is, or has been, traded in the secondary market? Alternatively, do members conclude that traded loans not be reclassified as debt securities?

(b) If traded loans are reclassified as debt securities, should the definition of the requirements for a secondary market be elaborated according to the criteria in the External Debt Guide or some other criteria? What are the members' views on whether, in addition to being tradable in secondary markets, there should be a requirement that the debtor is not legally prevented from buying back the debt?

(c) If traded loans are reclassified as debt securities, do members agree that the flows arising from traded loans becoming securities be treated as reclassifications in other changes in the assets and liabilities account?

(d) If traded loans are not reclassified, do members agree that loans should be broken down between traded and non-traded loans?

(e) Does the AEG agree that untraded securities should not be reclassified?

496. (Note: BOPCOM decided that untraded securities should not be reclassified.)

Discussion

497. The points raised in discussion on these questions were:

- in principle all loans are tradable so evidence from secondary markets is needed that a loan is actually being traded
- when there is evidence of trading a loan it should be classified as traded
- even if there is evidence of a market and there are quotations on the market then it is not necessarily the case that the loan has become a security
- banks "sell" loans, not securitisation
- three parties are involved – a debtor, a creditor and the person to whom the tradable loan is sold – but there will not be anything in the debtor's books which gives an indication of its status (i.e. a reclassification or a transaction)
- The case being addressed here is of large syndicated loans and not securitization of one or several loans.
- the BOPCOM recommendations should be adopted.

498. In summary, the AEG decided that the current SNA position should be maintained with respect to question (a). Questions (b) and (c) were not considered by the AEG because the traded loans would not be reclassified as debt securities. The AEG agreed not to break down loans into traded and non-traded categories and that untraded securities should not be reclassified.

Summary conclusions

Decisions

499. With respect to question (a), the AEG decided that the current SNA position should be maintained: that is, the loan should be reclassified as a security only if there is evidence of a market and there are quotations in the market.

500. This change of category of financial instrument is achieved via a change in classification entry in the other changes in the volume of assets account and not via transactions cancelling the loan and issuing a security.

501. The fact that a loan is sold once does not necessarily involve reclassifying the loan as a security.

502. Questions (b) and (c) were not considered by the AEG because in general traded loans would not be reclassified as debt securities – they would not change their classification status as a result of being sold.

503. There was agreement not to break down loans into traded and non-traded categories.

504. With respect to question (e), the AEG agreed that untraded securities should not be reclassified.

Classification of financial instruments

Issue 44: Paper SNA/M1.05/10.1; for information

Description of the issue

A number of proposals have been made to modify the classification of financial instruments. They include the following points.

(a) *With financial derivatives treated as a separate instrument in the 1993 SNA, it would be appropriate to introduce the term "debt securities" to replace "securities other than shares".*

(b) *Moreover, all types of financial derivatives are currently treated as a single item but there is an interest in splitting derivatives in forwards and options, given their different behaviour.*

(c) *Further considerations are to be given to the introduction of employee stock options.*

(d) *There is renewed interest in the question of whether non-monetary gold should be classified as a financial asset rather than under valuables in the asset classification.*

Presentation

505. The paper for this session (document number SNA/M1.05/10.1; Issue 44) was written by Carlos Sánchez Muñoz and Robert Dippelsman and presented by Robert Dippelsman. The session was chaired by Barbro Hexeberg.

506. The work on the classification of financial instruments has been part of the review being undertaken for the BPM update. Recommendations made are the result of consultation with compilers and users and they have been based on requests for additional detail and developments in financial markets and analysis. Another aim has been to bring the detail and terminology in BPM5 more fully into line with other manuals.

507. At the broadest level, the classifications are compatible with the existing SNA, with the proposed changes being only in presentation and detail. The aim of the presentation at the AEG meeting is to advise the AEG about developments because some recommendations could be taken up in the updated SNA.

