

REPORT

**Second Meeting of the Advisory Expert Group on National Accounts
8 -16 December 2004
at United Nations, New York**

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1 Introduction

1. The second meeting of the Advisory Expert Group (AEG) on National Accounts of the Intersecretariat Working Group on National Accounts (ISWGNA) was held during 8-16 December 2004 at United Nations, New York. Members of the AEG, members of the ISWGNA, the Project Manager and the Editor of the 1993 SNA update attended the meeting. The list of participants is annexed. Mr. Charles Aspden welcomed the participants on behalf of the ISWGNA. He informed the participants that Mrs. Carol Carson and Mrs. Anne Harrison have been appointed as the Project Manger and the Editor, respectively, for the 1993 SNA update.

2. Mr. Paul Cheung, Director, United Nations Statistics Division (UNSD), delivered opening remarks and welcomed the participants to the meeting. He observed that standards expressed in the 1993 SNA are central to the reporting of economic statistics and influence to a great extent the development of other major macro statistical standards. He reiterated the guidance from the United Nations Statistical Commission (UNSC) that the global statistical community should be involved, to the maximum extent possible, in the update process. The global engagement would lend more credibility and transparency to the process as well as enhance international comparability by encouraging countries to adopt the new standards in their changing economic environment. However, he sounded a note of caution that implementation feasibility should be an important criterion as many developing countries are still struggling to implement the current 1993 SNA. In conclusion, he wished all success with the deliberations.

1.1 Adoption of the provisional agenda

3. The provisional agenda (document No. SNA/M2.04/01) was adopted unanimously. As indicated in the agenda, items were distinguished as issues for decision and issues for information.

1.2 Progress Report of the Update of the 1993 SNA

4. The progress report on the 1993 SNA update exercise (document No. SNA/M2.04/02.1) was presented by Charles Aspden. It was noted, that since the time the ISWGNA was given the task by the UNSC in March 2003, considerable progress has been made. Various Expert Groups deliberating on the issues relating to the update are working in a very cooperative environment. Also, the governance arrangements have been further articulated, clarifying the relationships among ISWGNA: Management Group, ISWGNA: National Accountant Group, AEG, Project Manager and Editor. A high degree of transparency has been achieved through the consultation process with the international statistical community and through the well-designed interactive website <http://unstats.un.org/unsd/nationalaccount/snarev1.asp>. He also mentioned that a review of financial requirements for the revision process is underway, which might conclude that additional resources are needed.

1.3 Operational Guidelines

5. The Federal Statistical Office of Germany had sent a letter dated 18 November 2004 to the UNSD regarding the clarification of principles (i.e. operational guidelines) for the revision of 1993 SNA, with a request that this letter be brought to the attention of the AEG. The principles formulated in the letter emphasize that (i) revision of the 1993 SNA should not lead to large changes in the levels of gross national income and

the net lending/borrowing of Government, (ii) methodological changes introduced should be satisfactorily measurable, (iii) in case of doubt, transactions should be restricted to observable market transactions, (iv) estimation at constant prices should be feasible, (v) problems of quarterly and regional accounts should be solvable, (vi) in case of doubt, the methodology should be in accordance with the business accounting principles, (vii) changes should be acceptable to important users of data, (viii) changes in the methodology should be practical and useful from a policy point of view, and (ix) difficult and problematic items of the revision should be tested within satellite frameworks.

6. The Group shared many of the concerns expressed in the letter and agreed there should be a formal reply from the UNSD, as Secretariat, on behalf of ISWGNA. However, the Group expressed collectively the opinion that the first principle mentioned in the letter (i.e., no (or only small) changes of the level of Gross National Income (GNI) and of the level of net lending/borrowing of government) was not acceptable as a principle for the update process because it is too restrictive. It was noted that the operational guidelines for the update of the 1993 SNA already reflected many of the other concerns expressed in the letter. It was felt that these guidelines were sufficient and it would not be necessary to reject a proposal for change because any one of the points in the German letter was not met; these points were seen as being mainly indicative and not deterministic.

7. The revised operational guidelines for the meetings of the AEG were presented and discussed (document No. SNA/M2.04/02.2). Members emphasized that the issue papers should be made available to the AEG members at least one month in advance of the scheduled date of the meeting. Copies of AEG papers should be sent to members in addition to posting them on the UNSD's website. The revised guidelines were adopted unanimously.

1.4 List of clarifications

8. A provisional list of clarifications in the 1993 SNA Rev. 1 (document No. SNA/M2.04/02.3) was presented to the AEG. The list includes suggestions which should be made exclusively for the purpose of (i) introducing more user friendly terminology in the 1993 SNA Rev.1, (ii) amending wording errors and apparent inconsistencies or contradictions in different parts of the SNA, and (iii) rewording the text that has been found to be confusing, unclear and ambiguous. The clarifications contained in the document No. SNA/M2.04/02.3 were discussed briefly. The chapter on satellite accounts needs updating in respect of the revised SEEA and it could be useful to add in the revised version reference to new work on satellite accounts including the new NPI handbook and work on unpaid household production. The question of seignorage was raised again, the suggestion that the previous clarification suggested coins were a liability and some legal advice disagreed on this point. It was suggested that it would be useful to refer to Eurostat documents on regional accounts or a paper given at the ECE national accounts meeting in 2000 or 2001 on inventories. It has been agreed that the end date for receiving suggestions for clarifications is end 2005 but it was noted this was very late in the process and participants were encouraged to make their suggestions as soon as possible. The meeting was informed that the process of dealing with requests for clarification is that the editor will discuss the points raised with those sponsoring the clarification and agree suitable text with them before distributing it more widely for comment.

1.5 Review of country comments

9. The overview of country comments on the AEG recommendations was presented to the AEG (document No. SNA/M2.04/03). Responses from National Statistical Offices/Central Banks of 42 countries have been received. After detailed discussions it was decided that:

- (i) Countries should be requested at various international and regional meetings to file their comments. Regional Commissions should be involved in soliciting the response from the countries. Efforts should be made to solicit comments from as

wide a range of commentators as possible, including individuals with an expertise and interest in the subject not employed in statistical offices.

(ii) The UN web site contains details of all comments received on the decisions made by the AEG. Further comments on recommendations made in the February 2004 AEG meeting received by 31 December 2004 will be posted. There will be a period of 60 days for commenting on recommendations of future AEG meetings.

(iii) The decision to treat defense expenditure on durables as capital received a majority of supporting comments but in view of the significant number of dissenting comments, it was agreed that the project manager will investigate and follow up with those responsible to see how crucial this issue is to them. This is the procedure which will be followed in general for an issue which does not receive overwhelmingly favourable comments.

2 Databases (decision)

9. This session was chaired by Ivo Havinga, UNSD, and Charles Aspden, OECD, presented the issue (document No. SNA/M2.04/04).

10. Three questions were raised for decision:

(i) Does the AEG agree that the reference to “large”, as in “large databases”, should be dropped from the SNA?

(ii) Does the AEG agree that all databases should be capitalized in principle?

(iii) Does the AEG agree that the current SNA classification (AN.1122) for computer software should be changed from “computer software” to “computer software and databases”, with databases and software identifiable separately, as sub-classes, if possible?

11. The AEG agreed that the present SNA recommendation, that large databases should be treated as fixed capital, was ambiguous because “large” was a subjective qualification. This word should be dropped.

12. The AEG tentatively agreed that all databases were candidates for treatment as fixed capital. However, it requested the Canberra II Group (i) to provide a definition of “database” and a definition showing exactly which databases should be included (or excluded) in fixed capital; (ii) to consider the distinction between creation and maintenance and the implication for the inclusion in fixed capital; (iii) to add precision to the nature of employees to be included in the recommended means of valuing own account databases. It deferred part of this discussion to the deliberations on the issue of originals and copies.

13. The group agreed to include a single category in the classification of assets for “software and databases”, with a disaggregation into “software” and “databases”.

3 Mineral exploration (decision)

14. This session was chaired by Ivo Havinga, UNSD, and Anne Harrison presented the issue (document No. SNA/M2.04/05).

15. The following points were brought up to the AEG for decision, after having been agreed in the Canberra II Group:

(i) The produced asset “mineral exploration” should be described as “mineral exploration and evaluation” and the coverage should be described using the criteria of the International Accounting Standards Board (IASB).

(ii) The assets for mineral exploration and evaluation and for subsoil deposits should continue to be recorded as separate assets, the first a produced asset and the second a non-produced asset.

(iii) The description of the valuation of mineral exploration should be clarified to ensure that actual market costs are used when specialized enterprises provide inputs to the activity.

(iv) The valuation of subsoil resources should be based on the current market value, which in practice may be estimated by the net present value of the resource rent of the resource. The resource rent is the part of gross operating surplus that is

unattributable to other identified assets, specifically fixed assets including mineral exploration and evaluation.

(v) Payment by the extractor to the owner of the resource should be recorded in national accounts as property income (rent) regardless of the label given to the payments.

16. The group agreed to change the item “mineral exploration” to “mineral exploration and evaluation” and to draw on the IASB coverage of this item to specify the SNA item.

17. The group agreed to maintain a distinction between mineral exploration and evaluation as a produced asset and the mineral deposit as non-produced asset. (A few members of the group withdrew their preference for treatment as a joint asset to achieve consensus.)

18. The group agreed that the description of the valuation of this item should be clarified to make explicit that it is market production to be valued either at market prices, if purchased, or as the sum of costs plus mark-up, if produced on own-account.

19. The group agreed that the preferred valuation for mineral deposits, market price, is seldom available. In default, the deposit should be valued as the present value of future receipts of resource rent.

20. All participants agreed that in principle payments by the extractor to the owner of the resource should be recorded as property income. However, it was noted that when the owner is government, these payments may be described as taxes and there is problem of political sensitivity in having a tax figure in the SNA which is lower than the figure government reports in its accounts. Further, a single payment may represent both the property income element as corporate income tax and the means of separating these into two elements may be difficult. This problem was noted and requires further

consideration. This is likely to recur in Canberra II and TFHPSA discussions on when licences should be regarded as taxes or fees for a service. The question was raised about whether the SNA definition of a mineral deposit, which is presently confined to proven reserves, should be extended to include probable reserves also. It is increasingly common for this to be the commercial practice and some countries cannot make a division between proven and probable.

21. The question of attribution of the ownership of a deposit extracted by a unit not the legal owner is deferred to a future meeting when leases and licenses will be discussed more generally.

4 Informal sector (information)

22. The session was chaired by Ivo Havinga, UNSD, and Vu Viet, UNSD, presented the issue. The paper (document No. SNA/M2.04/12) reviewed the methodology of the informal sector that had been elaborated mainly by the ILO and the Delhi Group on Informal Sector Statistics, and by other institutions. It concluded that the current treatment in the SNA is included in the Annex of Chapter IV, but its description is insufficient and not clear. The Annex of Chapter IV recommends to include unincorporated production units of the household sector of the SNA, for which no complete sets of accounts are available; that are not registered under specific forms of national legislation; that would meet the characteristics of the informal sector, as determined in the ILO (15th ICLS) resolution; but leaves to the countries to decide the size of employment under a certain level. Question is whether unincorporated/informal enterprises are determined by not having a full set of accounts or by use of a size criteria (which may be the level at which registration applies). Moreover, the Delhi group has wrested with the question of what exactly it is that is most interesting from a policy point of view, informal activity, employment in informal activities or informal workers, i.e. those who are casual workers in both formal and informal activities (including government) but excluding those with regular working conditions in

informal activities. In conclusion, the paper states that further clarification of the definition and policy demand is required to agree upon an internationally comparable definition of informal productive units as compared to informal employment.

