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SNA/M1.06/41

**Fourth meeting of the Advisory Expert Group on National Accounts
30 January – 8 February 2006, Frankfurt**

Clarification C15
The public sector

FOR INFORMATION

THE GENERAL GOVERNMENT AND PUBLIC SECTORS

by John Pitzer

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The General Government and Public Sectors

This document is a partial first draft of the proposed chapter about the general government and public sectors. It follows the outline agreed between the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD). At this stage, the authors are most concerned with whether the length and level of detail of various sections are appropriate. Although less concerned with editorial matters, all comments will be accepted gratefully. The authors are mindful of the fact that many substantive decisions have not yet been taken by the Advisory Expert Group even though this text might imply that they have been taken. The text will be revised as necessary to reflect the decisions of the AEG.

A. INTRODUCTION

1. This chapter is concerned with the problems of accounting for the activities of government. The chapter is necessary because governments often act with multiple purposes, and the legal form of a transaction may not always indicate the economic substance. Additionally, governments may own public corporations. Transactions between a government unit and a subordinate public corporation may have no effect on the economic status of the two units when they are considered as a conglomerate, but might have an important impact on the various balancing items of each unit when considered separately. It is, therefore, important to identify units and characterize correctly the economic substance of transactions between government units and the public corporations they control.
2. Dividing the total economy into sectors enhances the usefulness of the accounts by grouping together institutional units with similar objectives, functions, and types of behaviour. The sectors defined in Chapter IV are based on the objectives, functions, and behaviours believed to be the most generally important for each type of unit. For the analysis of government, a different grouping may sometimes be appropriate.
3. Institutional units are economic entities that are capable, in their own right, of owning assets, incurring liabilities, and engaging in economic activities and in transactions with other entities. The various sectors and sub-sectors of an economy are composed of institutional units that are resident in the economy, and the total economy consisting of the entire set of resident institutional units.
4. The general government sector, as defined in Chapter IV, consists of units engaged in non-market production. These units implement fiscal policies directly through imposing taxes, collecting other revenues, and spending for non-market output and transfer payments; and indirectly by controlling public corporations.
5. The public sector is a broader concept. In addition to units of the general government sector, it includes all resident public corporations. Statistics on the public sector are useful, for example, for analysing the total resources controlled by public authorities, total public debt, the sustainability of fiscal policies, the use of public corporations to carry out fiscal policies, and the effects of privatization.
6. The preferred presentation of public finance statistics for analyzing government economic activities and policies differs from the sequence of accounts for institutional units and sectors because it requires aggregates, such as total revenue and expenditure, and balancing items, such as a cash balance or the gross/net operating balances, that are not in the sequence of accounts. On the other hand, some balancing items that are in the sequence of accounts, such as net lending/borrowing, are equally important in fiscal analysis; but others,

such as gross and net value added, are less important for the analysis of government.¹

1. THE GENERAL GOVERNMENT SECTOR

7. Government units are legal entities established by political processes which have legislative, judicial, or executive authority over other institutional units within a given area. The principal economic functions of government units are (1) to assume responsibility for the provision of goods and services to the community or to individual households at prices that are not economically significant, and (2) to redistribute income and wealth by means of transfer payments, financing both of these activities primarily from taxation or transfers from other government units. All components of a resident government fulfilling these non-market functions are presumed to be resident units. Thus, the economic territory of a country includes the areas of any components formally located in foreign countries, such as embassies.
8. Government units can include social security funds and units financed through either budgetary or extra-budgetary sources. The government units in a country can be quite varied in their level of authority, location, and functions. Thus, sub-sectors may be created as the analytical demands may require. The most common sub-sectors are for the central, state, and local governments with social security funds allocated either to each level of government or forming a separate sub-sector.
9. Non-market NPIs are included in the general government sector if they are controlled by government units. Control of a non-market NPI is defined as the ability to determine the general policy or programme of the NPI, which is judgmentally determined after considering several indicators, such as the ability to appoint the officers of the NPI.
10. The definition of economically significant prices is crucial for determining the boundary of the general government sector. Public units may be created with the legal form of a corporation without necessarily being market producers. They may not sell their output at all or they may sell it for prices that are not economically significant. At the same time, it is quite possible that a government unit may include a component that does sell its output for economically significant price and operates with sufficient independence to be classified as a quasi-corporation.
11. In the government context, an economically significant price is one that covers a strong majority of the producer's costs, including the cost of capital services, while the consumers are free to choose whether to purchase or not based on the price. If a unit sells only or mostly to governments, then more evidence is demanded to demonstrate that the unit is operating in a competitive market environment.
12. Although the sequence of accounts for institutional units and sectors is the most appropriate for organizing and compiling the statistics, flexibility is permitted in the actual presentation for specific purposes. For government, it has proven helpful to combine several accounts (production account, primary and second distribution of income accounts, use of income account, and part of the capital account) into a single revenue and expense account showing all of the governments sources and uses of funds other than purely financial transactions. The financial account, other changes in assets account, and the balance sheet remain as in the sequence of accounts. In compiling the revenue and expense account, certain non-monetary transactions that appear both as a resource and a use can be omitted without affecting balancing items. For example, the output of education services and the final consumption of those services are offsetting non-monetary transactions, but the costs of producing those services are monetary transactions that need to be retained.
13. Because of transactions unique to government or having multiple purposes, there are likely to be difficult accounting choices in classifying and valuing government transactions. For

¹ *Government Finance Statistics Manual 2001* contains a description of balancing items important for the analysis of government.

example, determining the amount of tax revenue is difficult because governments are rarely able to collect all of the taxes to which they are legally entitled, some taxes are paid long after they are due, some are disputed in court, and the existence of taxable events may be unknown to the government.

- 14. Governments often possess fixed assets that non-government units do not possess, such as military items, historic monuments, other heritage assets, and infrastructure assets. Determining service lives, capital services, and depreciation patterns for these assets is difficult. Governments also engage in a wide variety of debt operations, many for policy objectives; operate unfunded pension schemes for both their own employees and for the general population; and either give or receive international aid in kind. Each of these operations can present unique and difficult accounting problems.

2. THE PUBLIC SECTOR

- 15. The public sector is a grouping of institutional units that is an alternative to the sectors defined in Chapter IV. It consists of all units of the general government sector and all public corporations. Public corporations are market producers that are controlled either by other public corporations or by government units.
- 16. Figure 1 illustrates the relationship between the public sector and the sectors defined in Chapter IV, with the public sector consisting of the units shaded and enclosed by the heavy

line. The objectives, functions, and behaviour of public corporations differ from general government units primarily because corporations are market producers financing their productive activities by charging economically significant prices and general government units are non-market producers financing their productive activities by taxation or transfers from other general government units. All units of the public sector, however, can be considered to be carrying out the fiscal policies of government.