1993 SNA/MFSM Classification

F.1 Monetary gold and SDRs

F.2 Currency and deposits

Currency

Deposits

Transferable deposits

Other deposits

F.3 Securities other than shares

F.4 Loans

F.5 Shares and other equity

F.6 Insurance technical reserves

Net equity of households in life insurance reserves

Net equity of households in pension funds

Prepayment of premiums and reserves against outstanding claims

F.7 Financial derivatives [ADDED IN 2000]

F.8 Other accounts receivable/payable

Trade credit and advances

Other

Question (a) – Broad outline of classification

508. There is interest in debt instruments as a grouping. This is a major and growing area of economic analysis (debt has specific implications for financial soundness and vulnerability, with links between flows and stocks becoming more prominent).

509. The BPM5 already uses the equity/debt/other grouping. There is strong and increasing analytical interest in debt as a grouping. The publication of the External Debt Guide in 2003 has helped but a link to total and domestic debt would be useful. Is it possible to introduce a debt concept explicitly in the SNA? This concept is already included implicitly. Should we include a definition? Should it be shown as an "of which" item under Total Financial Assets/Liabilities in the SNA instruments classification? If so, does the AEG have any comments on specific instruments to be included under debt and other headings?

510. The 1993 SNA term is "Securities other than shares" while the BPM5 term is "Debt securities". Some financial derivatives are securities, so the 1993 SNA term became inaccurate after the exclusion of financial derivatives in 2000. Further, the term "Other" is not informative. There is no mention of debt, although these instruments all involve debt.

511. Links between an instrument and the corresponding type of income are useful for rate of return analysis and show the connection between balance sheets and the income parts of accounts. A table is presented in the issues paper. (Note that the SNA version would be different, although this is purely presentational, and there is no change in substance.)

Question (b) – Shares and other equity:
Possible additional components

512. Should mutual funds be included as a standard or as a supplementary item (a supplementary item is used here to cover an item that is defined and discussed in the manual, but that is voluntary, to be included, or not, according to national circumstances). They could be classified either under shares and other equity or separately. Mutual funds have grown rapidly in recent years. They have a different role to the rest of equity in the financial process because they have an intermediary role. They are more like other collective investment schemes (pensions and life insurance) which are already shown as separate instruments.

513. Should money market mutual funds (MMMF) be presented as a standard or supplementary item? They have a role in monetary statistics. Although equity, they are highly liquid and included in money supply.

Question (c) – Financial derivatives:
Possible additional components

514. There is interest in additional information on a supplementary basis, possibly classified by instrument type:

(a) forwards (including, e.g., futures and swaps)

(b) options.

515. They could possibly be classified by underlying risk category:

(a) interest-generating (deposits, loans, debt securities)

(b) equities

(c) money market and other investment funds shares/units

(d) other financial units

(e) commodities.

Question (d) – Other

516. Should trade-related credit be shown as a supplementary item:

(a) trade credit (credit from the seller) is already identified separately

trade-related credit (credit from an associated entity or government) is not.

Additional questions

517. There are additional papers on some specific financial instrument classification questions, which are dealt with in separate papers:

(a) reverse transactions

(b) traded loans – whether and when they should be reclassified as securities;

(c) loans and deposits – the borderline between them

(d) non-monetary gold and/or gold accounts – whether and when these are financial assets. (This item is for discussion at the next AEG meeting.)

Recommendations/questions

518. In summary, the following questions were presented for the AEG's consideration:

(a) Does the AEG agree with broad classification into equity, debt securities and other financial instruments?

(b) Does the AEG agree to change the term "securities other than shares" to "debt securities"?

(c) Does the AEG wish to add any additional components to the "Shares and other equity" category?

(d) Does the AEG wish to add any additional components to the "Financial derivatives" category?

(e) Should trade-related credit be shown as a supplementary item?

Discussion

519. The discussion started with some participants suggesting that it would be useful to have mutual funds and money market mutual funds set out separately in the classification, because they are treated differently in money supply statistics. Also, listed and unlisted shares should be shown separately. A split of quoted and unquoted shares would be useful because quoted shares are important for financial market analysis (there is no similar requirement for unquoted shares, other than to isolate them from quoted shares). There was also support for using the term "debt securities" in place of "securities other than shares".