23. The AEG reaffirmed the importance of the informal production and the existing analytical demand, particularly in developing countries. Therefore, it supported recognition of informal activities in the updated 1993 SNA. It was debated whether this should be achieved by an updated annex to reflect the latest guidelines of the ICLS made in December 2003, or through inclusion elsewhere, e.g. under the chapter on satellite accounts or the chapter on labor inputs (employment). In any case, more clarity about the definition is needed to meet the analytical demand.

24. Regarding the elements of the definition, the Group confirmed that it should determine a minimum number of criteria in order to become operational and internationally comparable. Some members questioned the usefulness of employment size as a criterion for delineating informal production units. Also, it discussed whether agricultural activities should be excluded, and if so, on what grounds. Apparently, separating the non-agricultural units of the household sector is important for policy makers in developing countries in their effort to formulate policy that encourages non-agricultural activities where agriculture is predominant.

25. Members of the AEG confirmed that the informal sector is not a separate institutional sector in the SNA sense, and noted that the 1993 SNA, in line with the 15th ICLS resolution, considers it a sub-sector of the household sector. The AEG recommended that an extended text should cover a close definition of the informal sector and clarify its borderline in relation to analytical demands on informal activity and employment. Moreover, the text should make reference to the treatment of household production in satellite accounts.

5 Originals and copies (decision)

26. This session was chaired by Brian Newson, Eurostat, and Anne Harrison presented the issue on behalf of the Canberra II Group (document No. SNA/M2.04/06).

27. The Canberra II considered three options for recording the original and copies in national accounts.

1. Payments for licences to use copies and licences to reproduce copies should be treated as payments for part of the original (Peter Harper's proposal).
2. Both originals and copies are recognized as assets when conditions of being assets are met (OECD/Eurostat Taskforce on Software proposal).
3. Payments for licences to use and licences to reproduce the original "idea" should be treated as rental payments (Robin Lynch's proposal).

28. The Canberra II Group decided that option 2 is the most appropriate. The key points in the Canberra II Group proposal were:

- (i) Creation of an original is production treated as capital formation when it provides a stream of future income;
- (ii) Both the originals and copies may be treated as assets;
- (iii) Copies can be divided into licences to use and licences to reproduce;
- (iv) Licences to use an original are fixed capital formation if they meet the qualifying conditions, otherwise they are treated as production of service;
- (v) Payments for licences to use spread over the life of the licence, when they meet the criteria for being an asset, should be treated as capital at the time of acquisition (on financial lease terms), if this is possible in practice, instead they are recorded as capital as they happen;
- (vi) Two options for the treatment of licences to reproduce: if the agreement between the originator and reproducer is similar to an operating lease, the regular payments are purchases of services, new production by the holder of the original; if the originator transfers all or some of the responsibility for making copies and servicing their use, this is the sale of all or part of the original asset and not new production.

29. The following questions were brought up to the AEG for decision:

Licences to use

- (i) Are copies issued under licence to use the outcome of production?
- (ii) Can these copies be treated as GFCF in their own right distinct from the original?
- (iii) When payments for this GFCF are spread over time, should it be treated similar to a financial lease?

Licences to reproduce

- (i) When the licence has the characteristic of an operational lease, should payments be payments for services (and new production)?
- (ii) When the holder of an original divests himself of responsibility for reproduction and servicing of copies, does this represent the sale of an asset?

30. Robin Lynch presented his minority view in the Canberra II Group, dealing with differences between option 2 and option 3 of the treatment of originals and copies. According to his views only the original is an asset, while creating a copy (of knowledge) is fundamentally different process from the creation of fixed tangible assets. The creation of a copy allows access to the original; any payment should be recorded as rent - (intellectual) property income; use has no direct effect on the original value; no capital is consumed; and it does not affect GDP.

31. After lengthy discussion the majority of the AEG members expressed overwhelming support for option 2.

32. Concerns were raised by many participants on the need for the clarification of assets like licences to use. Subsequently, the AEG agreed to seek clarification on conditions under which the license to use, even though renewed annually, can be treated as an asset.

33. The UNSD brought up a question to the AEG on the product classification of the asset “licence” – is it a good or a service? If it is classified as a good, it must be

physically identifiable. The chair of the Canberra II group replied that there is an item in the Canberra II programme dealing with the classification of assets and clarification of terminology. Moreover, the need was expressed that this classification issue should be coordinated with ongoing revision work on balance of payments, international trade in services and the Central Product Classification.

34. In conclusion, the following agreements were reached.

i) Majority of the AEG members agreed that copies generated for issue under licence to use are the outcome of new production.

ii) There was no disagreement about question ii on licences to use. Basically copies (licences to use) will be treated as GFCF in their own right distinct from the original when they display the characteristics of fixed assets.

iii) Canberra II needs to clarify further when annual payments can be regarded as evidence of transfer of economic ownership. Many participants expressed concern at treating a licence for use paid for over a period of time as a financial lease. If this is to be done, there needs to be explicit guidance on how to determine interest and loan repayment and how to record these in the accounts.

iv) The question about the transfer of economic ownership is closely related to the issue of lease and licences, so the AEG decided to wait for the outcome of the Canberra II deliberations.

v) A large majority of the AEG members favoured the recording of licence to use when it has the characteristic of an operational lease as payment for service (and new production) and when the holder of an original divests itself of part or all of the responsibility to issue and service copies under licences to use by means of a licence to reproduce as the sale of the corresponding part of the asset.

vi) Having two possible treatments for licenses to reproduce could affect the classification of assets (to be considered by Canberra II) and the borderline between goods and services in trade figures.

6 Treatment of non-performing loans (decision)

35. This session was chaired by Brian Newson, Eurostat, and Adriaan Bloem, IMF, presented the issue (document No. SNA/M2.04/07).

36. The background of the issue is that the financial crises of the 1990s led to renewed interest in the question of how (unsecured) non-performing loans (NPLs) should be accounted for in macroeconomic statistics. The 1993 SNA, in particular, NPLs are not distinguished from all other loans in either the flow accounts or the balance sheets. The origin of the issue is that the current 1993 SNA records loans at nominal value irrespective of changes in their quality in terms of credit risk and other changes in the market. In addition, the 1993 SNA recommends that interest on NPLs continues to accrue, even if the contractual payments are not made. As a result, the accounts may provide a seriously overoptimistic view on the financial positions of holders of non-performing loans.

37. A questionnaire sent out by the EDG on NPLs asked respondents for their preferred solution. Option 1 was to make no changes to the 1993 SNA. Option 2 was to continue measuring loans at nominal value in the main accounts, but include mandatory memorandum items on their market-equivalent value and on interest arrears. Option 3 was to record loans at market-equivalent value in the creditors' accounts only, with memorandum items on nominal values and interest arrears. Option 4 was to measure loans at market-equivalent value for both creditors and debtors, with memorandum items on their nominal values and interest arrears.

38. The various contributions and responses to the questionnaire were nearly unanimously in favor of remedying current SNA guidelines, unambiguously rejecting Option 1. Similarly, the idea of having asymmetrical creditor and debtor accounts was rejected (Option 3). There was a small, although not necessarily conclusive, margin of support for Option 2. The EDG moderator concluded that there was broad consensus that the concept of market value could also apply to loans. However, a large group of

the respondents hesitated to embrace market-equivalent valuation mostly because of doubts about the robustness and comparability of the data.

39. The presentation raised the question how “market values” should be interpreted for loans (fair values expressed as nominal values of loans net of expected losses), whether interest should accrue if loans are non-performing, and whether it makes sense to continue FISIM calculations on interest not longer paid.

40. The EDG recommended that:

i) The 1993 SNA Rev 1 continues to measure loans at nominal value in the accounts;

ii) The updated 1993 SNA show as memorandum items (a) the market-equivalent value of loans and (b) interest arrears on loans (including interest on arrears);

iii) In order for this solution to be implemented, the memorandum items should be regarded as mandatory if the country wished to be viewed as implementing the 1993 SNA;

iv) After experience has been gained in presenting the market-equivalent value of loans as memorandum items, and after stabilization of the accounting standards’ position on fair valuation, a review should determine the appropriateness of recording loans at market value in the accounts proper;

v) Attention be given to the further harmonization of the terminology and definitions used by the international macroeconomic statistics manuals concerning loans and interest accrual.

41. The vast majority of the AEG members supported option 2. The underlying reasoning, however, varied among the members.

42. One member saw it as best for users to have nominal values, especially for debtor data, as market values could be misleading. He was supported by another member who noted that although SNA is based on market principles, there is a different valuation of loans and bonds. He mentioned that national accountants often

say that they need “true financial positions”. That may be correct for creditor data, but fair values do not reflect the true positions of debtors. He also noted that market values could be difficult to obtain for non-financial corporations, households and rest-of-the-world. He also asked if other accounts receivable/payable would be affected by the proposal.

43. Regarding FISIM, one member noted that the production occurs whether interest is paid or not, as services are still provided to manage the NPLs. Another member expressed concern regarding the calculation of FISIM.

44. One member warned that many countries have limited financial markets and would not be able to provide data according to option 3. He also suggested that “mandatory” should be replaced by “recommended” regarding the information requirement for memorandum items for market-equivalent values and interest arrears.

45. On the discussion about the sector coverage of the mandatory items in option 2, many supported memorandum items for creditor data for banks and governments. A minority supported memorandum items for creditor data for other sectors.

46. A large majority of AEG members supported option 2, with one member supportive of option 4. This means that the AEG recommends SNA Rev.1 to:

- (i) continue measuring loans at nominal value,
- (ii) show market-equivalent values of loans and interest arrears as memorandum items, preferable for the whole system but at least for banks and government as creditors,
- (iii) regard these memorandum items as mandatory,
- (iv) review in future the recording loans at market value, and
- (v) harmonize terminology across manuals as several participants thought “market” and “market equivalent” unfortunate terms in this context.

47. The group recognized, however, the need for a clarification of

- (i) the definition of NPLs,
- (ii) the specification of the content of the memorandum items,
- (iii) the difference between NPLs and normal expected losses, and
- (iv) the consequences for the FISIM calculations.

48. The questions were raised: Can an adjustment for the underperformance of loans be made only globally in a system which is supposed to be capable of implementation at many levels of disaggregation? Also should the treatment for NPLs be applied to other doubtful items such as trade credit?

49. The group also asked for a numerical example showing how the recommendations would fit into the accounting system. The AEG asked IMF to clarify the unresolved questions.

7 Government and other non-market producers' owned assets – cost of capital services (decision)

50. This session was chaired by Adriaan Bloem, IMF, and Anne Harrison presented the issue (document No. SNA/M2.04/08).

51. The issue is whether to replace the estimate of consumption of fixed capital for assets of general government and other non-market producers by an estimate of their capital services – i.e., consumption of fixed capital plus a rate of return to capital. It was pointed out that this change will have implication on the estimation of non-market output value and thus on GDP. The current 1993 SNA, by convention, implies zero net operating surplus for non-market producers and therefore no return to capital on their assets. This convention leads to inconsistency in estimation of capital services rendered by similar asset used in market and non-market production. The point was made that this does not have to be seen as part of the whole capital services argument but that the rate of return can be seen as the opportunity cost of capital for non-market producers so why not include in sum of costs. Further that estimating non-market production itself

is an imputation so characterizing the proposal as to be avoided just because it is an imputation may be unjustified.