- 17. Because governments are responsible for the resources employed by public corporations and the results obtained from their use, statistics for the public sector are also a means of demonstrating accountability to the public. Indeed, the formulation and implementation of a government’s fiscal policy and its results as reflected in statistics for the public sector is the primary measure of accountability.
- 18. The units in the public sector can be combined in numerous ways depending on the specific analytical need. There are essentially two dimensions involved. First, governments are classified as being at the central, state, or local level. Second, the types of units in the public sector are classified as general government units (including non-profit institutions controlled by government), non-financial corporations, and monetary and non-monetary financial corporations. The two dimensions can be combined to create numerous sub-sectors. Figure 2 illustrates two of these combinations. The units in the shaded area

**FIGURE 1
THE PUBLIC SECTOR AND ITS RELATION TO OTHER INSTITUTIONAL SECTORS**

GENERAL GOVERNMENT SECTOR	FINANCIAL CORPORATIONS SECTOR	NON-FINANCIAL CORPORATIONS SECTOR	NON-PROFIT INSTITUTIONS SERVING HOUSEHOLDS SECTOR	HOUSEHOLDS SECTOR
PUBLIC	PUBLIC	PUBLIC	PRIVATE	PRIVATE
	PRIVATE	PRIVATE		

**Figure A.2
Sub-sectors of the Public Sector**

	Central Government	State Government	Local Government
Central Bank and Other Monetary Corporations			
Non-Monetary Financial Public Corporations			
Non-financial Public Corporations			
General Government Units			

represent the non-monetary central government and the units enclosed in the thick line represent the non-financial public sector.

19. In addition to the uses of statistics for the public sector cited above, useful analyses could be conducted with statistics for public corporations, focusing on principal indicators and ratios in terms of the corporate sector and the whole economy.
20. Control of a corporation is determined by the ability of an institutional unit to determine the general corporate policy of the corporation. Frequently, government control of corporations is undisputed because it owns all or a majority of the shares issued by the corporation or special legislation entitles the government to appoint a majority of the directors. In other cases, the degree of government control is not clear and several factors influencing control should be considered before making a final assessment.
21. The analytical presentation of statistics of the public sector is the same as for the general government sector, except that some items will have different levels of importance or may exist only for the public sector. For example, liabilities for equity securities applies only to public corporations and market output will have a much greater importance for the public sector than for the general government sector.

3. RELATIONS BETWEEN GOVERNMENT AND CORPORATIONS

22. It is often difficult to characterize transactions between government units and corporations, especially public corporations. For example, when a government unit is the only owner of a public corporation, money flowing from the corporation to the government could be a tax, a dividend, a capital transfer, or a withdrawal of equity. Money flowing to the corporation could be a purchase of output, a subsidy, a current transfer other than a subsidy, a capital transfer, or a purchase of equity. The legal designation of flows between a government unit and a public corporation is not always a good indicator of the economic substance.
23. Governments also engage in relationships with private corporations for policy reasons other than arms-length transactions such as purchases of goods and services and imposing tax laws. For example, public-private partnerships are long-term arrangements in which a private unit finances the acquisition of fixed assets and then uses them to produce services to be sold to the government or to the public on behalf of the government. At the end of the arrangement, the government often obtains legal ownership of the assets without a monetary payment. Determining which unit is the economic owner of the assets, how the various flows are to be classified, and how the

government eventually obtains ownership of the asset can be difficult.

24. Another example of accounting difficulties unique to government arises when governments sell a small number of permits to engage in some type of activity so that monopoly profits are created. What may appear to be the sale of an asset to a private unit is in fact a means of raising taxes, in this case other taxes on production. Securitisation of future tax receipts is a more general example of this type of transactions. It is

important that receipts from such securitisation operations be treated as borrowing rather than the sale of an existing asset.

25. Bailouts of private and public corporations, including the central bank, issuing loans at concessional interest rates, accepting lump-sum payments in exchange for accepting the liability for an unfunded pension scheme, and dealing with policy-related non-performing loans are other examples of government transactions with corporations that cause accounting difficulties.

B. THE GENERAL GOVERNMENT SECTOR

1. THE COMPOSITION OF THE GENERAL GOVERNMENT SECTOR

26. Text to be added

Definition of a government unit, including social security funds, extra-budgetary organizations, and ancillary organizations

27. Text to be added

Sub-sectors of the general government sector, including social security

28. Text to be added

Criteria for control, especially non-profit organizations

29. Text to be added

The notion of “economically significant prices” and quasi-corporations

30. Text to be added

Borderline with other sectors (non-financial and financial corporations, NPISH)

31. Text to be added by

Residency, including special purpose entities

32. Text to be added

Joint ventures

33. Text to be added

Supranational authorities

34. Text to be added

2. THE ACCOUNTS OF THE GENERAL GOVERNMENT SECTOR (PUBLIC FINANCE PRESENTATION)

35. The public finance accounts will show the SNA codes of transactions, in full coherence with the System’s articulation of accounts.

36. More introductory text to be added

Government revenue

37. Text to be added

Government expenditure

38. Text to be added

Government expense

39. Text to be added

Government net acquisition of non-financial assets

40. Text to be added

Government balances, including relationships with traditional SNA balancing items

41. Text to be added

Net saving, current deficit/surplus, the operating balance

42. Text to be added

Changes in net worth due to saving and capital transfers

43. Text to be added

Net borrowing/net lending and total deficit/surplus

44. Text to be added

Financial account

45. The financial account includes the net acquisition of financial assets and the net incurrence of liabilities. The account differs from the financial account in chapter XI mainly in the classifications used. Here, financial assets and liabilities are classified first by the residence of the counterparty of the instrument (either domestic or foreign) and then by type of instrument using the same classification of instruments as in chapter XI. One impact of the residence criterion is that monetary gold and SDRs is a separate category not associated with residence because there is no counterparty. An additional, alternative classification of financial assets and liabilities by the residence and sector of the counterparty rather than by the type of instrument is also encouraged.

46. The same degree of netting as in chapter XI is suggested. That is, each category of financial assets and liabilities represents the net change in that category. Financial assets are not netted against liabilities of the same category.

47. Privatization operations and transactions between government units and public corporations are likely to need particular care in compiling the net acquisition of financial assets.

48. Transactions in policy-related financial assets are particularly important for fiscal analysis. It is suggested that a sub-category be created for these assets whenever possible. These assets will be found primarily in loans, securities other than shares, and currency and deposits. There is no category of international reserves, but governments are encouraged to report statistics on these assets. Either a sub-category can be created or a memorandum item can be added.

49. Arrears are important for some governments. A subcategory of each type of liability involving arrears is encouraged.

50. Debt is not an official category of liabilities. It is recommended above that a definition of debt be established. If successful, all liabilities could be classified as debt, equity, and other at a level after residence and before type of instrument.

Other changes in assets accounts

51. The other changes in volume of assets and revaluation accounts are virtually identical to the parallel accounts described in chapter XII. All entries in both accounts originate from sources other than transactions. Both account records changes in assets and changes in liabilities from non-transaction sources.

52. Revaluations will be the same as in the account described in chapter XII, but with the possibility of additional relevant information as memoranda items. For example, it might be useful to show the impact of treating undistributed earnings of public corporations as if they had been paid and reinvested, which would eliminate some revaluations. More generally, revaluations in the equity of public corporations held by government units are likely to be particularly important and, at the same time, difficult to measure because it is unlikely that there will be any market prices.

53. Other changes in the volume of assets should be identical to those described in chapter XII. The classification of types of other changes in the volume of assets account should be considered suggestive and implemented flexibly. Some categories might be quite

important for government and used in this account but not important for other sectors and not shown in the parallel account for the total economy.