520. One of the problems in making significant changes to the classification is that there could be implications for the classification structure. For example, to include "Mutual funds" at the same level as "Shares and other equity" would involve adding an extra item to the top structure of the classification, which will lead to a problem with the existing codes. (BOPCOM is reluctant to add new standard items but would support this case.) An alternative was suggested; it would involve amalgamating "Currency and deposits" and "Loans" into a single item under F.2, which would leave F.4 free for mutual funds. However, the existing classification is broadly in descending order of liquidity and having mutual funds following "Securities other than shares" would destroy that order. Another alternative would be to include "Mutual funds" as a component of "Shares and other equity".

521. A concern was expressed that the next financial crisis could be associated with financial derivatives, so it would be useful to have detailed data on these. A worthwhile split would be to have forwards/options classified by risk category (interest-generating equities, money market, other financial units etc).

522. The Chair summed up by saying that the AEG broadly supported the BOPCOM proposals. The question of the best approach to handling changes in the classification could not be resolved by the AEG at this time. Reimund Mink agreed that the ECB will write a paper setting out possible options for making changes in the classification of financial instruments.

Summary conclusions

Observations

523. Several members of the AEG expressed support for the use of the term "debt securities" to replace "securities other than shares".

524. Several members wished to see mutual funds explicitly included in the classification but views were divided about which level. There was support to distinguish money market funds within mutual funds.

525. Reservations were expressed about moving away from the present classification, based on degree of liquidity, towards the broad three-level grouping though the attractions of the link to income was noted.

526. Reimund Mink agreed that the ECB will write a paper exploring possible options for changes in the classification of financial instruments more generally.

Wrap-up

Taking stock

527. The AEG reached recommendations on several important issues and a number of other issues. There were also several information items and the AEG was given previews on a number of topics. The process has worked very efficiently and the e-discussions worked very well and helped us prioritize our time.

528. The new formats for reports will encourage more effective consultation with the broader international community.

Looking ahead

529. This week's work was an important milestone for the AEG. We are on course to reach the targets set by the Statistical Commission. The next AEG meeting will be held at the ECB, in Frankfurt, starting in the week beginning January 30, 2006. It will be the last of the issue-oriented meetings, so lots of work is underway. The agenda will be ambitious, including:

(a) pensions

(b) informal sector

(c) financial services

(d) leases and licenses

(e) SPVs.

530. We will continue on the work programme laid out in 2003. The ISWGNA will review the schedule of meetings and modalities of the next phase now that this week's milestone has been passed. However, some points are clear now. First, there will be at least one AEG meeting (after January 2006). Second, AEG members will have an opportunity to comment on draft text. Reports of this meeting will be circulated in the next few weeks. Reports on related meetings will be provided to AEG members as they become available. Action items will be followed up as appropriate. The work program for 2006-2007 will be finalised, probably after September.

Follow-up work

The areas where further work was indicated in the meeting are highlighted in yellow. Because this may not show up clearly on black and white paper copies, the paragraphs concerned are listed below.

12, 13, 25, 27, 46, 60, 109, 112, 114, 115, 116, 123, 192, 194, 242, 268, 283, 349, 356, 357, 383, 415, 431, 447, 461, 526.

Agenda

Third Meeting of the Advisory Expert Group on National Accounts

UNESCAP, Bangkok

18-22 July 2005

Monday, 18 July

9.00 – 12.30 Morning session

Chair: Barbro Hexeberg, World Bank, Chair of ISWGNA

Opening of the meeting

Welcome by UNESCAP

Approval of the agenda (Document SNA/M1.05/01)

Cost of capital services (Document SNA/M1.05/04; Issue 15) – decision
Presenter: Anne Harrison

Government and other non-market producers: cost of capital of own assets (Document SNA/M1.05/05; Issue 16) – decision
Presenter: Anne Harrison

13.30 – 17.30 Afternoon session

Chair: Carol Carson

Obsolescence and depreciation (Document SNA/M1.05/06; Issue 23) – decision
Presenter: Charles Aspden

