

**DRAFT REPORT**

**Fourth Meeting of the Advisory Expert Group on National Accounts**

**30 January – 8 February 2006**

**at the European Central Bank, Frankfurt**

Leases and licences, part 1 .....	1
Leases and licences, part 2 .....	20
Contracts and leases: Government permits .....	23
Amortization of intangible non-produced assets .....	31
Merchanting .....	32
Satellite accounts.....	39
Interest under high inflation .....	40
Review of the outcome of e-discussions - The right to use/exploit non-produced resources between residents and non-residents.....	40
Review of the outcome of e-discussions - Water .....	42
Review of the outcome of e-discussions - Illegal activities .....	43
Review of the outcome of e-discussions - Measurement of non-market volume output .....	46
Review of the outcome of e-discussions - SNA/ISIC aggregations for SNA data reporting .....	47
The treatment of employer pension schemes and other defined benefit pension schemes .....	48
Pension schemes.....	55
Definition of economic assets .....	59
Review of the outcome of e-discussions - Impact of non-performing loans on FISIM .....	64
Review of the outcome of e-discussions - Retained earnings of mutual funds, insurance corporations and pension funds .....	65
Review of the outcome of e-discussions - Financial instruments, non-monetary gold .....	66
Output of central banks .....	68
The production of financial corporations and price/volume measurement of financial services and non-life insurance services .....	74
Equity .....	85
Treatment of currency unions.....	88
Direct investment .....	89
Globalization: A progress report .....	89
Assets boundary for intangible non-produced assets - Other intangible fixed assets.....	90
Classification and terminology of non-financial assets.....	93
Country comments on recommendations made by the July 2005 AEG meeting .....	101
Non-market producers' owned assets - Cost of capital services .....	102
Liability aspects of SDRs and international reserves .....	107
Debt concessionality .....	109
Debt reorganization .....	114
Classification and terminology of financial assets and liabilities in the updated SNA .....	114
Classification and terminology of financial corporations in the updated SNA .....	121
Drafting and review phase of the update, including outreach .....	125
Units in the 1993 SNA .....	128
Public-private partnerships.....	141
The general government and public sectors .....	145
Consistency of recommendations.....	147
The treatment of the informal sector .....	162
Review of the outcome of e-discussion – The concept of persons in the 1993 SNA Rev. 1 .....	169
Working time measurement .....	170
Government/public sector/private sector delineation issues .....	172
Government dividends and capital transactions with public corporations in the updated SNA ....	177
Granting and activation of guarantees in an updated SNA .....	181
Summary conclusions and wrap-up .....	188
Agenda .....	190
List of participants.....	195

## **Agenda**

1. The topics in this report follow the order of the initial agenda, as attached, even though in the event some re-allocation of time was found necessary during the meeting.

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### **Leases and licences, part 1**

#### **Issue 21; Paper SNA/M1.06/09.1; for decision**

##### **Description of the issue**

*The 1993 SNA refers to contracts, leases and licences in a number of contexts but there is no overview that sets out the principles of the appropriate treatment of all such arrangements.*

*Further, clarification is desirable concerning several specific points:*

- (i) the definition and treatment of operating and financial leases on fixed assets,*
- (ii) when legal constructs should be recognized as assets,*
- (iii) whether tradable government permits should be treated as assets,*
- (iv) can sub-contracting lead to the creation of an asset,*
- (v) can a difference between a contract price and the corresponding prevailing price affect the treatment of existing leases.*

##### **Presentation – questions (a), (b), (c) and (d)**

2. The papers for this session (document numbers SNA/M1.06/09.1 and SNA/M1.06/09.2; Issue 21) were written and presented by Anne Harrison. The session was chaired by Barbro Hexeberg (World Bank).

3. The presentation and discussion on this topic were very lengthy. To enable the reader to obtain an impression of the direction of the debate, the presentation, discussion and outcomes are presented section by section

##### ***Introduction***

4. Three sets of cases were identified,:

- (1) leases and licences in respect of fixed assets;
- (2) leases and licences in respect of natural resources;
- (3) other leases, licences and contracts.

##### ***Fixed assets***

5. Contracts concerning fixed assets whose real prices decline over their service lives are treated as either operating or financial leases.

### *Operating leases*

6. An operating lease is an agreement between a lessor and lessee for the latter to rent machinery or equipment temporarily for use in the production process. The lessor is responsible for the maintenance and repair of the asset being leased and the leased asset appears in the balance sheet of the lessor.

### *Financial leases*

7. In a financial lease, the asset plays no technical part in the production of the lessor. The lessee is responsible for maintenance and repair of the asset, and the value of the asset appears in the balance sheet of the lessee.

### *Timing*

8. Operational leases tend to be shorter than financial leases - financial leases tend to cover most or all of the asset's life. These facts are indicative and not determining.

### **Questions**

9. The first two questions concerned clarification of the distinction between operating and financial leases.

- (a) Does the AEG agree on the distinction between operating and financial leases as depending primarily on whether the lessor or lessee has responsibility for the maintenance of the leased asset and a production activity in which it was used?
- (b) Does the AEG agree that operating and financial leases are not assets in their own right?

10. There were two questions clarifying the recording of financial leases.

- (c) Does the AEG agree that the breakdown between repayment of principal and interest is estimated in a manner similar to determining depreciation and net operating surplus/return to capital in the case of a fixed asset?
- (d) Does the AEG agree that a financial service may be provided by the lessor if the lessor is a financial institution; if this is so the service is reflected in FISIM?

### **Discussion – questions (a), (b), (c) and (d)**

11. The discussion opened with a comment that the questions do not adequately distinguish the characteristics of operating and financial leases. For example, it is necessary to determine the effective economic owner of the asset (see ISWGNA paper from 2001). It is impossible to determine the status of a lease unless the characteristics are well defined. Even though the paper is heading in the right direction in emphasising economic characteristics (e.g. who is responsible for repair and maintenance), this is not a sufficient criterion by itself. International accounting standards should be referred to to set out principles.

12. An alternative view was that it is not possible to elaborate any more than has been done in the paper. Too much detail might simply cause confusion. There is a difference between legal and

economic ownership. To start off, the SNA should establish the broad principles, while recognising some details still need to be sorted out. The distinction between operating and financial leases should be based on the effective ownership. Responsibility for repairs and maintenance is not necessarily the only criterion applicable. The paper on PPPs sets out the case very well. While in general the answer to question (b) is yes, financial leases can be assets in their own right in certain circumstances. It will be difficult to come to a “one size fits all” solution. For example, land can be treated differently depending on the length of time of the lease. It will be important to set out the underlying principles and a set of guidelines for applying them, particularly the special circumstances that may lead to the treatment of a lease as an asset (e.g. footballer’s contracts).

13. The Chair concluded there was broad agreement on questions (a) and (b) but more work is required on the detail. The Project Manager expressed her concern that here and elsewhere suggestions for more work need to be accompanied by offers to do the work if it is to be done and in a timely manner.

14. The discussion on question (c) concentrated on the underlying components of the lease, which were identified as payment of interest and repayment of capital. The importance of the residual value in financial leases was debated. There was general agreement that the issues are too complicated for the SNA to explicitly cover every type of situation. An example was given of more than 700 PPP cases being closely examined by UK government accountants and business accountants, who were unable to agree on who owns the assets in practice in many of these cases.

15. The AEG agreed that the SNA should set out principles on which decisions are to be based. In general, it is reasonable to assume assets are run down to a zero value (or scrap value) but a financial lease can have a residual value if it does not cover the whole life of the asset. If this is so, then the value of the principal of the loan is not for the entire value of the asset.

16. The AEG acknowledged that it is difficult to set out the details in practice and it is impossible to try to cover all potential situations in the SNA. The idea of there being an asset underlying a loan adds confusion to the concepts. It is possible to use the perpetual inventory method to determine the residual value in financial leases, similar to its use in other aspects of estimating the values of capital assets. The SNA needs to explicitly state that different assumptions lead to different values even in cases where the principles are similar.

17. The AEG was not keen about spending more time on investigating this issue. All the criteria have been set out. There may be some elaboration required for complex cases but it is impossible to anticipate and solve all these in the SNA.

18. The Chair’s summary was that the paper correctly sets out the issues with respect to questions (c) and (d). However, some more guidelines would be useful, but without changing the principles set out in the paper.

## **Summary conclusions - questions (a), (b), (c) and (d)**

### ***Outcomes***

- (a) There was broad agreement on this point but further elaboration is needed including a reference to criteria for economic ownership.

- (b) There was agreement that leases are seldom assets in their own right; some specific instances to the contrary are discussed below.
- (c) The proposals set out in the paper are correct but some further explanation is required, with care being taken to ensure the principles set out in the paper are not changed.
- (d) The AEG agreed.

## **Presentation – questions (e), (f), (g), (h) and (i)**

### *Operating leases*

- 19. Two separate issues are involved with operating leases:
  - (1) the effect of different prices;
  - (2) prepayments.
- 20. The key question in both these cases is “What constitutes the market price?”.

### *Example 1 – the going rate is greater than the lease payment*

21. Assume the lessee has agreed to pay 140 for a building, but the going rate is now 180. Therefore, the unencumbered value is 180 (i.e. without the existing tenant) while the encumbered value is 140. In other words, the going rate exceeds the lease payment. In effect, the lessee has an asset of 40 *if he can legally and practically transfer/trade the lease*, while the lessor has a negative asset (of -40). The value of the asset in the lessor’s balance sheet is 180 (unencumbered) but the lessee has a new asset of 40, with the lessor having an offsetting -40. Therefore, in this case, the total value of the two assets to the lessor is 140 (the encumbered value).

### *Example 2 – the going rate is less than the lease payment*

22. In this case, assume the lessee agrees to pay 140 for a building, but the going rate is now 120. The unencumbered value is 120, while the encumbered value is 140. In other words, the going rate is less than the lease payment. The value of the asset in the balance sheet of the lessor is 120 (unencumbered) so the lessor has an asset of 20 in addition to the building, and the lessee has an asset of -20. The total value of the two assets for the lessor is 140 (i.e. the encumbered value). If the lessee cannot legally and practically transfer/trade the lease, then there is no new asset for the lessee.

### **Questions**

- 23. There were five questions relating to the treatment of operating leases, especially those where the lessee might have the right to transfer the lease.
  - (e) Does the AEG agree that the payment due under a lease agreement represents the market price even if a newly leased identical asset would command a different price?
  - (f) Does the AEG agree that if a lessee is able legally and practically to sub-contract a lease at a higher rental, this represents an asset for the lessee and a reduction in net

worth of the lessor? In this case the value of the object of the lease appears in the lessor's balance sheet at the unencumbered value with the reduction shown separately?

- (g) Does the AEG agree that if the lessee is not able either legally or practically to sub-contract a lease, the value of the object of the lease appears in the lessor's balance sheet at the encumbered value? In this case there is no separately identified asset belonging to the lessee?
- (h) Does the AEG agree that these assets (or reductions in net worth) are only relevant in the case of operational leases?
- (i) If the benefit which comes from a transferable/enforceable lease is regarded as a non-financial asset (under contracts, leases and licences), how should the negative counterpart be shown?

### **Discussion – questions (e), (f), (g), (h) and (i)**

24. There was a debate over the relationship between the “market price” and the “prevailing price”. For example, what is the market price for a concert ticket which costs less than it can be sold for on E-bay?

25. The majority view was that, in practice, the market price is the contract price between the buyer and seller. If the prevailing price is different then that has to be handled separately for any new contracts because it is impossible to check how prices evolve over time and then make adjustments for earlier contracts. An example was given of whether economic reality would dictate we should adjust discount air tickets to a full “market price” in the national accounts.

26. The Chair summed up the discussion on question (e) that, despite some disagreements, the majority agreed that the market price is equal to the contractual price.

27. The discussion on questions (f) and (g) commenced with a debate about the example in the paper. Real estate property prices are very difficult to determine because prices of some products are not readily identifiable. The prevailing price is affected by the “search costs” for tenants so the value of an occupied property is different from that for a vacant property. The example of subletting is another example of an unusual contractual situation. If the lessee contracts to a new tenant, he is still the lessee in the contract but is making a windfall gain with the lessor effectively being outside this contract. Some concern was expressed about using the terms “encumbered” and “unencumbered” although this point was not pursued by the AEG. There was also a query as to whether the proposal in question (f) is consistent with the treatment of goodwill.

28. A lease is different from a concert ticket because a lease lasts for a potentially lengthy time. If a lease price changes and the lessee can get more for the lease then it is simply reflecting changes in market rates. However, the lessor is locked into the existing contract with the lessee at the market price set at the time the contract was signed. The change in the market price since the initial contract was let is irrelevant. The issue is similar to one of “fair value” in accounting standards. Unless a new contract is let, changes in the market price are irrelevant. In effect, sub-letters hold an asset when rents are higher than the actual rents they are paying under their lease contract.

29. Several participants expressed concern that even if it were recognised that in principle an asset existed, in practice it would be impossible to measure them comprehensively. The Editor suggested replacing questions (f) and (g) by the following:

“In principle there may be an asset but it should be only be recognised if the asset can actually (or potentially) be transferred.”

30. The AEG agreed with this suggestion.

31. The AEG agreed with question (h) without discussion.

32. The discussion on question (i) started with a number of participants suggesting that the asset looks like some sort of financial instrument and so the issue is how it should be classified. An advantage of treating it as a non-financial asset is that it is in the same part of the balance sheet as the asset to which it relates so that the encumbered and unencumbered values can be added together; in other words, both the plus and the minus should be classified the same way (i.e. either both financial or both non-financial). In general participants thought that it would be classified as a non-financial non-produced asset but it would not necessarily be the case in all situations. If the lease is recorded at its unencumbered value then the value of the encumbrance might be recorded as some sort of financial derivative. The fundamental decision is whether such assets should be valued at their encumbered or unencumbered prices.

33. Some participants expressed concerns about the above proposal. An example was given of a lease with an unencumbered value of 1000 and an encumbered value of 800. The difference can only be recorded when the contract is transferable or when there is a subletting transaction, which is too complicated. In practice, we should put 800 in the balance sheet of the lessor and 200 in the balance sheet of the lessee, provided he succeeds in subletting. One participant said individual assets should not be put in a single account just so they can be aggregated. The Editor suggested that, if the asset is to be classified as a financial derivative, then the definition of a financial derivative will have to change.

34. The discussion moved on to whether or not encumbrance is an important characteristic. The key issue is how much the asset can be sold for. Whether or not it is encumbered is just one of the underlying characteristics. The split suggested by the Canberra II Group for encumbered and unencumbered was simply to cover the practical issue of measuring the stock of assets. If the unencumbered value can be worked out then the effects of encumbrances can be deducted. Some participants argued that encumbrance affects the price at which an asset can be sold and so it is a price-determining characteristic. In this case, encumbrances are part of the operational risks. If encumbrances are recorded as financial derivatives then we will incorrectly record the value of non-financial assets. It will be necessary to record the unencumbered values along with the value of encumbrances or the encumbered value. The possibility of encumbrances changing the value of an asset should be taken into account and decisions should be based on whether or not encumbrances change the characteristics (and therefore the value) of the underlying assets.

35. Other issues raised during the discussion were:

- the perpetual inventory method (PIM) is a second-best way of calculating capital stock and principles should not be compromised to cater for the PIM;
- non-produced assets are not one of the factors of production, they carry a financial risk so they should be recorded separately, but it is difficult to separate the financial and non-financial aspects in practice;



- if a lease is not transferable then the encumbered value is appropriate;
- we should not let a small number of occurrences get in the way of the basic concepts;
- some difficult examples could arise in Europe, particularly associated with government intervention.

36. The Chair summed up by saying there was no agreement on question (i). A small group was set up to look at the issue and report back later in the week (see the paper prepared by Peter Harper, Robert Heath and Robin Lynch in *ANNEX 1: - Treatment of transferable operating leases* below).

### **Summary conclusions - questions (e), (f), (g), (h) and (i)**

#### ***Outcomes***

- (e) The majority of the AEG agreed that the contractual price represented the market price.
- (f),(g) The AEG agreed that the two propositions could be combined. In principle there may be an asset attributable to the lessee but it should be only be recognised if the asset can actually or potentially be transferred.
- (h) General agreement – no discussion.
- (i) A sub-group of the AEG met to reformulate this question in the light of the discussion. The sub-group provided three alternatives for recording. The AEG agreed that the leased asset should always be recorded by the lessor at the encumbered value. If the encumbered value is less than the unencumbered value and only if it can be actually or potentially transferred, the lessee would have an asset, to be included in the heading “contracts, leases and licences”

### **Presentation – questions (j) and (k)**

#### ***Prepayments***

37. The Canberra II Group decided there is no single rule for the treatment of prepayments; rather the treatment depends on the contract terms. In the case of a single upfront payment if there is a transfer of the risks and rewards then an asset is acquired (e.g. originals and copies). However, a single upfront payment on an operating lease would be treated as trade credit.

38. A different case is a large initial payment followed by smaller ones. This may be an acquisition (e.g. of a copy or equipment) followed by a service agreement. On the other hand, it may be trade credit for an operating lease.

#### ***Question***

- (j) Do you agree the treatment of prepayments may be a payment for a service or the acquisition of an asset depending on the nature of the agreement?

39. A further case would be where one unit contributes assets to a collective project in lieu of finance. The presenter suggested the SNA treatment should be to impute a financial transaction and a purchase of equipment (parallel with wages in kind).

### ***Question***

- (k) If a party to a collective project contributes an asset in lieu of a financial payment, the SNA treatment should be to impute a financial transaction and acquisition of an asset in a similar way to the treatment of wages in kind.

### **Discussion – questions (j) and (k)**

40. There was no discussion.

### **Summary conclusions - questions (j) and (k)**

#### ***Outcomes***

41. The AEG agreed with both these propositions.

### **Presentation – questions (l), (m), (n) and (o)**

#### ***Natural resources***

42. One example is those natural resources with infinite lives and whose use does not affect their nature or value. At the end of a lease, the legal owner resumes ownership. A second case is where demand exceeds sustainable supply, permits are usually used to restrict demand. The third case is when but continued use eventually exhausts the asset. Examples are (respectively) land, fish and oil and each of these three cases is considered separately.

43. In the case of land, for which regular payments are made, the situation is like an operational lease in that regular payments are made to the owner. However, unlike an operational lease, the owner has no associated productive activity and yet the asset remains on the owner's balance sheet. It was suggested that another sort of lease could be introduced in the SNA, a resource lease. A resource lease is an agreement whereby the legal owner of a natural resource with infinite life makes it available to a lessee in return for a regular payment (i.e. rent). The resource appears in the balance sheet of the lessor. No consumption of fixed capital is recorded for either the lessee or lessor.

44. A situation can arise when the demand for a resource exceeds supply and access is often controlled via the government issuing permits to exploit the resource concerned. Examples are fish, forestry and emissions to air and water. Emissions permits will be covered as part of the discussion on government permits as taxes.

45. The situation with oil etc is different from emissions because exploitation eventually exhausts the resources over which the permit has been granted. It will be covered as part of the next paper.

## **Questions**

46. Four questions were raised concerning the use of natural resources authorised by permits.
47. The first of these questions concerned the lease of a natural resource with an infinite life made available by the legal owner to a lessee in return for a regular income (rent). Such a lease does not quite fit either the operating or financial lease conditions. The AEG was therefore asked:
- (l) Is the concept of a resource lease in addition to operating and financial leases helpful?
48. Two other questions related to the use of environmental assets. One concerned resources with sustainability constraints such as fish and the other emissions permits.
- (m) Does the AEG agree that fishing quotas represent assets to the holders? Can this be generalised to quotas, licences, etc for all protected plant and animal species?
  - (n) Does the AEG think emission permits should be recorded as taxes in the first instance and assets when they are traded in secondary markets or as assets from inception? Does this generalise to all assets used as “sinks”?
49. The fourth question concerned permits not issued by government.
- (o) Does the AEG agree that when there is an underlying asset, payments should be property income; when there is no underlying asset, payments should be recorded as a payment for a service?

## **Discussion – questions (l), (m), (n) and (o)**

50. The AEG deferred discussion on question (l) until the e-consultation with the Canberra II Group was reported and questions (m) and (n) until after the paper on government permits was presented.
51. The AEG agreed with question (o).

## **Summary conclusions - questions (l), (m), (n) and (o)**

### **Outcomes**

- (l) The AEG agreed that the introduction of a resource lease as a third kind of lease would be helpful.
- (m), (n) The AEG deferred these questions until the paper on government permits was discussed.
- (o) The AEG agreed to the proposal on permits not issued by government.

### **Other leases, licences and contracts**

52. The key topic under this heading was the provision of goods in the future. Examples are an option to purchase aircraft (the Canberra II Group says this is an asset). Another example is having

full order books, which the Canberra II Group says is not an asset, except in the context of a takeover. Provision of services in the future is a related topic. Examples are time share and footballers' contracts.

### **Questions**

53. The last section of the first paper on leases and licences dealt with the provision of goods in the future, for example options to purchase aircraft or the provision of services in the future by nominated persons, for example, footballers' contracts.

- (p) Is the provision of a good in future, e.g. an aircraft option, an asset, specifically some sort of financial derivative?
- (q) Does the AEG agree that, e.g. footballers' contracts, may be a non-financial asset in the group "contracts, leases and licences"?

54. Given the amount of time the Canberra II Group had spent investigating the questions surrounding contracts, leases and licences, the AEG was asked

- (r) Should there be generic advice about the treatment of contracts, leases and licences?

### **Discussion – questions (p), (q) and (r)**

55. The AEG agreed that there is an asset involved in question (p) provided there is a demonstrated value so the discussion was mainly around the type of asset involved. An example discussed by the AEG was the kind of asset associated with an option for an airline to buy extra aircraft from a manufacturer. This type of option does not meet the definition of a financial derivative. It will be important to sort out what types of transferable contracts should be treated as financial derivatives and whether or not a new category of financial derivatives will be required in the updated SNA. The paper needs to clarify the circumstances in which such treatment is appropriate. In practice, the options are neutral initially and then acquire value for one party as time evolves. It is necessary to have a demonstrated market to derive a value. One way of looking at the classification is to determine if there is a counterpart liability. If so, it is a financial derivative, otherwise it is a non-financial, non-produced asset.

56. The Chair summed up the debate on question (p) that the AEG agreed there is an asset if there is a demonstrated value but the type of asset needs to be further clarified.

57. The AEG considered two broad possibilities for treating footballers' contracts (question (q)):

- as a non-financial asset;
- as a pre-payment for services.

58. The key points put forward by those in favour of treating footballers' contracts as assets were:

- they are similar to an option on the purchase of a plane, with the counterpart in this case relating to the person or company delivering the service;

- if these contracts are a pre-payment then we need to set out how to handle any subsequent change in the contract (e.g. contracts can be traded, but between clubs not footballers);
- a lot of football clubs are non-financial corporations and a large part of their assets is the amount they would receive if they sold their players to other clubs;
- the contracts are payment for someone to deliver a service that is valued at the amount of the service likely to be provided, so it is a non-financial asset;
- the value of the contract rests with the football club and the player is not free to negotiate elsewhere if his form improves;
- if a footballer's form deteriorates or he is injured, there is a negative value then associated with the contract;
- clubs have a demonstrated asset and there can be positive or negative aspects associated with it.