Balance sheets

54. This account completes the sequence of general government accounts and is completely integrated with the flow accounts. Just as in Chapter XIII, this account is presented as a set of three sub-accounts. The first sub-account is the balance sheet at the beginning of the accounting period. The second sub-account is a compilation of all changes in the stocks of assets and liabilities during the period. The third sub-account is the balance sheet at the end of the accounting period. It is equal to, and can be derived from, the sum of the entries in the first two sub-accounts. That is, the stock of any given category of assets or liabilities at the end of the accounting period is equal to the stock at the beginning of the period and the change in that stock during the period.
55. The same definition of an economic asset is used in the general government accounts as in the System. Hence, the total value of assets and liabilities should be identical and the classification of each should be identical. The importance of public debt, however, may suggest a slightly different presentation to indicate clearly which liabilities are considered debt and the total value of the outstanding debt.
56. In addition to the classification of assets described in chapter XIII, it may be useful to classify general government assets as being general-purpose assets, which are assets that are used much like any other unit might use them; heritage assets, such as historic monuments; and infrastructure assets, such as roads and communications facilities. Also, the division of liabilities into debt, equity, and other and the identification of policy-related financial assets and international reserves may be appropriate.

Consolidation

57. Consolidation is a method of presenting statistics for a set of units as if they constituted a single unit. It involves eliminating transactions and reciprocal stock positions among the units being consolidated. Consolidation may be undertaken for any group of units, but the reference here is to the general government sector and its sub-sectors.
58. Although it is generally recommended that statistics in the System should not be consolidated, some analytical purposes are better served by consolidated statistics. For example, assessing the overall impact of government operations on the total economy or the sustainability of government operations is more effective when the measure of government operations is a set of consolidated statistics. To relate government aggregates to the economy as a whole (as in revenue or expense to GDP ratios), it is better to eliminate the internal churning of funds and include only those transactions that actually cross the boundaries with other sectors or non-residents.
59. Consolidation has the effect of measuring only transactions or stocks of the consolidated units with units outside the consolidation. Consolidated statistics do not reflect economic interactions within the grouping. The distorting effects on aggregates of differing administrative arrangements across countries are thereby eliminated. Without consolidation, for example, a country that employs a unified budgetary mechanism for carrying out transactions would show smaller unconsolidated aggregates than a country that conducts the same level of activity but uses extra-budgetary units.
60. Consolidation adjustments do not affect balancing items because the items consolidated are symmetric within each account. That is, two sides of the consolidation adjustment fall within the same account. For example, a grant from a central government to a local government unit is consolidated by eliminating the expense from central government and the revenue from the local government, thus

leaving unchanged saving of the general government sector.

61. Conceptually, the nature of consolidation is to eliminate all flows among the consolidated units, but practicality should be kept in mind. For example, some argue that transactions in the production account, such as taxes paid by a government unit to another government unit and sales and purchases of goods and services, should not be consolidated, partly because they generally are minor and partly because production statistics are generally compiled on an establishment basis. The decision about the level of detail employed in consolidation should be based on the policy usefulness of the consolidated data and the relative importance of the various types of transactions or stocks.

62. The major transactions considered for consolidation, in likely order of importance, are:

- Current and capital transfers, such as central governments grants to lower levels of government.
- Transactions in financial assets and liabilities, such as loans to other governments for policy purposes and acquisitions of government securities by social security funds.
- Interest income/expense on intergovernmental holdings of financial assets and liabilities.
- Taxes paid by one government unit or entity to another.
- Purchases/sales of goods and services between government units.
- Acquisitions/disposals of non-financial assets, including intergovernmental transactions in land, buildings, and equipment.

63. Two types of transactions that appear to take place between two government units are never consolidated because they are rerouted in the System to other units. First, all employer social contributions, whether paid to social security funds or government pension funds, are treated as being paid to the employee as part of

compensation and then paid by the employee to the fund. Second, all taxes withheld by government units from the compensation of their employees, such as pay-as-you-earn (PAYE) taxes, and paid to other governments should be treated as being paid directly by the employees. The government employer is simply the collecting agent in this case for the second government unit. Taxes on gross payroll and workforce that are not earmarked as social contributions should, however, be consolidated when they are significant and can be identified.

64. Practical difficulties always arise with consolidation. For example, when a transaction to be consolidated is identified in the records of one unit, it is expected that the corresponding transaction will be found in the accounts of the counterparty, but it may not exist there, it may be recorded in a different period, it may have a different value, or it may be classified as a different type of transaction. These difficulties may be more obvious with intergovernmental transactions, they are inherent in the quadruple system of recording used in the System and could exist with any transaction.

3. ACCOUNTING FOR SPECIFIC ACTIVITIES OF GENERAL GOVERNMENT

65. Text to be added

Accrual recording of government transactions

66. Text to be added

Tax revenue and credits

67. Text to be added

Interest (including fungible bonds, index-lined securities, zero-coupon bonds, derivatives)

68. Text to be added

Consumption of fixed capital for government assets

69. Text to be added

Debt operations, including cancellation, assumption, rescheduling, guarantees

70. This section describes debt reorganizations and selected other debt operations. A debt reorganization is a contractual arrangement for altering the terms for servicing an existing debt, usually on more favourable terms for the debtor. A government unit may be the debtor, the creditor, or a third party. Debt reorganizations include debt assumptions, debt payments on behalf of others, debt forgiveness, debt restructuring and rescheduling, debt conversions, and debt prepayments and buybacks.
71. Debt assumption is a trilateral agreement between a creditor, a former debtor, and a new debtor under which the new debtor assumes the former debtor's outstanding liability to the creditor. This occurs most frequently when a government guarantees the debt of another unit and the guarantee is called.
72. If a government assumes the debt of another unit, it records a new liability and the liability of the original debtor is extinguished. The new debt instrument does not necessarily have the same terms and conditions as the debt instrument that has been extinguished. The amount of the new debt is the full amount of the outstanding debt unless there is an agreement with the creditor to reduce the amount of debt owed.
73. When assuming the debt of another unit, a government may acquire a legal claim against the defaulting unit. If it does and if there is a realistic probability that the claim will be paid so that the government has an effective claim, the government records the acquisition of a financial asset equal in value to the present value of the amount expected to be received and a capital transfer for any difference between the asset acquired and the liability incurred. If the original debtor is bankrupt or its financial circumstances are in such bad shape that it is highly unlikely that it will be able to repay the assuming government unit, a capital transfer is recorded with a value equal to the liability incurred. If the defaulting unit is a public corporation controlled by the

assuming government unit and an on-going concern, the government unit records an increase in equity ownership in that public corporation rather than a capital transfer.

74. It is also possible for a government to have its debt assumed by another government. Most often, a higher level of government will assume the debt of a lower level of government. The government that has its debt assumed records either a capital transfer receivable, a new debt to the assuming government unit, or both.

75. <u>Debt guarantees</u> . This section will describe the treatment of guarantees as decided by the AEG.
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76. Debt payments on behalf of others occur when governments make one or more debt service payments on behalf of other units without assuming the entire debt. As with debt assumption, the treatment of the transactions associated with debt payments on behalf of others depends on whether the unit making the payments receives an effective financial claim against the unit for whom the payments were made. If there is an effective financial claim, the unit making the payments records the acquisition of a financial asset. If not, the unit making the payments records a current transfer payment.
77. Debt forgiveness is the extinction or reduction of a debt by contractual agreement between the creditor and the debtor. The amount of debt that has been forgiven is the value of debt before the forgiveness less the value of any debt remaining after the forgiveness. In the case of a marketable security, there may be little actual forgiveness because the market value of the debt had already been reduced through revaluations. The new contractual terms may merely recognize the existing market conditions. In the case of a loan, there may be a substantial forgiveness because the debt is expressed in nominal value rather than market value. The net worth of the debtor increases by the amount of debt forgiveness and the net worth of the creditor is correspondingly reduced. The counterpart transaction in each case is a capital transfer.

