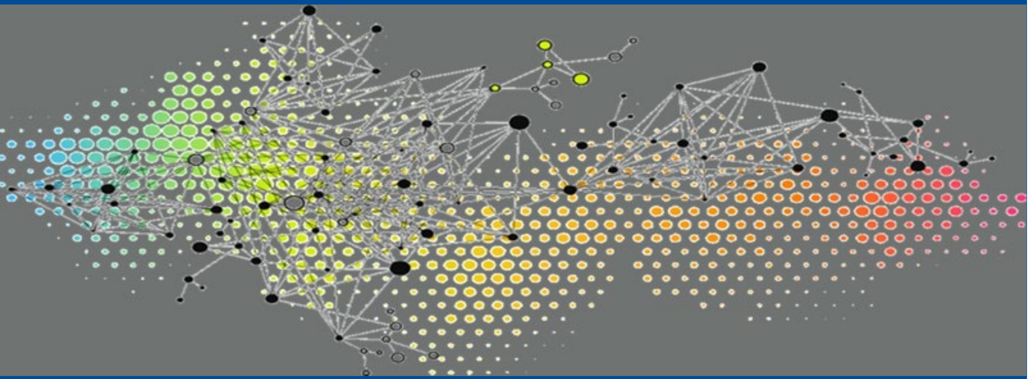
STATISTICS

INTER SECRETARIAT WORKING GROUP ON NATIONAL ACCOUNTS



D.16 Treatment of Retained Earning (BOPCOM 21/16)

Joint (Virtual) Thirty-Seventh Meeting of the IMF Committee on Balance of Payments Statistics and Seventeenth Meeting of the Advisory Expert Group on National Accounts

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Acknowledgement

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Issues Discussed

Issue 1: Calculation of Reinvested Earnings (RIE)

BPM6 guidance on the calculation of retained earnings and RIE may be confusing to users.

- Recommend to clarify the language.

Not easy to find a complete/detailed information in the financial statements and reports.

- Requires exclusion of items that are not always standardized in the enterprises' accounting frameworks.
- Non-standardized forms/formats of financial statements impose barriers to automation.

Difficulties to measure and to analyze the statistical concept of NOS financial corporations are particularly relevant.

Concept of income generated by direct investment enterprises (DIEs) does not deduct the expense relate to the provisions for bad loans.

- Can lead to large differences between financial and statistical measurement of earnings for financial corporations.
- To assist users in interpreting the income of financial DIEs keep the current RIE imputation and present provisions as a memorandum item.

Issue 2: RIE along the Ownership Chain

According to *BPM6* paragraph 11.47, "*passing of retained earnings from indirect holdings should be taken into account through the chain of direct investment relationships*".

- ➢ Long ownership chains have the potential to hinder the distinction between operational and non-operational earnings.
- ➢ Calculating indirect RIE for Special Purpose Entities (SPEs) is difficult.
- ➢ Members of the drafting have different interpretations about its practical implementation.
- ➢ Differences in recording RIE from indirectly held entities can level and partner economy allocation of income statistics, leading to global and bilateral asymmetries among economies.

Three alternatives were considered:

(A) **the status quo** (i.e., recognizing all of the earnings generated down the DI ownership chain in primary income)

(B) **recognizing all of the earnings generated down the DI ownership chain as primary income** but reporting indirect income separately

(C) **limiting the imputation of RIE to the P&L account** of the immediate DIE

Issue 3: Investment Income Attributable to Investment Fund Shareholders—Retained Earnings

Under *BPM6*, paragraph 11.38, **undistributed earnings of investment funds** are imputed as being payable to the owners and then reinvested in the funds.

- Applicable to both DI and portfolio investment.
- Investment income is attributable to the shareholder on the one hand and the financial services incurred by the fund are charged to the shareholders on the other hand.

Recommendations:

- Retained earnings (and net income) generated by investment funds should always be compiled regardless of the fund attributes.
- A distinction is needed whether operating expenses are explicitly paid the shareholders.
  - **Explicit expenses** should be recorded as financial services paid by the shareholders to the respective counterpart.
  - **Expenses implicitly** paid by the shareholders and FISIM should be recorded for simplicity as financial services paid by the shareholders to the investment fund.

Outcomes of IMF/UNSD Global Consultation

Fifty-one respondents from 50 economies

Conceptual Issues

- Most respondents agreed that the *BPM6* paragraphs describing retained earnings should be revised.
- A large majority agreed that the recognition of all the earnings generated down the DI ownership chain as primary income is the best option (Status quo).
  - While acknowledging the practical challenges.

Current Compilation Practices

- Less than half supported reporting indirect income separately.
- More than half of respondents agreed that a memorandum item showing new obligatory provisions for bad loans would help users interpret the statistics of RIE for credit institutions.
- Around half of respondents supported the proposed treatment of operating expenses that are charged explicitly.
- Less than half supported the treatment of operating expenses that are charged implicitly.

Outcome of the WGIIS Consultation

Issue 1: Calculation of RIE

- Unanimous agreement on the need to revise the *BPM6* paragraphs describing retained earnings and reinvested earnings.
- Majority did not support the proposal of a memorandum item identifying change in provisions for bad loans.

Issue 2: RIE along the Ownership Chain

- Various challenges were raised: data availability; difficulties to verify data and to communicate with respondents; reporting burdens for multiple affiliates; and difficulties measuring non-COPC items from indirectly held affiliates.
- Majority of respondents favoured maintaining the status quo, mostly to keep consistency with existing data and because it is the most theoretically sound recommendation.

Issue 3: Investment Income Attributable to Investment Fund (IF) Shareholders – Retained Earnings

- Most respondents agreed that RIE should be compiled regardless of the fund’s attributes.
- Dissenting opinions on the proposal to differentiate the treatment of fees that are charged implicitly or explicitly.

Questions for Discussion

Questions for Discussion: Issue 1

1) *Do the Committee and the AEG agree that* BPM6 *paragraphs describing retained earnings and reinvested earnings should be revised to reflect the discussion in relevant paragraphs in the GN?*

2) *Do the Committee and the AEG consider it relevant to clarify and address, either in the revised BPM or in the BPM Compilation Guide, shortcomings in the compilation of DI income as described in* BPM6 *and to include examples of calculation of RIE?*

3) *Do the Committee and the AEG agree to separate as a memorandum item the obligatory provisions for bad loans when calculating the RIE for credit institutions?*

Questions for Discussion: Issue 2

1) *Do the Committee and the AEG agree that the recognition of all the earnings generated down the DI ownership chain as primary income is best on a conceptual basis (Alternative A)? If so, do you think the practical challenges encountered by some countries justifies deviating from the conceptually preferred basis Alternative C?*

2) *If you prefer to keep the current guidance (Alternative A), do the Committee and the AEG agree that the presentation proposed in Alternative B (to report indirect income separately) would be useful to enhance transparency and data comparability across countries?*

Questions for Discussion: Issue 3

1) *Do the Committee and the AEG agree that RIE and net income should always be compiled regardless of the fund's attributes?*

2) *Do the Committee and the AEG agree with the proposed treatment of operating expenses charged either explicitly or implicitly in the compilation of investment funds' RIE?*

Thank You