59. Opinions were expressed for the assets to be classified as non-financial or as financial, although the majority favoured them being treated as financial assets.

60. The key points put forward by those in favour of treating footballers' contracts as pre-payments for services were:

- footballers' contracts involve hiring people, who are not asset (because the human body is not an asset under the SNA);
- it is necessary to identify a counterpart liability for an asset to be created and there is none in this case.

61. Arguments specifically treating them as pre-payments were that the footballer does not get paid until he plays each game and the contracts can be bought out by another club, with the initial club (not the footballer) receiving the purchase payment.

62. One participant argued that, in the updated SNA, the principle should be to establish rules to handle all sorts of contracts, no matter whether they are for footballers or for options on the purchase of an aircraft. However, another participant pointed out that there is a choice with an aircraft purchase option in whether or not the holder chooses to exercise it, which is quite different from a footballer's contract. A further point was that the contracts can have different options associated with them and having a value later on is not necessarily tied in with the initial value. In such cases, these contracts are like financial derivatives because their value is dependent on outcomes.

63. The Chair suggested that, because of the lack of agreement on question (q), this topic should be considered by someone in the group set up to look into the issues associated with question (i). The report is presented below (see the paper prepared by Peter Harper in *ANNEX 2: - Treatment of transferable footballers' contracts*).

64. The AEG agreed to question (r), with no discussion.

## Summary conclusions – questions (p), (q) and (r)

### **Outcomes**

- (p) The AEG agreed there is an asset if there is a demonstrated value but the type of asset needs to be further clarified.
- (q) The AEG agreed that such contracts should be treated as non-produced, non-financial assets.
- (r) The AEG agreed.

### **Residual issues**

65. After the initial debate on leases and licences the AEG agreed that a small group would consider some residual issues and present reports on each:

- treatment of transferable operating leases; and
- treatment of transferable footballer's contracts.

66. The reports are presented as Annex 1 and Annex 2 below.

### **Presentation - transferable operating leases**

67. Consider a building that has a transferable operating lease. If the lease did not exist, the building would be valued at 150 (this is its unencumbered value). If the encumbered value of the building is 120 then the lease has a demonstrated value of 30. There are 3 options available for treating this situation.

#### **Option 1**

68. If the building is valued at its encumbered value of 120, then the lease should be treated as a non-produced, non-financial asset of the lessor, valued at 30. There is an issue of the consistency of recording with the valuation of the underlying asset when the lease is not transferable. It could be argued, however, that value of building is understated.

#### **Option 2**

69. In this case, the underlying asset is valued at its unencumbered value of 150 and the lease is treated as a non-financial non-produced asset of the lessee and as a non-produced non-financial liability of the lessor. The building could be considered to be valued at its correct value but the non-financial liability appears to be quite unusual.

#### **Option 3**

70. In this case, the underlying asset is again valued at its unencumbered value of 150. However, this time the lease is treated as a financial asset of the lessor and a financial liability of the lessor (30). The building could be considered to be valued at its correct value, but at a different value to buildings with non-transferable leases.

## ***Classification issue***

71. Under option 3, the financial instrument is considered to be of a 'derivative' type. This would require a change to the current classification, as follows:

Derivatives (previously financial derivatives and employee stock option)

Financial derivatives (unchanged)

Employee stock options (unchanged)

Other derivatives (new category).

## ***Main points***

72. The net worth is the same under all options, for both the lessor and the lessee and for the economy as a whole. We need to also consider leases with 'negative' values. When the issue was discussed by the Canberra II Group, a majority favoured option 3, with some support for option 1.

## **Discussion - transferable operating leases**

73. The first point in the discussion was the prevalence of subletting. Examples are available of cities/countries in which subletting is sufficiently widespread to consider it as a realistic, common occurrence that needs to be dealt with in the updated SNA. In effect, subletting involves transferring the lease. The AEG was assured that the issue is not simply one of a label.

74. One participant said that option 2 is not consistent with the treatment of non-financial assets generally. Conceptually the value of the lease is the difference between the contract price and the current value and this implies there is a financial derivative. It is slightly different though because the value of the derivative becomes zero at the end of its life which is contrary to the normal situation with a financial derivative which starts off with a value of zero. There was little support for option 2 within the AEG.

75. The discussion then moved to the pros and cons of options 1 and 3. In favour of option 3 is that transferable contracts offer an advantage to either the lessor or the lessee depending on how prices of similar products move. Counting against option 3 is that the derivative involved would not be like a normal financial derivative and it is difficult to identify the liability associated with the lease.

76. Option 1 is consistent with cases where the lease is not transferable. In such cases, it would be necessary to record the value for the owner, which is consistent with the earlier AEG decision that the correct value is the recorded value. In addition, a contract implies the parties are locked in. From a conceptual point of view, there is no difference between a contract on a building and a footballer's contract. To consistently record different types of lease then requires option 1 to be adopted. A couple of comments were made that, at an extreme, the value of the building can disappear under this option.

77. A comment was made that the lessee does not have the (potential) asset until he sells the asset (i.e. the sublet lease). However, the Canberra II Group agreed that if an asset could have an observed value and was potentially saleable then it has a value even if it is not sold.

78. The Chair concluded that, on balance, the AEG supported option 1 that such leases should be treated as non-produced, non-financial assets of the lessee.

## ***Outcome - transferable operating leases***

79. The AEG agreed that such leases should be treated as non-produced, non-financial assets of the lessee (option 1 of the 3 options presented).

## **Presentation - transferable footballers' contracts**

### ***Background***

80. Footballers can be signed to long-term contracts, with pre-determined payments. In some cases, due to an improvement in the footballer's skills, the contract may have a realisable value and so contracts are often sold from one club to another.

### ***Option 1***

81. Under this option, the contract is not recognised as an asset. However, it is not clear how transactions in the contracts should be recorded under this option.

### ***Option 2***

82. The contract is treated as a non-produced non-financial asset. Increases in the value of the contract would be reflected as an increase in net worth, which would be consistent with the idea that an increase in a footballer's skills leads to an increase in the value of his contract.

### ***Option 3***

83. The contract is treated as a financial asset, with an offsetting liability recorded against the footballer. This is similar to option 3 in the 'transferable operating lease' case and it would have the same classification consequences. However a (potentially) significant difference is that there is no underlying asset in the case of footballers' contracts because human capital is not an asset in the system.

## ***Canberra II Group recommendation***

84. The recommendation of the Canberra II Group was to adopt option 2. However, there was not any extensive discussion on the issue.

## **Discussion - transferable footballers' contracts**

### ***Transferable footballers' contracts***

85. The discussion initially covered the potential outcomes involved with changes in a player's skill level and the impact on the value of the contract. For example, if a player's skill increases then there is an increase in the value of the asset (the contract) but the SNA does not recognise human capital. There was a suggestion that it would be necessary to impute higher wages for a footballer if his skills increase but this view gained no support. In refuting these views one participant argued that option 2 does not value human capital because the contract is the asset and the holder of the asset is the football club, not the player.



86. Some concern was expressed about the possibility that the non-financial asset could have a negative value under option 2. A counter argument was that assets can have a negative value as would be the case with a nuclear power station just before it is decommissioned because of the clean-up costs involved.

87. A large number of participants indicated their preferences, with a significant majority preferring option 2. This is consistent with option 1 on transferable operating leases discussed immediately above.

***Outcome - transferable footballer's contracts***

88. The AEG agreed that such contracts should be treated as non-produced, non-financial assets.

## ANNEX 1: Treatment of transferable operating leases

### *Paper prepared by Peter Harper, Robert Heath and Robin Lynch*

89. The AEG has concluded that a transferable operating lease where value can be established should be treated as an asset in the system. However, agreement has yet to be reached on how this asset should be recorded. The purpose of this note is to set out possible options for treatment to assist the AEG in making a recommendation on the issue.

90. Three options are put forward. To elaborate these options, an example is provided. The same example is used for each option to assist in comparing the impact of different options. In this example, it assumed that there is a transferable operating lease on the building. If the lease did not exist, the building would be valued at 150 (the unencumbered value). The lease has a demonstrated value of 30 (because the prevailing rental is higher than the rental in the lease). Therefore, the encumbered value of the building is 120.

91. Before setting out each of the options, it is worthwhile recalling the decision with regard to operating leases that are not transferable. In these cases, the AEG decided that the lease was not an asset, and that the underlying asset should be valued at its encumbered value.

#### **Option 1**

92. In this option, the underlying asset is valued at its encumbered value, and the lease treated as a non-produced non-financial asset. The entries in the balance sheet of the lessor, lessee and economy as a whole would be:

	<u>Lessor</u>	<u>Lessee</u>	<u>Economy</u>
Building	120	-	120
Non-produced, non-financial assets	-	30	30
<b>Net worth</b>	<b>120</b>	<b>30</b>	<b>150</b>

93. The advantage of this option is that, because the building is valued at its encumbered value, there is consistency with the recording of underlying assets where the lease is not transferable.

94. The disadvantage of this option is that, because the lease is transferable, it could be argued that the value of the building is understated. From the perspective of the economy of the whole, the building is worth 150, because the building can be sublet.

#### **Option 2**

95. In this option, the underlying asset is valued at its unencumbered value; the lease is treated as a non-produced non-financial asset; and a 'non-financial' liability is recorded against the lessor. The entries in the balance sheet of the lessor, lessee and economy as a whole would be:

	<u>Lessor</u>	<u>Lessee</u>	<u>Economy</u>
Building	150	-	150

Non-produced, non-financial assets	-	30	30
Non-produced, non-financial liabilities	-30	-	-30
<b>Net worth</b>	<b>120</b>	<b>30</b>	<b>150</b>

96. The advantage of this option is that the building is valued at its unencumbered value, which it could be argued is the correct value given that it can be sublet.

97. The disadvantage of this option is that it creates a new category within non-produced assets – non-financial liabilities. This category is highly unusual, as to date all liabilities in the system are financial. Also, by including the building at its unencumbered value, there is a difference in treatment with the value of underlying assets when leases are not transferable.

98. A possibility would be to record this ‘liability’ in the same category as the underlying asset (the building in this case); however in effect this is a variant of option 1.

### Option 3

99. In this option, the underlying asset is valued at its unencumbered value; the lease is treated as a financial asset; and a (financial) liability is recorded against the lessor. The entries in the balance sheet of the lessor, lessee and economy as a whole would be:

	<u>Lessor</u>	<u>Lessee</u>	<u>Economy</u>
Building	150	-	150
Financial assets	-	30	30
Financial liabilities	-30	-	-30
<b>Net worth</b>	<b>120</b>	<b>30</b>	<b>150</b>

100. The advantage of this option is that the building is valued at its unencumbered value, which it could be argued is the correct value given that it can be sublet. Also, it shows the asset/liability pair within the financial account, where asset/liability pairs are generally recorded.

101. The disadvantage of this option is that by including the building at its unencumbered value, there is a difference in treatment with the value of underlying assets when leases are not transferable.

102. An issue with this option is the classification of the financial instrument. This instrument is similar in nature to financial derivatives, but unlike financial derivatives the transferable leases are unlikely to be traded in organised financial markets. A proposed solution would be to rename the ‘financial derivatives and employee stock options’ category<sup>1</sup> in the financial accounts to simply ‘derivatives’ and show the following breakdown:

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<sup>1</sup> The previous ‘financial derivatives’ category was expanded to include employee stock options as a result of a previous AEG decision.

## Derivatives

Financial derivatives

Employee stock options

Other derivatives.

103. The lease financial instrument would be classified in the 'other derivatives' item. This item could also be used to record, for example, options to purchase aircraft that are transferable.

104. A precise definition would need to be developed for this item to ensure that it didn't become a 'catch-all' category for a wide range of contractual arrangements. Key features of the definition would include evidence of transactions, or preferably markets, in the instruments, and that value of the instrument can be identified.

### **General comments**

105. It should be clear from the examples that the net worth for both the lessor and the lessee, and for the economy as a whole, is identical in each case; the differences relate to the breakdown of net worth into its components.

106. The case of a transferable lease that has a negative value should also be considered. While these cases are likely to be rare, they may exist. Under option 1, the non-produced, non-financial asset would be shown with a negative sign, which would be unusual. Under option 2, the lessee would be shown as having a 'non-financial liability', with the lessor showing a lease asset. Under option 3, the derivative asset/liability positions would be 'reversed' between the lessee and lessor.

107. When the treatment of transferable operational leases was discussed by the Canberra 2 Group meeting at Geneva 2005, a few members were in favour of option 1, no-one was in favour of option 2, and a significant majority was in favour of option 3. It may be that some of those who favoured option 1 would prefer option 2 over option 3.

## **ANNEX 2: Treatment of transferable footballer's contracts**

### ***Paper prepared by Peter Harper***

108. In its initial discussion on transferable contracts, the AEG was unable to decide how to treat so-called 'footballer's contracts'. These are contracts in which a footballer agrees to receive a future, pre-determined, income stream in exchange for providing his footballing 'services' to a particular club. It may be that the market value for the footballer's skills increases – perhaps because the footballer has become a better player than when the contract was signed – and that because of this the club holding the contract may then be able to 'sell' the footballer to another club for a positive payment.<sup>2 3</sup> How should such contracts be recorded in the system? From the specific case of footballer's contracts, the case of contracts providing for the future delivery of labour 'services' more broadly can be generalised.

109. The purpose of this paper is to assist the AEG in reaching a conclusion on this issue. Three options for treatment are proposed.

#### **Option 1**

110. In this option, the contract is not recognised as an asset. However, this would be inconsistent with a general view that transferable contracts for which values can be observed in their own right are to be treated as assets. Also, if the contract is not recognised as an asset, how would any transactions involving the contract (such as its sale from one club to another) be recorded?

#### **Option 2**

111. In this option, the contract would be treated as a non-produced, non-financial asset. It would be recognised in the system when value could be observed and subsequent changes in the value of the asset would be recorded in the revaluation account. There would be no 'offsetting' liability, so an increase in the value of the asset would represent an increase in overall net worth. This would be consistent with the idea that an improvement in the footballer's skills, which are valued by society, should be reflected as an increase in the net worth of the economy.

112. Under this option, any contract that was in a 'negative' position (from the perspective of the club) would be treated as a negative non-produced non-financial asset, which is perhaps a drawback with this option.

#### **Option 3**

113. In this option, the contract would be treated as a financial asset, with an offsetting (financial) liability recorded against the footballer. Under this option, changes in the value of the contract

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<sup>2</sup> It may be that at the inception of the contract, some or all of the footballer's income was pre-paid. In this case, any subsequent transfer of the contract may include an element of the residual amount of prepayment. Payment of this amount does not represent a payment for the contract per-se, rather it represents the transfer of the prepayment asset from one club to another.

<sup>3</sup> It may be that a footballer's ability deteriorates during the life of the contract, perhaps because of injury, in which case the club holding the contract would need to pay another club to take over the contract.

would not lead to a change in overall net worth, although the net worth of both the club and the footballer would be affected.

114. This option is similar to the option 3 put forward for the treatment of transferable operating leases. As such, there would be the same issue of classification. It is proposed that if this option is accepted, then the classification treatment proposed in the transferable operating leases payment be accepted in this case also.

115. While this option is similar to the transferable operating lease option 3, there is an important difference. In the case of operating leases there is an underlying asset. In the case of transferable football contracts there is no underlying asset in the system; with human capital of course not being recognised as an asset. In the case of operating leases, the 'liability' entry is considered necessary to offset the increase in unencumbered value of the underlying asset.<sup>4</sup> However, because there is no increase in the value of an underlying asset in the case of footballer's contracts, it could be argued that in this case such a liability entry is unnecessary. Also, it may be hard to conceive that the footballer has any liability to the club beyond his original contractual requirements.

116. This option does, however, deal more neatly with the situation where the contract has a negative value from the perception of the club. In these cases, the asset/liability pair would be 'swapped' between the footballer and the club.

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## **Leases and licences, part 2**

### **Issue 21; Paper SNA/M1.06/09.2; for decision**

#### **Presentation**

117. The paper for this session (document number SNA/M1.06/09.2; Issue 21) was written and presented by Anne Harrison. The session was chaired by Barbro Hexeberg (World Bank).

#### ***Introduction***

118. The key issue being examined in this topic is partitioning the ownership of assets. Partitioning occurs when the benefits from an asset are divided between two or more units. One common case is when one unit receives the benefits for a certain period of time and then another unit takes over (e.g. when an asset is leased out for a fixed period of time and then reverts to the owner), while another is where the benefits in each period are shared between two or more units. Partitioning can provide a solution to the problem that arises when the ownership of an asset is not transferred when a licence is granted over that asset.

119. At its meeting in December 2001, the ISWGNA found that there was a need for more broadly-based work on the treatment of intangible assets. For example, an alternative treatment should be investigated whereby the spectrum is "sold" for a finite amount of time.

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<sup>4</sup> In alternative 3 of the transferable operating leases paper, the underlying asset (ie the building in the example provided) is recorded at its unencumbered value.

## **Canberra II Group e-consultation**

120. Paper SNA/M1.06/09.2 reported the results of an e-discussion carried out among members of the Canberra II Group in an attempt to complete some matters unresolved at the end of the last meeting. These were concerned with partitioning the benefits of an asset between different units either over time or within the same period of time. The Canberra II Group considered the following questions in the e-consultation:

- Q1 Do you think that any lease of a produced asset for less than the entire life of the asset should be automatically treated as an operating lease? If no, is this a change or a clarification of the 1993 SNA?
- Q2 Assuming a financial lease may be for less than the whole of the life of a produced asset, how would you prefer to record the partition of ownership between the legal owner and economic owner of an asset.
- the same sort of solution as for a transferable operating lease;
  - the mobile phone licence solution;
  - the alternative, two financial asset solution;
  - another (please specify)?
- Q3 To record the partition of ownership of a mineral deposit between the extractor and the owner would you prefer:
- the same sort of solution as for a transferable operating lease;
  - the mobile phone licence solution;
  - the alternative, two financial asset solution;
  - another (please specify)?
- Q4 Do you agree that the concept of a resource rent is a useful means of describing the regular payments for the use of a resource which does not decline in value over the terms of a lease but where the user of the resource and the legal owner differ?
- Q5 To record the partition of ownership of land under a long lease paid for up front would you prefer:
- the same sort of solution as for a transferable operating lease;
  - the mobile phone licence solution;
  - the alternative, two financial asset solution;
  - another (please specify)?
- Q6 To record the partition of ownership of a radio spectrum between the user and owner would you prefer:
- the same sort of solution as for a transferable operating lease;
  - the mobile phone licence solution;
  - the alternative, two financial asset solution;

- another (please specify)?

121. In summary, the AEG noted that the result of the e-discussion among the Canberra II Group members suggested that the overwhelming response to question 1 was that a financial lease could be for less than the entire life of an asset and that the concept of a resource lease (question 4) was thought to be helpful. On the four other questions, alternative recordings had been proposed to members of the Canberra II Group and they were in favour of a solution positing two loans, one for the value of the asset to be paid by the lessee and one for the residual value of the asset to be exchanged for the asset at the end of the lease.

122. The questions for the AEG coming out of this e-consultation are:

- (a) How does AEG react to the Canberra Group 2 consultation?
- (b) Is this a basis for proceeding?
- (c) Would worked examples help reach a final recommendation?
- (d) Can we work towards a solution by end March?

## **Discussion**

123. There was general support amongst AEG members for the outcome of the e-discussion. However, a couple of participants felt that the e-discussion outcome was not really “a consensus” and that there are no substantial arguments for changing the treatment on mobile phone licences. The problem was considered in depth three years ago and nothing new has arisen since then that has changed the underlying situation. Other AEG members argued that it is not a fundamental change to the ISWGNA decision; rather it is a clarification.

124. One participant said that business accounting treats phone licences as an asset and this influenced the ISWGNA’s decision. The Canberra II Group proposals are not really a major change from the 2001 decision. He asked if a 25 year lease on land is considered an asset or not. There was a short debate with the key issue being the need to determine if the effective ownership of land has changed when it is leased. It is difficult to draw a precise dividing line - a 10-year lease would probably be an operating lease but a 50 or 99 year lease indicates an effective change in ownership. Other factors to consider would be whether the government intends to renew the lease or not and whether the amount paid for the renewal of the lease is economically significant.

125. Despite some pressure to make a final decision on the spot, the AEG agreed that it would be useful to set out some worked examples based on the Canberra II Group decisions to improve understanding of the issues by those not in the Canberra II Group (it was mainly Canberra II Group members who had been involved in the e-discussions). The aim is to finalise the issue by the end of March.

## **Summary conclusion**

### ***Outcomes***

126. The AEG noted that the result of the e-discussion among the Canberra II Group members suggested that the overwhelming response to Q1 was that a financial lease could be for less than the entire life of an asset and that the concept of a resource lease (Q4) was thought to be helpful.



On the four other questions, alternative recordings had been proposed to members of the Canberra II Group and they were in favour of a solution positing two loans, one for the value of the asset to be paid by the lessee and one for the residual value of the asset to be exchanged for the asset at the end of the lease.

127. The AEG was prepared to consider the recommendation from the Canberra II Group sympathetically but agreed that a worked example showing all the recording implications would be useful in reaching a final position. It was agreed that such examples would be prepared and circulated to the AEG in time to reach a position by the end of March 2006. Charles Aspden will lead this work.

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## **Contracts and leases: Government permits**

### **Issue 21; Paper SNA/M1.06/08; for decision**

#### **Description of the issue**

*A special case concerning contracts and leases is when government issues certain sorts of permit to undertake some specific activity which are restricted in number and which are frequently expensive. Examples are taxi license and casino licences. Should these be treated as the payment of a tax or the sale of an asset?*

#### **Presentation**

128. The paper for this session (document number SNA/M1.06/08; Issue 21) was written by John Pitzer and presented by Brent Moulton. The session was chaired by Barbro Hexeberg (World Bank).

#### ***Possible classification of permits***

129. There are several possible ways in which permits can be classified:

- tax;
- purchase/sale of a service;
- lease of a non-financial asset:  
operating lease, or  
financial lease, or  
rent;
- purchase/sale of an existing asset;
- creation of a non-produced, non-financial asset;
- financial asset.

#### ***Canberra II Group concerns***

130. The Canberra II Group had some particular concerns about the treatment of permits. They related to the types of non-financial assets that may be created from permits being issued, the

treatment of assets once they are in the system, the principles that could be used to distinguish permits that are non-financial assets or represent transactions in non-financial assets from other permits, and the definition of a tax necessary to separate taxes and assets.

### ***Definition of a tax***

131. Three major characteristics of taxes are that they are compulsory, unrequited, and they are received by a government unit. A tax payment becomes compulsory if a transaction occurs or a condition exists that would give rise to a tax being paid and the government learns about the transaction or condition.