52. The Canberra II Group proposed treating similar assets, as providing similar services regardless of the nature of production. Four different types of assets were recognized and priorities to estimate them set out:

- (i) Assets used by civil servants in the course of their work – e.g., computer, vehicle, building – first priority;
- (ii) Assets bringing benefits to the economy at large – e.g., roads and other infrastructure – second priority;
- (iii) Assets used by the community at large – e.g., recreational areas such as city parks, monuments – lower priority;
- (iv) Land – as a produced and non-produced asset.

53. The following questions were put forth:

- (i) Should a return to capital be included for any assets used in non-market production?
- (ii) If so, for which of the above mentioned four types?

54. Various AEG members voiced concern regarding the comparability among countries, feasibility of measurement, assumptions on the rates of return, the impact on GDP from non-market producers, back casting of data and the introduction of additional imputations in the system. Some members supported the proposal in principle with increasing concerns when going down the list of asset categories. Most members agreed that the derivation of rates of returns for the first two types of assets is achievable.

55. The majority of participants supported strongly the principle of including a return to capital, mainly on the first and second type of assets, although expressed concerns about the proposal's practical feasibility in their countries. It was pointed out

that even if adopted, these proposals will not be for implementation before about 2010-2012 so rejecting on the grounds of present infeasibility may be too conservative.

56. It was recognized that experiences in measurement of capital services for non-market producers should be obtained in developing countries. Two members volunteered to pilot such projects with the assistance of the Bureau of Economic Analysis (BEA) of the USA.

57. No decisions were reached on the issue but this session can be summarized as follows:

- (i) The majority supported the principle of estimating cost of capital services for non-market producers, but many participants expressed concerns about practical feasibility on how to derive rate of return and how to value assets;
- (ii) Most of the participants were supportive for the estimation of the capital services for the first and second types of assets – “computer, vehicle, building” and “roads and other infrastructure”, but their support was diminishing going down the list;
- (iii) Many participants worried about the possible lack of comparability around the world if the proposal is adopted;

58. Moreover, it was decided to take the following steps:

- (i) A global consultation involving Statistical Offices and Central Banks will seek their views on both conceptual and practical feasibility aspects and the ISWGNA will summarize the results and present them to the AEG for further deliberation.
- (ii) The practical feasibility of the proposal on the base of case studies will be tested in Trinidad and Tobago and in Costa Rica with the assistance of BEA.

8 Treatment of land improvement (decision)

59. This session was chaired by Adriaan Bloem, IMF, and Charles Aspden, OECD, presented the issue (document No. SNA/M2.04/09).

60. The reason for considering this issue is that the treatment of land improvements in the current 1993 SNA seems unsatisfactory. Land improvements are recorded as gross fixed capital formation but are also recorded as non-produced assets on the balance sheet and consumption of fixed capital is recorded in respect of a non-produced asset. This treatment is not symmetric with the treatment of buildings and structures and land.

61. The following options were considered by the Canberra II Group:

- (i) Leave the SNA as it is.
- (ii) Classify land as either a produced or non-produced asset according to how much land improvements contribute to total value.
- (iii) Identify land improvements as produced assets and unimproved land values as non-produced assets.
- (iv) Treat land improvements in the same way as buildings and structures. This means adopting option iii where possible and option ii where not.

62. The majority of Canberra II members favoured option iv and recommended that:

- (i) Land improvements should be treated like other GFCF and should result in a produced asset.
- (ii) Land should be valued at its present unimproved value.
- (iii) Where land and improvements cannot be separated, adopt the recommendations for land/structures – para. 13.57 for balance sheet and para. 7.131 for rentals/rent.
- (iv) Cost of ownership transfer on land (COTL) be treated as cost of ownership transfer (COT) on other types of non-financial asset and be recorded as a fixed asset. Allocate it to land improvements.

63. A large majority of AEG members indicated that the definition of land improvements should be revisited. For example, dykes, which often have dual purpose, would fit better in the category of structures than in land improvements. As another example, it was mentioned that work undertaken in the neighbourhood of a tract of land, such as building an access road, could enhance the value of the land but this was via an externality and should not itself be classified as land improvement. Participants agreed that the Canberra II should discuss the issue of the classification of structures

and land improvements in the context of its work on classification of assets. Given that the recommendation of treating GFCF of land improvements as other GFCF and as part of a produced asset has been accepted, the delineation of what constitute land improvements and what constitute structures is no longer crucial as both assets would be treated in the same way.

64. A large majority of participants agree that the term “land improvement” is judgmental. In reality, most of the changes in land do not represent improvement in terms of the environment, e.g. clearing of marshes. The term “land alteration” was suggested. “Land transformation” and “virgin land” were mentioned as substitute terms for land improvements and unimproved land.

65. Some participants expressed concern regarding splitting the value of improvements and of structures from the total value of the land. They indicated that there is no direct relationship between the total value of land and the value of improvements. The improvements are, in the same vein as structures, externalities that would result in increased land values. In the same vein, it was argued that payments on buildings should be considered rentals and all payments on land should be considered rent. The argument behind this is that when one rents a building, one rents the structure; when one rents the land, one rents it with the structures and improvements on it. It was argued that in most situations, in urban and agricultural areas (with the exception perhaps of cases of terraced land, which requires regular maintenance), the value of land carries the higher value as compared to the buildings and structures on which they sit. Therefore, if the split between the value of land improvements and unimproved land cannot be done, the payments on land would be recorded as rent.

66. A large majority of participants argued that they are already implementing the recommendations, as they cannot distinguish land improvements from structures and thus treat both in the same way.

67. In conclusion, the AEG almost unanimously supported the recommendations of the Canberra II Group:

- (i) GFCF of land improvements should be treated like other GFCF and result in a produced asset appearing separately in the balance sheet;
- (ii) The non-produced component of land should be valued at its present unimproved value;
- (iii) Where the value of land cannot be partitioned into an improved and unimproved part, adopt recommendations for land and associated structures as in para. 13.57 for balance sheets and para. 7.131 for rent and rentals;
- (iv) Costs of ownership transfer on land should be recorded as fixed assets and included with land improvements.

68. The AEG further requested:

- (i) to re-examine the boundary between land improvements and structures with a view to moving some items such as major dykes, seawalls, etc. to structures.
- (ii) to reconsider the term improved and unimproved land. The terminology should be in line with that in the SEEA-2003 handbook.

9 Costs of Ownership Transfer Part II on non-financial assets (decision)

69. This session was chaired by Adrian Bloem, IMF, and Anne Harrison presented the issue (document No. SNA/M2.04/10).

70. The issue had been discussed extensively from 1999 onwards in an EDG and in the Canberra II Group. The issue was considered in the AEG meeting in February 2004. In that meeting, it was decided that (i) COT should continue to be recorded as fixed capital formation and (ii) the COT on acquisition should be written off over the period the owner expects to hold the asset instead of over its entire life as in the 1993 SNA. The remaining three issues were the topics of discussion in this meeting: (a) treatment of COT on disposal of assets, (b) installation (and de-installation costs) and (c) costs of assets incurred at the end of an asset life (terminal costs), such as de-commissioning of nuclear power stations and dismantling of oil rigs.

71. The following points were presented for approval during the current AEG meeting after a written consultation with the Canberra II members and the discussion in the Canberra II meeting in September 2004.

(a) Costs of ownership transfer on disposal of an existing asset are recorded as gross fixed capital formation when it occurs but should be written off over the period during which the asset is held. This means making an estimate of disposal costs, if any, at the time the asset is acquired. (The SNA currently recommends disposal costs should be recorded as fixed capital formation at the time of disposal, and then written off immediately in the other changes in assets account.)

(b) Installation (and de-installation) costs and transportation costs should be included in the costs of ownership transfer when separately invoiced. When there is no separate invoice for these costs, they should be included in the acquisition price of the asset in question. (The SNA is ambiguous about where installation and transportation costs belong.)

(c) Terminal costs of assets, such as de-commissioning of nuclear power stations and dismantling of oil rigs, should be treated in the same way as costs of ownership transfer on disposal of an asset. That is, they are recorded as gross fixed capital formation when they occur but are written off over the life of the asset. (The SNA currently makes no recommendation on the treatment of these costs.) However, when terminal costs are either not anticipated or cannot be predicted with reasonable accuracy, they are still recorded as gross fixed capital formation when they occur but may be written off as consumption of fixed capital immediately. (The last sentence is what is commonly referred to as the “provision”.)

72. The AEG unanimously accepted the three points, with point c subject to the provision.

73. Discussion arose with regard to the exact calculation of terminal costs. The issue paper (No. SNA/M2.04/10) suggests that the value of the asset at the time of acquisition is equal to the value of the asset minus the net present value of the terminal cost at the time the asset is acquired. Although this treatment seems to be consistent with IASB, it was not considered in line with national accounts concepts. The value of the terminal costs should be spread out over the lifetime of the resource, therefore it was not considered reasonable to allocate a large proportion of it to the first period. There was discussion about whether the initial value of an asset should take into account the net present value of the terminal costs at the time of acquisition or whether the whole of these should be written off over the life of the asset. After considerable discussion, the AEG came down in favour of the latter.

74. Some members raised the issue that the recommendation brings the payment for the disposal cost (or terminal cost) into the calculation and treats it as consumption of fixed capital of an investment (or asset) that has not taken place. It has been pointed out that business accounts take the future disposal or terminal cost as a provision for current cost.

75. It was further noted that accounting problems analogous to the terminal costs appear in the context of severance payments for labor services and that distributing terminal costs over the lifetime of an asset may create an inconsistency within the SNA between accounting for labor services and capital services. It was, however, agreed that given the great uncertainty with the labor services, it was not reasonable to accrue them over the lifetime of the employees.

76. Although the inclusion of the provision in the proposal had the effect of generating almost unanimous support for the recommendation, it raised the issue of data comparability, if some countries apply the recommendation and others apply the provision. It is understood that in the short term countries are going to record terminal

costs as gross fixed capital formation when they occur and write them off as consumption of fixed capital immediately. However, in the longer term it is likely that they will record the terminal costs as gross fixed capital formation when they occur but write them off over the life of the asset.

10 Progress Report on the Work Programme of the Task Force on Harmonization of Public Sector Accounting (TFHPSA) (information)

77. This session was chaired by Charles Aspden, OECD.

78. The progress report (document No. SNA/M2.04/11.1) on the Work Programme of the Task Force on Harmonization of Public Sector Accounting (TFHPSA) was presented to the AEG by Lucie Laliberté (Chair of the TFHPSA).

79. The TFHPSA, comprising two Working Groups (WG-I and WG-II), is the first initiative at the international level where statisticians and accountants focus on harmonizing their respective standards. Whereas WG-I is striving for the convergence between public accounts and statistical guidelines, WG-II is working for the harmonization of public sector statistical guidelines in the context of the 1993 SNA revision. The AEG was briefed about the progress of work done by WG-II on five priority issues identified on the basis of their relevance for policy makers, as described below.