78. Debt restructuring is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor, including extended repayment periods, reductions in the contractual interest rate, added or extended grace periods, more favourable exchange rates for foreign currency debt, and rescheduled payments of arrears. The debt instrument that is being restructured is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. If there is a difference in value between the extinguished debt instrument and the new debt instrument, it is a type of debt forgiveness and a capital transfer is necessary to account for the difference. As with debt forgiveness, the difference in the values of the restructured and original debt may depend on whether they are valued at market or nominal value.
79. A debt-for-equity swap occurs when a creditor agrees to replace a debt owed to it by an equity security. For example, the government may agree with a public enterprise owned by it to accept an increase in the government's equity stake in the public enterprises in place of a loan. The recording of this event depends on the value of the shares and other equity received by the general government unit. While they should be recorded at market value, this value may be difficult to determine if there is not an active market for shares. In the latter case, the shares should be valued at the total value of the public enterprise's assets less the total value of its non-equity liabilities. Any difference in the value of the debt instrument being extinguished and the replacement equity is either a capital transfer or a revaluation. If the agreement had an explicit debt forgiveness element then the creditor government should record a capital transfer payable. Otherwise the difference should be recorded as a revaluation.
80. Debt prepayments and buybacks refer to early repayments of debt. A government may be either a creditor or a debtor in this type of a transaction. In some cases a discount is part of the repurchase arrangement. If the early payment is part a debt relief arrangement, then the debt relief portion is treated similarly to debt forgiveness. That is, the difference between the buyback price and the value of the debt extinguished is a capital transfer receivable by the debtor. On the other hand, if the early payment was not part of a debt relief arrangement, then any difference between the value of the debt extinguished and the amount paid should be recorded as a holding gain or loss.
81. Debt write-offs and valuation changes refer to unilateral reductions by a creditor in the amount owed to it. A debt write-off occurs when a creditor concludes that a debt obligation owed to it has no value or has less value than the book value because the debt is not going to be paid in full. Bankruptcy of the debtor is a common source of write-offs. When a government creditor writes off debt, the counterpart transaction is an other change in the volume of assets. A unilateral repudiation, by a debtor government is not recognized in the System.
82. Governments may recognize the reduction in value of their financial assets because of developments in capital markets. Loans should be recorded at nominal value in governments' balance sheets but secondary markets may develop for government loans. In this case, the loans should be reclassified as securities other than shares and valued at market prices. If the secondary market value is lower than the nominal value on the government's balance sheet, then a reduction in the value of the government's financial assets is recorded as a revaluation.
83. Debt servicing in arrears occurs when a debtor misses an interest or principal payment. The amount that should have been paid is considered in arrears. In general, it is good practice to maintain separate records within each category of debt of those instruments that are in arrears, both principal and interest, and those that are not in arrears.
84. Defeasance is where a debtor exactly matches the debt service outflows with financial assets with the same or greater debt service inflows. This may occur where a debtor has the wherewithal to pay down some of its liabilities but does not have sufficient debt maturing at present and the secondary market is too

expensive at the time to buy back its debt. In order to separate the debt and financial assets that form part of the defeasance arrangement from the rest of the debtor’s financial assets and liabilities, they may be transferred to a separate entity. Although the debtor may wish to regard the defeased debt as being effectively extinguished, the gross position should still be recorded. That is, the debt should continue to be shown on the liabilities side of the balance sheet and the off-setting financial assets recorded on the asset side. If a separate unit is created to hold the assets and liabilities, that new unit should be treated as an ancillary unit and consolidated with the defeasing unit.

85. Debt issued on concessional terms. Paragraph to be added only if the AEG decides to treat concession debt differently than commercial debt.

Pension obligations (government employees, social security)

86. A task force is investigating possible changes in the treatments of pensions, including social security benefits. At this point, it is not possible to present even tentative conclusions. The task force will meet next on September 21-23, 2005.

87. There are several competing proposals. One is to treat all unfunded employers’ pension schemes, including government schemes for its employees, identically to funded employers’ pension schemes, which would require that the liabilities of such schemes be recognised. Pension obligations of social security schemes, however, would not be recognised. Actuarial valuations would be used to measure employers’ social contributions and property income attributed to insurance policy holders. The net assets of defined benefit employers’ schemes would be allocated to the sponsoring employer.

88. A second proposal would not change the current treatment of funded and unfunded pension schemes regarding recognition of the liability for future pension benefits. Instead, a full set of supplementary accounts where both employer unfunded schemes and social

security would be recorded as if they were saving schemes.

89. A third, compromise proposal would incorporate unfunded employer pension schemes in the core accounts as a separate category from the funded schemes, with a separate set of transactions, leading to alternative balancing items. Social security liabilities would, for the most part, continue to be excluded. The exception would be when government employees are directly attached to a social security system. Because the borderline between social security systems and pension systems set up by government for their own employees is arbitrary, the liability for social security benefits to government employees would be recorded as if it were an employer pension scheme.

90. To some extent, the differing proposals arise from the existence of many different types of pension systems. In some countries, the contract between the government and its employee is a legally enforceable contract and the government cannot revise the amount of pension benefit already earned by an employee except by exercising its sovereign powers. In other countries the government may change the pension law at any time, including a change to reduce the amount of benefits payable to their own employees.

91. There are several other difficulties to be worked out by the Task Force. For example, some social security systems are fully or partially funded. Some are contributory and some are non-contributory. Do these features make a difference in the treatment of social security? Should the dual recording of social contributions and benefits for funded schemes be continued? The term “defined contribution” is not current used in the SNA. Should it be used in the revised SNA?

Military expenditures

92. Text to be added

Rate of return on government assets/capital services

93. Non-market output other than output for own final use, which includes most output by units of the general government sector, is to be measured by the sum of the costs of production, which is the sum of intermediate consumption, compensation of employees, capital services of non-financial assets, and other taxes (less subsidies) on production.. Output for own final use should, if possible, be valued at basic prices, but if reliable basic prices cannot be calculated, then this output should also be measured by the sum of the costs of production.
94. One reason to use capital services rather than depreciation as a cost of production is to make the value of the output of non-market services invariant to whether non-financial assets are owned or rented. If the non-financial assets were rented, then the rental paid would need to include a return to capital to the owner. It should not matter to the measurement of the output whether the non-market producer owns the asset or not.
95. When an asset is used in market production, there is a return to capital implicit in the value of the operating surplus of that producer. The net operating surplus arises in large part because an asset generates services which exceed the depreciation of the asset, and if this excess does not at least equal the return to capital, then the asset is not cost-effective to the producer.
96. For an asset to be cost effective to a non-market producer, it must also generate capital services that include a rate of return at the current market rate. An approximation of the value of capital services is depreciation plus a return to capital. This value affects the output and value added of all output measured by their costs of production. Consequently, it is particularly important to measure capital services accurately for non-market producers.
97. The complete formula for calculating capital services comprises four principal terms:
- i) a return to capital (i.e. the real interest rate multiplied by the value of the asset at the beginning of the period)
 - ii) *less* the anticipated real holding gain or loss of owning an asset
 - iii) *plus* depreciation
 - iv) *all multiplied by* a discount factor that takes account of the fact that the three other terms are in the future.²
98. For most assets the anticipated real holding gain will be zero, or close to zero, but for some assets the anticipated real holding gains/losses can be significant. For example, an owner of a computer would normally expect its price to fall in real terms over and above that due to depreciation given past experience of falling real prices. Hence, an enterprise providing computer services, or leasing out computers to other enterprises, would take account of the expected price fall in setting the prices it charged for those services.
99. When, as is usually the case, the real interest rate is small then a reasonable approximation is to estimate the user cost of capital as equal to depreciation and a return to capital.
100. An appropriate interest rate (or rate of return) for government and other non-market producers should reflect the cost of borrowing money. The obvious thing to do is to take a representative average of government bond rates of different maturation.
101. It is best to calculate capital services at as detailed a level as the data allow, and to group assets together that have similar depreciation and asset inflation rates. For example, it is best not to have computer equipment in the same group with assets that have long economic service lives and do not have declining real asset inflation rates.
102. Capital services should be calculated for all non-financial assets used by non-market producers, including land, infrastructure assets, and historic monuments. The return to