132. In some cases, taxes may be described as being “conditional”. In such cases, the taxes become compulsory only if a specified event occurs or a particular condition exists. The specified event/conditions often are optional to some degree. Examples include owning property or purchasing a luxury good. A decision to engage in taxable activity is based on total benefits likely to arise and the associated costs of the activity.

### ***Unrestricted permits***

133. In the current SNA, the distinction between a tax and a service is based on whether the government produces a service that is delivered to the individual purchaser, and on whether the cost of producing any such service relative to the price of the (unrestricted) permit. The author of the paper considers there is no reason to change this treatment. However, the 1993 SNA provides no guidance on permits that involve the use of existing non-financial assets, or on prepayments creating financial assets, or on permits that are themselves intangible non-financial assets (either produced or non-produced).

### ***Asset-related permits***

134. If a permit gives someone permanent control of an existing non-financial asset then it should be treated as the sale of an asset. If a permit gives someone temporary use of an existing non-financial asset then it should be treated as the lease of an asset. In cases where a prepayment of a tax or service is made then a financial asset should be created.

### ***Restricted permits: Tax or non-produced asset?***

135. Permits allow a transaction or activity to occur. The question that needs to be answered is whether selling permission to engage in a transaction or an activity can be considered as being “requited”. Only government permits are being considered in this paper, so the payment is to government. The situation being considered is where permits are compulsory if the transaction or activity is to occur. Such permits are unrequited if no service or asset is received in exchange, or if the price is out of all proportion to the value of the service or asset involved.

136. Explicit taxes are imposed by government units on non-government units, after a taxable transaction or activity takes place. On the other hand, permits are imposed by government units before the transaction or activity can take place. Non-government units engage in taxable transactions or activities because they expect the benefits from the transaction or activity to be in excess of total costs (including the tax). Therefore, non-government units purchase permits because they expect the benefits from the transaction or activity to be in excess of total costs (including the permit).

137. There are several similarities between permits and explicit taxes.

- payment is compulsory because of the sovereign power of government;
- no unit would pay an explicit tax or purchase a permit without the government's sovereign power being exercised;
- payment is made because the expected benefits are greater than the total cost (including the explicit tax/permit);
- purchasing a permit is a cost of doing business that reduces the net return of the business;
- granting permission is not something of value for which the unit is willing to pay;
- some units that otherwise would engage in the activity do not because of the cost of the permit.

### ***Setting the price of a permit***

138. Government is a monopoly seller of permits. The price can be set to maximize revenues or to pursue other policy goals. If the price set and the number of permits issued are not limited, then the number sold depends on the price and the demand. The government might limit the number of permits because the market may not clear or because the government lacks information on the likely demand. It is important to determine the demand before setting the price.

139. An auction is a means to determine the market clearing price when the number of permits is limited. The willingness of units to bid does not imply that services or assets are being obtained because the government, using its sovereign power, requires the permit for the unit to carry on a business. Units are willing to bid based on the expected benefits from engaging in the underlying activity. Bidding to purchase permits is consistent economic behaviour, even though the permits are fundamentally taxes.

140. Multi-year permits require a split of the values associated with them. Only the first year's share of the cost is a tax with the remainder being a financial asset. The early returns to the issuing government are transactions in financial assets. Multi-year permits may be tradable. If the price can vary from the recorded value, it is necessary to record the creation of a non-produced, non-financial asset. The value of this asset is zero when the permit is issued. Thereafter, the value varies with the market price of the permit.

### ***Canberra II recommendations***

141. The Canberra II Group recommended that:

**Recommendation 1** All government permits that rely on the exercise of sovereign powers and are issued on a restricted basis should be treated as taxes.

**Recommendation 2** The method of setting the price of a restricted government permit is not relevant for its treatment as a tax or an asset.

**Recommendation 3** If permits are valid for several years, only the portion representing the current year is a tax. The remainder is a financial asset for the purchaser and a liability for the government.

**Recommendation 4** Permits that are transferable or that can be returned to the issuing government for a refund of the unexpired portion are treated as financial assets/liabilities. If a multi-year permit is transferable, a non-produced, non-financial asset is deemed to be created, with a value that varies according to market conditions.

## Discussion

142. The discussion focussed mainly on recommendation 1, with the debate split between those that agreed with the recommendation and those who considered that restricted government permits should be treated as an asset. Some comments were made about the possibility, in some cases, of permits being a payment for a service.

143. The main arguments for treatment as a tax were:

- creating a permit is not the result of an economic exchange;
- is road pricing, via a permit, a payment for a service or a tax – it probably has an element of both but it is not an asset;
- the government intervenes because it is impossible for too many users to be involved in some activities and so a pricing mechanism is used to control the activity concerned;
- governments exercising their sovereign power are generally levying a tax;
- the amount of the tax can be identified on the basis of the total amount paid less the amount of capital services provided;
- a permit gives economic benefits to the purchaser even though it involves paying taxes.

144. The main arguments for treatment as an asset were:

- to treat a permit as a tax it must be both compulsory and also unrequited and the Canberra II Group argument is circular because it assumes a permit is not an asset and so it must be unrequited - you could just as easily come from other direction and obtain the opposite result;
- if entities bid competitively to obtain a permit then they must expect to obtain some benefit, of economic value, which implies it is required;
- treatment as a tax implies a liability on the government's books in perpetuity which does not make sense;
- value is created for the purchaser;
- the entity acquiring the permit gains an economic benefit but other entities have a destruction of wealth (minor in individual cases but significant across an economy as a whole);
- the government is not "creating wealth" through permits but it is effectively redistributing it;
- there is an underlying asset with restricted permits so the payment for them cannot be a tax, even if it proves difficult to determine the value of the asset;

- taxes are not set on a market price basis;
- those who buy a permit have a higher market share;
- an auction, which determines a “market price”, cannot be associated with a tax;
- the key issue is whether there is an underlying value.

145. The discussion then considered the broader issues. There was fairly widespread support for the argument that it is not possible to have a “one size fits all” solution. It is necessary to set out the criteria that identify a tax and an asset and treat each instance separately. Some permits can be a tax but some have an economic value that is not associated with a tax. It is necessary to distinguish between restricted and unrestricted permits in reaching a decision. A key issue is associated with identifying what is required and unrequired. However, the idea of “exercising sovereign power” is irrelevant to the classification of a permit.

146. There was no agreement on the status of an auction in the process of issuing a permit. On the one hand, proponents of treating restricted permits as a tax considered that having an auction to allocate the permits is aimed at maximising the tax take and so is effectively using the permit holders as tax collectors. On the other hand, supporters of treating them as an asset saw the auction process as people outbidding each other to pay the highest amount of tax (and pay it in advance) which is not rational behaviour.

147. There was general agreement that the cost of a permit carries through to the prices charged for the services provided by the activity for which the purchase of the permit is needed. A parallel was made with someone buying a permit to run a casino. They are purchasing the right to charge higher prices (similar to a royalty) but the royalty would not be treated as a tax, so what is the difference with a permit?

148. The Editor queried the criteria that would be applied to analyse permits on a case by case basis. She said she would need more clarification to be able to write this part of the SNA.

149. The Chair said the ISWGNA will look into the issue, focussing on the contentious issues in the Canberra II Group paper, and come back to the AEG with some recommendations.

## **Summary conclusion**

### ***Outcomes***

150. Recommendation 1 should have referred to the treatment of government permits without any underlying assets<sup>5</sup>. The discussion identified the possible treatments as taxes, assets or services, depending on the situation.

### **Residual issue - Treatment of (restricted) government permits**

151. After the initial debate on restricted government permits the AEG agreed that a small group would consider some residual issues on leases and licences and on government permits and present reports on each.

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<sup>5</sup> The expression “underlying asset” sometimes causes confusion. A permit is said to have an underlying asset if the permit allows the holder to use an asset owned by the unit issuing the permit.

152. The report on permits is presented as Annex 3 below.

## **Presentation - Treatment of (restricted) government permits**

### ***Key issue***

153. The key issue is whether or not the issue of permits is an unrequited transaction. If the transaction is unrequited, it should be treated as a tax and, if it is required, then it should be treated as the acquisition of a non-produced, non-financial asset.

### ***Case for unrequited payments***

154. The main argument in favour of the transaction being unrequited is that no producer would willingly purchase a permit and, as a result, nothing of economic benefit is being obtained. Such restricted permits permit monopoly profits and their issuance is a claim of government on these profits. Therefore, issuing these permits is analogous to direct taxation. Accordingly, the method for setting the price charged (e.g. by auction) is not relevant.

### ***Case for required payments***

155. The permits represent ‘something of value’, which is demonstrated by potential holders bidding to acquire them. Permit holders will almost certainly perceive they have something of value, and it will be reflected on their balance sheets. It will also be reflected in the market value of the holder. There is a degree of ‘unwillingness’ in any payment for an asset. It is not clear as to the nature of the claim on government and, likewise, it is not clear as to the nature of the liability of the government to the permit holder.

### ***Canberra II Group’s view***

156. A majority of the Canberra II Group was in favour of the ‘unrequited’ case – i.e. a tax. A minority expressed a view that the acquisition was required – i.e. the acquisition of a non-produced non-financial asset.

## **Discussion - Treatment of (restricted) government permits**

157. As was the case in the earlier discussion on permits, the debate was split between those who argued for restricted government permits to be treated as a tax and those in favour of treating them as a non-produced non-financial asset.

158. The main points for treating them as a tax were:

- businesses bid for an opportunity for an economic benefit;
- in effect the government is collecting a prepayment of a tax and this prepayment unwinds over the course of the life of the permit;
- payment for the permits is not obligatory, it can be compared with the VAT included as part of the price of a good or service;
- a government issues permits to avoid raising other taxes;
- government has the ability to nominate any type of business activity that would require a restricted permit;

- the permit holder is being used to raise tax via the higher prices charged so it is a prepayment of tax;
- it is not possible to define the borderline for an asset underlying the permit;
- the proposed treatment is completely parallel with the treatment of unrestricted permits because it is a service if the price is commensurate with the service provided, and a tax if it is much more significant.

159. The main arguments for treating permits as an asset were:

- the transaction is required because a significant payment indicates it is something for something (rather than for nothing);
- the method of payment indicates it is not a tax because taxes are not set at a “market rate”
- the government will have a liability recorded under other accounts receivable/payable when there is only a single payment from the sale;
- the government has something of value (i.e. a non-produced non-financial asset) which is created via an other volume change rather than by production;
- if someone acquiring a casino licence is paying a tax then they recover it only by charging more or by recovering a higher rate on its gambling;
- there is no recourse back to government if a purchaser cannot make money from the permit;
- a taxi owner pays income tax in addition to the “tax” paid for the permit;
- people want to pay for the permit so it is not a tax because there are ongoing benefits and it can be on-sold;
- a permit such as a taxi licence is a store of value for the owner.

160. The Chair concluded there was no overwhelming majority either way.

161. The Project Manager indicated there is no fallback to the current SNA because there is no treatment defined in it. The ISWGNA will discuss the problem to find a possible way forward.

### ***Outcome - treatment of (restricted) government permits***

162. The AEG was almost equally split on this issue, with a very narrow majority favouring treatment as a tax rather than as a sale of a non-produced, non-financial asset. The ISWGNA will consider this matter further.

## **ANNEX 3: Treatment of government permits**

### ***Paper prepared by Peter Harper***

163. In its initial discussion of *Contracts and Leases: Government Permits* (SNA/M1.06/08), the AEG was unable to agree on a recommendation. The heart of the issue is whether permits that are issued by government on a restricted basis and that do not involve the use of an underlying asset should be treated as taxes or as the acquisition of an asset by the permit holder. Examples of these permits include licences to operate casinos and taxi licences (medallions).<sup>6</sup> It was agreed that the key point for decision is whether or not these permits are unrequited, as taxes in the system are payments to government that are compulsory and unrequited. There is no dispute that the payments for such permits are compulsory.

164. The purpose of this paper is to assist the AEG in reaching a conclusion on this issue. It sets out the arguments for both positions. It uses the term ‘permits’ as a shorthand for those government permits issued on a restricted basis that do not involve the use of an underlying asset.

165. By way of background, ‘unrequited’ is not specifically defined in the SNA. Paragraph 7.48 states that a payment is unrequited when ‘government provides nothing in return to the individual unit making the payment’. As to what is ‘nothing in return’, the SNA does not provide any guidance.

#### **Position 1 – Payments for permits are unrequited**

166. The basis of the argument that payments for permits are unrequited is that no producer would willingly purchase a permit without a legal requirement to do so. Because of this, the producer is not receiving anything of benefit by acquiring the permit. Permits that are restricted enable producers to generate monopoly profits. The issuance of the permits enables the government to claim some or all of these monopoly profits. This is a device akin to directly taxing these profits. Therefore, the issuance of permits is analogous to direct taxation and should be treated as such.

167. As a consequence of this view, the method of setting the price for a restricted government permit (for example, by way of an auction) is not relevant for its treatment as a tax or asset.

168. An elaboration of these points can be found on page 7 of *Contracts and Leases: Government Permits*.

#### **Position 2 – Payments for permits are required**

169. The basis for the argument that payments for permits are required is that permits, which can generally be traded, represent ‘something of value’ to the holder.<sup>7</sup> The permit holder would almost

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<sup>6</sup> The treatment of permits on an unrestricted basis -- that is, permits that are generally available to anyone willing to pay for them -- is non contentious. Such permits are treated as either taxes or services, depending on whether the level of effort to issue the permit is commensurate with the cost of the permit.

The treatment of permits that involve the use of an underlying asset is the subject of separate discussion.

<sup>7</sup> Even if the permits are not tradable, they are reflected in the value that the market places on the entity that holds the permit.



certainly consider that they have paid to receive something of value, and they would most likely record an asset in their balance sheet. The fact that the permit holder would not have purchased the permit unless he was required to do is not considered relevant. In any transaction involving the purchase of an asset (or other product) there is generally a degree of ‘unwillingness’ on the part of the producer, in that the producer would clearly prefer to not enter into the transaction if it could somehow be ‘avoided’. Rather than the means of setting the price for the permit as not being relevant, then a producer’s participation in an auction process indicates that the producer does perceive they are receiving something of value; otherwise why would producers bid against each other.

170. It could be argued, as *Contracts and Leases: Government Permits* does, that the asset held by the producer simply represents pre-paid taxes. However, this treatment, by definition, requires a claim on the government, and it is not at all clear as to what the nature of this claim is. Likewise, the nature of the liability that is held by the government is not clear – in what sense is the government really liable to the entity owning the permit?

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## **Amortization of intangible non-produced assets**

### **Issue 28; Paper SNA/M1.06/13; for decision**

#### **Description of the issue**

*The final report of the ISWGNA in 2001 on mobile phone licenses includes a brief discussion of the issue of the amortization of intangible non-produced assets. Can a way be found to show the impact on net worth of the decline in the value of non-produced assets due to production via transactions rather than as other changes in the volume of assets?*

#### **Presentation**

171. The paper for this session (document number SNA/M1.06/13; Issue 28) was written and presented by Charles Aspden. The session was chaired by Barbro Hexeberg (World Bank).

172. The issue is whether the cost of acquiring a non-produced asset should be a deduction from gross value added for the user of the asset. If so, where does the corresponding increase in the value of the asset to be ultimately returned to the owner show up?

173. This issue is important in the context of the mobile phone considerations. In effect, we want to see the reduction in the value of capital in the production account of the licence holder. To do so, we would need a compensating adjustment for the spectrum owner and it is not clear where to put it. One way would be to settle for having both recorded in the other change in assets account.

174. Several proposals have been put forward to address this problem. Dippelsman and Mahle suggested recording the value as a new form of property income. The outcome would be correct values for saving, but with no impact on the production account. Binns et al presented two alternative possibilities. The first was to transfer ownership of the spectrum to the user and treat any upfront payment as pre-paid interest. However, this still does not address the production account problem. The second alternative was to treat the decrease in the value for the licence holder as a form of consumption of fixed capital in the production account and have a corresponding increase for the spectrum holder in the other changes in volume of assets account.

175. The Canberra II group looked at the problem of asymmetries associated with these treatments. The “two-asset solution” would give a means of recording a decrease in the value of the asset of the licence holder balanced by an increase in net worth of the spectrum owner via accrued interest.

## **Discussion**

176. There was one question as a result of the presentation, about why the mobile phone issue features so prominently in this paper. The presenter explained that it would be effectively redundant if a decision were made to treat mobile phones as “two assets” and the paper should just refer to non-produced non-financial assets.

## **Summary conclusion**

### ***Outcome***

177. This issue will be considered in connection with the worked examples being produced on leases and licences (see paragraph 89 above).

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## **Merchanting**

### **Issue 41; Paper SNA/M1.06/19; for decision**

#### **Description of the issue**

*Merchanting is defined in the **Balance of Payments Manual** as the purchase of a good by a resident (of the compiling economy) from a nonresident and the subsequent resale of the good to another nonresident, without the good entering the merchant’s economy. The SNA does not cover the topic. The existing definition of merchanting may capture activity that is part of the production process in an increasingly globalized and inter-connected world, which is not the intent behind the definition of merchanting activity. Therefore, there is a need for a clear and precise definition of merchanting; arising out of this there needs to be clear guidance on whether merchanting (when redefined) should be recorded on a net or a gross basis and under goods or services.*

#### **Presentation**

178. The paper for this session (document number SNA/M1.06/19; Issue 41) was written by Hidetoshi Takeda (IMF) and presented by Adriaan Bloem. The session was chaired by Charles Aspden (OECD).

#### ***Definition***

179. Merchanting is defined as the purchase of a good by a resident (of the compiling economy) from a non-resident and the subsequent resale of the good to another non-resident, without the good entering or leaving the merchant’s economy. The difference between the value of the goods when acquired and the value when sold is recorded as the value of merchanting services provided by the compiling country.

## ***Recording***

180. If a business in country A sells goods, valued at 80, to a business in country C and a business in country B sells services, valued at 20, to country C, the final product is imported from country A to country C, valued at 100. The outcome will almost certainly be a global mismatch of goods by value because no imports of merchanting are ever recorded. The processes associated with merchanting are inconsistent with the normal recording of wholesale and retail margins. In practice, the classification of the transaction varies according to whether the goods pass through the merchant's economy or not. The gross transactions do not match between the financial account and the current account.

181. Problems can also arise with the timing of the transactions. If a merchant buys in period 1 and then sells in period 2, the imports are recorded as entering into the compiling country in period 1 even though they do not physically enter the country. There will then be negative imports from the compiling country in period 2.

182. The key points are that the existing SNA methodology does not apply the standard change of ownership to these transactions. Merchanting as presently defined captures more than one type of activity. Problems also arise with the recording of holding gains and losses, which should not be included in the value of the services exported.

183. Merchanting was discussed at the July 2005 AEG and since then further consultation has taken place.

## ***What exactly is included in merchanting?***

184. Merchanting can be split into three broad categories of global manufacturing, global wholesaling/retailing and commodity dealing. **Global manufacturing** activities aim to make profits from the production of goods and the international movements of goods take place as a part of the process. **Global wholesaling/retailing** activities aim to obtain a margin (or fee, or commission) from buying and selling goods. **Commodity dealing** activities aim to obtain profits from trading risks, in commodities.

## ***Proposed treatments***

185. Global manufacturing should be treated as trade in goods. Recording should be on a change of ownership basis and it should avoid exceptional treatment. This would maintain consistency with the treatment of goods for processing and avoid negative imports. It is necessary to track values of physical movements of goods (merchandise trade) as well as imports of goods on a BoP basis.

186. Global wholesaling/retailing should be treated as trade in goods unless done on a fee basis when they would be services (brokerage). They should be treated on a change of ownership basis and it would still be necessary to distinguish physical movements and the BoP consequences. Such a treatment would avoid negative imports.

187. Commodity dealing involves either hedging or speculation. It is mostly done via derivatives (futures and options) so it is recorded in the financial account. Commodity markets are concerned with price setting and risk trading. For the London Metals Exchange, perhaps 95per cent of transactions are settled in cash based on the contract price. Transactions in commodities should be recorded at the market price on a change of ownership basis.

## ***Data collection issues***

188. There may be some data collection and reconciliation problems involved with treating merchanting on a gross basis. For example, there is a risk of double counting trade data coming from customs and that collected by other means such as through business surveys. In practice, there is a risk of increased bilateral asymmetries.

189. The alternative to the proposals is to maintain the status quo and treat Merchanting on a net basis as a service. It would mean that all cross country sourcing would be treated as brokerage.

## ***Questions***

### **Global manufacturing**

- (a) Should transactions in goods resulting from global manufacturing be recorded as trade in goods (under a separate heading) rather than services (as now)?
- (b) In other words, should such transactions be recorded on a gross basis, following the change in ownership principle, as for goods for processing?

### **Global wholesaling/retailing**

- (c) Should global wholesaling/retailing when trading in goods be recorded as trade in goods (under a separate heading) or trade in services (as now)?
- (d) If it is to be recorded as trade in goods, should this be on a gross basis when there is a change in ownership?
- (e) Or should it be recorded on a net basis as services (as now)?

### **Commodity dealing**

- (f) Make clear most commodity dealing transactions are transactions in financial derivatives?
- (g) When accounts are settled in commodities, and there is an actual flow of goods, should these transactions be recorded on a change of ownership basis, gross in goods (under a separate heading), or a net basis as services (as now)?

## **Discussion**

190. While merchanting is small in some countries it is very significant in Japan, for example. If transactions occur in different periods they are recorded in inventories. AEG members agreed that merchanting is likely to become more significant and so a firm resolution is required in the updated SNA. Consistency of treatment for global wholesaling and manufacturing is important.

191. Gross/net change of ownership

192. There is a problem dealing with wholesaling and retailing in the SNA and BOP on a consistent basis since there is no production account in the BOP. In the national accounts or in the

IO tables, goods bought by wholesalers and retailers do change ownership and may enter the inventories of the wholesalers and retailers but the gross purchases are not shown as such; output is measured by the margin between purchases and sales. At first sight, therefore, the present treatment of merchanting in the context of global wholesaling and retailing seems the obvious parallel. However, it is possible within the production account for wholesalers and retailers to eliminate holding gains and losses between domestic purchases and sales but holding gains and losses are not eliminated by simply deducting purchasers from sales as recorded in international trade data.

193. Moreover, measuring global wholesaling and retailing on a net basis leads to counter-intuitive entries of negative imports (rather than a decrease in inventories) when goods are sold in a period later than when they are purchased. Further, the entries in the financial accounts need to follow the change of ownership (gross) basis if they are to be captured accurately.

194. The principle of recording transactions on a change of ownership basis is fundamental in the BOP. A recommendation had been made to follow this in the case of goods for processing (when there is no change in ownership) and the logical consequence is to do the same when there was a change of ownership. If the change of ownership basis does not work then there are implications for SNA principles generally.

195. Recording on a change of ownership basis may seem more immediately appropriate, and consistent with domestic recording conceptually but several participants were concerned about the difficulty in practice of distinguishing between global manufacturing (when items are sourced abroad on own account), items being processed abroad and global wholesaling and retailing. While it was supposed that multi-nationals did have the relevant data available, there were doubts expressed about whether the necessary information would be available to the compilers of the accounts.