Overview of comments on decisions of the second AEG meeting (Document SNA/M1.05/03) – information
Presenter: Ivo Havinga

Financial services (Document SNA/M1.05/26; Issue 6a) – information
Presenter: Charles Aspden

Employer pension schemes (Document SNA/M1.05/28; Issue 2) – information
Presenter: Adriaan Bloem

Tuesday, 19 July

8.30 – 12.30 Morning session

Chair: Charles Aspden, OECD

G**eneral government and public sectors: Chapter and Annex outline** (Document SNA/M1.05/09.2; Issue C15) – information
Presenters: Lucie Laliberté and Jean-Pierre Dupuis

Public/private/government sectors delineation (Document SNA/M1.05/09.1; Issue 36) – decision
Presenters: Lucie Laliberté and Jean-Pierre Dupuis

Non-resident SPEs linked to government (Document SNA/M1.05/31; Issue 25e) – information
Presenter: Jean-Pierre Dupuis

13.30 – 17.30 Afternoon session

Chair: Carol Carson

Research and development (Document SNA/M1.05/20; Issue 9) – decision
Presenter: Charles Aspden

Monday's conclusions

Outcome of e-discussion on five issues
Presenters: Ivo Havinga

Originals and copies (Documents SNA/M1.05/18.1 and 18.2; Issue 11) – decision (e-discussion issue)

Databases (Documents SNA/M1.05/19.1 and 19.2; Issue 12) – decision (e-discussion issue)

Land improvements and structures (Documents SNA/M1.05/22.1 and 22.2; Issue 20) – decision (e-discussion issue)

Water as an asset (Documents SNA/M1.05/23.1 and 23.2; Issue 31) – decision (e-discussion issue)

Purchased goodwill and marketing assets (Document SNA/M1.05/24.1 and 24.2; Issue 22) – decision (e-discussion issue)

Wednesday, 20 July

8.30 – 12.30 Morning session

Chair: Charles Aspden, OECD

Tax revenues, uncollectible taxes and tax credits (Document SNA/M1.05/07; Issue 35) – decision
Presenter: Jean-Pierre Dupuis

Granting of guarantees (Document SNA/M1.05/08; Issue 37) – decision
Presenter: Lucie Laliberté

13.30 – 17.30 Afternoon session

Chair: Adriaan Bloem, IMF

Merchanting (Document SNA/M1.05/14; Issue 41) – information
Presenter: Robert Dippelsman

Goods sent abroad for processing: progress report (Document SNA/M1.05/16; Issue 40) – decision
Presenter: Anne Harrison

Tuesday's conclusions

Outcome of e-discussion on five issues
Presenters: Ivo Havinga

Migrants' transfers (Documents SNA/M1.05/13.1 and 13.2; Issue 38b) – decision (e-discussion issue)

Residence of households: non-permanent workers (Documents SNA/M1.05/15.1 and 15.2; Issue 39c) – decision (e-discussion issue)

Residence of households: ships' crew and patients (Documents SNA/M1.05/15.3 and 15.4; Issue 39c) – decision (e-discussion issue)

Multi-territory enterprises – basis for allocation (Documents SNA/M1.05/27.1 and 27.2; Issue 25c) – decision (electronic consultation issue)

Reverse transactions (Documents SNA/M1.05/25.1 and 25.2; Issue 1) – decision (e-discussion issue)

Thursday, 21 July

8.30 – 12.30 Morning session

Chair: Ivo Havinga, UNSD

Non-performing loans (Document SNA/M1.05/21; Issue 4a+4b, 38c) – decision
Presenter: Adriaan Bloem

Distinction between loans and deposits (Document SNA/M1.05/10.2; Issue 44a) – decision (1.0)
Presenter: Robert Dippelsman

Fees on securities lending and reversible gold transactions (Document SNA/M1.05/12; Issue 43c) – decision
Presenter: Robert Dippelsman