² A more detailed description of the method of calculating capital services will be included in the revised chapter about the production account.

capital should reflect the true value of the asset; if the asset has an elevated value because it is rich in historical or cultural associations, the return to the asset will reflect this higher value.

Transactions with international and supranational organizations

103. Text to be added

The distinction between government purchases, subsidies, and other transfer payments.

104. Text to be added

Development assistance

105. One way in which governments provide development assistance to other countries is by lending funds at an interest rate that is intentionally less than the market interest rate for a loan with comparable risk. In general, it is difficult for a statistician to determine the market interest rate of a loan and the SNA

guidance is to accept the contractual rate as if it were the market rate. In the case of concessional development loans, the difference between the market rate and the contractual rate may be large, and an estimate of the market rate may be available within acceptable error. In this case, the grant component of the loan can be calculated and treated as a transfer payment.

106. Another method of providing international assistance is through grants in kind, such as deliveries of food stocks. There are two valuation issues in these transactions. First, it is not clear what costs should be included, such as transportation to the foreign country, delivery costs within that country, the compensation of government employees to prepare the shipments or oversee their delivery, insurance, and so forth. Second, the prices of the goods being delivered, such as the food stocks, in the receiving country might be quite different from the prices in the donor country. The prices of the donor country should be used.

C. THE PUBLIC SECTOR

107. Text to be added

1. THE COMPOSITION OF THE PUBLIC SECTOR

108. Text to be added

Identification of public corporations

109. Text to be added

Criteria for control and economically significant prices

110. Text to be added

Sub-sectors of the public sector

111. Text to be added

2. THE ACCOUNTS OF THE PUBLIC SECTOR

112. Statistics for the public sector can be presented within the same framework as the sequence of accounts for institutional sectors as presented in chapters VI through XIII. For specialized analysis of government macroeconomic policies and their impact on the total economy, however, a modified presentation of the same economic events is often preferred. In particular, measuring production, especially non-market production, is not important for this type of analysis. As a result, there is no separate production account. Separation of the stages of distribution of income is also less important and the various entries for this distribution of income can be shown in the same account. The focus of the public sector operations account is on revenue and expense rather than resources and uses, and some types of revenue, notably taxes, are combined into a single category of

transactions rather than in several separate categories.

113. It is also advantageous to omit certain internal transactions. For example, the costs of producing fixed assets on own account are recorded in the System as uses in the production account and then recorded again as the acquisition of a fixed asset in the capital account. Because analysis of government policies does not require a measure of production, the statistics can be simplified by recording the production expenses only as capital transactions. Another major difference concerns output produced for non-market distribution. To record both its production and its disposition as a transfer or final consumption requires the same value to be recorded twice, similar to own-account capital formation. The second recording as consumption or a transfer payment can be avoided without loss for this type of analysis.

The sequence of public sector accounts

114. In each account and for each category of transactions, other economic flows, stocks of assets and liabilities, and balancing items, four columns are provided in each account. The first column is for the general government sector. In many cases, the values entered here will be the same as for the general government sector in the sequence of accounts. The second column is for the aggregate of public corporations. The third column shows the total value of items that are to be eliminated in consolidation, and the fourth column shows the resulting total for the entire public sector. This presentation emphasizes the advantage of consolidated statistics described above and stresses the accountability of governments for the entire public sector.
115. The operations account includes the transactions that would normally be recorded in the production account, the generation of income account, the allocation of primary income account, the secondary distribution of income account, the use of income account, and the capital account, but with different treatments given to certain transactions to

meet the needs of government macroeconomic policy analysis. The receipts side of the account (equivalent to the resource side of the current accounts in the system) includes all revenue transactions, which are defined as transactions that increase the net worth of the unit. The outlays side of the account (equivalent to the use side of the current accounts in the system) includes all expense transactions, which are defined as transactions that decreases net worth, and acquisitions less disposals of non-financial assets.

116. Revenue less outlays is equal to the operating balance. Because estimates of consumption of fixed capital may be exceptionally problematic, provision is allowed for expense to be recorded gross and net of depreciation. Revenue less all expense other than depreciation is defined as the gross operating balance. The gross operating balance less depreciation is the net operating balance. The net operating balance less acquisitions less disposals of non-financial assets equals net lending/borrowing.
117. Combining current and capital transactions in the same account causes the balancing item of revenue less expense to differ from saving, the corresponding balancing item in the System.

Public sector revenue

118. Taxes in the System are allocated to various accounts depending of the role of the taxes in income and accumulation. In the public sector accounts, all taxes are collected in the same category of transactions. The classification of taxes is quite different from the classification in the System, and a cross-classification will be provided. Capital and current taxes are combined within the same category, illustrating a crucial difference between the public sector accounts and the accounts of the System.
119. Social contributions differ substantially from the System because only those contributions that do not lead to increases in liabilities are recorded here and all contributions are

recorded in the System. One consequence is that the adjustment item for the change in net equity of households in pension funds is not required in the public sector accounts.

120. Transfer payments between governments are scattered in the main classification of transactions among current transfers within general government, current international cooperation, miscellaneous current transfers, investment grants, and other capital transfers. In this account, all of these transfers are combined and labelled grants. Grants received are particularly important for fiscal analysis because they represent revenue beyond the direct control of the receiving government.
121. Other revenue includes all property income receivable and all market sales.

Public sector expenditures

122. Compensation of employees is the same as in the System except that the amount associated with own-account capital formation is recorded only as the acquisition of a fixed asset. The same is true regarding the intermediate consumption and depreciation associated with own-account capital formation. In order to maintain the same concept of compensation of employees as in the production account, the goods and services produced by the employer and provided to its employees as compensation are deemed to be sold to the employees with an equal amount imputed as compensation.
123. Property income payable is the same as in the allocation of primary income account except that no estimate of FISIM is made in the public sector account.
124. Subsidies are recorded as a use (outlay) in the public sector account. In the allocation of primary income account, they are recorded as a negative resource (receipt). Otherwise, the concepts are identical.
125. Grants payable correspond to grants receivable in concept, but the category is less important for fiscal analysis because grants payable are within the control of the unit. As

with receipts, grants payable include capital as well as current grants.