196. Several participants expressed the view that, if merchanting is significant, the implications are that both exports and imports will be distorted under a gross approach, particularly for countries that have a large amount of merchanting activity. Amongst some of those who preferred a net approach, there was some doubt as to whether the practical problems could be overcome, although it was acknowledged that measurement problems will arise in both the gross and net approaches. It should be possible to provide data on both a gross and a net basis as well to assist in analysis because the gross basis can affect the measure of global manufacturing, with a large number of imputes required.

197. Practical problems

198. The current treatment under the 1993 SNA is that, if goods come in during one period and go out the next period they show up as inventories in the first period and then negative imports in the next period. Under the proposals in the paper they would show up as exports instead.

199. As far as multinational enterprises are concerned, the practical problems are huge because residency and the ownership of goods can change overnight within multinationals. Several changes in ownership can occur during the production of goods and some participants argued that users are not assisted by recording the gross values associated with these changes in ownership so they require net recording.

200. There were some who were not convinced the proposal will lead to a better outcome than the current one and they queried why we would not show the change of ownership that actually occurs.

201. A further expressed was that it is not really a choice between gross and net recording; if the transactions are in a single period it becomes net otherwise it is gross. Transactions should be recorded at market prices, which could be complicated by transfer pricing. Inventories held abroad will give rise to implicit entries which could lead to inconsistencies in the accounts.

202. Where is BOP?

203. A suggestion was made that the gross figures should be recorded as goods and then the net ones would provide a measure of the service. Most users would find it useful to have merchanting specifically recorded as services, which is their correct classification. There are many cases in trade in services where the counterparty is recording the services as trade in goods. A suggestion was made to have a “merchanting” category in exports with positive and negative (gross) entries in the international trade accounts. A number of AEG members supported the proposal, with one commenting that in a country with a significant “merchanting province”, users want to see the distinction between the exports of goods and merchanting services between provinces. Another cautioned that it will be difficult to ensure the implications are fully thought through. In debating whether the flows would be goods or services, a statement was made that the counterparty will record the gross flows as goods.

204. BOPCOM has considered this issue over many years and is still divided, but leaned towards treating merchanting on a gross basis and to classify it as goods.

205. This proposal seems close enough to the BOPCOM position to be acceptable.

206. The AEG agreed that this proposal should be adopted for global manufacturing and wholesaling/retailing. The AEG also agreed with the recommendations on commodity dealing.

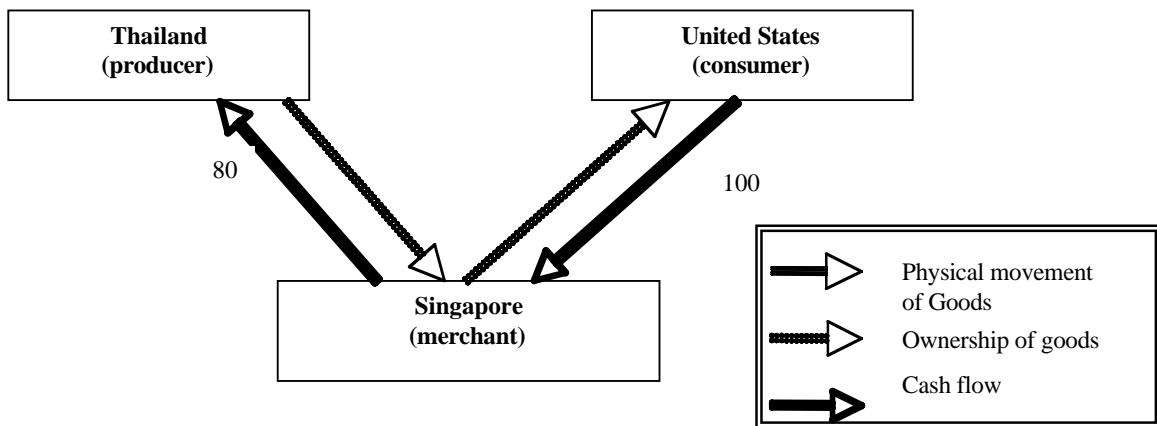
## ANNEX 4: Merchanting Transactions\*

### *Paper by Robert Heath*

207. \* NOTE: The type of financial account transactions that arise could vary but might include trade credit and/or transactions in currency and deposits.

208. The following examples illustrate the basic picture of transactions under the proposal for merchanting activity before the AEG.

209. A merchant in Singapore (merchant) purchases goods for Thailand (producer) for 80 and resells them to the United States (consumer) for 100. The parts are shipped directly from Thailand to the United States. Singapore reports the gross figures and the net of 20 under goods as merchanting. Thailand and the United States report exports of 80 and imports of 100 respectively. This is analogous in the national accounts where a wholesaler buys a good produced for 50 (at basic prices) and sells it for 100, with a margin of 50, except that the merchanting margin could include holding gains and losses.



#### Current recording

#### Proposed recording

		Credit	Debit		Credit	Debit
Singapore	Services (merchanting)	20		Goods (merchanting)	100 (exports) <u>-80</u> (imports) 20 (net)	
Thailand	Goods	80		Goods	80	
United States	Goods		100	Goods		100
Global balance	Services (merchanting)	20		Goods	100	100
	Goods	80	100			

### Summary conclusion

#### Questions

#### Global manufacturing

- (a) Should transactions in goods resulting from global manufacturing be recorded as trade in goods (under a separate heading) rather than services (as now)?
- (b) In other words, should such transactions be recorded on a gross basis, following the change in ownership principle, as for goods for processing?

### **Global wholesaling/retailing**

- (c) Should global wholesaling/retailing when trading in goods be recorded as trade in goods (under a separate heading) or trade in services (as now)?
- (d) If it is to be recorded as trade in goods, should this be on a gross basis when there is a change in ownership?
- (e) Or should it be recorded on a net basis as services (as now)?

### **Commodity dealing**

- (f) Make clear most commodity dealing transactions are transactions in financial derivatives?
- (g) When accounts are settled in commodities, and there is an actual flow of goods, should these transactions be recorded on a change of ownership basis, gross in goods (under a separate heading), or a net basis as services (as now)?

### **Outcomes**

- (a)-(g) The AEG agreed that all three types of merchanting (global manufacturing, global wholesaling/retailing, and commodity dealing that is settled by trade in commodities) should be recorded as follows:

“The acquisition of goods is recorded as an import (shown as a negative export) by the global manufacturer, global wholesaler/retailer or commodity dealer (merchant). The subsequent resale of the goods is recorded as exports by the merchant. The difference between the two is shown as net exports of goods by the merchant. The merchant’s output is recorded as a wholesale/retail service within the national accounts, exclusive of holding gains/losses while the goods are held (in inventory) by the merchant.”

The inclusion of the wholesale/retail margin and the holding gains/losses accruing while in inventory in the gross value of exports by the merchant is consistent with the measurement of supply and use of these margins in the SNA and with the BPM.



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## **Satellite accounts**

### **Issue C13; Paper SNA/M1.06/37; for information**

#### **Description of the issue**

*There are three proposals to improve the relevance of this chapter, in particular in the discussion of satellite accounting related to a more extensive production frontier for non market production (inclusion of domestic own-account production of services, etc.): (1) Discuss the function of double-entry bookkeeping (accounting independently for value of outputs and value of inputs) in non-market accounting context and the implications of adopting this approach for the development of non-market satellite accounts; (2) Discuss more explicitly the various possible approaches to valuing the inputs and outputs to non-market production and, if possible, endorse some general principles for doing this recommendation. This might also include taking a general position on physical versus monetary accounting (see the current comments on this topic in the context of environmental accounting at paragraph 21.138); (3) Propose non-market accounts for some specific areas in addition to the environment, say perhaps an education account and a health account.” These proposals reflect the findings of a recent study by the U.S. National Academy of Sciences on this topic.*

#### **Presentation**

210. The paper for this session (document number SNA/M1.06/37; Issue C13) was written by Anne Harrison. There was no presentation on this topic, but key points set out in the paper were discussed briefly. The session was chaired by Barbro Hexeberg (World Bank).

#### **Discussion**

211. The Editor explained that the current proposal for the updated chapter on satellite accounts is for it to be shorter than the current chapter, with a brief description of SEEA, plus some other satellite accounts. There will be more cross-references in the updated SNA to other documentation than is the case in the 1993 SNA and illustrative examples will be used to provide ideas on the different sorts of satellite accounts that can be set up.

#### **Summary conclusion**

##### ***Outcomes***

212. The AEG was pleased to note the proposals concerning the presentation of satellite accounts in the updated SNA.

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## **Interest under high inflation**

### **Issue 8; Paper SNA/M1.06/34; for information**

#### **Description of the issue**

*The treatment of nominal holding gains and interest on financial assets under conditions of high inflation was described in the 1993 SNA (Chapter XIX, Annex B) and subsequently in the OECD publication **A Manual on Inflation Accounting**. These two publications take different approaches, however. What should appear in the 1993 SNA Rev. 1*

#### **Presentation**

213. The paper for this session (document number SNA/M1.06/34; Issue 8) was written by Anne Harrison. There was no presentation on this topic, but key points set out in the paper were discussed briefly. The session was chaired by Barbro Hexeberg (World Bank).

#### **Discussion**

214. The consensus of those who spoke was that there is value in both the Hill and Vanoli approaches and the issues will be set out in the updated SNA but without coming down in favour of either side. It is not possible to resolve all the conceptual issues before the updated SNA is drafted although we are not far from a resolution. The issue should be included on the research agenda as part of an examination of the whole concept of income in the SNA.

215. The ISWGNA has recognised it as an important issue but not in isolation. It is more important to work through all the problems associated with dealing with accounts under high inflation rather than confine the work to interest alone.

#### **Summary conclusion**

##### ***Outcome***

216. The AEG was pleased to note the proposals concerning the coverage in the updated SNA of issues related to interest under high inflation.

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## **Review of the outcome of e-discussions - The right to use/exploit non-produced resources between residents and non-residents**

### **Issue 18, Papers SNA/M1.06/26.1, SNA/M1.06/26.2**

#### **Description of the issue**

*Except for land, transactions of the right to use or exploit non-produced resources between residents and non-residents have not been fully elaborated by the 1993 SNA. For land a notional resident unit is created which is deemed to purchase the land while the non-resident is deemed to purchase a financial asset (equity) of the notional unit. Should the treatment of*

*land be extended to other non-produced resources such as water, fish, etc. or should there be alternative treatments?*

## **Summary conclusion**

### **Questions**

217. The AEG members were asked whether they agreed to the following 11 points:

#### ***For land:***

- (a) All land must be owned by a resident unit, whether it is natural land or land improvements?
- (b) The lessor of land or buildings held under a financial lease must be a resident unit, notional if necessary?

#### ***For mineral deposits (or static natural resources subject to multi period extraction),***

- (c) The issue of a licence establishes a sufficient centre of economic interest for the holder of the licence to be regarded as resident (the BOPCOM view) or must production start to establish this (the CG view)?

#### ***For radio spectra (where there is no change in the asset brought about by usage),***

- (d) the holder of a licence to use the spectra would normally be resident but exceptions may occur in certain cases such as geographically small countries covered by facilities in neighbouring countries?

#### ***For logging (or static natural resources subject to short-term extraction),***

- (e) extraction must take place for more than a year to establish a resident unit?
- (f) A fee for one-time extraction represents the sale of an asset?
- (g) Illegal extraction should be recorded as uncompensated seizure?

#### ***For fish:***

- (h) A fishing vessel becomes resident only if the operator establishes a base in the country in question, otherwise the residence of the vessel remains that of the operator, regardless of the area in which it is fishing?
- (i) Fish beyond the EEZ may be treated as assets if allocated by international agreement?
- (j) Permits to catch fish may represent assets in their own right?
- (k) Illegal fishing should in principle be recorded as uncompensated seizure?

218. The AEG members who participated in the e-discussion overwhelmingly supported all except one of the proposed recommendations. The ninth proposal, (i), generated some disagreement.

### **Outcome**

219. The AEG was pleased to note the outcome of the e-discussion. On the third proposal, the views of BOPCOM and the Canberra II Group are different, with the former considering that a licence being issued is sufficient to establish residence while the latter considered production must be observed before residence is established. The AEG recommends that the BOPCOM approach be adopted in the updated SNA.

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## **Review of the outcome of e-discussions - Water**

### **Issue 31, Papers SNA/M1.06/27.1, SNA/M1.06/27.2**

#### **Description of the issue**

*When water is no longer free, how should the charge for it be treated? Although a large share of the charges represents distribution costs, is there an element that should be treated as giving rise to rent in a similar way to land or mineral resources? How should the use of water as a sink for waste be treated?*

#### **Questions**

220. Two questions were put to members of the AEG

- (a) Do you agree with the proposal to amend the wording of paragraph 6.24 to ensure there is consistency on the classification of water as a good and its transport as a service but without changing the existing convention on including the carrying of water within the production boundary?
- (b) Do you agree that
  - i. if a payment to discharge water is a fine intended to inhibit discharge, it should be treated as a fine;
  - ii. if a limited number of permits is issued with the intent to restrict discharges, the payment should be treated as a tax if the medium into which the water is discharged is not regarded as an asset in the system;
  - iii. if the discharge medium is an asset and the necessary conditions are met concerning the terms on which discharge is permitted, then the payment for the permit should be treated in the same way as the payment for a licence to use the radio spectrum for mobile phones; if the charge is linked to remedial action, this represents a payment for a service unless the amount levied is out of all proportion to the costs involved in subsequent water treatment in which case the payment should be treated as a tax.

221. The AEG members participating in the e-discussion overwhelmingly supported all proposed recommendations.

222. The AEG was pleased to note the recommendations agreed to in the e-discussion.

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## **Review of the outcome of e-discussions - Illegal activities**

### **Issue 33, Papers SNA/M1.06/28.1, SNA/M1.06/28.2**

#### **Description of the issue**

*Since the publication of the 1993 SNA, the handbook Measuring the Non-observed Economy has considered in detail and provided recommendations on the recording of illegal activities such as bribery, extortion and money laundering in addition to theft and fencing. The review should consider to what extent the recommendations included in the Handbook on the recording of production and redistribution of income from such activities should be included in the updated SNA.*

#### **Presentation**

##### ***Paper SNA/M1.06/28.2 – Report of e-discussion on illegal activities***

223. The paper on the results of the e-discussion was written by the UN Statistics Division and presented by Ivo Havinga.

224. The clarifications for recording illegal activities covered the following:

- scope of illegal activities
- guidelines for recording:
  - theft
  - fencing
  - bribes
  - extortion
  - money laundering.

225. In most cases there was overwhelming support. However, support was less strong in the cases of where bribery is accepted as standard practice in provision of non-market services (Q5) and for money laundering (Q9). There was a split of opinion in the cases of the recurrent theft of significant value by employees (Q2) and the recurrent theft of water and electricity of significant value by households (Q3).

## Discussion

### *Bribery*

226. The first few speakers were opposed to treating bribery as a transaction in the SNA. The discussion then moved to the general situation underlying the bribery. There was some support for the case that bribery is something by mutual agreement which implies it is a transaction so it should be recorded as compensation of employees, otherwise as a current transfer. An important distinction to make is whether or not the practice is generally acceptable or not, and a distinction would need to be made between tips and bribes.

227. The SNA and the Handbook on the Non-Observed Economy (NOE Handbook) are not consistent on this issue. Including bribery under exhaustiveness principles (as required in the NOE Handbook) means the other side of the transaction also needs to be covered. One participant commented that SNA principles should take precedence over the NOE Handbook where inconsistencies arise.

228. Participants provided a number of examples of bribery that could potentially be recorded in the SNA (the view being that bribery is part of output and so part of compensation of employees). They generally related to situations where paying bribes is accepted practice and the bribe is very large in relation to the goods or services involved. Examples were:

- doctors being paid by pharmaceutical companies to prescribe particular drugs;
- payment of bribes in schools, which can be as much as 50 per cent of total compensation of employees in developing countries;
- School boards can raise money to pay teachers more and this should be part of compensation of employees (not considered a bribe though by AEG members).

229. If bribes are transactions then they need to be classified. Should they be classified as unrequited current transfers or as payment for a service (“extortion services”?).

230. The Chair summed up that there was general agreement amongst AEG members that bribery should not be treated as compensation of employees. This is contrary to the recommendations in the NOE handbook and the NOE handbook’s status should be clarified. The consensus was that there is no need for bribes to be discussed in the SNA.

### *Theft*

231. The initial reaction of AEG members was that theft should not be considered as a transaction. Some were uncomfortable with the idea of appearing to condone theft by including it in an international manual as a “transaction”.

232. An example was then provided in which theft that is regular is, in effect, a substitute for compensation of employees. Another example is the tacit support by government agencies for theft (e.g. electricity in shanty towns) can be deliberate and this is effectively a transfer to households. However, drawing a parallel from this to the case of employee theft, the implication would be that the SNA would have to record transfers from companies to households, which is outside the scope of the system.

233. One participant made the point that sometimes it costs a business more to prevent the theft (such costs being recorded in the accounts as a business expense) than the theft costs. Perhaps a criterion for whether or not to record theft in the accounts could be whether or not the activity is subject to criminal laws.

234. The Chair concluded that, on balance, the AEG felt that theft should be outside the scope of transactions recorded in the updated SNA.

## **Summary conclusion**

### ***Questions***

235. The AEG members were asked whether the following nine clarifications should be incorporated into the updated SNA.

- (a) The explanation of illegal activities in the 1993 SNA should be further clarified by providing examples based on those in the NOE Handbook. These include activities such as production and distribution of illegal goods and counterfeit products, production of illegal services, production activities which are usually legal but which become illegal when carried out by unauthorized producers, theft and resale of stolen goods, bribery, extortion, money laundering, and forgery.
- (b) Recurrent theft of significant value by employees should be recorded as compensation in kind of employees.
- (c) Recurrent theft of water and electricity of significant value by households should be recorded as final household consumption expenditure. This treatment requires an imputation of a current transfer-in-kind from the producer (non-financial corporation sector) to the consumer (household sector).
- (d) Sale of stolen goods (fencing) should be recorded similar to the recording of sales of second-hand goods – that is, recording the value added and trade margins of distribution activities.
- (e) In the provision of market goods and services, bribes taken by employees as an additional margin on the “official” price should be recorded as an increase in the value of output of market production matched by an identical increase in the compensation of employees.
- (f) If the bribery is accepted as standard practice in provision of non-market services, then the bribe should be recorded as additional compensation of employees and an increase in output of government.
- (g) Bribes linked to the provision of non-market services that are not allowed or not publicly accepted should be recorded as current transfers. The same holds for payments to persons in privileged positions to obtain a contract.
- (h) Extortion payment should be recorded as an other change in the volume of assets account.

- (i) The difference between the value of the illegal cash and the value of the legalised (laundered) cash should be looked upon as a provision of services.

236. AEG members participating in the e-discussion overwhelmingly supported clarifications (a), (d), (g) and (h). The other clarifications required further discussion during the meeting.

### **Outcomes**

237. The AEG agreed that theft should not be treated as a transaction. The AEG also agreed that bribery should not be treated as compensation of employees, contrary to the possibilities mentioned in the *Handbook on the Non-Observed Economy*. The consensus of the AEG was that bribery should not be discussed in the updated SNA.

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## **Review of the outcome of e-discussions - Measurement of non-market volume output**

### **Clarification C10, Papers SNA/M1.06/31.1, SNA/M1.06/31.2**

#### **Description of the issue**

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

#### **Discussion**

238. The discussion on this topic concentrated on question (a) below. While no-one disagreed with the proposition that it is necessary to take account of the quality of the services being produced to enable accurate estimates to be produced, there was no support in the AEG for the methods proposed to adjust for quality change. Points raised were:

- the marginal benefit topic has so many exceptions that it becomes problematical;
- willingness to pay is not an indicator of quality - it is a price indicator;
- the proposal does not cover externalities of public goods;
- the marginal benefit of education is related to both the student and society in general.

239. The Chair said the outcome of the discussion on question (a) was that marginal benefits should not be included as part of the output of non-market services. The AEG noted the outcome of the e-discussion on the other questions.

#### **Summary conclusion**

##### **Questions**

240. The following four questions were put to the AEG members:



- (a) Does the AEG support the inclusion of new sentences in Chapter 16 of the SNA discussing the importance in theory of taking into account marginal benefits to households in the estimation of the volume change of non market services?
- (b) Does the AEG support the inclusion in the new SNA of more precise definitions of “input”/”output”/”outcome”?
- (c) Does the AEG agree to include in the new SNA positive and practical descriptions of acceptable output indicators, in particular for education and health?
- (d) Does the AEG agree to revise paragraph 16.139 to give it a more positive tone and reflect current thinking?

241. The AEG members participating in the e-discussion overwhelmingly supported three of the four proposals relating to measurement of non-market volume output. They were about equally divided on the proposal to include new sentences in the SNA discussing the importance in theory of taking into account marginal benefits to households in the estimation of the volume change of non-market services.

### **Outcomes**

242. The AEG agreed that marginal benefits should not be described as the basis for measuring the volume of non-market services. The AEG noted the other 3 recommendations were agreed to in the e-discussion.

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## **Review of the outcome of e-discussions - SNA/ISIC aggregations for SNA data reporting**

### **Clarification C12; Papers SNA/M1.06/33.1, SNA/M1.06/33.2**

#### **Description of the issue**

*The SNA 93 industry classification is shown as the ISIC 2-digit classification. In addition to this classification, the ESA 95 includes top level industry classifications which regroup ISIC/NACE positions. They are known as the A3 (three positions)/A6/A31/A60 classifications. These top level classifications are heavily used in the transmission of national accounts data for Eurostat and OECD countries. It would, first, be useful that these top level classifications are defined in the new SNA. Second, a revision of these classifications is in progress in Eurostat, alongside the revision of the NACE/ISIC. A paper has also been prepared by the UN. The OECD/Eurostat and the UN will cooperate to propose top-level aggregations acceptable to all.*

#### **Summary conclusion**

##### **Questions**

243. Two questions were put to the members of the AEG:

- (a) Do you agree that the proposed top-top aggregation can be accepted for SNA data reporting?
- (b) Do you agree that the proposed intermediate aggregation (A\*38) can be accepted for SNA data reporting?

244. The AEG members participating in the e-discussion overwhelmingly supported the proposed top 10 and A\*38 aggregations for SNA data reporting.