10.1 Government/public/private sector delineation

80. The AEG was informed that TFHPSA, in their deliberations held during September 2004, noted that (a) control in the public sector is not necessarily based on equity ownership as in the case of the private sector, (b) clarification is needed with the cases of public-private joint ventures, special purpose vehicles (SPVs), (c) the present SNA rule for identification of the Government NPIs as those controlled and mainly financed was considered to be too restrictive, and (d) there was no majority in the meeting for adopting a quantitative threshold (sales covering more than 50% of the

production costs) to determine the economically significant prices. Distinctions in c and d may be more important than a quantitative threshold of the proportion of costs covered by sales in distinguishing market and non-market.

81. In the discussions it was pointed out that the approach of the 1993 SNA is to first delineate as between government or corporations and then, if a corporation, as between a public or private corporation. One member expressed the view that Government accounts are often susceptible to manipulation, especially with respect to deficit and taxes. There is a tendency to show less taxes or borrowing by governments by using the public corporations accounts. There is a thin line of classifying a receipt as transfer or tax. In this context the experience of the Netherlands was mentioned where the resources given by the government to the schools (non-market producer) are treated as transfers but those to the hospitals (market producer) are treated as sale of service. There was a general feeling that more guidelines are required in the SNA to delineate between the market output and non-market output. The discussions concluded with the following observations:

- (i) The present SNA two-layer delineation criterion (of first delineating between government or corporation and then between public or private corporation) should be retained.
- (ii) The different criteria of “control” in case of public and private corporations need to be clarified. In the case of public corporations, “control” in the SNA should follow the view of public accountants.
- (iii) More guidelines need to be included in the SNA to delineate tax and income (also with respect to mineral deposits).
- (iv) Clarifications/guidelines need to be included for delineating market and non-market producers and also to delineate between transfer and sales.
- (v) The substantial work done on delineation of NPI and the government sector in the Handbook of NPI satellite accounting published by the UNSD should be consulted.

10.2 Accrual of earnings on equity in public corporations

82. The issue relates to the adequacy of the 1993 SNA in reflecting the government controlling interests in public corporations, particularly as to how the income from such interests should be recognized in the Government statistics. The lack of detailed guidance on the subject leaves the possibilities open that may lead to asymmetric treatment and possible manipulation of the recording of government transactions and balances. The TFHPSA considered the following options to deal with the situation:

(i) **Recommendation 0:** Drop reference to ‘transfers’ concerning certain public corporation’s transaction with governments, this would effectively entail accrual instead of cash recording of earnings/losses of quasi-corporations, losses of government trading corporations, and profits of fiscal monopolies.

(ii) **Recommendation 1:** Classify using ESA 95, Manual on Government Deficit and Debt and GFSM 2001. While this would improve transparency and accountability, this approach would not solve all the problem of asymmetry and inconsistency.

(iii) **Recommendation 2:** Apply the statistical treatment provided for foreign direct investment with imputed reinvested earnings. Profits and losses of public corporations would be accrued in the government accounts as property income transactions, with a corresponding financial transaction reinvested in equity to record the immediate reinvestment of income.

83. Recommendation 2 was supported in principle by the majority of the AEG members as its implementation would help reflect the economic reality in a better way. This also reduces the manipulation of the recording of government transactions and balances. Several participants made the point that the solution must be as proof against deliberate manipulation of the government deficit as reasonably possible.

84. Some members expressed the view that so far the treatment of reinvested earnings was applicable only with the rest of the world, and if this concept is being extended to the public sector then logically it should be extended to all other institutional sectors of the economy. There would be practical difficulties in its

implementation in the absence of reliable and timely data. The implementation of this recommendation would require timely data at the time of the release of preliminary estimates of the GDP and other macro-economic aggregates. This kind of data would obviously not be available then and later when it becomes available would cause huge revisions in the estimates for some countries, putting the credibility of the estimates at risk.

85. With the majority of the AEG members favoring recommendation 2, but taking into account the views of members that saw conceptual and practical difficulties in the reinvested approach earnings, the TFHPSA was invited to pursue its research to account for income of government in its public corporations.

10.3 Tax revenue, accrual recording and tax credits

86. Three issues were presented to the AEG members, namely (a) definition of tax revenue, (b) implementation of the accrual principle and (c) tax credits.

87. Regarding the definition of the tax revenue, the proposal made for the core definition included only a minor change in the SNA to replace “nothing in return” with “nothing directly in exchange”. The proposal was supported by the AEG and a view was expressed that definition of tax be elaborated by developing a number of criteria as well as a list of taxes.

88. One member mentioned that there is growing tendency among governments to devise schemes so as to dress more and more receipts in the garb of sale of permission so as to minimize the tax incidence. Other members expressed the view, however, that it may not be possible to classify all sales of permission as tax and it would require examination on a case-by-case basis. More guidelines need to be developed to

distinguish based on the substance of the permission. It was mentioned that the sale of permission is on the agenda of the Canberra II Group.

89. As regards implementation of the accrual recording of tax, the important role of statistics in explaining underlying economic events was cited as an important reason for seeking the correct treatment of accrued taxes. It was mentioned that the approach in both public accounts (IPSAS) and national accounts was converging.

90. As regards tax credits, the issue is that tax credits are not referred to in the 1993 SNA. The proposal has been made in the September meeting of the TFHPSA to introduce them in the SNA. The term “payable tax credits” is preferable to “non-wastable tax credits”. A clear distinction between the gross/net treatment of taxes was called for.

91. A suggestion was made by one of the AEG members that the tax credit may be treated as a benefit because that is the very intent of the tax credit, especially for those that are not subject to taxes. One of the members mentioned that in some countries social benefits are net of taxes and in some countries they are not. So treating the tax credits as benefit would imply a huge difference.

92. The discussion on the issue concluded with the following:

- (i) Regarding the definition of the tax revenue, the proposal made to replace “nothing in return” by “nothing directly in exchange” in the core definition of tax in the SNA was supported.
- (ii) The TFHPSA should coordinate with the Canberra II Group, which is debating the issues relating to the sale of permission.
- (iii) There was support for introducing tax credits in the SNA.
- (iv) There was some support from a limited number of participants for recording taxes on an assessment basis, and the difference being treated as capital transfer.
- (v) Guidelines are to be developed for differentiating between tax credits and benefits.
- (vi) The term “net” taxes should be deleted as it may be confused with “taxes less subsidies”.

10.4 Contingent liabilities: government guarantees

93. The issue under consideration is that guarantees given by government produce economic effects and should be reflected in the government accounts (transactions and balance sheet), at least under certain conditions.

94. In the SNA, guarantees in the form of contingent assets are not recognized. There are the following options to deal with guarantees.

- (i) record a government liability through a transaction for the net present value of expected future cash flows under the guarantee;
- (ii) record expected cost as expenses of the guarantor (none if treated as derivative);
- (iii) the recording of acquisition of liability depends on whether it is treated as derivative, insurance or provision.

95. A majority of members expressed the view that this approach is rather subjective as it does not depend on actual registration but rather on probability. This may affect the character of the SNA, which is a well articulated system for economic analysis. The discussion on the issue concluded with the observation that there is a lot of difficulty and data problem associated with the valuation of the guarantees and there appear to be no enthusiasm in recording these in the SNA.

10.5 Restructuring agencies and SPVs

96. Issues covered are privatization, restructuring agencies, securitization, and special purpose entities. The question was raised whether an SPV not engaged in production could be considered as an ancillary corporation when it operates in the same economic territory of any of its owners. Another issue raised was the necessity of classifying all institutional units that are part of the government sector as residents.

97. As regards the progress on the issue it was mentioned that some of these issues are on the agenda of the Canberra II Group, the BOP Committee and UNSD's EDG on ancillary units. The TFHPSA would follow up with them as these are cross-cutting issues.

10.6 Chapter/Annex on public sector

98. The group strongly supported the inclusion of a chapter/annex on the public sector in the updated SNA.

99. The chapter/annex, among other things, should bring out the articulation between general government and public corporations.

11 Cost of capital services in the production account (information)

100. This session was chaired by Barbro Hexeberg, World Bank, and Charles Aspden, OECD, on behalf of the Canberra II Group, presented the issue (document No. SNA/M2.04/15).

101. Due to some outstanding and related issues (the measurement of the rate of return – endogenous, exogenous, ex post, ex ante; research and development; decomposing gross mixed income into labour and capital components), cost of capital services will be further discussed by Canberra II at its March 2005 meeting.

102. The current SNA explicitly identifies the costs of labour and intermediate consumption but does not explicitly identify capital inputs. In order to record the full costs of capital in the production accounts, the Canberra II Group has taken the view that:

- (i) The cost of capital services from all non-financial assets should be shown as an “of-which” item in both current and constant price terms;

- (ii) The recommendation, as such, does not impinge on the values of other aggregates;
- (iii) The cost of capital services measures should not be introduced into the national accounts in an isolated manner, they should be compiled in an integrated and consistent way with estimates of CFC and capital stock with due consideration given to the model and choice of parameter values;
- (iv) Methods of measurement should be based on existing practices of countries.

103. The Canberra II Group has investigated most assets groups and has concluded that for land, fixed assets, natural and sub-soil assets and inventories, the contribution of capital to the production process should be recognized in the accounts.

104. Many AEG members supported in general the proposal that capital services should feature in the updated SNA in some way. They considered the issue very important since the measurement of capital services provides a better understanding of what contributes to the gross operating surplus. Moreover, its introduction would support the calculation of multifactor productivity. Most interventions also shared the opinion that those data are highly demanded by economists for their analytical needs and we need to respond to their request as if we don't do it, others will, based on less detailed information than available in statistical offices and so probably of lower quality. Only a few countries in the world would be able to derive satisfactory estimates of capital services from produced and non-produced assets but there can be developments between now and the probable date of implementing the update.

105. Despite the recognition of the importance of the proposal, the majority of the participants disagreed with presenting these estimates as "of which" item in the core set of accounts. The general preference of the participants was to include them as a satellite account or an annex due to the difficulties with their measurement. The majority supported the idea of explaining all relevant issues of measuring capital and its productivity in a systematic way.

106. Many participants expressed concerns about the estimation of capital services on the basis of the assumptions and about the movement of the revised SNA from observed statistics to modeling, which causes many practical and conceptual problems.

107. The question was raised whether the calculation of compensation of employees is a normal constant price calculation. It was pointed out that for both constant price calculation and productivity analysis the changes in the quality of labor per hour should be estimated.

108. Further clarifications were requested on:

- (i) how rate of return on land should be derived;
- (ii) how the capital services calculation would be extended to all sectors in the economy, since the SNA requires the compilation of accounts by industries and institutional sectors;
- (iii) how to explain the residual (difference) between the “of which item” and gross operating surplus.

109. It was concluded that all points will be sent back for discussion in the next meeting of Canberra II Group. Subsequently, Canberra II Group will report back to the AEG for further consideration.

12 Aggregation structures for ISIC Rev.4 (information)

110. This session was chaired by Barbro Hexeberg, World Bank, and Ivo Havinga, UNSD, presented the issue (document No. SNA/M2.04/13).

111. The International Standard Industrial Classification of All Economic Activities (ISIC) is currently being revised for 2007. The timeline approved by the United Nations Statistical Commission calls for a final draft to be presented to the Commission in March 2006 for approval. This revision of ISIC and the Central Product Classification

(CPC) will be finalized one year earlier (in 2007) than the revision of the SNA (in 2008).

112. The objectives of the current revision process for ISIC put high priority on improving the relevance of the classification, on improving the comparability of ISIC with activity classifications of other international groupings and on maintaining the continuity of the classification. As part of improving the relevance of the classification, specific requests have been made since the beginning of this revision process to consider the introduction of an “information section” and the introduction of additional detail in the services area of the classification. Changes in the structure, corresponding to these and other requests, have increased the number of items at the section level of the classification from 17 to 21, and at the next level (division level) from 62 to 89.