126. Social benefits in the public sector account are quite different from the same category in the allocation of primary income account. In the public sector account, the payment of social benefits that were recognized as liabilities, primarily pensions, are not classified as social benefits. In addition, the value of any goods and services produced by the unit involved and distributed as a social benefit is recorded under the various production expense categories rather than as a social benefit.
127. Other expense, like grants payable, is a mixture of current and capital transfers.

Public sector balances

128. Text to be added

Public sector financial account

129. The financial account includes the net acquisition of financial assets and the net incurrence of liabilities. The account differs from the financial account in chapter XI mainly in the classifications used. Here, financial assets and liabilities are classified first by the residence of the counterparty of the instrument (either domestic or foreign) and then by type of instrument using the same classification of instruments as in chapter XI. One impact of the residence criterion is that monetary gold and SDRs is a separate category not associated with residence because there is no counterparty. An additional, alternative classification of financial assets and liabilities by the residence and sector of the counterparty rather than by the type of instrument is also encouraged.
130. The same degree of netting as in chapter XI is suggested. That is, each category of financial assets and liabilities represents the net change in that category. Financial assets are not netted against liabilities of the same category.
131. Privatization operations and transactions between government units and public corporations are likely to need particular care

in compiling the net acquisition of financial assets.

132. Transactions in policy-related financial assets are particularly important for fiscal analysis. It is suggested that a sub-category be created for these assets whenever possible. These assets will be found primarily in loans, securities other than shares, and currency and deposits. There is no category of international reserves, but governments are encouraged to report statistics on these assets. Either a sub-category can be created or a memorandum item can be added.
133. Arrears are important for some governments. A subcategory of each type of liability involving arrears is encouraged.
134. Debt is not an official category of liabilities. It is recommended above that a definition of debt be established. If successful, all liabilities could be classified as debt, equity, and other at a level after residence and before type of instrument.

Public sector other changes in assets account

135. The other changes in volume of assets and revaluation accounts are virtually identical to the parallel accounts described in chapter XII. All entries in both accounts originate from sources other than transactions. Both account records changes in assets and changes in liabilities from non-transaction sources.
136. Revaluations will be the same as in the account described in chapter XII, but with the possibility of additional relevant information as memoranda items. For example, it might be useful to show the impact of treating undistributed earnings of public corporations as if they had been paid and reinvested, which would eliminate some revaluations. More generally, revaluations in the equity of public corporations held by government units are likely to be particularly important and, at the same time, difficult to measure because it is unlikely that there will be any market prices.
137. Other changes in the volume of assets should be identical to those described in chapter XII. The classification of types of other changes in

the volume of assets account should be considered suggestive and implemented flexibly. Some categories might be quite important for government and used in this account but not important for other sectors and not shown in the parallel account for the total economy.

Public sector balance sheet

138. This account completes the sequence of general government accounts and is completely integrated with the flow accounts. Just as in Chapter XIII, this account is presented as a set of three sub-accounts. The first sub-account is the balance sheet at the beginning of the accounting period. The second sub-account is a compilation of all changes in the stocks of assets and liabilities during the period. The third sub-account is the balance sheet at the end of the accounting period. It is equal to, and can be derived from, the sum of the entries in the first two sub-accounts. That is, the stock of any given category of assets or liabilities at the end of the accounting period is equal to the stock at the beginning of the period and the change in that stock during the period.
139. The same definition of an economic asset is used in the general government accounts as in the System. Hence, the total value of assets and liabilities should be identical and the classification of each should be identical. The importance of public debt, however, may suggest a slightly different presentation to indicate clearly which liabilities are considered debt and the total value of the outstanding debt.
140. In addition to the classification of assets described in chapter XIII, it may be useful to classify general government assets as being general-purpose assets, which are assets that are used much like any other unit might use them; heritage assets, such as historic monuments; and infrastructure assets, such as roads and communications facilities. Also, the division of liabilities into debt, equity, and other and the identification of policy-related financial assets and international reserves may be appropriate.

Consolidation rules

141. Text indicating the same classification rules should be used for the public sector as for the general government sector.

D. RELATIONS BETWEEN GOVERNMENT AND CORPORATIONS**1. TRANSACTIONS BETWEEN GOVERNMENT UNITS AND PUBLIC CORPORATIONS**

142. Text to be added

Earnings from equity investment

143. Text to be added

Taxes versus withdrawal of equity

144. Text to be added

Dividends versus withdrawal of equity

145. Text to be added

Acquisition of equity, capital transfers, and subsidies

146. Text to be added

Privatization and nationalization, including holding corporations

147. Text to be added

Restructures, mergers, and reclassifications

148. Text to be added

Transactions with the central bank

149. Text to be added

Quasi-fiscal operations

150. Text to be added

2. OTHER TRANSACTIONS WITH CORPORATIONS

151. Introductory text to be added

Public-private partnerships

152. Public-private partnerships (PPPs) are complex, long-term contracts between two units, one of which is normally a private, for-profit enterprise and the other normally is a government unit.³ PPPs normally involve a collection of expensive fixed assets being acquired by a private unit, which then operates and manages the assets to produce and deliver services either to the public unit or to the general public on behalf of the public unit. At the end of the contract, the public unit often acquires legal ownership of the fixed assets, sometimes without payment or for a payment that clearly is less than the market value. The fixed assets are often referred to as infrastructure assets because many of the large projects undertaken by means of PPPs involve the provision of services to the public that government is normally expected to provide, such as transportation, communications, health, and education services.

153. Governments engage in PPPs for a variety of reasons, including the hope that private management may lead to more efficient production and that access to a broader range of financial sources can be obtained. PPP contracts frequently generate difficult

³ It also possible for a public corporation to occupy the role of either unit and for a private non-profit institution to occupy the role of the government unit.

accounting decisions because legal ownership of the assets may differ from operational control, there may be an advance agreement for the transfer of legal ownership part way through the service lives of the assets, observed monetary transactions may take place at prices that are not market prices, and actual transactions may have to be rearranged to reveal their true economic character.

154. PPPs can vary greatly. A general description that includes the most common accounting problems is as follows: A private enterprise agrees to acquire a complex of fixed assets and then to use those assets and other production inputs to produce services. Those services may be delivered to the government, either for use as an input to its own production (for example, motor vehicle maintenance services) or for distribution to the public without payment (for example, education services), in which case the government will make periodic payments during the contract period and the private enterprise expects to recover the cost of its investment and earn an adequate rate of return from those payments. Alternatively, the private enterprise may sell the services to the public (for example, a toll road), with the price regulated by the government but set at a level that the private enterprise expects will permit it to recover the cost of its investment and earn an adequate rate of return. At the end of the contract period, the government is likely to gain legal ownership and operational control of the assets, possibly without payment.
155. The private enterprise acquires the fixed assets and is the legal owner of the assets during the contract period. The contract may require, however, that the assets meet the design, quality, and capacity specified by the government, be used in the manner specified by the government to produce the services required by the contract, and be maintained in accordance with standards specified by the government. Furthermore, the assets typically have service lives much longer than the contract period so that the government will control the assets, bear the risks, and receive the rewards for a major portion of the assets' service lives. Thus, it frequently is not
- obvious whether the private enterprise or the government controls the assets over their service lives and/or will bear the majority of the risks and reap the majority of the rewards.
156. As with leases, the economic owner of the assets related to a PPP is determined by assessing which unit bears the majority of the risks and which unit is expected to receive a majority of the rewards of the assets. Some of the factors that might be considered in making this assessment are
- Construction risk, which includes the possibility of additional costs resulting from late delivery, not meeting specifications or building codes, and environmental and other risks requiring payments to third parties,
 - Availability risk, which includes the possibility of additional costs or the incurrence of penalties because the volume and/or quality of the services do not meet the standards specified in the contract,
 - Demand risk, which includes the possibility that the demand for the services is higher or lower than expected,
 - The presence, if any, of third party revenues—the greater the reliance on sales to the public, the more the private enterprise should be assessed to be the economic owner,
 - The degree to which the government determines the design, quality, size, and maintenance of the asset,
 - Residual value and obsolescence risk, which includes the risk that the asset will be less than their expected value at the end of the contract and the degree to which the government has an option to acquire the assets.
 - The degree to which the government is able to control the prices of the services produce
157. The relative importance of each factor is likely to vary with each PPP. It is not possible to state prescriptive rules that will be applicable to every situation in a satisfactory way. The provisions of each PPP will have to be evaluated in order to decide which unit is the economic owner.