### **Outcome**

245. The AEG was pleased to note the recommendations agreed to in the e-discussion.

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## **The treatment of employer pension schemes and other defined benefit pension schemes**

### **Issue 2; Paper SNA/M1.06/03.1; for decision**

#### **Description of the issue**

*In the 1993 SNA, promises to pay future pension benefits are not recognized as liabilities of social security schemes or unfunded employer schemes. The review will investigate the analytical relevance of recording these promises as liabilities in the national accounts and, if appropriate, formulate recommendations regarding their valuation and measurement. The review should also address the problems of under- and over-funded defined benefit schemes where at present liabilities are recognized only to the extent that reserves have been built up. The implications for the definition of output of pension schemes, compensation of employees and saving as well as measurement issues need to be addressed. The review will also seek to reconcile the recommendations of the 1993 SNA and the IMF Government Finance Statistics Manual regarding the treatment of unfunded employer pension schemes*

#### **Presentation**

246. The paper for this session (document number SNA/M1.06/03.1; Issue 2) was written by Brian Donaghue, consultant to the Task Force on Employer Retirement Schemes and presented by John Ruser. The session was chaired by Carol Carson (Project Manager).

#### **Introduction**

247. One of the key findings of the Task Force on Employers' Retirement Schemes (TFERS) was that the SNA is inconsistent in its recommended treatment of funded and unfunded pension schemes. To achieve consistency, a majority of the Task Force recommended that it would be necessary for all pension liabilities of employers to be recognized, regardless of the extent of the funding of the schemes. The stocks and flows of all pension schemes should be recorded in the core accounts, based on actuarial estimates.

248. To meet users' needs, the stocks and flows of funded and unfunded schemes should be separately identified, although the TFERS recognized the practical problems involved. The TFERS

acknowledged that measurement issues exist, but was aware that actuarial estimates are available in many countries on the liabilities of such schemes.

249. The TFRS also considered that issues associated with identifying the borderline between pensions and social security must be resolved in the updated SNA.

### ***Attributes of employers' pension schemes***

250. Pension schemes provide retirement benefits based on a contractual employer-employee relationship. The schemes may be funded, unfunded, or over- or under-funded. They are often mandated by government but this is not an essential characteristic. The schemes may also be autonomous or non-autonomous (autonomous schemes involve institutional units separate from the employers, while non-autonomous schemes are managed by employers, with or without segregated reserves).

### ***The 1993 SNA treatment***

251. Under the 1993 SNA guidelines, an output for autonomous pension schemes is recognised but not for non-autonomous schemes. The cost of a non-autonomous schemes is considered as ancillary to the employer's main output. In practice, the treatment of non-autonomous funds fails to recognize that pension schemes provide services to the beneficiaries, not to their employers.

252. Employer liabilities and household assets are recorded under the 1993 SNA only for funded schemes. This treatment fails to recognize employer obligations (liabilities) and the corresponding household assets for unfunded schemes. Nowhere else in the 1993 SNA is a liability recognized only when there is a matching asset.

253. The estimates of the associated compensation of employees for those employees in funded schemes are based on the actual employer contributions to the pension schemes. The 1993 SNA recommends that an amount be imputed for employees who are in unfunded schemes. In principle, the SNA recognizes that the imputation should be based on actuarial considerations. As a practical alternative, the SNA suggests using actual benefits paid out to current pension recipients in the current period.

254. The underlying economic principle is that the compensation element should include the increase in employers' pension liabilities from an additional year's work, regardless of the source of the funding. The main shortcoming of the current treatment is that changes in employer pension liabilities have no direct relationship to actual employer contributions or the actual benefits due to be paid out under the scheme.

255. Under the 1993 SNA, property income is recorded only for funded pension schemes; it is treated as an investment return on fund assets ("pension fund reserves"). This approach fails to recognize the increase in the assets/liabilities due to the passage of time, regardless of the existence of segregated assets. The investment return includes only property income, not holding gains. This results in an inconsistent treatment of schemes invested in interest-bearing as against those invested in non-interest bearing securities.

### ***Shortcomings of the 1993 SNA treatment***

256. The SNA is internally inconsistent. Compensation of employees in the income account includes an estimate of imputed employer contributions for unfunded schemes but the

assets/liabilities related to future benefits are not recognized in the financial accounts or in the balance sheets. In contrast, such assets and liabilities are recognized for funded schemes but only to the extent that these schemes are actually funded. No recognition is made of the fact that the liabilities towards the employees may be such that the schemes are either under- or over-funded. .

### ***Task Force conclusions***

257. In principle, output should be recorded separately for both autonomous and non-autonomous funds. The output of pension funds should be measured at cost, including the full management cost of any insurance company managing a fund. The output should be recorded as being consumed by the beneficiaries (i.e. households)

258. It is appropriate to use expected transactions and expected property income to explain the service charge of autonomous pension funds. However, further work is needed on the implications of using expectations in the practical calculation of the output of pension funds.

259. The value of property income should be the expected property income on the accumulated value of benefits (due to the unwinding of the discount of these benefits) plus the imputed service charge for funds management. The fact that some property income for autonomous funds may be funded from holding gains is not a reason to exclude this amount.

260. There are two main valuation approaches that could be used in developing actuarial estimates:

- the projected benefit obligation (PBO), which is calculated as that part of total pension benefits employees will earn during their entire career, based on years of service to date, and
- the accrued benefit obligation (ABO), which is calculated for years of service to date based on current wage and salary rates.

261. In practice PBO will exceed ABO for an individual, with very large difference in the early years of a person's career, but with the gap decreasing as the retirement date approaches. In the national accounts, the accumulated value of benefits should be based on only the current wages and salaries (i.e. ABO). It should not take projected future wages and salaries into account (as would a PBO calculation). However, the PBO estimates could be provided as a memorandum item.

262. The value of household pension assets is consistent with the actuarial value of the employer's liability to provide future retirement benefits due to service provided to the current date.

263. The Task Force concluded an acceptable discount rate would be the interest rate on high quality securities relevant to the sponsor of the pension scheme. The securities should have terms to maturity that are consistent with the time horizon of the pension liability.

264. The Task Force concluded that the sectoring of pension funds is related to the nature of the scheme. Autonomous schemes should be included in the pension sub-sector of the financial corporations sector. Non-autonomous schemes should be included in the sector of the sponsor of the scheme unless a quasi-corporation is established for a fund, in which case it is allocated to the same sector as the autonomous funds (i.e. the pension sub-sector of the financial corporations sector).

265. A majority of the Task Force members considered that all pension liabilities of employers should be recognized, regardless of the extent of funding. The stocks and flows related to all pension schemes should be recorded in the core accounts. The Task Force recognized the practical problems of recording the stocks and flows associated with unfunded schemes, and so recommended that the data relating to funded and unfunded schemes should be separately identified. Specific guidance needs to be given on how to handle so-called “notional defined contribution” schemes<sup>8</sup>.

266. The Task Force also considered the borderline between pension schemes and social security schemes. Social security is essentially a redistributive process imposed and controlled by government, with the benefits provided not being directly linked to the size of contributions. Some governments operate schemes combining this basic social security function with what is effectively a multi-employer pension scheme. The Task Force concluded that the criteria for distinguishing basic social security from employer-related pension schemes need to be reviewed as a matter of urgency.

### **Questions**

267. Does the AEG agree that:

- (a) Liabilities/assets and associated economic flows of all pension schemes should be recognized in the core accounts of 1993 SNA?
- (b) Accumulated benefits and related economic flows for all defined benefit schemes should be calculated using actuarial methods?
- (c) Output should be calculated for non-autonomous schemes on a cost basis, and cost attributed to the beneficiaries (i.e. household sector)?
- (d) Expected holding gains and losses can be used in order to explain the service charge imposed by autonomous pension schemes?

### **Discussion**

268. Broadly, in discussing the first question posed by the presenter, AEG members views fell into two broad groups that can be summarised as follows:

- unfunded government employee schemes and social security schemes are inextricably mixed and it is impossible to separate them so it makes no sense to show government liabilities for unfunded government employee schemes without also doing the same for all social security schemes;
- unfunded government employee schemes are effectively contractual obligations of government in its capacity as an employer that are distinct from the government’s social security scheme, a number of countries record liabilities in their government accounts, and they are viewed as “assets” by the employees concerned.

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<sup>8</sup> This is the terms used to describe a scheme such as that pioneered by Sweden where there is no stock of assets but the expected liabilities are kept in balance with expected contributions by changing the benefits due under the schemes on a continuing basis.

269. The issues related to unfunded pension schemes are important in Europe because of the variable share of funded/unfunded schemes in different countries. However, a key problem in Europe is that separating social security schemes and government employee schemes is difficult. This does not affect private corporations because they have contractual obligations that can be costed. The borderline between social security schemes and government employee schemes has so far proven impossible to define. One proposal is to include unfunded government employee schemes as part of social security schemes, but not to include them in the core accounts. This compromise would provide useful information for users without creating problems in the core accounts.

270. INSEE has posted a note on its website, supported by the national statistical offices in Spain, Italy and Germany, expressing concerns about the Task Forces recommendations. Two key problems concerning these countries are that there are no assets corresponding to the unfunded liabilities and there are implications for the national accounting treatment of social security schemes.

271. A broad range of AEG members supported the Task Force proposals. In some countries, current government accounting standards require unfunded liabilities for government employee pension schemes to be explicitly shown in their accounts. The argument that no assets can be directly matched to the unfunded liabilities is not relevant because it is common for government to not have assets explicitly matching government liabilities (e.g. government holdings of US securities). It is not really accurate to refer to schemes as being “unfunded” even though there are no traded instruments associated with the liability. Other points raised in support of explicitly recording the unfunded liabilities were:

- from a general economic perspective, consumer behaviour is based on assumptions about the “pension assets” they will be able to access at retirement, and households do not distinguish between funded and unfunded schemes as far as their “asset holdings” are concerned;
- practical difficulties are not a reason to exclude unfunded liabilities because similar sorts of difficulties can arise in obtaining actuarial estimates of the liabilities in funded defined benefit schemes; it is appropriate to use actuarial estimates in the accounts, where necessary;
- having schemes that are over-funded or under-funded can create estimation problems in the national accounts, but changes to the extent of over- or under-funding are important to recognise in the accounts because they can have a direct impact on corporate profitability;
- comparability between countries is best achieved by treating all government employee pension schemes the same way otherwise differences in the share of funded to unfunded schemes between countries will affect the analysis of government liabilities;
- GFS standards already recommend recording government liabilities for unfunded employee pension schemes and the SNA should be brought into alignment with the GFS Manual.

272. The discussion moved to a proposal put forward by François Lequiller (OECD). Its focus is different, because the aim is to determine whether or not there is a liability rather than whether or not a scheme is unfunded. The following was presented for the AEG’s consideration:

“Even within employer schemes, the criterion to recognise a pension liability should take into account the nature of the pension obligation. When the value of the pension obligation by the sponsors of the scheme is guaranteed to the employees, this is that the employers are, legally or by past practice, bound to fulfil their obligation vis-à-vis individual employees, then the pension has all the characteristics of a liability for the scheme and of an asset for households and is therefore included in the financial tables of the SNA (as AF6). However, when the sponsor does not make a commitment that the value of the obligation will remain unchanged, in particular when the formulae underlying the of the obligation can be changed to the detriment of the beneficiary, then the pension obligation does not have all the characteristics of a liability in the System. In this case, this pension obligation can be recorded in a supplementary set of accounts and not in the core accounts. Such situations may occur for pension schemes sponsored by the general government, in particular for social security schemes, where the government can change its obligations by law retroactively. It can happen also for schemes set up by government for its own employees.”

273. The discussion then concentrated on the aspect of the proposal related to the “strength of the liability”. One concern was about how strong a liability has to be for it to be included in the core accounts? Crossing boundaries becomes a problem under this proposal because there could be a switch from the core accounts to supplementary accounts and vice versa (e.g. if a company makes a large payment into their pension scheme to reduce/eliminate under-funding.).

274. The AEG considered a proposal to adopt an approach similar to the “FISIM compromise” in the 1993 SNA, under which countries could use the 1968 SNA approach to measuring FISIM if they did not have sufficient data to allocate FISIM to end users. There was some support but also some strong opposition from AEG members who felt it could potentially create too many inconsistencies between countries.

275. A comment was made that two issues need to be looked at separately rather than getting mixed up:

- the dividing line between social security and social insurance, and
- whether or not a liability exists.

276. One AEG member considered that a problem with François Lequiller’s solution is some things that are currently recognised as liabilities would no longer be recorded as liabilities, because of the implications of the phrase “where the government can change retroactively its obligation by law”.

277. A majority of the AEG supported the proposal that liabilities/assets and associated economic flows of all pension schemes should be included in the core accounts. The Chair noted a number of issues associated with the decision and the related discussion. Further work will be required to identify criteria that would enable the borderline between social security and other areas to be identified more readily. It would then be possible to progress to François Lequiller’s approach based on the quality/strength of the liability. Ideally, the unfunded liabilities should be recorded in the core accounts but at this stage it may be necessary to show them in supplementary accounts because of the problems raised during the discussion. On the other hand, it is important to take account of those countries that already include the unfunded liabilities in their core accounts.

278. The discussion on the second question was relatively brief. In some cases, sufficient data are available to enable actual estimates to be made without having recourse to actuarial calculations. The changes in liabilities do not necessarily equate to contributions into less payments from

defined benefit schemes. It is the employer who bears the risk of shortfalls rather than the employees. Therefore, it is necessary to focus on the emerging liabilities rather than the contributions; whether the scheme is funded or unfunded is not relevant, nor is the level of funding at any point in time.

279. The Chair suggested that the recommendation could be changed by removing the term “related economic flows” from the recommendation and including it as a footnote rather than as an integral element.

280. There was no detailed discussion on the third and fourth questions, although points were made on several different issues related to the questions:

- the value of the costs gets added on to the property income of households;
- non-autonomous schemes should be set up as quasi-corporations in the financial sector;
- the the 1993 SNA algorithm to calculate the output of pension schemes can produce some strange outcomes depending on the way pension schemes derive their income (through dividends or interest or capital gains, etc) and, at the extreme, it can result in large, negative estimates for output;
- some fundamental inconsistencies can arise because decisions on investment strategies are inevitably based at least in part on expected holding gains;
- in some cases prices have to be imputed and holding gains/losses may have an impact on the implicit prices calculated for the imputation but this does not imply the holding gains/losses are included in production.

## **Summary conclusion**

### ***Outcomes***

- (a) There was strong support within the AEG for the recommendation by the Task Force on Employers’ Retirement Schemes to recognise the liabilities involved with all employer pension schemes, including unfunded ones, and any associated assets and transactions.

The AEG saw that there are problems for several countries in drawing a distinction between pension schemes for government employees and social security schemes.

The AEG felt it necessary to develop criteria that would distinguish between the several types of schemes. Possible criteria, among others, could be the employer/employee relationship or the nature of the liability (e.g. whether it is a contingent or an actual liability).

The ISWGNA will explore alternatives for developing criteria.

The AEG noted the possibility, until such criteria are developed, of countries not including the liabilities for pensions of government employees in the core accounts but of including them together with the liabilities for social security schemes in supplementary accounts.



The AEG also supported the possibility of including supplementary accounts for social security schemes.

- (b) The AEG agreed with this recommendation, but with the understanding that, in some circumstances, related economic flows need not be calculated on an actuarial basis.
- (c) The AEG agreed that this statement should be modified by adding the words “In principle” at the start.
- (d) The consensus within the AEG was to accept this recommendation but acknowledging that it may have to be revisited following discussions on other aspects of the System associated with holding gains and losses.

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## **Pension schemes**

### **Issue 2; Paper SNA/M1.06/03.2; for decision**

#### **Presentation**

281. The paper for this session (document number SNA/M1.06/03.2; Issue 2) was written and presented by François Lequiller. The session was chaired by Carol Carson (Project Manager).

#### ***Introduction***

282. No changes are proposed to the main report of the Task Force. The Task Force was not able to cover all issues, so it concentrated on the following points for which clarification had been requested:

- exchanges of explicit pension obligations between schemes, and
- borderline cases between social security and employer schemes

283. The paper uses the terminology “saving schemes” versus “current transfer schemes”. It is equivalent to “recognise a pension liability” versus “not recognise a pension liability”.

#### ***Exchanges of pension obligations***

284. Over the past decade, a number of cases have arisen of large one-off transactions between pension systems, with the larger ones ranging between 0.3 per cent and 0.6 per cent of GDP. Some well-known examples are France Télécom and EDF in France, Belgacom in Belgium and Daiko Henjo in Japan. Generally, such transfers are linked to the partial privatisation of public enterprises or to reforms of the pension systems. Such transactions are presented as an exchange (in principle a balanced exchange) of a pension obligation against a financial asset (cash) so, in principle, there is no change in the net worth of the transactors.

285. Difficulties arise when one of the transactors is involved with an unfunded scheme, particularly if it is classified to the social security system (i.e. government). Pension liabilities are not recognised for social security so national accountants generally classify such transactions as a capital transfer received by government. However, this results in a change in net worth of

government which contradicts the principle that the transaction should have a neutral effect on the net worth of the transactors.

286. The first question to the AEG was a proposal that the updated SNA should explicitly recommend that these types of transactions be treated in a way that leaves the net worth of all transactors unchanged.

287. The presenter noted that this question was circulated to members of the Task Force and it received almost unanimous support. However, two interesting comments were received during the consultation:

- if the exchange is unbalanced (i.e. the lump sum does not correspond to the pension liability), then there should be a capital transfer recorded; and
- it is not obvious that the best technical solution is to create a pension liability, and other treatments are possible (withdrawal of equity, pre-payment of contributions, other change in volume).

### ***Borderline between employer and social security***

288. The main recommendation put forward by the Task Force is to *recognise the liability of all employer schemes*. Implicitly, the criterion is shifted from *funded/unfunded* in the 1993 SNA to *employer pension scheme/social security*. One issue not considered by the Task Force was the difference between an employer scheme and a social security scheme. A particular problem is that the term “social security” covers a wide array of systems, which are different from one country to another.

289. If the AEG accepts that a scheme should be recorded as a saving scheme based on the characteristics of the pension obligation itself rather than on the unit involved (employer/social security) then the criterion would become based on deciding whether it is a full liability or a provision. The outcome would be the difficult issue of the delineation between employer and social security would be largely overcome. In effect, a social security pension obligation would imply a provision is required in the accounts.

290. The current SNA has a good definition of social security. The key elements are that:

- it is imposed and controlled by government;
- it covers the community as a whole;
- contributions are compulsory.

291. The current SNA also describes social security schemes as those *where benefits are not linked to contributions*. In some countries though, “social security” covers systems where pension benefits are linked to contributions. Some of these systems could be considered as *collective multi-employer schemes* i.e. multi-employer schemes imposed by the general government. Some social security schemes may have funds so there can also be funded social security schemes. Therefore, the presenter suggested extending the definition of social security pension schemes to include “collective multi-employer schemes”. An important remark is that the objective is to better describe the current reality and it does not have any implications in terms of new treatments.

292. The second question posed to the AEG was whether the SNA definition of social security pension schemes should recognise the existence of “collective multi-employer schemes” and of

“funded social security schemes”. The question had been circulated to members of the Task Force. The proposal did not receive a lot of support from Task Force members, mainly because the term “collective multi-employer schemes” was not well understood. However, none of the Task Force members disagreed with the fact that social security schemes can cover very different types of schemes. The presenter suggested a fall-back solution to limit the main criteria in the definition of social security to “imposed and controlled by government” and “compulsory contributions”.

293. If social security is defined only by the fact that it is imposed and controlled by government, then a problem arises about what to do with its implicit pension obligations. The AEG was asked whether it considered that all unfunded, collective multi-employer schemes should be treated as current transfer schemes.

294. There are also examples of “mixed schemes” labelled as “social security” because they are organised by general government (thus “imposed”) but some parts of these schemes have the characteristics of funded pension schemes (this is the case of the notional defined contributions schemes). Poland, Sweden and Hungary all have schemes of this type. Eurostat decided to “extract” these schemes from social security and treat them as saving schemes, even when they are guaranteed by the government. The AEG was asked to endorse the Eurostat decision.

### **Government employees’ schemes**

295. Part of the origin of the Task Force was to determine whether to treat these schemes as saving schemes. One question to be resolved was what happens when government employees are part of the larger social security scheme or in a scheme very similar to the social security scheme. More crucially, what happens if the government changes the “name” of its employees’ scheme and calls it a part of social security? In such a case, does the pension liability of government disappear? The final question for the AEG was whether it supported the proposition that pension schemes for a government’s own employees should always be shown as an employer scheme (saving scheme) even if the scheme is labelled or organised under a more general social security scheme. A slight majority of the Task Force was in favour of this proposal but those opposing it were strongly opposed.

### **Questions**

296. Does the AEG:

- (a) agree to add a specific recommendation in the SNA recognizing as pension liabilities those pension obligations that are exchanged in an explicit transaction between two units, even if the SNA does not record specifically pension liabilities for one or several of these units?
- (b) agree that the definition of social security pension schemes should mention the existence of “collective multi-employer schemes” and of “funded social security schemes”?
- (c) confirm that all unfunded collective multi-employer schemes are to be treated as current transfer schemes?
- (d) support to treat as saving schemes all funded schemes, even if organised as a part of social security?

- (e) support that government pension schemes for its own employees should always be shown as an employer scheme (saving scheme) even if the scheme is labelled or organised under a more general social security scheme?

## Discussion

297. Some general comments were made about the sorts of difficulties that can arise in various parts of the accounts when a public trading enterprise is privatised. If pension funds are managing something on behalf of the government then, in practice, the effective control of the schemes probably never moves from the government sector. France Telecom progressively moved from a public trading enterprise to a private corporation, but the staff employed were still civil servants even after the full privatisation. In the French national accounts, they were shown as employees of a private corporation. However, the pensions were still the responsibility of the government.

298. In response to a request for clarification about the main characteristics of “collective multi-employer schemes”, the presenter responded that they are defined benefit schemes, generally organised or legislated by general government. They have to be fully funded if they are in the private sector and function like savings schemes.

299. Another view expressed was that the distinction between employee pension schemes and social security can be determined by looking at whether retirement benefits are based on contributions from the employees concerned, with the payouts being based on income, contributions and years of service or some combination of these; if these conditions are not met then it indicates the payments are social security. Some AEG members felt that this distinction was too black and white because, while some social security schemes are basic (“social assistance”) there can be something in between these and the sort of pension scheme described in the first part of this paragraph. Part of the confusion could be that the the 1993 SNA definition of social security is based on contingent liabilities that do not exist in the 1993 SNA. Perhaps a solution could be to say schemes that do not satisfy the 1993 SNA definition of social security schemes should be classified as something else despite their label; it would be necessary to look closely at the underlying substance on a case-by-case basis. There was a degree of nervousness about using funding/lack of funding as criteria for classification. It is necessary to look closely at liabilities in determining the status of a scheme. The AEG noted that Europe is moving away from treating such savings schemes as social security because they are defined contribution schemes with the risk being with the households involved in the schemes.

300. Other points raised during this discussion were:

- the proposed definition of social security is too broad - if the government cannot readily dictate the level of benefits then it is not social security;
- social security is redistributive in nature;
- government having regulatory control is not a sufficient criterion for a scheme to be classified as social security;
- funded social security schemes can have assets even though no liabilities are shown;
- the economic reality (i.e. structure and economic substance) is critical, not the label;

- the 1993 SNA has a definition of social security but the strength of the liability should also be taken into account and there should be some sort of redistributive function involved, e.g. a private insurance company cannot form a social security scheme.