113. As the numbers of categories at 21 or 89 are deemed too high for national accounts purposes, a request has been made to produce separate aggregations that are more suitable to the national accounts. This request has been supported by the Statistical Commission. The OECD and Eurostat, together with UNSD, will cooperate in developing this top-top structure further.

114. As an initial step, the UNSD paper presents several aggregation structures: “Top-10”; “Top, 30-40” and other aggregations that may be used in national accounts. The AEG was asked to discuss the following:

- (i) whether a single aggregation structure consisting of about 10 categories should be recommended for general use in the SNA framework;
- (ii) whether an intermediate aggregation structure with about 30 (or more) categories should be recommended for use in SNA or not;
- (iii) whether a group of individual aggregations, such as those for use in the supply and use tables of the SNA, should be recommended.

115. The following observations and comments were made during the discussion:

116. It is important to consider in this discussion whether these aggregation structures have uses apart from the national accounts. If the national accounts are their only user, there might be no need to write them in ISIC.

117. It is also important to set up the analytical criteria for choosing the structure: what distinction do we want such a structure to convey: primary, secondary and tertiary sectors; final consumption versus intermediate consumption; market vs. non-market activities; business vs. personal services activities?

118. Other considerations for deciding the aggregation structures suggested by the participants should also include: the top-top structure is used for quarterly national accounts data and therefore should not be numerous and should maintain the continuity over time for broad international comparability.

119. There was a strong support among the AEG group for having a “top-10” aggregation structure, although 10 is not necessarily the magical number. Some participants observed that for their countries “manufacturing” is important to be identified separately at the top-top level. Whereas for others, “mining and quarrying” is important enough to be separately identified. There was also an observation on the need to identify “real estate” activities separately in the top structure, as it has a different market dynamic than others.

120. There were also observations disagreeing with the grouping R+S+U, T+V, G+H+J at the top-10 structure. There was a view to reshuffle the groupings of the services portion to reflect the distinction non-market vs. market services.

121. No majority view emerged on how this top level aggregation structure should look at this point. However, it was stated that, in coordination with UNSD, OECD will create an Electronic Discussion Group to discuss and decide on a top aggregation

structure of ISIC. The recommendation of the EDG will be brought to the AEG for decision. The AEG suggests that this discussion should go beyond OECD and encompass a broad range of countries.

122. On the question of the aggregation level for SUT and I-O tables, it was recalled that in the present 1993 SNA, the aggregation is there only for illustration purposes and needs to be small enough to fit the tables in the pages. This aggregation does not need to be revised, except for the terminology that may be adapted to changes in the 1993 SNA.

13 Treatment of provisions in the national accounts: elements for the review of the SNA (information)

123. This session was chaired by Ivo Havinga, UNSD, and Charles Aspden, OECD, presented the issue.

124. The presentation was different from the paper "*The Treatment of Provisions in the National Accounts: Elements for the Review of the SNA*" by Francois Lequiller, OECD (No. SNA/M2.04/16) and the AEG only discussed the modified proposals.

125. The proposal that provisions should be included in the list of clarifications put forward three types of necessary clarifications:

- (i) Recognize that some new types of provisions are (implicitly) to be included in the updated SNA, if the proposals are accepted.
- (ii) Discuss more the differences with business accounting principles regarding provisions.
- (iii) Clarify the treatment of transactions that are implicitly linked to provisions.

126. Under type iii, two examples were provided:

Example 1: A government can buy back a bad debt which is provisioned by an enterprise.

- What should be the treatment in national accounts of the difference between the nominal price paid and the provisioned value when the SNA does not recognize provisions?

Example 2: A public energy enterprise and the government exchange a lump-sum payment with a provision on termination costs.

- What should be the treatment of the lump-sum payment when the provision is not recognized by the SNA?

127. The AEG was asked whether it supported the inclusion of an item on provisions in the list for clarifications.

128. Several members found the issue useful, but difficult, and underlined the need for clarification as there are different classes and types of provisions. They also asked for examples in order to see a more complete picture. Others pointed out the need to clarify provisions in the relation between business statistics and national accounts, which in part will be addressed under the issue of non-performing loans.

129. The AEG concluded that there is a general need for clarification of provisions and they should be considered in a section to the SNA update. The clarifications should not be limited to business accounts and it should also deal with the asymmetry problem as well as the consequences for FISIM.

130. The following possible typology was suggested:

- (i) Actual liabilities related to past events;
- (ii) Provisions to cover events certain to happen but of uncertain timing;
- (iii) Provisions to cover events likely to happen but of uncertain timing;
- (iv) Contingencies;
- (v) Impairment, which is a valuation issue.

131. The need for symmetry of treatment between liabilities and the corresponding assets was mentioned.

132. The members of the AEG were invited to send different examples of provisions to Anne Harrison, Editor, prior to the next meeting.

14 Progress on the Work Programme of BPM update: Balance of Payments issues for the SNA review (information)

133. This session was chaired by Ivo Havinga, UNSD, and Manik Shrestha, IMF, presented the progress on the Work Programme of BPM update (document No. SNA/M2.04/17).

134. The mechanism adopted for seeking solutions to the issues identified to be included in the updated BOP manual provides ample opportunities to all stakeholders to participate. The draft Annotated Outline for the revised BOP manual has raised about 100 questions for which suggested solutions have been invited. The responses received from the interested parties are first considered by Technical Expert Groups (TEGs) specially constituted for the purpose. The recommendations of the TEGs are in turn considered by the IMF Committee on Balance of Payments Statistics (BOPCOM) and if the issues so considered are deemed to have linkages with the SNA, then these are brought up to the AEG. About seven of such issues have been resolved.

135. The progress on the issues since the last meeting of the AEG has been summarized in the document No. SNA/M2.04/17. The AEG expressed satisfaction about the progress of the work.

136. One of the members enquired about progress on the issue relating to the meaning of the “national economy” as the same was not indicated in the document. The

aspects of this topic being dealt with by the BOP community are the inclusion of offshore centers and SPEs (discussed under units, below) and the meaning of an economy or economic territory in general and in the context of economic and monetary unions (to be discussed by the BOPCOM in June-July 2005). Several AEG members voiced their concern, as the issue is important for the SNA update and it would be better if the preliminary discussion was held early before the issue is brought up to the BOPCOM for deliberations.

15 Change of economic ownership (decision)

137. This session was chaired by Ivo Havinga, UNSD, and Manik Shrestha, IMF, presented the issue (document No. SNA/M2.04/18).

138. The reason for considering this issue is that currently the 1993 SNA does not explicitly define ownership, and ownership can be interpreted on either legal, physical or economic basis, which deserves further clarification in the 1993 SNA update. Financial leasing is a typical case in the 1993 SNA where economic ownership with well-defined risks, rights and benefits is recognized. Therefore, the purpose for adopting the term “economic ownership” is to eliminate the ambiguity in all manuals and macroeconomic statistics, which would set a clear timing for recording transactions that change economic ownership. In this regard, it was suggested that business accounting standards should be taken for reference.

139. It was noted that the term “*change of economic ownership*” received a broad consensus in the BOP Committee.

140. The following question was therefore put forth before the AEG: *Does the Committee agree with the proposal to adopt the term “change of economic ownership” instead of “change of ownership”?*

141. The AEG unanimously supported the recommendations of adopting the term “*change of economic ownership*”, though further clarification is warranted, especially about the real meaning of economic ownership.

142. Concerns were expressed about the difficulty in observing changes in economic ownership, e.g. internal transactions among multinational enterprises, re-export, and exclusive export zones. One member cited the example of public railway enterprise, with legal ownership that lies with the finance corporation, and economic ownership attributed to the railway corporation. Others referred to the implications for possible shared ownership of assets and the time at which change in ownership occurs (e.g. signing a contract), as well as issues that still need to be explored, e.g. military contracts.

143. The AEG requested the Canberra II Group for further clarification of the following issues:

- (i) provide better definitions of ownership, i.e. physical, legal and economic ownership, and clarify what constitutes the change of economic ownership;
- (ii) consider the issue of economic ownership as cross-cutting issue with respect to originals and copies, repo arrangements, financial leasing, delivery contracts of military equipments and the like.

16 Application of accrual principles to debt arrears (decision)

144. This session was chaired by Ivo Havinga, UNSD, and Manik Shrestha, IMF, presented the issue (document No. SNA/M2.04/19).

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

whether the GFSM and BOPM should align with the SNA on the treatment of debt arrears.

146. The *External Debt Guide* defines arrears as amounts that are past due-for payment and unpaid. The time of recording basis followed in the *BPM5*, *External Debt Guide*, and *GFSM 2001* is that when a debt liability goes into arrears, transactions are imputed as if the repayment of debt liability had been made and a new short-term liability created. This type of recording conforms to the due-for-payment basis as repayments are recorded at the time they are due.

147. The treatment followed, in principle, in the 1993 SNA and *MFSM 2000* is that repayments of debts are recorded when they are extinguished (such as when they are paid, or rescheduled, or forgiven by the creditor). This type of recording conforms to the accrual basis. Under this approach, arrears will continue to be shown in the same instrument until the liability is extinguished.

148. When a liability goes into arrears, the terms and characteristics of the entire liability or only the portion in arrears may change. If the terms and conditions change with respect to any part of the liability, that part is to be treated as a separate instrument. However, the 1993 SNA does not discuss this issue specifically (for example, whether to treat such events as transactions similar to debt reorganizations or as other changes due to reclassification of instruments).

149. The AEG was asked the following questions:

(i) Does the AEG agree that the time of recording and treatment of arrears be harmonized in various macroeconomic statistics?

(ii) Does the AEG agree with the recommendation that no transactions should be imputed when a liability goes into arrears?

(iii) Which of the two alternative treatments – transactions or reclassification/other changes – is appropriate if the terms and characteristics of financial instruments change when a liability goes into arrears?

150. The AEG members supported unanimously that the various statistics should be harmonized on the treatment of arrears, that no transactions should be imputed, and that arrears should be recorded as reclassification if the terms and characteristics of a liability changes when it goes into arrear.

151. On the question of the term structure of loans under arrear, one member said that a long-term loan remains long-term even if it goes into arrear since we classify loans according to original maturity.

152. The AEG concluded that:

(i) the time of recording and treatment of arrears should be harmonized in various macroeconomic statistics, (ii) no new transaction category will be created for recording of interest in arrears, and (iii) if terms and characteristics of the financial instrument change when it goes into arrear, it should be recorded as reclassification in the other changes in volume of assets account.

153. The AEG asked the IMF to include the clarification of the treatment of arrears in a paper that would also include the treatment of non-performing loans (as noted under non-performing loans, above).

17 Residence of households (decision)

154. This session was chaired by Ivo Havinga, UNSD, and Robert Dippelsman, IMF, presented the issue (document No. SNA/M2.04/20).

155. The presentation was based on earlier discussions in the Balance of Payments Technical Expert Group (BOPTeG) and the recommendations of the Balance of Payments Committee. The situation presented under this item is arising as a result of globalization and an increased international mobility of labour. Therefore compilers call for more guidance on determining residence of individuals. The importance of symmetry of reporting on both sides was also mentioned.

156. Four questions were presented to the AEG for decision. The experts' views and conclusions are summarized in the sequence of the questions.