158. Likewise, the complexity and variety of PPP contracts precludes the enumeration of detailed rules governing the transactions to be recorded concerning the control and use of the assets. Instead, all of the facts and circumstances of each contract should be considered, and then an accounting treatment should be selected that best brings out the underlying economic relationships. There are, however, a few common difficulties.
159. If the private enterprise is assessed as being the economic owner and if—as is common—the government obtains legal and economic ownership at the end of the contract without an explicit payment, a transaction must be recorded for the government’s acquisition of the assets. One general approach is for the government gradually to build up a financial claim and the private unit gradually to accrue a corresponding liability such that the value of both will equal the expected residual value of the assets at the end of the contract period. Implementing this approach requires existing monetary transactions to be rearranged or new transactions to be constructed using assumptions about expected asset values and interest rates. An alternative approach is to record the change of legal and economic ownership as a capital transfer. The capital transfer approach does not reflect the underlying economic reality as well, but data limitations, uncertainty about the expected residual value of the assets, and contract provisions allowing various options to be exercised by either party could make using a capital transfer prudent.
160. Another important problem arises when the government is assessed as being the economic owner of the assets but does not make any explicit payment at the beginning of the contract. A transaction must be constructed to accomplish the acquisition. The most common suggestion is that the acquisition be made with an imputed financial lease because of the similarity with actual financial leases. The implementation of that choice, however, depends on the specific contract provisions, how they are interpreted, and possibly other factors. For example, a loan could be imputed and actual government payments to the private unit, if they exist, could be rearranged so that a portion of each payment represents repayment of the loan. If there are no actual government payments, then non-monetary transactions could be constructed for the loan payments. Other means of payment by the government for the asset could be an operating lease prepayment if an operating lease is imputed or an intangible asset for right of the private unit to access the assets for the production of services.
161. A third important problem concerns the measurement of production, which is at the heart of the SNA. Whatever decisions are made about which unit is the economic owner of the assets during the contract period and how the government eventually acquires them, care should be taken that production is correctly measured. Again, there are options and their desirability varies with the exact situation and the availability of data. The difficulty arises when the government is assessed as being the economic owner of the assets but the assets are used by the private unit to produce services. It is desirable to show the value of the capital services as a cost of production of the private unit, but that may require the imputation of an operating lease, which in turn may require a rearrangement of actual transactions or a construction of non-monetary transactions to identify the lease payments. An alternative is to show the cost of capital services in the production account of the general government sector but to classify the output of the government in the same way as the classification of the output of the private unit so that the total output in the economy is correctly classified.

Licenses and concessions

162. Governments exercise their sovereign powers to require non-government units to purchase permits or licenses to engage in specified activities. If the permits are issued in unrestricted numbers, they are either taxes or sales of government-produced services as described in Chapter VII. Some permits that can be sold only by a government, however, are sold on a restricted basis, where restricted

means the number of permits is limited and the permit holder enjoys some degree of exclusivity in undertaking the permitted activity and the exclusivity results in monopoly profits. Depending on the degree of exclusivity and the demand for the goods and services produced by the activity, the potential profits may be quite large and the permits can be sold for correspondingly large amounts.

163. All government permits that rely on the exercise of a government's sovereign powers and are issued on a restricted basis are compulsory, unrequited payments to the government and should be treated as taxes.⁴ The permits clearly are compulsory because they are required before a unit can engage in the specified activity.
164. Payments for the permits are also unrequited because the permits are merely a means for the government to claim the monopoly profits created by its exercise of sovereign powers, which is just one aspect of the government's power to tax. Exercise of sovereign powers to raise prices, create monopoly profits, and then claim those profits by selling compulsory permits is equivalent to imposing a tax on the goods and services authorized to be produced by the permit. Instead of collecting the tax directly from purchasers of the goods and services when they are produced and sold, the government collects the tax when the permit is sold and the owner of the permit serves as a middleman by collecting the tax later from the purchasers.
165. If permits were assets, then the government selling the permits must have the same asset on its balance sheet before the sale. That asset can only be the power to require the purchase of restricted permits, a power that exists only because of the government's sovereign powers. Moreover, it is a power that the government can change at will increasing or decreasing the scope of the restricted permits that other units are compelled to purchase.

⁴ It is assumed that the price of restricted permits will be out of all proportion to the cost of providing any services that may accompany the permits so that the permits would be classified as taxes rather than sales of services.

The power to tax is not recognized as an asset in the System.

166. The criteria used to set the prices of permits can be quite diverse. The purpose of requiring the permit might be non-financial, such as compiling a business register, in which case the price might be quite low. Another possibility is that the permit's only purpose is to raise revenue, in which case profit maximizing principles will be applied. If the number of permits is limited, demand will exceed supply if the price is set too low and vice-versa. If the price is too low, then it must employ non-monetary criteria to select the units allowed to purchase the permits, and those units will receive a windfall gain. Instead the government might use an auction to determine the price. The prospective purchasers will bid for the right to purchase a permit because the net benefits expected from the permitted activity will provide at least the market rate of return. Thus, the method of setting the price of a restricted government permit is not relevant for its treatment as a tax or an asset. Auctions can be efficient methods of establishing a price when there is a limited number of an item for sale. The question with an auction is the character of the item being sold, not the auction itself. In this case, the character of a restricted government permit is not changed when it is sold by auction.
167. The purchase of a permit that is valid for several years should be seen as the advance payment of a tax. The portion representing a tax in future years should be treated as a financial asset. Thus, if a permit is valid for five years, one-fifth of the total amount paid should be treated as a tax in the year the permit is purchased and the remaining amount should be treated as a financial asset. In each succeeding year, the financial asset would be reduced and a tax expense would be the counter entry. Actual implementation should, however, be practical. If the permits are sold on a regular basis for amounts that do not change greatly, then recording the entire purchase as a tax in the year purchased would achieve a similar result at less cost.