301. The AEG discussion took the line that, in exploring the borderline between employer pension schemes and social security, it is essential to look at the economic substance rather than labels. The AEG was concerned about using criteria based on “funded” and “unfunded” as a means of distinguishing the status of schemes. While the AEG would be willing to explore the strength of a liability as an indicator, the general consensus was that this is not conclusive by itself, particularly regarding social security schemes. It is clear that most cases are not clearly “either/or”. A set of criteria needs to be set out to correctly classify these borderline cases.

302. The Chair suggested that the ISWGNA should look into the issues and come back to the AEG with a proposal for organising a way ahead.

## Summary conclusion

### Outcomes

- The AEG agreed that, when the obligation to pay pensions passes from one unit to another, this should be recorded as a transaction in pension liabilities even if neither unit has previously recorded them.
- The AEG did not support this proposal. The consensus was that it is necessary to look at the economic substance behind schemes rather than the way they are labelled. There was general concern about using criteria based on distinguishing the status of schemes depending on whether they are funded or unfunded.
- The AEG did not support this proposal for the same reasons as for question (b).
- The AEG did not support using only “funded” as a suitable criterion in this context. A liability should be recorded for schemes that are funded and where the benefits are related to the contributions even though the schemes may be described as social security schemes.
- The AEG recommended the ISWGNA should investigate the criteria for identifying such schemes and report back to the AEG with a proposal outlining the most appropriate approach (see the first question of paper SNA/M1.06/09.1).

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## Definition of economic assets

### Issue 30; Paper SNA/M1.06/14; for decision

#### Description of the issue

*The SNA should provide a clear definition of what constitutes an asset that is consistent with where the asset boundary falls in respect of currently known entities, as well as providing guidance for determining whether entities that appear in the future fall within the asset*

*boundary. It should be accompanied by guidance on how assets should be valued. Does the definition in the 1993 SNA need further elaboration?*

## **Presentation**

303. The paper for this session (document number SNA/M1.06/14; Issue 30) was written and presented by Anne Harrison. The session was chaired by Dieter Glatzel (Eurostat).

304. The System describes how labour, capital and natural resources including land are used to produce goods and services, which are used for production, consumption and accumulation. Benefits are the means of acquiring goods and services for production, consumption or accumulation in the current period or future periods

305. Own account production leads to an immediate benefit. Wages and salaries are acquired by employees and consumption may be financed from current or past benefits. Production and accumulation involve postponing benefits to future periods while a financial asset converts a benefit in one period into a benefit in another period. Current benefits may be acquired by committing future benefits in the form of financial liabilities.

306. The legal owner of entities such as goods and services, natural resources, financial assets and liabilities is the unit entitled in law and sustainable under the law to claim the benefits associated with the entities. Entities in the system must have owners. Risks are incurred in a production and they are rewarded via operating surplus. Income from employment and transferring benefits across periods also involve risk and, in practice, different degrees of risk.

307. The economic owner of an entity such as goods and services, natural resources, financial assets or liabilities is the institutional unit which is entitled to claim the benefits associated with the use of the entity in the course of economic activity by virtue of accepting the associated risks. Every entity has a legal owner and an economic owner, who are often the same. The legal owner may hand over risk to the economic owner for another package of risks and benefits. The government may act on behalf of the community at large.

308. An asset is an entity from which the economic owner can derive a benefit or series of benefits in future accounting periods by holding or using the entity over a period of time, or from which the economic owner has derived a benefit in past periods and is still receiving a benefit in the current period. Because it represents a stock of future benefits, an asset can be regarded as a store of value. This definition changes the wording but not the substance of the present definition. Only economic assets are recognised in the system.

309. A financial liability is established when one unit (the debtor) is obliged, under specific circumstances, to provide a payment or series of payments to another unit (the creditor). The most common circumstance is a legally binding contract which specifies the terms and conditions of the payment(s) to be made and payment according to the contract is unconditional. In addition, a financial liability may be established not by contract but by a long and well-recognised custom which is not easily refuted. In these cases, the creditor has a valid expectation of payment, despite the lack of a legally binding contract. Such liabilities are called constructive liabilities.

310. Whenever either of these types of liabilities exists, there is a financial claim which the creditor has against the debtor. Like the liabilities, the claims are unconditional. In addition, a financial claim may exist which entitles the creditor to demand payment from the debtor but

whereas the payment by the debtor is unconditional if demanded, the demand itself is discretionary on the part of the creditor.

311. Financial assets encompass all financial claims plus monetary gold, SDRs of the IMF and shares in corporations. However, this may change for unallocated gold accounts and SDRs.

312. The asset boundary includes all entities that meet the definition of an asset. All appear on the balance sheet of the economy. All assets can be represented by a monetary value. This value represents the market's view of the total of the benefits embodied in the asset.

313. The classification can be summarised as follows:

Non-financial assets

Produced

Non-produced

Financial assets

314. Produced assets enter via production within the domestic economy or imports. They include historical monuments and valuables. They leave the System via being exhausted, being sold to residents for use other than as an asset, or by being sold to non-residents.

315. Non-produced assets include natural resources, contracts, leases and licences, and financial assets and liabilities (which are recorded when commitments are made or cease).

316. Exclusions from the asset boundary are consumer durables, human capital, environmental assets, contingent financial liabilities, and assets owned by non-residents.

### **Questions**

317. Does the AEG agree:

- (a) with the need to define ownership and benefits?
- (b) with the thrust behind the proposed definitions?
- (c) with the revised definition of an asset?
- (d) with the exclusions from the balance sheet?
- (e) that constructive liabilities should be included in the asset boundary?

### **Discussion**

318. Some non-native English speakers indicated that the area of assets is a very difficult one as far as terminology and translation problems are concerned. The Editor indicated comments on potential translation problems would be welcome.

319. There was general agreement that the current definition of an asset is not clear enough. The proposed definition is the same in substance as the existing one and the broad approach adopted is a valid one. Setting out a definition and then setting out elaborations works well.

320. Some concern was expressed that the criterion that an asset must be a store of value has been watered down in the paper. It would be useful to develop the existing text on assets – economic benefits, stores of value etc.

321. The Editor said it has become necessary to change the definition of an asset because it is not precise enough, in particular it does not cover some financial liabilities and constructive liabilities. Starting with benefits is a way of linking activities and assets. It is not possible to use value as a starting point.

322. Several participants spoke in support of defining a new structure on the basis that it is necessary because of the proposed changes to the assets boundary. The proposed structure is sensible but there was some disagreement on the whether the focus should be more on benefits than on risk. One view was that risks should be taken into account but international standards are moving more towards control as the key criterion. An alternative view was that risk is at the heart of things and so should be upfront. A demonstrated market is necessary and demonstrated risks rather than potential ones. Water is an example of being a much greater benefit in some cases than in others. Providing a store of value is another criterion - a value must be demonstrated for something to be included as an asset.

323. Other issues raised were that benefits are rewards and so the wording needs to be changed to reflect this. Ownership is another important criterion, particularly identifying who are the economic owners in PPPs. The dropping of the word “economic” from “benefits” in the suggested definition of an asset has was questioned. Several participants supported the current definition being used as the starting point and then any necessary changes should be made to it.

324. The Editor explained that benefits are rewards which come from production. This is not true in some cases, particularly with respect to financial assets and so the existing definition has not stood the test of time. The treatment of financial derivatives is a key area that needs to be updated. Concentrating more on risk in the definition leads to the problem of trading the importance of one risk another in trying to make a decision on the appropriate classification. There is a contradiction in saying not to change the existing approach but concentrate more on risk.

325. The discussion moved on to the proposed exclusions from the balance sheet. Points raised were that the way the asset boundary is defined should identify exclusions, it is important to have a list of exclusions from the balance sheet but the current list is not exhaustive, and we need to look further on what other liabilities could be recognised, although the SNA should not necessarily mirror all business accounting rules on liabilities. There was some disagreement about the benefits of defining something by identifying all possibilities; rather setting out principles and then a set of examples was considered the best way to proceed.

326. The final question (about including constructive liabilities) was then discussed briefly. One participant said he supported the proposal on constructive liabilities but it needs to be made clear they are not the same as contingent liabilities, and nor are they legal liabilities. They must also be able to be reliably measured. Another participant suggested that some ideas should be taken from accounting standards on constructive liabilities.

327. The Chair asked how the discussion so far affected the need to change the existing definition of an asset. The Editor indicated that the existing definition refers only to “ownership rights” but does not mention either “economic” or “legal”. Also, there is nothing about “demonstrated value”.



328. The next intervention was along the lines that the expression “economic ownership” is useful. However, the legal owner still has some ownership rights even though the risk has been transferred. It is important to not create a split between legal and economic ownership.

329. Another comment made was that paragraph 10.3 of the 1993 SNA refers to “every economic asset must function as a store of value” and this should be retained in the updated version. The Editor said she felt the definition needs to be stronger about demonstrating value.

330. The Chair told the AEG that they must give specific some guidelines to the Editor. He asked if anyone would like to keep the current definition as is, but no-one wanted to do so.

331. The discussion then moved to the extent of change desirable. One participant said the issue is not whether to change but the extent of change needed, and he personally would prefer minimal change. One of the problems with the existing definition is that it is possible to start from different points and finish up with different views on the asset boundary. Risk needs to be talked about in terms of benefits (e.g. derivatives) and the issue of legal/economic ownership. The updated SNA needs to provide broad guidance on the factors to be taken into account and some of the issues covered in the PPP paper are relevant.

332. One participant said he would be happy to give the Editor a mandate to sharpen the current definition. The Chair indicated that the AEG should give the Editor a mandate to redraft the current definition of an asset. Some AEG members want minimal changes but others have indicated some problem areas that need to be tightened up (e.g. risk).

333. The Project Manager said that the Editor will redraft the assets chapter and, if specific points come up, the AEG will be able to check out the draft. Conclusions will be sent out so that anyone reading the draft chapter will know the background.

334. The Chair asked AEG members to send any specific comments to the Editor in writing.

## **Summary conclusion**

### ***Outcomes***

335. The AEG acknowledged there are some shortcomings with the 1993 SNA definition and agreed that some changes are required. In particular, the existing definition does not adequately cover issues such as risk, demonstrable value and constructive obligations.

336. The AEG asked the Editor to amend the current definition of an asset, particularly taking into consideration the need for attention to risk and constructive liabilities. A draft of the relevant chapter(s) will be circulated to the AEG for comment.

337. Any specific comments should be sent in writing to the Editor as soon as possible. Comments on potential translation problems that may affect the terms able to be used in the English version should be provided directly to the Editor.

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## **Review of the outcome of e-discussions - Impact of non-performing loans on FISIM**

### **Issues 4a, Papers SNA/M1.06/25.1, SNA/M1.06/25.2**

#### **Description of the issues**

*The financial crises of the 1990s led to renewed interest in the statistical treatment of non-performing loans. The purpose of the review is to determine what criteria should be applied in the SNA to the writing-off of non-performing loans and to make sure that they are consistent with the other major macroeconomic statistical systems (balance of payments, government finance statistics, and monetary and financial statistics).*

#### **Discussion**

338. The only comment was that a cut-off should be identified for when a service is no longer being provided by a non-performing loan.

#### **Summary conclusion**

##### **Questions**

339. The AEG was asked to express a preference for one of the following options for recording the interest on non-performing loans.

- (a) Option 1 is the option in the 1993 SNA, except that an amendment is needed to say that any FISIM associated with unpaid interest must also be accrued as part of the principal outstanding. It is consistent with the decision to record the even non-performing loans at nominal value. It is operationally feasible and would lead to no change in GDP.
- (b) Option 2 appears to recommend a change in the SNA by choosing to record interest on a cash rather than an accrual basis. The possible impact on GDP, compared with measuring interest on a full accrual basis is described in the full explanation of option 2. In practice, if a statistical office records interest in the accounts on the basis of interest reported by banks, it is probable that this may be on a cash basis or at least exclude interest due on loans the bank considers to be non-performing. To the extent this is so, a conceptual change in the SNA would not lead to any change in practice.
- (c) Option 3 is a change from the SNA. The consequences for the impacts on GDP and other aggregates is described above. Although this option starts from the reference rate approach to calculating FISIM the implication is that the final estimate for (SNA) interest is not derivable by applying the reference rate to the stock of performing loans.

340. None of options 1, 2 or 3 imply changes in current recording of entries in the balance sheets.

- (d) Option 4 is noted mainly for the record. If a decision were to be made to change the valuation of loans in the balance sheet from nominal value to market value, then options 1 and 2 would not apply and the choice would then be between options 3 and 4. However, option 4 is inconsistent with the decision to keep the valuation of NPLs at nominal value in the balance sheet.

### **Outcome**

341. The AEG noted that the e-discussion had revealed a clear preference for option 1.

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## **Review of the outcome of e-discussions - Retained earnings of mutual funds, insurance corporations and pension funds**

### **Issues 42, Papers SNA/M1.06/29.1, SNA/M1.06/29.2**

#### **Description of the issues**

*In the 1993 SNA, retained earnings of an entity are generally treated as the income and saving of the entity, rather than the owner. However, exceptions are made for life insurance companies, pension funds and foreign direct investment companies, where there is an imputed outflow to the policyholders, beneficiaries, or owners (respectively), with an equal financial account inflow from them. The ESA 95 introduces a similar treatment for mutual funds by imputing a distribution of retained earnings to the investors and a subsequent reinvestment in the fund. Should the SNA follow this treatment to have a more consistent treatment of various forms of collective investment schemes?*

#### **Summary conclusion**

##### **Questions**

342. Does the AEG agree:

- (a) to exclude holding gains or losses from the property income attributed to holders of assets in investment funds? At a later stage, the question could be part of a broader discussion, in particular of the definition of income itself, beyond the publication of the next edition of the SNA.
- (b) that property income attributed to holders of investment funds on an accruals basis should be recorded as a new property income category “property income attributed to holders of investment funds” which should be further split into “dividends distributed to investment fund shareholders” and “retained earnings attributed to investment fund shareholders”?
- (c) that the counter-entry of “retained earnings attributed to investment fund shareholders” should be recorded as a new financial asset category “investment fund shares/units”?

## **Outcome**

343. The AEG was pleased to note these recommendations were agreed to in the e-discussion.

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## **Review of the outcome of e-discussions - Financial instruments, non-monetary gold**

### **Issues 44; Papers SNA/M1.06/30.1, SNA/M1.06/30.2**

#### **Description of the issues**

##### ***Monetary gold and SDRs***

*(a) Should monetary gold be treated as a financial asset rather than as a valuable?*

*(b) The 1993 SNA classifies Special Drawing Rights (SDRs) as assets without corresponding liabilities arguing that IMF members do not have an unconditional liability to repay their SDR allocations. However, SDR allocations have attributes of liabilities because interest is payable on them and a country terminating IMF membership would be required to repay its obligations including any SDR allocations. Also, the IMF **Monetary and Financial Statistics Manual** recommends that the value of allocated SDRs be shown both on the assets and liabilities side of the balance sheets of central banks, which is in accordance with the IMF's SDR Department's guidance to member countries. Should SDR allocations be considered liabilities in the SNA?*

#### **Presentation**

344. The papers for this session (document numbers SNA/M1.06/30.1 and SNA/M1.06/30.2; Issue 44) were written by the IMF and the UNSD respectively and presented by Manik Shrestha. The session was chaired by Dieter Glatzel (Eurostat).

##### ***Background***

345. The existing treatment for non-monetary gold is to treat it either as a valuable (a store of wealth) or in the same way as any other goods. Transactions in non-monetary gold between residents and non-residents are included as exports/imports of goods. The BoP compilation guide also allows a net treatment as a merchanting service when the gold does not cross frontiers.

##### ***Issues***

346. The key issue is that exports/imports data are distorted for countries with large international markets in gold due to the large value of transactions unrelated to physical use of gold. Gold has a number of characteristics of financial instruments. Monetary gold is traded on financial markets in a way similar to foreign currencies, not only in the spot market but also in markets for secondary and derivative instruments. The gold market is highly liquid and there are gold lending/deposit markets. On the other hand, some gold is used as non-financial assets (valuables and commodities).

347. The main question is how to distinguish financial gold from commodity gold.

348. One possible treatment is that holdings by, and transactions between, financial institutions and/or bullion traders should be treated as financial gold, while holdings by other sectors would be either valuables or commodity gold, depending on the circumstances. There are some concerns with this alternative. When gold transactions result in a change of classification (between commodity gold and financial gold or between monetary gold and non-monetary financial gold) they would have to be separately identified and reclassification entries recorded. There is no corresponding liability readily identifiable.

### ***Proposed treatment***

349. The BOPCOM noted that two forms of gold account are possible. These are described as “allocated gold accounts” and “unallocated gold accounts”. The distinction between allocated and unallocated gold accounts is precise, practical, and recognized in the balance sheets of account providers. The distinction is conceptually sound because an allocated gold account gives full outright ownership of gold and is equivalent to a custody record of title. The unallocated gold account does not give the holder the title to physical gold, but provides a claim against the account provider denominated in gold; in effect it is a deposit denominated in gold. It is proposed that allocated gold accounts be treated as ownership of a non-financial asset while unallocated gold accounts would be treated as a financial asset. The proposal will clarify SNA paragraph 11.64 “.... deposits, loans, and securities denominated in gold are treated as financial assets (not as gold) and are classified along with similar assets denominated in foreign currencies in the appropriate category.”.

350. The implications of these proposals are that the concern about the distortion of exports and imports data is avoided; the impact will be largely on balance sheets and financial accounts, and will be important for only a few countries; net worth is unaffected, but for the account providers/dealers both assets and liabilities are increased equally.

351. The principles appear applicable to unallocated accounts for other precious metals.

### ***Questions***

352. The following questions were considered by the AEG:

- (a) Whether unallocated gold accounts should be classified as financial assets/liabilities?
- (b) Whether other unallocated metal accounts should also be classified as financial assets/liabilities?
- (c) Whether other forms of unallocated commodity accounts, if such exist, should also be classified as financial assets/liabilities?
- (d) if any accounts are classified as financial assets/liabilities, whether they should be classified as deposits?  
*if they are deposits, whether they can be classified as foreign currency deposits, or whether a specific deposit class needs to be assigned?*
- (e) If included in foreign currency deposits, whether the classification should be changed to “foreign currency and other”?

## Discussion

353. The discussion commenced with AEG members providing reasons for their responses to the discussion. The lack of strength of the response in terms of the proportion having no opinion was noted.

354. There was a brief discussion on question (e) but little support for the proposed change.

## Summary conclusion

### *Outcomes*

355. The AEG noted that there was little opposition to these proposals covered in the discussion, although there was a high proportion of “No opinions” for some of them.

356. The AEG agreed to questions (a), (b) and (d), but not question (c). On question (e), the AEG felt it was not necessary to change the terminology “In foreign currencies”.

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## Output of central banks

### Issue 6b; Paper SNA/M1.06/05; for decision

#### Description of the issue

*The 1993 SNA recommends that the services of central banks be measured on the basis of receipts from fees, commissions, and financial intermediation services indirectly measured (FISIM). This method sometimes results in unusually large positive or negative estimates of output. In 1995, the ISWGNA therefore decided to allow countries to measure the output of central banks, as a second best, at cost. However, the ISWGNA did not provide further guidance on the implications of this method. The review seeks to clarify the impact of the different roles that central banks perform on the nature of their output and the appropriate valuation and allocation to associate with the output of central banks.*

#### Presentation

357. The paper for this session (document number SNA/M1.06/05; Issue 6b) was written by Adriaan Bloem, Cor Gorter and Lisbeth Rivas and presented by Adriaan Bloem. The session was chaired by Ivo Havinga (UNSD).

### *Background*

358. The SNA treats central banks just like other financial intermediaries producing for the market. Shortly after the 1993 SNA was published, the ISWGNA became aware that some countries were recording implausibly large positive, negative, or fluctuating values for central bank output. As announced in the January 1996 issue of *SNA News and Notes*, the ISWGNA decided to allow countries, as a second best approach, to measure central bank output at cost.

359. A problem that arose as a result of this change was that the ISWGNA did not explain what cost valuation would imply for the accounts of the central bank. In particular, it did not make clear

which units are supposed to consume central bank output if it is measured at cost. This paper attempts to clarify this issue. Secondary goals are to answer the following questions:

- Would it be possible to refine the ISWGNA decision by specifying in which circumstances cost valuation is appropriate?
- Could guidelines be formulated to avoid the occurrence of strange values for the output of central banks?

### ***Two approaches for measuring output***

360. The first approach is to treat central banks the same as any other financial intermediaries. The output of directly charged fees and commissions would be measured at the prices at which they are sold and FISIM would be measured as the difference between property income received and interest paid.

361. The second approach is to measure output at cost – the sum of intermediate consumption, compensation of employees, consumption of fixed capital, and other taxes (less subsidies) on production.

### ***Differentiating between market and non-market services?***

362. Examples of services produced by central banks are:

- issuing and managing the country's currency;
- monitoring and controlling money supply;
- taking deposits that are used for clearance between financial institutions;
- supervising, regulating, and surveying banking operations;
- holding and managing the country's international reserves;
- acting as a banker to the government;
- performing transactions with the International Monetary Fund;
- providing credit to other depository corporations;
- accepting deposits and providing credit to non-financial corporations;
- clearing and settlement services;
- international payments services; and
- deposit insurance and guarantee functions.

363. In trying to differentiate between market and non-market services, the criterion of "economically significant prices" is difficult to apply because few central bank services are directly paid for. It is more appropriate to consider the "inherent character" of the services, particularly whether or not they are collective in nature. Support is found in the 1993 SNA, paragraph 9.83, which defines collective services as follows:

- (a) Collective services can be delivered simultaneously to every member of the community or of particular sections of the community, such as those in a particular region of a locality;

- (b) The use of such services is usually passive and does not require the explicit agreement or active participation of all the individuals concerned;
- (c) The provision of a collective service to one individual does not reduce the amount available to others in the same community or section of the community. There is no rivalry in acquisition.

364. There are three broad groups of central bank services. **Monetary policy** services are collective in nature because they serve the community as a whole. **Financial intermediation** services are not collective because they cannot be delivered simultaneously to all, and their use by one reduces the availability to others. The third group consists of **borderline cases**, like supervisory services, which may be classified as collective or market on the basis of how they are paid for.

365. The central bank services listed above were grouped into these three categories as follows:

***Clearly collective, to be measured at cost:***

- issuing and managing the country's currency;
- monitoring and controlling money supply;
- taking deposits that are used for clearance between financial institutions;
- holding and managing the country's international reserves;
- performing transactions with the International Monetary Fund.

***Clearly not collective, to be measured at market prices:***

- acting as a banker to the government;
- providing credit to other depository corporations;
- accepting deposits and providing credit to non-financial corporations and households;
- clearing and settlement services;
- international payments services;
- deposit insurance and guarantee functions.

***Possible borderline cases:***

- supervising, regulating, and surveying banking operations.