157. *Question 1: Does the AEG agree with the approach of harmonization of residence concepts?* Members of the AEG unanimously supported seeking harmonization with the residence concepts of demographic, migration, tourism and education statistics, as long as the conceptual integrity of the SNA can be maintained.

158. *Question 2: Does the AEG agree that “predominant center of economic interest” be adopted?* It was explained that this criterion is needed to decide the residency of persons with multiple residences and migrant workers who work most of the year in a country but spend some time of the year in their home country. In conclusion, the majority of the AEG agreed to adopt the concept “predominant center of economic interest”.

159. *Question 3: Does the AEG prefer the continuation of the existing exceptions for students, patients and ships' crews? Does the AEG prefer the one-year criterion?* All AEG members were in favor of using the one-year criterion for determining residence. Some members questioned maintaining exceptions for patients or ships' crews. Most expressed the view that they were indifferent to the exceptions given to patients or ships' crews, but were strongly in favor of keeping the exception for students, as users want to see the exports of educational services. Regarding ships' crews, some members expressed the view that these should be treated in relation to the concept of

“predominant center of economic interest” of the crews (i.e. households), not of the ship operators. In conclusion, the AEG favored the one-year criterion rather than a discretionary approach, with the existing exceptions of students and patients and with clarifications of the situation of ships’ crews.

160. *Question 4: Does the AEG agree with the supplementary presentation approach proposed in the Annotated Outline for the revision of BPM5?* The AEG supported the supplementary presentation as it is important for those countries that are sources or hosts of large numbers of migrant workers.

18 Treatment of multiterritory enterprises (decision)

161. This session was chaired by Ivo Havinga, UNSD, and Robert Dippelsman, IMF, presented the issue (document No. SNA/M2.04/21).

162. Multiterritory enterprises are single enterprises that are run as a seamless entity having substantial operations in two or more economic territories, so that separate branches can not be identified. The criterion for assigning residency to a multiterritory enterprise has been specified only for an enterprise that operates mobile equipment in several jurisdictions, including ships, aircraft and railways. There is a need to prescribe guidelines generalized to all kinds of activities. At present, there is no guideline for the treatment of enterprises operating under joint jurisdictions of more than one economic territory (like hydro-electric schemes on border rivers, pipelines running through more than one territory, etc.). With progressive increase in the number of such enterprises, there is a need to prescribe guidelines in the matter.

163. These issues have been discussed first by the BOP Technical Expert Group (BOPTG) and subsequently by the BOP Committee (BOPCOM). The two groups made the following recommendations for the considerations of the AEG:

- (i) In the case of multiterritory enterprises, BOPCOM proposes to apply the general principles in BPM5 (at present limited to mobile transport enterprises) to all kinds of activities and to consider other possible factors for splitting

(e.g. some operational factors such as shipping tonnage, rather than just equity shares). The complexities of practical implementation should be acknowledged in the revised manual.

(ii) For enterprises operating in the joint jurisdiction zone, which have not been addressed in the present manual, guidance and examples should be provided in the revised one, but flexibility should be allowed in the implementation.

(iii) For enterprises operating both in multiterritory zones and joint jurisdiction zone, the revised manual should indicate the need for collaboration between the compilers of the territories concerned. The implications for other economies, when compiling partner data, should also be noted in the manual.

164. The AEG expressed the view that all attempts should be made to establish the parent-branch relationship for dealing with multiterritory enterprises. [Comment: This multiterritory enterprise issue could disappear if the later decision on branches is not reworded. If no decision-making or record-keeping is needed to qualify as a separate institutional unit, because any production is enough to identify a branch, then operations by multiterritory enterprises in each territory will (almost?) always qualify as separate branches.] One should resort to the present proposal only when establishing such a relationship does not become possible. The task of splitting entities is a complex one. As for the partner data, implications could be in several areas, like BOP, employment, consumption, to name a few.

165. A suggestion was made during the discussions that it would be worthwhile to examine the international accounting standards (IAS) as to how the division of the head office and branches is dealt with.

166. Some members wanted more examples and practical experiences to be part of the guidelines as the split has to be examined on a case-by-case basis. It was suggested that a group of countries dealing with such problems provide their experiences to be used in developing guidelines.

167. The AEG discussed the issue and reached the following conclusions:

(i) In principle, the group was in agreement that the treatment of multi-territory enterprises should be extended to all kinds of activities when the parent-branch relationship cannot be established.

(ii) International accounting standard board (IASB) recommendations may be examined to see whether some guidelines on the subject exist.

(iii) The problem of joint jurisdiction zones was recognized and the AEG agreed that these need to be examined on the case-to-case basis. Work in this area is required in the affected countries.

19 Holding companies, special purpose entities and trusts: clarification of their status as units and residence (decision)

168. This session was chaired by Ivo Havinga, UNSD, and Robert Dippelsman, IMF, presented the issue (document No. SNA/M2.04/22).

169. Special purpose entities, international business companies, special purpose vehicles and shell companies are the terms used to cover legal structures that have little or no employment, limited operations or limited physical presence in the jurisdiction in which they are created. Such entities are referred herein as SPEs. These are typically used as devices to hold assets and liabilities and do not necessarily undertake production.

170. The issues are whether SPEs are separate institutional units; the determination of their residency; harmonization of the internationally accepted definitions of such entities; and their classification by institutional sector and economic activity. These issues have been deliberated upon by the BOP Technical Expert Group (BOPTEG) and the BOP Committee (BOPCOM). The two groups made the following recommendations for the consideration of the AEG:

(i) Does the AEG agree that SPEs incorporated in the economic territory, separate from its owners, should be treated as a separate institutional unit?

(ii) Does the AEG agree that SPEs should be treated as resident in their territory of incorporation?

(iii) Does the AEG agree with the approach of separately identifying SPEs on the basis of national definitions, as needed, but not having a standard definition or SPE sub-sector?

171. The AEG noted that SPEs are incorporated by the non-residents and these are treated as separate institutional units in line with general principles, although the SNA does not discuss these cases. One may not insist on the requirement of having a full set of accounts by these entities and in cases where significant production takes place, the problem should be reckoned with to reflect the economic realities.

172. As regards proposal iii, members were of the opinion that efforts should be made to evolve an internationally accepted definition of SPEs and it should not be left open to countries to define them. The group requested some indicative guidelines on the identification of SPEs across manuals, although an internationally standard definition of SPE is not available in light of national diversity.

173. It would be worthwhile to liaise with the working group (OECD Task Force) on financial services.

174. The discussion on this issue concluded with the following observations:

In principle, the AEG agrees with the proposal that SPEs, incorporated in the economic territory separate from its owners, should be treated as a separate institutional unit and be treated as resident in their territory of incorporation, except for SPEs created by government. The issue of SPEs owned by a government but incorporated in another economy should be coordinated with TFHPSA.

20 Recognition of branches (decision)

175. This session was chaired by Ivo Havinga, UNSD, and Robert Dippelsman, IMF, presented the issue (document No. SNA/M2.04/23).

176. The criteria for identification of branches had been discussed extensively by the Balance of Payments Technical Expert Group (BOPTEG) and Direct Investments Technical Expert Group (DITEG). The two groups had agreed on the following recommendations:

(i) The physical presence criterion would apply only to those industries that require physical presence. For activities (such as financial intermediation and operational leasing) that can be undertaken without physical presence, such a criterion is not required for determining the existence of an institutional unit.

(ii) Being subject to income tax laws, rather than paying income taxes as in *BPM5*, should be taken as an indicator.

(iii) Some flexibility is needed, so that the criteria would be used as indicators with compiler's discretion. Not all of the criteria need to be met.

(iv) The criterion of having separate income statements and balance sheets was considered to be the strongest factor, and would usually be decisive.

(v) The group noted the importance of where decisions are made and observed that separate accounting could be a reflection of it.

177. The presentation briefly pointed out the current statistical treatment of this complicated issue, when an institutional unit has substantial operations outside its home economy for which no separate legal entity is created. A "branch" – notional resident institutional unit of that economy – needs to be created for statistical purposes. The *BPM5* and the 1993 *SNA* have similar criteria for identifying the operations of an unincorporated branch as a separate institutional unit.

178. The following points were presented for approval of the AEG:

(i) Does the AEG agree with the recommendation that physical presence only be required for activities other than financial intermediation?

(ii) Does the AEG agree that being subject to income tax laws should be taken as an indicator of a branch rather than a requirement?

(iii) Does the AEG agree that all criteria should be taken as indicators of a separate branch, while noting that availability of separate accounts be given a very strong weight?

179. The AEG agreed unanimously on the first point. It is essential to have significant economic activity rather than a physical presence of financial intermediaries to be recognized as a branch.

180. The group strongly supported the second point stating that being a subject to income tax laws should be taken as an indicator of a branch rather than a requirement.

181. Regarding the third point, the majority of the AEG members considered the criterion for availability of separate accounts too restrictive. They expressed preferences for taking into account the production in the economy and focusing on the identification of this unit rather than seeking its full set of accounts. All criteria should be considered as indicators for a separate branch but not all criteria have to be met. Even if the entity does not have a full set of accounts, if it engages in significant amount of production from a physical base in the territory over an indefinite or long period, it should be treated as a branch.

182. With the qualification on the third criteria, the group suggests noting that this is a qualification of the BOPCOM conclusion, so further consultation will be needed.

21 Goods sent abroad for processing (decision)

183. This session was chaired by Ivo Havinga, UNSD, and Robert Dippelsman, IMF, presented the issue (document No. SNA/M2.04/24).

184. A change in the treatment from gross to net was recommended by BOPTEG and approved by BOPCOM. This proposal was presented to the AEG for decision.

185. BOPCOM agreed that the value added in goods for processing without change of ownership of the goods should be treated as services in international statistical guidelines, on both conceptual and practical grounds. The current treatment on a gross basis for goods for processing involves imputations of contra entries in change in financial accounts and balance sheets. The identification and measurement of goods for processing is difficult.

186. It was noted that *BPM4* treated the value added in goods for processing as a service and that gross recording of goods for processing in *BPM5* was an effort to be consistent with the national accounts. It was also mentioned that, within the national accounts community, more focus is being given now to the treatment of goods for processing as services. On the other hand, there were suggestions that there should be a presumption against reversing changes made for *BPM5* from *BPM4*. The group indicated a need for consultation with national accounts and international merchandise trade statisticians.

187. The question raised was: *Does the AEG agree with the recommendation that goods sent abroad for processing should be treated as services?*

188. A slight majority of the AEG members supported the net treatment and provided the following arguments in favor:

- (i) Goods received by the manufacturer for processing are not recorded in business accounts of the processors, who do not know their values. Imputations of values and consequent imputation of contra liability in financial accounts is difficult.
- (ii) There is no change in ownership of the goods.
- (iii) The treatment is compatible with manufacturing services inside the country where the output of the processor is the processing service provided and can be classified as production under contract for a fee.

(iv) This net treatment is appropriate where processing for a fee is an increasingly common phenomenon in the global market place.

189. Others argued against the change because:

- (i) Conceptually it is difficult to understand that manufacturers can produce services.
- (ii) I-O table compilers like to maintain consistency with merchandise trade statistics and reflect significant transformations in the economy.
- (iii) GAT and GATS have different agreements for goods and services, and trade negotiators want to monitor them.
- (iv) Goods sent abroad for processing are normally recorded on the gross basis by customs and appear as such in merchandise trade, unless they are subject to special custom regime where goods sent in and out temporarily are not subject to taxes. The different recording of goods in merchandise statistics and BOP/national accounts creates problems for users.