13.30 – 17.30 Afternoon session

Chair: Adriaan Bloem, IMF

Retained earnings on mutual funds and other collective investment schemes (Documents SNA/M1.05/17.1 and 17.2; Issue 42) – decision
Presenter: Reimund Mink

Wednesday's conclusions

Government transactions with public corporations: super-dividends, capital injections and reinvested earnings (Document SNA/M1.05/29; Issue 34) – information
Presenter: Jean-Pierre Dupuis

Measurement of non-market output in volume terms (Document SNA/M1.05/30; Issue C10) – information
Presenter: Charles Aspden

Valuation of equity (Document SNA/M1.05/32; Issue C9) – information
Presenter: Charles Aspden

Friday, 22 July

8.30 – 12.30 Morning session

Chair: Ivo Havinga, UNSD

Interest on index-linked debt instruments (Document SNA/M1.05/11.1; Issue 43a) – decision
Presenter: Robert Dippelsman

Debt instruments indexed to a foreign currency (Document SNA/M1.05/11.2; Issue 43a) – decision
Presenter: Robert Dippelsman

Traded loans (borderline between securities and other financial instruments) (Document SNA/M1.05/10.3; Issue 44a) – decision
Presenter: Robert Dippelsman

14:00 – 17.00 Afternoon session

Chair: Barbro Hexeberg, World Bank, Chair of ISWGNA

Classification of financial instruments (Document SNA/M1.05/10.1; Issue 44a) – decision
Presenter: Robert Dippelsman

Thursday's conclusions

Wrap up of the meeting
(including summary assessment of outcomes)
Presenter: Carol Carson

17.00 Close of meeting

National Accounts and Related Manuals

SNA: *System of National Accounts, 1993* by Commission of the European Communities/Eurostat, International Monetary Fund, Organisation for Economic Cooperation and Development, United Nations and World Bank

ISIC: *International Standard Industrial Classification of All Economic Activities, Revision 3.1*, United Nations, 2003

CPC: *Central Product Classifications, Version 1.1*, United Nations, 2003

NPI Handbook: *Handbook on Non-Profit Institutions in the System of National Accounts*, United Nations, 2003

SEEA-2003: *Integrated Environmental and Economic Accounting 2003*, by European Commission/Eurostat, International Monetary Fund, Organisation for Economic Cooperation and Development, United Nations and World Bank

BPM5: *Balance of Payments Manual Fifth Edition*, International Monetary Fund, 1993

GFSM 2001: *Government Finance Statistics Manual 2001* by International Monetary Fund

MFSM 2000: *Monetary and Financial Statistics Manual*, International Monetary Fund

External Debt Guide: *External Debt Statistics: Guide for Compilers and Users*, International Monetary Fund, 2003

Acronyms

BoP	Balance of payments
BOPCOM	IMF's Balance of Payments Committee
BPM5	Balance of Payments Manual 1993 (fifth edition)
CPC	Central product classification
COICOP	Classification of individual consumption by purpose
COFOG	Classification of the functions of government
COFC	Consumption of fixed capital
CPI	Consumer Price Index
Eurostat	Statistical Office of the Commission of the European Communities
FISIM	Financial intermediation services indirectly measured
FRA	Forward rate agreement
GDP	Gross domestic product
GFCF	Gross fixed capital formation
GFS	Government Finance Statistics
GFSM2001	Manual of Government Finance Statistics (2001 edition)
GNI	Gross national income
GOS	Gross operating surplus
IMF	International Monetary Fund
I-O	Input-output
ISIC	International Standard Industrial Classification of All Economic Activities
MFP	Multifactor productivity
NDP	Net domestic product
NPI	Non-profit institution
NPISH	Non-profit institutions serving households
NPL	Non-performing loan
NPV	Net present value
OECD	Organisation for Economic Cooperation and Development
PIM	Perpetual inventory method
PPP	Purchasing power parity
R&D	Research and development
SAM	Social accounting matrix
SDRs	Special drawing rights
SNA93	System of National Accounts (1993 edition)
S-U	Supply-use (tables)
UNSD	United Nations Statistical Division
VAT	Value added tax