***Market services and non-market services***

366. The first step is to distinguish, where possible, separate establishments for market and for non-market services. In most cases, this is not likely to be a major problem because central banks usually have different departments to perform their various roles and the administrative records of central banks are excellent. Total output is then simply the sum of the output of the market and non-market establishments. An advantage of this approach is that it avoids the problem of treating central bank output as either all market or all non-market.



367. If central banks are treated as producing non-market services (recorded at cost), there has to be someone consuming the services. One option would be for the central bank itself to consume them but this would require a major change in the SNA. A second option is for the government to consume the services as a form of collective service. However, since government does not pay the central bank for this service a way has to be found to leave the government current account unaffected. A solution would be to record an expense for government for the value of the service and record a counterpart current transfer from the central bank to government.

368. Financial intermediation may be “polluted” with policy measures. For example, interest rates may be set higher/lower than market rates or special rates may be paid on the reserve deposits of financial institutions, or high rates could be paid on deposits to defend the currency, or low rates could be charged on loans if the central bank acts as a development bank. The solution is to separate the policy measure from the market service and to use market interest rates as the prices for the services.

369. There are two options for classifying the policy element. The first is as transfers received and paid but a problem is that there is no voluntary element in most cases. A second (preferred) option is as taxes and subsidies, which is consistent with the obligatory and policy nature of the payments. It is traditional to treat taxes levied or subsidies paid by the central bank as received/paid by government. As a result, it is appropriate to record offsetting transfers between the central bank and government.

## ***Recommendations***

### ***Output of Central Banks and use of Central Bank services***

- (a) The national accounts should measure central banks’ collective services, such as monetary services, using the cost approach and allocate them to government as government final consumption expenditure.
- (b) The national accounts should measure central banks’ individual services, such as financial intermediation services, from receipts and allocate them to the units that pay for these services.
- (c) For a few services like supervisory services it may not be obvious whether they are non-market or market:
  - if they are non-market, they should be measured at cost and allocated to government as government final consumption expenditure;
  - if they are market, they should be measured from receipts and allocated to financial corporations, the government, non-financial corporations, and the rest of the world as intermediate consumption and exports, respectively.

### ***Valuation of market services***

- (d) Implicit transfers resulting from central banks using off-market interest rates for policy reasons cause distortions in measuring financial intermediaries’ output and value added and therefore should be removed from the calculations.

Because these transfers are made for policy reasons the national accounts could record them as taxes (“other taxes or subsidies on production” if the counterparts

are producers). This method requires that offsetting transfers between government and the central bank be recorded.

The second option to deal with these deviations would be to record them as current transfers from or to the central bank without rerouting through government.

## Discussion

370. The first point made in the discussion was that recommendation (a) is ambiguous because “collective” does not mean “non-market” and “individual” does not mean “market”. The basic split should be “non-market” (which is often collective) and “market” (which is often individual). Some concerns were raised about some aspects, with a general issue being that the proposal is too complex regarding the market/non-market split.

371. The paper should focus on where general national accounting principles are being applied and where something different is being proposed. Proposing to use non-market principles for non-market activities is fine but some market producers undertake non-market functions. Trying to identify small individual units within a central bank and allocate them to either market or non-market services is too complex and is unnecessary in most cases. It will be difficult, if not impossible, to obtain the data in the detail required to put this proposal into practice. Setting out the general principles is the key issue; developing short cuts in practice will be inevitable. By and large, central banks provide a community service, and so should be valued at cost. The market element should be split out only if it is significant. In general, we should show the services of the central bank being sold to government, so they become part of government final consumption expenditure.

372. One participant proposed that the whole of a central bank’s output should be valued at cost because the bank is working on a non-profit basis. An opposing argument was that consistency problems will arise across countries if the whole output is valued at cost because the market element varies from one country to another. A further problem is that it means having a non-market producer in the corporation sector and it implies final consumption expenditure by the corporation, both of which are contrary to the existing SNA principles.

373. The Editor suggested the issue should be put on the research agenda. It is necessary to find a simple way of deriving the market/non-market split. Only a summary of the detail in the paper should be included in the updated SNA.

374. The AEG agreed that, conceptually, a central bank can have a combination of market and non-market activities and, depending on the country, different approaches may be required (either non-market or market or some combination, as appropriate).

375. The Chair summed up the discussion on recommendation (a) by saying there was overwhelming support that the distinction is useful conceptually but countries should implement the proposal taking account of their individual circumstances.

376. Two contrary views were presented at the start of the discussion on recommendation (b) and (c), which were treated together:

- the central bank should consume its own non-market services;

- the non-market services produced by the central bank services should be consumed by because a corporation cannot undertake final consumption in the SNA.

377. The discussion was fairly brief but came to the view that the non-market services of central banks should be treated as being consumed by government. Market services of the central bank are provided to a range of units who pay for them.

378. The first few speakers on recommendation (d) opted for deviations from market rates being classified as current transfers, provided they were sufficiently large to require being recorded separately. Several others then provided examples of some large implicit subsidies (e.g. interest rate subsidies) being given to certain activities via central banks in developing countries. A suggestion was made that such subsidies should be shown in a memorandum item rather than the core accounts because of the extent of imputation required. Guarantees of loans by a central bank can be a subsidy and should be treated as such.

379. On balance, the AEG considered that deviations from market rates should be classified as subsidies. However, there is sufficient uncertainty surrounding the detail that it would be useful to consider these issues further by putting them on the long-term research agenda.

## **Summary conclusion**

### ***Outcomes***

#### ***Output of Central Banks***

- (a) The AEG agreed in principle with the proposal to distinguish between market and non-market output. Non-market output should be valued at cost. The group noted that exact implementation might be very resource intensive and that the issue may not be of significant importance. It was therefore agreed that countries should have flexibility in the degree to which they applied the distinction.

#### ***Use of Central Bank services***

- (b), (c) It was agreed that the non-market services of central banks should be treated as acquisition of services by general government financed by an imputed transaction. Market services of the central bank are provided to a range of institutional units who pay for them.

#### ***Valuation of market services***

- (d) It was noted that the interest rates set by the central bank may be so high or low as to represent inclusion of an implicit tax or subsidy. The AEG agreed these should be identified explicitly as such when they are significant. Then, they should be recorded as taxes or subsidies.

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## **The production of financial corporations and price/volume measurement of financial services and non-life insurance services**

### **Issue 6a; Paper SNA/M1.06/04; for decision**

#### **Description of the issue**

*The business of financial corporations has undergone a structural transformation towards an increasing importance of portfolio management of financial assets with the aim of generating holding gains and a decreasing importance in simple intermediation. The definition of financial corporations and of financial services needs examining to ensure all the activities of financial corporations are adequately captured in the SNA. The review will also cover the measurement of production of financial services in volume terms.*

#### **Presentation**

380. The paper for this session (document number SNA/M1.06/04; Issue 6b) was written by Anders Nordin and presented by François Lequiller. Mr Akhilesh Kulshreshtha presented an additional paper, on the treatment of informal sector financial activities (including own money lenders) in the SNA. The session was chaired by Ivo Havinga (UNSD).

#### ***Introduction***

381. The OECD Task Force on Financial Services (the “Task Force”) set out a series of recommendations focussing on the following 8 topics:

- (1) definition of financial corporations;
- (2) treatment of own funds;
- (3) treatment of SPE and customers;
- (4) identifying financial services;
- (5) treatment of holding gains and losses;
- (6) choice of the reference rate;
- (7) treatment of market makers ;
- (8) price and volume issues.

382. The presentation provided some background to these recommendations and set out the recommendations themselves for discussion. The questions shown at the end of this presentation are based on the issues underlying the Task Force’s recommendations.

## **Topic 1: Definition of financial services and financial corporations**

383. In the 1993 SNA the definition of financial corporations was mainly related to the activity of financial intermediation. The key elements were “risk taking” and “repackaging”. No services or composition of assets and liabilities are explicitly specified in the 1993 SNA and there is a degree of ambiguity about the role of own funds in the process.

384. The Task Force proposed to extend the definition of financial services as follows:

“The production of financial services is the result of financial intermediation, *risk management, liquidity transformation* and/or auxiliary financial activities.”

385. Financial services provided include monitoring services, convenience services, liquidity provision services, risk assumption services, underwriting services and trading services.

### **Task force recommendation 1**

*In principle, financial services can be provided as a secondary activity. In practice, however, in many countries, the provision of financial services is so strictly regulated that there may be no other unit providing financial services. By convention, even if financial services are provided by non financial corporations, no indirect charges are imputed. On the other hand, financial services provided for explicit charges are recorded as such.*

386. Note: The definition of financial corporations is also discussed in Paper SNA/M1.06/24 “Classification and terminology of financial corporations in the updated SNA”. It will be necessary to make the two definitions consistent. As part of the process of doing so, the following sentence should be added to the above definition:

“A financial intermediary (corporation?) does not simply act as an agent for other institutional units but places itself at risk by acquiring financial assets and incurring liabilities on its own account.”

## **Topic 2: Own funds**

387. The issue of own funds particularly relates to units that finance themselves exclusively via equity. Paragraph 6.134 of the 1993 SNA states that lending of own funds “ (...) is not financial intermediation as [units] do not channel funds from one group of institutional units to another. Lending as such is not a process of production and the interest received from the lending of own funds cannot be identified with the value of any services produced.”

### **Task force recommendation 2**

*the 1993 SNA states that lending own funds does not give rise to production. While it is true that units lending own funds do not engage in financial intermediation, under a broader definition of financial services units lending own funds may provide a financial service. At a minimum, an incorporated enterprise (thus with a full set of accounts) which, as its main activity, provides loans to a range of clients and incurs the financial risk of the debtor defaulting, should be treated as a financial corporation. Its allocation to the appropriate sub-sector has yet to be determined.*

*In addition, some unincorporated enterprises which provide loans to a range of clients (other than just family and friends) on a regular business basis may also be treated as providing financial services. The advice of experts from countries where this practice is*

*widespread is needed to specify when and how such units are to be identified and whether they are to be treated as unincorporated enterprises in the household sector or quasi-corporate enterprises in the financial sector.*

### **Topic 3: Activities and customers**

388. Some units are set up to carry out well-specified financial activities or transactions directly related to a specific purpose. Some examples are asset management, corporate treasury services, special purpose vehicles (SPVs). Other units provide financing and asset holding services to one company. Examples are holding companies, trusts and some government sector units (e.g. PPPs, securitisation)

#### **Task force recommendation 3**

*An entity providing financial services to only one unit or a group of units is considered to be a separate institutional unit (and a financial corporation) if it keeps a complete set of accounts and is capable of acquiring assets and incurring liabilities on its own account.*

*A similar entity which does not have a complete set of accounts is treated as an institutional unit (and a financial corporation) only if it is resident in a country other than that of any of the units to which it is providing the services, in accordance with SNA/BPM practice of treating non-resident unincorporated enterprises as quasi-corporations.*

### **Topic 4: Measuring FISIM**

389. The Task Force strongly recommended changing the current SNA regarding the calculation of FISIM. Key points were the use of a reference rate formula to calculate FISIM and systematically allocating FISIM. In addition, a specific recommendation was made on the scope of financial instruments to be considered in measuring FISIM.

#### **Task force recommendation 4**

*Financial institutions charge for some services explicitly and some implicitly. From an economic perspective, all financial instruments are potentially involved in the production of financial services. Some financial instruments attract only explicit charges but several may attract implicit charges alone or in addition to explicit charges. Deposits and loans attract implicit charges and these instruments are included in the calculations of FISIM. Other instruments may attract FISIM but will not be included unless a clear allocation to users is possible. Thus, in practice, FISIM may be limited by convention to loans and deposits.*

### **Topic 5: Treatment of holding gains and losses**

390. Expectations of holding gains provide incentives to engage in productive processes and so holding gains expectations are part of the decision making process. Holding gains are components of the returns on financial assets.

#### **Task Force recommendation 5**

*When measuring the implicitly valued output of financial institutions, the question arises of whether expected holding gains and losses of financial institutions on their own account should be included in the measure. There is no question of including holding gains and losses as such in a direct measure of output in the SNA. However, for certain financial instruments, expected price changes constitute an important part of expected returns. In*

*principle, therefore, they could be considered when approximating the value of financial services indirectly measured.*

*Despite this conceptual position, given the empirical difficulties in estimating expected holding gains and losses, it is presently not recommended to include expected holding gains and losses in the measurement of financial services output.*

### **Topic 6: The choice of the reference rate**

391. In the 1993 SNA, the reference rate is described as “...represent[ing] the pure cost of borrowing funds – that is a rate from which the risk premium has been eliminated to the greatest extent possible and which does not include any intermediation services”.

#### **Task Force recommendation 6**

*The reference rate used in the compilation of FISIM should be a risk-free rate that has no service element in it and that reflects the maturity structure of the financial assets and liabilities to which FISIM applies. It is recommended that a single reference rate be used for transactions in the local currency, but different reference rates may be used for transactions in other currencies.*

### **Topic 7: Market makers**

#### **Task Force recommendation 7**

*In practice, virtually all transactions in foreign exchange and securities are carried out via financial corporations. Two prices are quoted for transactions in securities: a bid price and an ask price. The first is the price which the potential buyer is to pay, and the second is the price that the owner receives on sale. The mid-price is by convention taken to be the average of these two prices. The difference between the bid price and the mid price is a margin paid by the buyer to the financial corporation, and the difference between the mid price and the ask price is a margin paid by the seller. The value of securities in the balance sheet is at mid price and excludes these margins.*

*Financial corporations buy and sell securities both on their own account and on behalf of clients. Buying and selling on behalf of clients may be on demand, that is in immediate response to an instruction from the client to buy or sell a specific security. Alternatively, a financial corporation may acquire a stock of securities in order to meet future demand immediately. This activity is called market making and may be undertaken by specialised financial corporations or financial corporations providing a wide range of financial services. The SNA should measure the margins on the buying and selling of all securities by all financial corporations and attribute these as being paid by the seller and the buyer respectively, regardless of the purpose for which the securities and other instruments are being bought or sold.*

*When there is a delay between the purchase and sale of a security, in order to avoid including holding gains and losses, the margins are calculated on the basis of the prices prevailing at the time the purchase and sale take place.*

## **Topic 8: Prices and volumes**

### **FISIM**

392. To measure the volume of output of the financial services component that is implicitly charged for, it is necessary to identify those services that make up the output. There is no directly observable price or quantity underlying FISIM. The current SNA does not provide a recommendation.

#### **Task Force recommendation 8**

*Ideally a direct deflator of the output at current prices should be constructed as a PPI that reflects the margin measure of FISIM. However the nature of financial services cannot easily be connected to price and quantity units. Besides, the change in quality is an important issue in financial services. The length of opening hours for bank branches, the proximity of a local branch, the quality of investment advice are some central quality features of financial services.*

*In the absence of direct deflators, one of the following approaches is recommended:*

- *The rate of change of the volume indicator can be derived using the rate of change of stocks of loans and deposits deflated by a general price index (e.g. the GDP deflator) on which the base year margin can be applied.*
- *Direct output indicator method. Break down the different characteristics linked to financial services (e.g. numbers and value of loans and deposits). For each of the characteristics an appropriate volume indicator is to be derived. The volume indicators are then weighted together.*

### **Insurance services**

#### **Task Force recommendation 9**

*The measurement of the output of non-life insurance services at current prices is obtained using a formula based on the difference between premiums (plus adjusted premium supplements) and adjusted claims. Ideally a direct deflator of the output at current price should be constructed as a PPI. However, this margin measure of the output of non life insurance does not lead to any easy interpretation of the nature of the quantity and price and, thus, this ideal index is generally not available.*

*Statistical offices do calculate price indices for non-life insurance services included as a PPI or as a CPI. These price indices, called here “premium price indices”, measure the change in the price of insurance policies with fixed characteristics. They are different from the ideal index, and should not be used to deflate the current price output unless there is evidence that the deflator for claims moves with the premium price indices. In the absence of this ideal deflator, it is recommended to compile directly a volume indicator using one of the methods proposed below, and obtain the price index as the ratio between the current price series and the volume series:*

- *Deflated premium method: Obtain a direct volume measure of the output (and by extension, the consumption) of non-life insurance services by extrapolating the current price measure of the base year by the rate of change of a volume index, which is obtained deflating gross premiums earned by a premium price index (PPI or CPI, depending of the context). When the premium price index covers premium*



*supplements, it is advisable to use the rate of change of a volume index compiled as gross premiums plus adjusted premium supplements deflated by this extended premium price index.*

- *Weighted quantity method (number of policies): In the absence of adequate premium price indices, a volume indicator can be compiled using quantity indicators such as the number of policies, by line of product (house-owner insurance, motor vehicle insurance, third party liability, etc.) appropriately weighted preferably by net premiums or, when not possible, by gross premiums.*

## **Discussion**

### *Financial institutions*

393. The AEG recognised there are a large number of corporations managing funds for others and so, on the surface, they should be classified as financial corporations. It is possible, though, to have auxiliary corporations that do not put themselves at risk. Funds can be set up in various ways, e.g. a fund itself and then also an asset manager of that fund, which would be considered as an auxiliary. In this case, the manager does not have any FISIM even though he does provide financial services. In the CPC there is no category for financial services. The SNA needs to make it clear that financial intermediation is a subset of the financial sector as a whole. Bankers think the SNA does not adequately describe what they are now doing in practice. A distinction is required between “clean” and “dirty” prices associated with securities.

394. The ECB participant indicated he did not see any benefit in changing the current definition in ESA95 (note: it refers to financial corporations in general) because the liquidity issue is already implicitly in the definition. The presenter explained the extra sentence is required to cover units linked to government and which are difficult to classify as market or non-market. Other participants agreed that the words “liquidity measurement” should be added, although there was a comment that “risk” can be used in different contexts and the specific risk should be noted. There is some confusion about units and how to treat them, particularly what sector/subsector to allocate them to.

395. The Chair indicated there was general support for recommendation (a), adding “risk management and liquidity transformation” to the definition.

396. The AEG agreed to recommendation (b).

397. The discussion on recommendation (c) opened with a question - everyone agrees lending of own funds includes a financial service, but is it financial intermediation? The answer was that, when you use own funds, a financial service is provided but there is intermediation only if funds other than own funds are used and if it is the primary activity of the producer unit involved. If an unincorporated enterprise is involved then it is classified to the household sector unless it is sufficiently large and fulfils the criteria to be classified as a quasi-corporation, in which case it would be in the financial sector.

398. Discussion on recommendation (d) was postponed until the session on Units in the SNA.

### *Financial services*

399. The discussion on recommendation (e) commenced with one participant saying that, in principle expected holding gains and losses should enter into the calculations. However, it would be important to clarify that holding gains/losses would not be included as output; rather they enter into the calculation of the price when a value is being imputed. We do not know the value of the output so we use an indirect way of measuring it. As a result, holding gains/losses may enter the calculation. Expected holding gains/losses can be estimated indirectly. If the sum of costs is used to measure output then the expected holding gains/losses may be included (wrongly) in the value of output. Another problem is that the 1993 SNA algorithm to impute the output can result in negative output so it will have to be changed.

400. The Chair summed up the discussion on recommendation (e) as there being fairly general agreement but with further elaboration of the expected holding gains/losses issue being required. Peter Harper and Peter van de Ven volunteered to work on this over the next few months.

401. The AEG agreed to recommendation (f).

402. The problems caused by relying on a single reference rate were covered initially in the discussion on recommendation (g). In particular, using a single reference rate can lead to negative output/price. For example, negative FISIM can be obtained by using a single reference rate (such as the inter-bank reference rate) if there are long-term fixed interest rates on some instruments, such as mortgages. It may be possible to use a single reference rate for each institutional unit provided allowance is made for expected holding gains/losses. There is also a risk element involved and that can differ for different banks and different components. The SNA should not be too prescriptive about a single reference rate and should refer to something like “an appropriate reference rate” instead.

403. The AEG agreed that multiple reference rates may need to be used in some circumstances, and to the following wording:

The reference rate used in the compilation of FISIM should be a rate that has no service element in it and which reflects the risk and maturity structure of the financial assets and liabilities to which FISIM applies. It is recommended that different reference rates should be used for transactions in other currencies.

404. The AEG agreed to recommendation (h).

### *Measurement in volume terms*

405. The discussion on recommendation (i) started with one participant pointing out that the proposal could result in a positive volume of FISIM even though FISIM is zero in value terms. The Editor suggested that the words “adjusted if necessary for changes in quality” could be added in the first bullet point. The debate moved to the most appropriate indicator of the volume of FISIM output. There was some support for the change in stocks of deposit/loans being the output indicator for FISIM, although that is dependent on there being no quality change. On the other hand, several participants argued in favour of transactions as a better indicator of the volume of activity than stocks of loans/deposits. Their main concern was that the deflated asset approach can produce strange results (e.g. due to portfolio changes).

406. The next part of the discussion was on the implications on volumes estimates of shifts between direct and indirect charges, which could occur with no change in current price values but with an apparent shift in volumes that is artificial. In such cases, offsets occur in both the prices and volumes of direct and indirect services, although they may not be directly observable. A shift in direct/indirect charging can result in (e.g.) higher direct prices and (offsetting) lower indirect prices. A possible alternative approach would be to compile a constant quality price index to deflate FISIM.

407. A suggestion was made to calculate volumes at the total level and then remove the direct charges component to give an imputed indirect component. The updated SNA should emphasise that “the measurement of FISIM volumes needs to take account of the total output of the direct and indirect components”.

408. The Chair said that the AEG agreed with the recommendation, with the suggested changes/additions to wording being taken into account.

409. The AEG agreed to recommendation (j).

## **Summary conclusion**

### ***Financial institutions***

#### ***Recommendations***

- (a) A definition of financial corporations based on the nature of their output (financial services) instead of their activity. “Risk management” and “Liquidity transformation” activities are added to “Financial intermediation” to better capture the nature of the activities of financial corporations.
- (b) That no FISIM is recorded for non-financial corporations. Only explicit financial services are recorded for such units.
- (c) That units producing financial services for only one unit or a group of units are considered as financial corporations if they keep a complete set of accounts and are capable of acquiring assets and incurring liabilities on their own account.
- (d) That units which provide financial services exclusively with own funds would be considered financial corporations and will thus be productive in the sense of SNA if they provide loans to a range of clients and incur the financial risk of the debtor defaulting.

#### ***Outcomes***

- (a) The AEG agreed with recommendation (a) on the definition of financial corporations and financial services. The service charge for money lenders can be compiled as the difference between the amount paid as interest and the reference rate times the amount of the loan.
- (b) The AEG agreed that, by convention, FISIM would be restricted to (i) financial corporations and (ii) loans and deposits.

- (c) Discussion of recommendation (c) was postponed to the discussion on units.
- (d) The AEG agreed that lending own funds may be a financial service and may include a service charge, though not financial intermediation activity. Incorporated money lenders should be treated as part of the financial corporations sector. Unincorporated enterprises which provide loans to a range of clients other than just family and friends, and take on the financial risk of the debtor defaulting, as a principal activity, should be treated as unincorporated enterprises (money lender) in the (informal) household sector or as quasi-corporations if they have sufficient accounting information to qualify as a quasi-corporation.