168. Some permits might be tradable or the permit holder might be able to sell the unexpired portion back to the issuing government. Because the unexpired portion of a permit is a financial asset, the secondary sale of a permit from one non-government unit to a second non-government unit would be the sale and purchase of a financial asset. If a permit is sold back to the government, the payment received would be the liquidation of a financial asset and its corresponding liability. If, however, the purchase of a multi-year permit had been treated in its entirety as a tax to simplify the accounting, then a secondary sale of the permit would be a negative tax for the selling unit and a positive tax for the purchasing unit. If the permit is returned to the government, the government would record a negative tax revenue. This treatment of secondary sales assumes that the price of the permit has not changed between the original purchase and the secondary sale. If the price has changed, the selling unit has a gain or loss from holding a multi-year contract with fixed prices.
169. Some restricted permits might be valid in perpetuity. For example, a license to operate a taxi may never expire. Permits of this nature should be extremely rare as the government is giving up any opportunity to change the tax rate in the future. In effect, the government and the permit owner have entered into a permanent contract for the permit holder to pay taxes as long as there is any demand for the goods and services authorized to be produced by the permit. The financial asset thus created is like a perpetual bond and conceptually should be treated in the same manner. The effort to compile statistics on this basis, however, may cost much more than the benefits obtained. Simpler methods would be to amortize the price of the permit over some suitably long but arbitrary period or to treat it as a capital tax in the year the permit is sold.

<p>this section may be eliminated or radically revised.</p>

171. Public corporations may set up non-autonomous funded pension schemes for their own staff. The corporation has a liability on its balance sheet equal to the present value of the future pension benefits that have been earned by its employees. By contrast, with an unfunded pension scheme, the employer does not have a liability for the pension benefits on its balance sheet.
172. For various reasons, the government that controls the public corporation may assume responsibility for the pension benefits of the employees of the corporation, perhaps to improve their balance sheets with a view to privatising the corporation. As a result of the transfer of the obligations to government, the pension obligations of the corporation may be transferred into the general social security scheme or just treated as an unfunded scheme separate from social security. To compensate the government for accepting the pension liability, government may receive a lump sum that is expected to cover the future pensions to be paid by government.
173. Because no liability is recorded in the System for unfunded pension schemes it is not possible to record the transaction as the exchange of equal valued assets and liabilities. In effect, the government has received assets but has not incurred any liabilities. The counterpart to the transfer of assets, therefore, must be a capital transfer payable by the corporation to the government, which improves changes in net worth due to saving and capital transfers, net borrowing, and the net worth of government. In the future, payments of pension benefits will be recorded as current government transfer payments, which will worsen the same balancing items. The disappearance of the pension liability is recorded as an other change of volume of assets in the accounts of the households involved and the corporation.

Exchange of provisions (pensions)

<p>170. Depending on the outcome of the pension task force and the AEG decisions about pensions,</p>
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Bailouts

174. A bailout is a loosely defined term meaning a rescue from financial distress. It is often used when a government unit provides temporary financial assistance to a corporation to help it transition through a period of financial difficulty or a more permanent injection of financial resources to help recapitalize the corporation. Bailouts of financial institutions are particularly noteworthy. The operations are likely to involve highly publicized one-time transactions with large values and, therefore, are easy to identify. For example, a government might buy assets other than loans from financial institutions at a price higher than the market price or provide equity financing on exceptionally favourable terms. In principle, such transactions should be partitioned and a capital transfer should be recorded for the transfer element.
175. Intervention of general government may take various forms. For instance:
- A government may guarantee certain liabilities of the enterprise to be assisted.
 - A government might purchase assets from the enterprise to be assisted for prices greater than their true market value.
 - A government might create a special purpose entity or other type of public body to finance and/or to manage the sales of assets or liabilities of the enterprise to be assisted.
176. Government guarantees during a bailout are treated in the same manner as other guarantees. In this case, they would be treated as one-off guarantees, which will normally lead to a capital transfer when the guarantee is called.
177. If the government buys assets from the enterprise to be assisted, the purchase price will normally be more than the true market price. A capital transfer should be recorded when government buys the assets from the financial institutions.
178. Governments often buy loans from financial institutions during a bailout for their nominal value rather than their market value. Given

that loans are valued at nominal prices in the System, there may not be justification for recording a capital transfer even though there clearly has been a transfer. If there is reliable information that some loans are irrecoverable (fully or for nearly their total amount), these loans should be accounted for at zero and a capital transfer should be recorded for their former nominal value.

179. If a public institutional unit is created by government with the task of assuming only the cost of the bailout, it should be classified in the general government sector. If the new unit is supposed to be an on-going concern, the classification inside or outside the general government sector has to be made following the general rules. Units that purchase financial assets from distressed financial corporations and in order to sell them in an orderly manner cannot be considered as being financial intermediaries because they do not really place themselves at risk. They must be classified in the general government sector.

Securitisation

180. Text to be added

Accounting for loans

181. In general, assets and liabilities are valued at their current market value in the system. Because loans are not traded, however, there normally is no market price for loans.⁵ Even estimating market-equivalent values for loans, such as using prices of comparable items or the present value of future cash flows, is not normally possible on a reliable and consistent basis. As a result, loans are measured at nominal value in the system.
182. The nominal value of a loan is the amount that the debtor owes to the creditor at a given time. It reflects the value of the loan at creation and the effects of interest accrued, repayments of principal. And changes in foreign-exchange rates. Conceptually, the nominal value of a loan can be calculated by discounting future

⁵ If loans are traded, they are classified as securities other than shares.

- interest and principal payments at the existing contractual interest rate.
183. The market value of a loan can differ from its nominal value because of changes in the interest rate or because it has become a nonperforming, or impaired, loan. A loan becomes nonperforming when payments of interest and/or principal are past due by 90 days or more, 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. After a loan is classified as nonperforming, it and any replacement loans should remain classified as nonperforming until they are written off or payments of interest and/or principal arrears are received.
184. Because the market value of loans is often quite different than the nominal value and because nonperforming loans imply that losses will be incurred, a memorandum item should be added to the balance sheet providing additional information about loans. There are two possibilities. First, it may be possible to estimate the market-equivalent value of a portfolio of loans. If so, this value should be indicated. This value allows for a more accurate analysis of the true financial position of an entity. It is recognized, however, that it will be more feasible to capture this item for loans as assets of creditors rather than as liabilities of debtors.
185. If the market-equivalent value of the loans cannot be estimated, then nominal value less expected losses should be stated. The losses, which include both interest and principal, relate more closely to nonperforming loans than does the preferred memorandum item of the market-equivalent value of all loans. The latter includes the effects of interest rate changes as well as losses.
186. When a loan becomes non-performing, the debtor often ceases to pay interest and arrears of both principal and interest accumulate. Information on interest arrears is useful for an analysis of a financial corporation's income generating capacity.
187. Interest arrears can be looked at from the perspective of both stocks and flows. From the perspective of stocks, accumulated interest arrears are part of the underlying nonperforming loans and are part of the memorandum item showing loans at their nominal value less losses.
188. From the perspective of flows, it is important that interest continue to be accrued on loans according to the terms of the contract irrespective of their status as performing or nonperforming. Because the increase in interest arrears represents income not likely to be received, a memorandum item should be included stating the amount of interest receivable during a period that is represented by interest arrears.

Annex on the General Government and Public Sectors

A. Introduction

189. A number of formulations have been proposed to adapt the traditional SNA sequence of accounts for analysis of public finance statistics. This annex will provide a

detailed correspondence between the SNA sequence of accounts and these public finance presentations.

B. Relationship between the sequence of accounts and public finance accounts

1. Government Finance Statistics Manual 2001

190. Text to be added

2. ESA95 Manual of government deficit and debt

191. Text to be added

3. OECD Revenue statistics

192. Text to be added

4. International Public Sector Accounting Standards

193. Text to be added