190. The AEG observed that the issue paper asked for a clearer definition of goods sent abroad for processing. In BOP and SNA context this concept refers typically to goods sent abroad for processing and then re-imported. Also it was clarified that in processing on a fee basis, processors do transform the goods but do not own material inputs or the resulting output.

191. The AEG did not reach a consensus on the issue though slightly more members supported the net treatment.

192. Finally, the AEG decided that the IMF and UNSD will prepare a paper to explore all aspects of the issue, with pros and cons. After that it will be sent simultaneously to the AEG and BOPCOM for written consultation.

22 Treatment of activation of guarantees (information)

193. This session was chaired by Brian Newson, Eurostat, and Manik Shrestha, IMF, presented the issue (document No. SNA/M2.04/25).

194. Liabilities can be guaranteed by a third party. Guarantees are arrangements whereby the guarantor commits to pay or assume the liability of another entity (the original debtor), if certain conditions are met (such as inability of the original debtor to pay). Guarantees may include repayments of principal and/or interest payments. A debt guarantee involves three institutional units: original creditor, original debtor, and guarantor. Activation of a debt guarantee creates a new liability and the guarantor now becomes the new debtor. This raises issues on how to treat flows between the original debtor and creditor and between the original debtor and the guarantor (the new debtor).

195. The AEG was asked the following questions:

(i) Does the AEG agree with the retention of the current treatment of guarantees (that a guarantee is a contingency until it is activated)?

(ii) Does the AEG agree with the recommendation that all flows arising from the activation of guarantees be treated as other changes in volume of assets?

196. Several AEG members argued that there are degrees of contingencies among the different guarantees that should be studied case by case.

197. Several members spoke against the use of other changes in volume of assets when guarantees are activated and suggested the use of transactions in the form of capital transfers.

198. It was decided to defer the decision on question i until the AEG has been given more information on the different types of guarantees in order to decide whether they are liabilities or not. On question ii, all members agreed that all flows arising from the activation of guarantees should be recorded as transactions in the form of capital transfers. It still leaves open the question of which of the two benefiting parties is the recipient of the transfer – the creditor or the guaranteed party or both.

199. The AEG suggested that IMF would provide further information and to inform BOPCOM accordingly.

200. Moreover, the coordination with the TFHPSA needs to be maintained.

23 Repurchase agreements, securities lending, gold swaps and gold loans: an update (information)

201. This session was chaired by Brian Newson, Eurostat, and Robert Dippelsman, IMF, presented the issue (document No. SNA/M2.04/26).

202. A securities *repurchase agreement (repo)* is an arrangement involving the sale of securities at a specified price with a commitment to repurchase the same or similar securities at a fixed price on a specified future date. A repo viewed from the cash provider is called a *reverse repo*. When the funds are repaid (along with an interest payment) the securities are returned to the “cash taker”. The provision of the funds earns the cash provider interest that is related to the current interbank rate and not the property income earned on the security “repoed”. Full, unfettered ownership passes to the “cash provider” but the market risk — the benefits (and risks) of ownership, such as the right to holding gains (and losses), and receipt of the property/investment income attached to the security — are retained by the cash taker as if no change of ownership had occurred, in the same manner as when collateral is usually provided. “Full, unfettered ownership” means that the cash provider acquires ownership of the security and may sell it. In some countries the repo market is large. Banque de France has estimated the repo market to approximately 40 percent of the total outstanding French government bonds.

203. *Securities lending without cash collateral* is similar to a repo, except that no cash changes hands. The borrower obtains full and unfettered ownership in the same way, and instead of cash provides the lender with collateral, usually securities. The

lender of the securities does not acquire full and unfettered ownership of the securities received as collateral. The lender of the securities receives a payment from the borrower, called a “fee”.

204. Repos are usually undertaken as a liquidity management tool, and they are often used by central banks as part of their monetary policy. The benchmark interest rate in some countries is the repo rate, like in the United States.

205. In the 1993 SNA and *BPM5*, it was recommended that repos/reverse repos should be treated as collateralized loans. One rationale given at the time was that the cash provider did not often have the right to on-sell a security acquired under a reverse repo. However, the right to on-sell has become almost universal. It is this development that has caused one difficulty in the measurement of repos, in that, if the recipient of the security that has been repoed (or lent) on-sells the security, it will be double counted as owned by both the original owner and the purchaser. The solution to the double counting is that the recipient of the security which on-sells should show its “short position” as a negative asset in the instrument involved being recorded.

206. In view of the problems that repos and securities lending both pose for statistical measurement – that the ownership change is not recognized, and the two parties can claim ownership to the same security at the same time – the IMF Committee on Balance of Payments Statistics has given extensive consideration to the issue. The conclusion the Committee reached was that repos should be recorded as collateralized loans, and that if the security acquired under a repo were on-sold outright, it should be recorded as a negative asset in the instrument being on-sold. For securities lending no transaction should be recognized; if the security borrowed is on-sold, it should be recorded as a negative asset, in that instrument, by the party that borrowed the security. Following the work of the Committee, the Intersecretariat Working Group on National Accounts reached the same conclusion.

207. As part of the Committee's consideration of these transactions, however, several countries agreed to participate in a survey of financial institutions, to find out more about their internal recording practices for repos and securities lending. The result, among other things, was that a significant minority of respondents record repos in what has come to be known as the "four-way-approach", that is, they record them as both collateralized loans and as transactions in the underlying security at the same time. The Committee continues to explore to what extent such an approach could be used for statistical purposes.

208. *Gold swaps* are usually undertaken between monetary authorities. The gold is exchanged for foreign exchange deposits (or other reserve assets) with an agreement that the transaction be unwound at an agreed future date, at an agreed price. *Gold loans or deposits* are undertaken by monetary authorities to obtain a non-holding gain return on gold which otherwise earns none. The nature of gold swaps and gold loans/deposits is similar to that of repos and securities lending, in that the market risk toward the underlying asset remains with the original holder. The statistical implications of gold swaps and gold loans/deposits are complex and have not been fully worked through. Work is still being undertaken by the IMF Committee on Balance of Payments Statistics to address the implications.

209. Few AEG members took the floor on this issue. One member mentioned that his country does not follow the SNA recommendation but records repos as transactions in assets. The obligations to reverse the transactions are recorded as forward positions. If the "four-way-approach" were approved for the SNA, it could be a second best solution for them. Another member pointed out that an increasing number of countries use the "four-way-approach".

210. The AEG concluded that it took note of the problem without offering any solution. The AEG encouraged the IMF to develop the issue further and present a proposal for a forthcoming meeting.

24 Treatment of debt instruments (Debt instruments indexed to a foreign currency and Interest on index-linked debt instruments) (information)

211. This session was chaired by Brian Newson, Eurostat and Manik Shrestha, IMF, presented the issue (document No. SNA/M2.04/27).

212. Two papers were presented under this item as work-in-progress, since they were considered by BOPTTEG but not yet submitted to BOPCOM.

213. For the purpose of defining and measuring interest, three categories of arrangements are distinguished: domestic-currency-denominated debt instruments, foreign-currency-denominated instruments, and debt instruments indexed to a foreign currency. Currently, the international statistical manuals treat the effect of exchange rate variations on debt principals differently, depending on whether the instrument is denominated in a foreign currency or indexed to a foreign currency. The former is treated as holding gains, whereas the latter is deemed interest.

24.1 Debt instruments indexed to a foreign currency

214. The first paper on *debt instruments indexed to a foreign currency* raised the question whether there are sufficient differences between a debt denominated in foreign currency and a debt with both principal and coupons linked to a foreign currency to warrant a difference in treatment. If not, the question arises as to what treatment to adopt for the debt instruments with both principal and coupons linked to a foreign currency: the foreign-currency denominated instruments or the index-linked instruments.

215. The IMF recommends that debt instruments with both principal and coupons indexed to a foreign currency should be treated as though they are denominated in that

currency. Thus the proposal removes an obvious anomaly by recommending identical treatment for instruments that have economically equivalent characteristics.

216. The AEG noted that this was a work in progress going in the right direction. Regarding next steps, after the BOP Committee's review in June next year, the issue will be brought back for decision to the AEG. Members requested that the full issue paper includes a worked-out numerical example. Several AEG members supported the identical treatment proposed by the IMF.

24.2 Treatment of interest on index-linked debt instruments

217. The second paper on *treatment of interest on index-linked debt instruments* focuses on how interest accruals should be determined for the accounting period when principal is indexed. It deals with the case where interest is unknown due to the fact the redemption value of the debt is unknown. The SNA treats the change in the value of the principal outstanding due to the movement in the relevant index as interest over the life of the instrument in addition to any other interest due for payment arising from coupon payments. In practice, the SNA suggests that the movement in the relevant index in the period may be used to estimate interest, while the External Debt Statistics Guide uses the most recent relevant observation of the index and recommends revision of back data to be undertaken when accrued interest costs are known with certainty. The backward revision is something that people are unhappy about. Four alternative broad approaches were examined by BOPTTEG for dealing with indexation of debt instruments: (1) three variations of the current SNA method consistent with the debtor approach; (2) an interpretation of the debtor approach based on yield-to-maturity at the time of issue; (3) an application of the creditor approach; and (4) an embedded derivative approach.

218. Members of the AEG had different views on the merits of these approaches, several of them supporting the yield-to-maturity interpretation of the debtor approach

and some giving consideration to the embedded derivative approach. It was mentioned that this discussion is linked to the more general issue of distinguishing holding gains from income.

219. Some members requested that the debts indexed to a stock index should also be looked at as they may accept zero interest with expected capital gains when SNA seems to be based on price index linked.

220. It noted with satisfaction that the ISWGNA already initiated commissioning an issue paper on the underlying principle in dealing with interest under high inflation, which may cross-cut with the issue of interest on index-linked debt instruments. AEG members would like to see worked-out examples when this issue comes back to them for decision.

25 AEG's written consultations on non-life insurance (decision)

221. This session was chaired by Brian Newson, Eurostat, and Charles Aspden, OECD, presented the results and conclusions of the written consultation (document No. SNA/M2.04/28) on behalf of the moderator, François Lequiller, OECD.

222. The first AEG in February 2004 agreed on most of the recommendations of the OECD Task Force on the measurement of insurance in the context of catastrophes. In that meeting, however, the AEG requested further clarification on two outstanding issues: (i) the inclusion of own funds in the calculation of insurance output and (ii) the treatment of profit sharing and bonuses.

223. Based on the AEG's suggestion, a written consultation was organized in April-May 2004. The AEG members were consulted through a questionnaire, consisting of

four questions, and a full background paper. In response to the BOP Committee's concerns that the optional treatment of the transfer as a capital transfer in exceptional cases will increase asymmetries between countries, the moderator re-included this question in the written consultation in addition to the two unresolved questions. The second question depended on the result of the first one.

224. The following four questions were asked:

- (i) Does the AEG support the inclusion of income from own funds in the formula for the calculation of non-life insurance output?
- (ii) If the response is yes to the previous question, which option (described in the background paper that was attached) would the AEG support?
- (iii) Does the AEG accept to classify commissions and rebates as negative premiums and profit sharing and bonuses as other income transfers?
- (iv) Does the AEG confirm that the SNA should allow an option permitting the treatment of some catastrophic claims as capital transfers rather than current transfers?

225. According to the moderator's view, the issue now is closed. He proposed to the AEG to endorse the conclusions and to amend the February 2004 decision about non-life insurance with them. The conclusions were:

- (i) The income from own funds should not be included in the formula used for the compilation of the non-life insurance production. The proposal was rejected by a significant majority (11/6) of the AEG members.
- (ii) Profit shares and bonuses should be treated as income and commissions and rebates as negative premiums. A large majority (12/5) of the AEG members agreed to the proposal.
- (iii) In exceptional circumstances, the implicit transfer should be treated as a capital transfer, despite possible asymmetries in the BOP of different countries. A very large majority (16/2) of the AEG members confirmed their initial choice to accept that treatment.

226. The AEG members unanimously agreed with the results and conclusions of the written consultation. The February 2004 decision on non-life insurance will be amended with them.

227. Many participants acknowledged the positive results obtained from the written consultation and thanked the moderator Francois Lequiller. They considered the written procedure a useful tool in the consultations among AEG members for future work of the AEG.

26 Treatment of employers' pension schemes (information)

228. This session was chaired by Charles Aspden, OECD, and Adriaan Bloem, IMF, presented the issue (document No. SNA/M2.04/29). John Ruser, BEA, also attended the meeting in the capacity of EDG moderator.

229. In several instances, the 1993 SNA does not appear to adequately reflect the responsibilities that employers, in particular government agencies, undertake by promising pensions to households. Specifically, the following issues can be mentioned:

(i) Promises to pay future pensions are recognized as assets/liabilities for funded employers' pension schemes, but not for the unfunded ones.

(ii) The values that the 1993 SNA records as "actual employers' social contributions" to defined benefit pension funds reflect amounts paid rather than the true cost to the employers who are liable to the pension entitlements of their employees (present value of additional pension promises) accrued during the accounting period.

(iii) Underfunding or overfunding of defined benefit employers' pension schemes is not portrayed as an obligation of or a claim on the employers supporting these schemes.

230. These 1993 SNA recording conventions may seriously distort the view on the proper economic transactions and financial positions of employers and government, on the one hand, and households, on the other hand.

231. An EDG on the treatment of pensions was established by the IMF in 2001. In view of the wide range of conditions under which social security schemes operate, the EDG considered it was too early to make concrete proposals regarding such schemes for the present SNA update.

232. On the basis of the contributions received from many experts, the results of a straw poll conducted by the group in September 2003, and discussions in various international statistical meetings, the EDG recommended the following:

- (a) Treat unfunded employers' pension schemes identically to funded employers' pension schemes.
- (b) For all defined benefit employers' pension schemes, use actuarial valuations to measure (i) employers' social contributions and (ii) property income attributed to insurance policy holders.
- (c) Allocate the net assets of defined benefit employers' pension schemes to the sponsoring employers.

233. The challenges for the national accountants in Europe were raised where there are different models for pensions and social security. The dichotomy of employee pension schemes and social security does not fit all countries. Another problem is the enormous amounts that are involved, based on uncertain demographical assumptions. The countries that had implemented the recommended principles had based their data on government calculations. Thus, it would be hazardous if the NSOs made the estimates. However, there is need for data on this issue. The question is more whether they should be recorded in satellite accounts or like funded schemes. Another question is whether funded and unfunded schemes could be regarded as similar since the guarantees seem different. One way of treating the unfunded pension schemes could be to insert "changes in equity in unfunded pension schemes" in the accumulation accounts after the [capital account]. It would lead to two figures for government borrowing. In the European discussion on the employers' pension liabilities six options had been proposed:

- (i) Follow the current SNA.
- (ii) Leave the core as it is, but use satellite accounts.
- (iii) Recognize employers' liabilities as recommended by the EDG.
- (iv) Record all pensions as liabilities, also social security.
- (v) Create new accumulation accounts.
- (vi) Show changes in pension liabilities in OCVA.

234. An AEG member argued for the satellite accounts option. He was uncertain whether treating unfunded schemes as funded would help decision making and was worried if the NSOs would have to estimate the pension liabilities. He saw the pay-as-you-go systems as fundamentally different from funded schemes, as the former is based on future events. He was supported by another member on his choice of satellite accounts. One member was worried if her national accounts office would have to calculate government pension obligations.

235. One member supported the recommendations of the EDG strongly and said that his country already had implemented the recommendations in the national accounts and the government accounts. He was supported by another member who found satellite accounts more like "tryout accounts" and not suitable for this issue.

236. A member saw pensions as the most important reason for changing the SNA. On the question of recording she referred to the parallel treatment of consumption expenditure in the SNA and suggested a treatment with and without unfunded pension liabilities. It would have some of the attraction of the satellite accounts but not the disadvantages. One member warned that the parallel treatment would have implications for the income accounts as well.

237. One member supported the EDG recommendations from a conceptual point of view. The obligations are clearly there even if funds are not set aside. He saw the pension obligations as legal obligations, but he was uncertain whether employers of underfunded schemes are responsible for the full amount. He also asked for a closer

look at the output calculations of pension funds and suggested that the EDG should study employment contracts to see if pension obligations are clearly recognized.

238. A member argued that one problem of the current treatment of unfunded pension schemes is that, even if the household sector perceives that it has pension claims, the current system fails to recognize them. He supported the inclusion of unfunded pension liabilities in the core accounts. Another member pointed out a weakness of the present treatment in a case where a government had bought an [un]funded pension scheme. The present system is unable to handle such transactions properly.

239. Several members supported the view that the actuarial estimated amounts should relate to the employees' accumulated rights up to the present date which could be based on another formula than for future rights which the government might consider change. If changes of the rights are made retrospective, the other changes in assets account should be used.

240. The discussion revealed that both funded and unfunded employer pension schemes were present in the countries of the members and that many countries are in the process of reforming the pension system.

241. The AEG concluded that unfunded and underfunded employers' pension schemes have to be treated in a new manner and the liabilities need to be recognized in the national accounts. However, the AEG disagrees about where to draw the line between pensions and social security and where to record the pensions (in the core, in satellite accounts or in "parallel accounts").

242. The AEG recognized the need to address the problem of output calculations, which, as it was pointed out, could be negative. The NSOs will face challenges if the

governments do not provide actuarial estimates of future pension liabilities for its employer pension schemes.

243. Furthermore, the group sees the need for coordination with the TFHPSA. ISWGNA will address the question whether the issue should be treated by a task force instead of by the EDG.

Annexes

AGENDA

Second Meeting of the Advisory Expert Group on National Accounts

United Nations, New York

8-16 December 2004

Wednesday, 8 December

10.00 Chair ISWGNA

Introductory remarks by ISWGNA

Opening by Mr. Paul Cheung, Director of the United Nations Statistics Division

10.30 Chair UNSD

Approval of agenda (Document SNA/M2.04/01)

Administrative matters

Progress report on the work programme (Document SNA/M2.04/02.1) – information

Revised operational guidelines, etc. (Document SNA/M2.04/02.2) – information

List of issues for clarification (Document SNA/M2.04/02.3) – information

Review comments on decisions of first AEG meeting (Document SNA/M2.04/03) – Information

12.30 Lunch

14.00 Chair UNSD

Databases (Document SNA/M2.04/04) - decision

Mineral exploration (Document SNA/M2.04/05) – decision

17.30 Close of day

Thursday, 9 December

9.00 Chair Eurostat

Originals and copies (Document SNA/M2.04/06) - decision

12.30 Lunch

14.00 Chair Eurostat

Non-performing loans (Document SNA/M2.04/07) - decision

17.30 Close of day

Friday, 10 December

9.00 Chair IMF

Government owned assets - cost of capital services (Document SNA/M2.04/08) - decision

Treatment of land improvement (Document SNA/M2.04/09) - decision

12.30 Lunch

14.00 Chair IMF

Cost of ownership - Part II (Document SNA/M2.04/10) -decision

17.30 Close of day

Monday, 13 December

9.00 Chair OECD

Progress on work programme of TFHPSA (Document SNA/M2.04/11.1) – information

Background paper on relationship between Macroeconomic Statistical Guidelines and Accounting Standards (Document SNA/M2.04/11.2) - information

12.30 Lunch

14.00 Chair WB

Informal sector (Document SNA/M2.04/12) – information

Alternative presentations of top structure of revised ISIC and CPC in the update of the 1993 SNA (Document SNA/M2.04/13) –information

Cost of capital services in the production account (Document SNA/M2.04/15) – information

Treatment of provisions (Document SNA/M2.04/16) – information

17.30 Close of day

Tuesday, 14 December

9.00 Chair UNSD

Progress on work programme of BPM update - “Balance of Payments Issues for the *SNA* Review” (Document SNA/M2.04/17) – information

Application of the concept of "transaction"

(a) "Change of economic ownership" as term (Document SNA/M2.04/18) – decision

(b) Application of accrual principles to debt arrears (Document SNA/M2.04/19) – decision

12.30 Lunch

14:00 Chair UNSD

Residence of households ("Predominant center of economic interest as term"; exception to one year rule for students, patients, and ships crew; and harmonization with demographic and other statistics) (Document SNA/M2.04/20) – decision

Units

(a) Treatment of multi-territory enterprises (Document SNA/M2.04/21) – decision

(b) Holding companies, special purpose entities, and trusts: clarification of their status as units and residence (Document SNA/M2.04/22) – decision

(c) Recognition of branches (Document SNA/M2.04/23) – decision

17.30 Close of day

Wednesday, 15 December

9.00 Chair Eurostat

Goods sent abroad for processing (Document SNA/M2.04/24) - decision

Treatment of activation of guarantees (Document SNA/M2.04/25) -
information

12.30 Lunch

14:00 Chair Eurostat

Repurchase agreements, securities lending, gold swaps and gold loans: An
update (Document SNA/M2.04/26) - information

Treatment of debt instruments linked to foreign currency (Document
SNA/M2.04/27) - information

Non life insurance (“outcome of the AEG consultations”) (Document
SNA/M2.04/28) – information/decision

Thursday, 16 December

9.00 Chair: OECD

Statistical treatment of employers’ pension schemes (Document
SNA/M2.04/29) - information

12.30 Lunch

14:00 Chair ISWGNA

List of actions requested by the AEG meeting

Summary of the AEG recommendations

17.00 Close of meeting

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Second Meeting of the Advisory Expert Group on National Accounts

United Nations, New York

8-16 December 2004

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List of references to manuals in the report

1993 SNA: *System of National Accounts, 1993* by Commission of the European Communities/Eurostat, International Monetary Fund, Organisation for Economic Cooperation and Development, United Nations and World Bank

ISIC: *International Standard Industrial Classification of All Economic Activities, Revision 3.1*, United Nations, 2003

CPC: *Central Product Classifications, Version 1.1*, United Nations, 2003

NPI Handbook: *Handbook on Non-Profit Institutions in the System of National Accounts*, United Nations, 2003

SEEA-2003: *Integrated Environmental and Economic Accounting 2003*, by European Commission/Eurostat, International Monetary Fund, Organisation for Economic Cooperation and Development, United Nations and World Bank

BPM5: *Balance of Payments Manual Fifth Edition*, International Monetary Fund, 1993

GFSM 2001: *Government Finance Statistics Manual 2001* by International Monetary Fund

MFSM 2000: *Monetary and Financial Statistics Manual*, International Monetary Fund, 2000

External Debt Guide: *External Debt Statistics: Guide for Compilers and Users*, International Monetary Fund, 2003