### *Financial services*

#### **Recommendations**

- (e) That expected holding gains and losses should not enter into the measurement of financial services output.
- (f) That FISIM should be systematically allocated. It is primarily deposits and loans attract implicit charges and these instruments are included in the calculations of FISIM. The calculation of FISIM should be based on the formula  $(r_L^t - rr^t)y_L^t + (rr^t - r_D^t)y_D^t$ . In this formulation,  $y_L$  is the amount of loans,  $y_D$  the amount of deposits,  $r_L$  is the loan rate,  $r_D$  the deposit rate and  $rr$  is a reference rate. This implies a change to the 1993 SNA that recommended calculating FISIM as “the total property income receivable by financial intermediaries minus their total interest payable, excluding the value of any property income receivable from the investment of their own funds, as such income does not arise from financial intermediation” (paragraph 6.125)
- (g) That the reference rate used in the compilation of FISIM should be a risk-free reference rate that has no service element in it and that reflects the maturity structure of the financial assets and liabilities to which FISIM applies. A single rate should be used for transactions in the local currency, whereas different rates may be used for transactions in other currencies.
- (h) That with respect to market making and trading services, the measurement of the implicitly priced elements - margins on foreign exchange and buying and selling of all securities by all financial corporations - be made regardless of the purpose for which the securities and other instruments are being bought or sold.

#### **Outcomes**

- (e) The AEG agreed with the recommendation to not include expected holding gains/losses in the measurement of financial services output but noted this may have to be reviewed in the context of consistency.
- (f) The AEG agreed.
- (g) The AEG agreed that a single reference rate should be used but, when relevant, a country could choose to use multiple rates. The reference rate used in the

compilation of FISIM should be a rate that has no service element in it and which reflects the risk and maturity structure of the financial assets and liabilities to which FISIM applies. It is recommended that different reference rates should be used for transactions in other currencies.

- (h) The AEG agreed that the margins on buying and selling of all securities by all financial corporations represent financial services. When there is a delay between purchase and sale of a security the margin at the time of each transaction should be used to eliminate holding gains/losses. The margin is calculated as the difference between the mid price and the buy/sell price.

#### *Measurement in volume terms*

#### **Recommendations**

- (i) That in the absence of direct deflators for the output of implicitly priced financial services at current prices, the rate of change of the volume indicator should be derived using the rate of change of stocks of loans and deposits deflated by a general price index (e.g. the GDP deflator) or using a direct output indicator method.
- (j) That in the absence of a direct deflator of non-life insurance output, a direct volume indicator should be compiled using an extrapolation of base-year figures by a volume index derived using a premium price index or by use of quantity indicators appropriately weighted, and obtain the price index as the ratio between the current price series and the volume series:

#### **Outcomes**

- (i) The measurement of the volume change in the output of financial intermediation should take into account the total output, including the direct charges. In the absence of direct deflators for the output of FISIM, one of the following approaches may be used:
  - (i) rate of change of the volume indicator can be derived using the rate of change of average stocks of loans and deposits deflated by a general price index (e.g. the GDP deflator) adjusted for quality change in the output of financial services
  - (ii) the output indicator method which involves breaking down the different characteristics linked to financial services (numbers and values of loans and deposits, savings, money transfers, etc). For each of the characteristics an appropriate volume indicator is to be derived. The volume indicators are then weighted together.
- (j) The AEG agreed to the recommendation on the calculation of a volume estimate of non-life insurance services.

## **Treatment of informal sector financial activities (including own money lenders) in the SNA - Mr Akhilesh Kulshreshtha**

### **Presentation**

410. The treatment of the activities of money lenders is not clear in the 1993 SNA. Paragraph 6.134 states that “.... lending own funds is not production”. On the other hand, paragraph 25 of annex 1 states “.... money lenders who make loans from own resources are also considered producers of financial services provided their services can be measured”.

411. In full, paragraph 6.134 says:

6.134. Some money lenders lend only their own funds. The activity of such small-scale money lenders, including many village money lenders, is not financial intermediation as they do not channel funds from one group of institutional units to another. Lending as such is not a process of production and the interest received from the lending of own funds cannot be identified with the value of any services produced

412. Implementing paragraph 6.134 leads to underestimating GDP in developing countries where the money lenders who make loans from their own funds are quite prevalent. In most Asian and African countries the size of the informal financial activities is quite significant and it is also underestimated due to the lack of accurate statistics on them. In India, informal financial activity is about ten per cent of total banking activity.

413. Those engaged in informal financial activities are basically involved in money lending, adopting several informal techniques (pawn shop, chit funds, sahuakar). In many cases they even employ people to help in organizing the job, keeping records and for ensuring repayment of the loans. The remuneration paid by own money lenders to such people is a component of value added.

414. It is not just the money lending activity from own/borrowed funds but the associated services that the borrower gets at the time when he requires them. The user pays for the services in the name of interest (along with the huge (hidden) service charges). Such activities rarely exist in developed countries.

415. A further inconsistency in the 1993 SNA is revealed by comparing paragraphs 6.133 and 6.134. Paragraph 6.133 says “The unincorporated financial intermediaries including informal activities are to be included as formal financial intermediaries”. However, the implication of paragraph 6.134 is that the activity is not production if the money lender did not formally borrow money. In developing countries, in regard to activities of financial informal sector, it is never clear whether the money lender did or did not borrow money for pursuing his activity. It could also be argued that the money lender used money of his relatives (of course in the same household).

416. To overcome the problem, the options are:

- to consider the activity as a financial intermediary service, or
- to consider the activities of the financial informal sector as a financial auxiliary service.

417. In the second option, the service charge can be estimated as the amount paid by the user minus the actual return to money capital.

### **Questions**

- (a) Do the members of AEG agree that the activities of the own-money lenders be considered as producers of financial auxiliary services?
- (b) Do the members agree that these money lenders be classified as unincorporated enterprises in the household sector?

### **Recommendations**

418. These points are covered in paragraph 397 and recommendation (d) above.

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## **Equity**

### **Issue C9; Paper SNA/M1.06/23; for decision**

#### **Description of the issue**

*Paragraph 13.73 of the 1993 SNA just says that "the value of shares that are not quoted on stock exchanges or otherwise regularly traded should be estimated using the prices of quoted shares that are comparable in earnings and dividend history and prospects, adjusting downward, if necessary, to allow for the inferior marketability or liquidity of unquoted shares", but without making reference to specific issues or methods. The issue is, however, very relevant, as unquoted shares in many countries are far more important than quoted shares. Nonetheless, little progress was formerly made in producing harmonized data on unquoted shares. There are two issues for clarifications to help harmonizing the valuation of equity:*

- (a) *The breakdown of AF5 into quoted shares, unquoted shares and other equity as done in the ESA95;*
- (b) *Recommendation of methods of valuation of different types of equity. This is not a substantive change issue but one that will discuss equity from both the asset and liability side, consider both intercompany and portfolio investment in relation to listed and unlisted equity. Expansion and clarification of equity in the SNA will pave the way for better harmonization with other standards, in particular BPM#5 (which does deal very closely with portfolio and direct investment).*

#### **Presentation**

419. The paper for this session (document number SNA/M1.06/23; Issue C9) was written by the OECD Task Force on the Valuation and Measurement of Equity and presented by François Lequiller. The session was chaired by Charles Aspden (OECD).

#### **Introduction**

420. The following issues were covered in this presentation:

- treatment of unquoted shares;
- equity components details;
- residual corporate net worth;
- stock-flow inconsistency.

### ***Unquoted shares***

421. The SNA recommends “market capitalisation” as the basis for valuing unquoted shares. However, the Task Force recommends that the new SNA should be more flexible with the main recommendation in this regard being to use transaction prices where they are available. In the absence of transaction prices there are several possible methods that could be used:

- market capitalisation method (with choice of applying a liquidity discount factor);
- net asset value;
- present value;
- own funds at book value.

422. Note that these methods are not ranked in a preferred order.

### ***Equity components’ details***

423. The Task Force recommended that the classification of the new SNA should distinguish the following components inside the position AF5 *Shares and other equities*:

AF5.1: Equity

AF5.1.1 Quoted shares

AF5.1.2 Unquoted shares

AF5.1.3 Other equity

AF5.2: Investment fund shares

424. The presenter noted that this proposal is consistent with that in the paper on *Liability aspects of SDRs and international reserves* (Issue 44) despite the difference in coding.

425. The Task Force recommended that the updated SNA include a paragraph to distinguish portfolio and direct investment in the case of equity and another to discuss the link between inter-company investment and direct investment.

### ***Residual corporate net worth***

426. The SNA states that *Residual corporate net worth* exists but does not say anything about the nature of this item. There can be an economic interpretation of Residual corporate net worth. It is a practical item in the sense that it reflects any valuation and coverage issues that drive a wedge between (i) the market value of corporate equity liabilities and (ii) the net asset values derived as the difference between assets and liabilities (excluding equity). It may be also considered a conceptual issue with an economic interpretation if (i) in a revised the 1993 SNA certain assets are



out of scope (e.g. certain intangible assets); or (ii) if it is felt that net asset values and market value of corporate equity are not equivalent (e.g. the latter can reflect excess demand for shares).

### ***Stock-flow inconsistency***

427. The treatment of reinvested earnings on foreign direct investment introduces an additional element in the financial accounts: It is the imputed reinvestment of subsidiary earnings, in both parent direct investment assets and subsidiary equity liabilities. Since the opening and closing balance sheet market value equity constrains the total change to a certain value, adding those imputed flows requires an offsetting adjustment elsewhere. While not a perfect solution, it is proposed to change the Revaluation account to maintain stock-flow consistency.

### **Questions**

428. Does the AEG:

- (a) agree on the principle of flexibility in the approaches to valuing unquoted equity?
- (b) accept the proposed approaches towards valuing unquoted equity?
- (c) accept the breakdowns of the item “Shares and other equity” into “Equity” and “investment funds” with equity being further disaggregated between quoted shares, unquoted share and other equity?
- (d) agree to include a paragraph to discuss the link between inter-company investment and direct investment?
- (e) agree that a conceptual description of Residual Corporate Net Worth is included in the SNA and that it appear as a sub-component of totals net worth.
- (f) support a change to the Revaluation Account to include the counterpart of imputed flows linked to re-invested earnings?

### **Discussion**

429. On the question of valuing unquoted shares, most speakers supported allowing a flexible approach. There was some support for adopting one or other of the four alternatives proposed (in the absence of any transaction prices) but the general consensus was that the AEG should not state a preference; rather this issue should be put on the long-term research agenda. The AEG noted that the OECD Task Force and the IMF/OECD Group did not come up with a preferred measure if transaction prices are not available.

430. The Chair summed up the discussion on the first two questions by saying that there was consensus on the need for flexibility and no strong feelings about the ranking of methods (other than transaction prices which would be the leading principle).

431. The AEG agreed with both these the proposals under questions (c) and (d) (i.e. the proposed classification of AF5 *Shares and other equity* and including a paragraph on the link between inter-company investment and direct investment without further discussion).

432. Several speakers opposed question (e) - the idea of breaking down total net worth to show residual corporate net worth explicitly in the accounts. The general opinion was that a residual variable in this context does not make much sense.

433. During the discussion of the final question, the AEG agreed that more explanation is required in the updated SNA about reinvested earnings, which is a transaction item not a revaluation item. It can be assumed that the value of reinvested earnings is absorbed into the value of equity in the corporation. Only changes in the valuation of equity of a corporation not explained by reinvested earnings should be shown in the revaluation account; the changes attributable to the non-resident share holders due to the reinvestment of their earnings should be shown as a transaction in the financial account, matching the outflow in the primary distribution of income account.

434. The Chair summed up by saying a further articulation of the flows is required in the updated SNA.

## **Summary conclusion**

### **Outcomes**

- (a) The AEG agreed to the principle of flexibility.
- (b) The AEG agreed that transaction prices are the preferred means of valuing unquoted equity. The AEG did not rank the other alternative methods proposed for valuing unquoted equity when transaction prices are not available.
- (c) To be discussed in the context of the classification of financial assets and liabilities.
- (d) The AEG agreed.
- (e) The AEG agreed that a description of the concept of Residual Corporate Net Worth would be useful but that a breakdown of total net worth to show this component explicitly in the accounts would not be useful.
- (f) The AEG agreed a further articulation of the flows relating to reinvested earnings is required in the SNA.

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## **Treatment of currency unions**

### **Issue C26; Paper SNA/M1.06/39; for information**

#### **Description of the issue**

*No change is required to the SNA, as there is no specific coverage of currency unions. The next edition of the BPM will include some clarification of application of existing concepts to economic and currency unions. A technical expert group with representatives of various multi-country groupings has been looking at these issues. A paper from the BOP Committee will be provided to AEG on a "for information" basis. However, the issue may arise at the AEG as to whether these topics should also be covered in the SNA.*

## **Summary conclusion**

### ***Outcome***

435. This was an information item and was not discussed by the AEG for lack of time. Comments would still be welcome and should be addressed to the ISWGNA.

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## **Direct investment**

### **Issue C28; Paper SNA/M1.06/40; for information**

#### **Description of the issue**

*A report, for information, from the IMF on the resolution by the IMF and OECD of issues that were taken to the IMF-OECD Direct Investment Technical Expert Group.*

## **Summary conclusion**

### ***Outcome***

436. This was an information item and was not discussed by the AEG for lack of time. Comments would still be welcome and should be addressed to the ISWGNA.

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## **Globalization: A progress report**

### **Issue 25c; Paper SNA/M1.06/42; for information**

#### **Presentation**

437. The paper for this session (document number SNA/M1.06/42; Issue 25c) was written by Carol Carson. There was no presentation on this topic, but key points set out in the paper were discussed briefly. The session was chaired by Barbro Hexeberg (World Bank).

#### **Discussion**

438. The main points that came out of the discussion were:

- it is important that consistency issues are dealt with;
- there is a need to draw on papers setting out the issues, particularly focussing on the practical implementation issues;
- globalisation goes beyond the corporate sector, in practice it covers the whole economy.

## Summary conclusion

### **Outcome**

439. The AEG made some specific suggestions on the outline and noted the potential implications of globalisation for the updated SNA.

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## **Assets boundary for intangible non-produced assets - Other intangible fixed assets**

### **Issues 13, 29; Paper SNA/M1.06/06; for decision**

#### **Description of the issues**

##### **Assets boundary for non-produced intangible assets**

*The category “other non-produced intangible assets” in the 1993 SNA was a placeholder intended to accommodate any new assets of similar type to those in the general category which did not fall in the more specific headings. However, this heading has been used in some instances to cover the securitization of future receipts of government. Should the heading continue to be included in the classification hierarchy and if so, what sort of items should be included in it?*

##### **Other intangible fixed assets**

*In the Annex of Chapter XIII, the 1993 SNA describes this item as consisting of “new information, specialized knowledge, etc. not elsewhere classified, whose use in production is restricted to the units that have established ownership rights over them or to other units licensed by the latter”. No specific examples of items to be included have yet emerged. Should this category be retained or removed?*

#### **Presentation**

440. The paper for this session (document number SNA/M1.06/06; Issues 13, 29) was written and presented by Charles Aspden. The session was chaired by Dieter Glatzel (Eurostat).

##### **Background**

441. The issue is whether instruments involving the securitisation of future receipts of government should be recorded as intangible non-produced assets. It arose when some European governments raised money by securitising future income receipts. Eurostat’s *Manual on Deficit and Debt* gives the following definition of securitisation:

“Securitisation is where a unit, named the originator, transfers the ownership rights over financial or non-financial assets, or the right to receive specific future flows, to another unit named the securitisation unit, that pays the originator from its own source of financing.”

442. One example of securitisation was the transfer of ownership rights by a government of the future receipts of its public lottery. In this case, the securitisation unit issued securities backed on

the future earnings of the lottery and paid the government with the proceeds of this issuance. The question is whether such transactions should be recorded as the sale of an asset or as borrowing by government. Eurostat decided that securitization is not the sale of an asset and developed a set of rules for deciding such matters. The matter was not helped by the definitions given by the 1993 SNA regarding intangible non-produced assets because they are not clear cut and are open to different interpretations.

443. Reasons for excluding securitised government revenue as an asset are that, in most cases only part of the revenue is used to repay the loan, and if securitised government revenue is an asset, then all future government income (in other words, the power to tax) would be an asset. Anticipated revenue of this sort is not flowing to a productive asset and it cannot be a non-financial asset because there is no counterparty with a corresponding obligation.

### **Definitions**

444. On page 310 of the 1993 SNA, intangible non-produced assets are defined as:

“... constructs of society. They are evidenced by legal or accounting actions, such as the granting of a patent or the conveyance of some economic benefit to a third party. Some entitle their owners to engage in certain specific activities and to exclude other institutional units from doing so except with the permission of the owner. Intangible non produced assets consist of patented entities, leases and other transferable contracts, purchased goodwill and other intangible non-produced assets.”

445. The term “construct of society” followed by a non-exhaustive list, comprising examples, could be interpreted as opening the door to the securitisation of government income.

446. On page 295 (paragraph 13.62) the SNA explains

“Intangible non produced assets entitle their owners to engage in certain specific activities or to produce certain specific goods or service and to exclude other institutional units from doing so except with the permission of the owner. The owners of the assets may be able to earn monopoly profits by restricting the use of the assets to themselves. Included are patented entities, leases and other transferable contracts, and purchased goodwill.”

447. This definition makes it clear that an asset is related to the unit being able to engage in productive activities. Securitisation of government revenue clearly fails this criterion. Nevertheless, it would be best to make it clear in the definition of an asset that future government revenue does not constitute an asset.

448. The Canberra II Group recommended that the SNA should make it clear that the securitisation of a future revenue stream is not an asset in the system. Also, the category “other intangible non-produced assets” should be eliminated.

### **Other intangible fixed assets – new information and specialized knowledge**

449. The 1993 SNA mentions these “not-elsewhere classified” items in the Annex of Chapter XIII, as units whose use is restricted to the units that have established ownership rights over them or to other units licensed by the latter. What is intended to be included in other intangible fixed

assets? The Canberra II Group has not been able to answer the question, except to note that it excludes R&D and intangible fixed assets currently recognised in the 1993 SNA. Nevertheless, the Group favours keeping the category.

### **Recommendations**

450. The following recommendations were presented for the AEG's consideration:

- (a) The definition of an asset given in the SNA should make clear that the securitisation of future revenue is not an asset in the system. When future income unrelated to any asset recorded on a unit's balance sheet is the subject of securitisation arrangements on the market such arrangements are always to be treated as borrowing. These arrangements involve the transfer of the entitlement to future income, which does not fit the definition of an economic asset.
- (b) The category "Other intangible non-produced assets" should be eliminated, and either the category "leases and other transferable contracts" should be redefined to include contracts such as mobile phone licences that are only transferable by means of a change of ownership of the licensee, or another category should be created to accommodate such contracts.
- (c) The category "Other intangible fixed assets" should be maintained.

### **Discussion**

451. Everyone who spoke on recommendation (a) supported it. One qualification was suggested – the word "asset" needs to be qualified (e.g. "financial" or "fixed").

452. The discussion on recommendation (b) was split into those who favoured retaining the category "Other intangible non-produced assets" because it may be useful for future developments (or at least until there is a final outcome on leases and licences) and those who felt that it provides temptation for something to be put into it and so eliminating it would force more thought to be put into classification issues.

453. On balance the AEG agreed with recommendation (b) that the category should be eliminated, but with the proviso that this not be done until after the AEG has made a final decision on leases and licences and has confirmed that the category is definitely no longer required.

454. The debate on recommendation (c) (to retain the category "Other intangible fixed assets") was similar to that on recommendation (b). However, one difference was that there was a feeling that it could include outputs of R&D, other than patented entities. For example, a set of architectural plans that are not immediately used would probably fit into this category.

455. The AEG agreed to recommendation (c) to retain the category. It may need to be renamed and this can be examined after leases and licences are sorted out.

### **Summary conclusion**

#### **Outcomes**

- (a) The AEG agreed.

- (b) The AEG agreed in principle, taking the view that there should be no categories that are not well-defined. However, the need for retaining this category should be re-examined after the work on leases and licences has been finalised.
- (c) The AEG noted that the Canberra II Group was in favour of retaining the category despite not being able to identify anything that would be included in it. The need for this category will be further investigated by the Editor.

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## **Classification and terminology of non-financial assets**

### **Issue 27; Paper SNA/M1.06/12; for decision**

#### **Description of the issue**

*Should the classification of non-financial assets be revised in light of the review of a wide range of non-financial assets? Is the tangible/intangible dichotomy still of primary importance in the classification?*

#### **Presentation**

456. The paper for this session (document number SNA/M1.06/12; Issue 27) was written and presented by Anne Harrison. The session was chaired by Dieter Glatzel (Eurostat).

##### ***Introduction***

457. The presenter set out the proposed classification from the highest level through to the most detailed level for the AEG to consider.

##### ***Top level***

458. The proposed highest level of the classification is:

*Non-financial assets*  
*Produced assets*  
*Non-produced assets*  
*Financial assets.*

##### ***Question***

- (a) Does the AEG agree with the highest level of the classification?

##### ***Produced and non-produced assets***

459. The high level structure for produced and non-produced assets is proposed to be as follows:

*Produced assets*  
*Fixed assets*  
*Inventories*  
*Valuables*  
*Non-produced assets*  
*Natural resources*

*Contracts, leases and licences  
Goodwill and marketing assets.*

460. The main differences from the existing classifications are that “Natural resources” used to be “tangible non-produced assets”, “Contracts, leases and licences” was previously part of “intangible non-produced assets” while “Goodwill and marketing assets” used to be the remainder of “intangible non-produced assets”.

461. Apart from the changes in terminology, it should be noted that “Goodwill and marketing assets” includes mastheads, logos, customer lists etc all of which may be marketed separately.

**Question**

- (b) Does the AEG agree with this high level structure for produced and non-produced assets?

**Fixed assets**

462. The proposed structure for fixed assets is:

*Dwellings*  
*Other buildings and structures*  
*Non-residential buildings*  
*Other structures*  
*Land improvements*  
*Machinery and equipment*  
*Transport equipment*  
*ICT equipment*  
*Other machinery and equipment*  
*Military assets*  
*Cultivated assets*  
*Livestock for breeding, dairy, draught etc.*  
*Vineyards, orchards and other plantations of trees yielding repeat products*  
*Costs of ownership transfer on non-produced assets*  
*Intellectual property products*  
*Research and development expenditure*  
*Mineral exploration and evaluation*  
*Computer software and databases*  
*Computer software*  
*Databases*  
*Entertainment, literary or artistic originals*  
*Other intellectual property products.*

463. The AEG previously concluded that weapons should not go into machinery and equipment. The AEG needs to decide if the military assets heading just includes offensive weapons or does it also include schools, hospitals etc currently included in the buildings category.

464. Other changes are that the category for costs of ownership transfer remains as a flow but not a stock; “Intangible fixed assets” becomes “Intellectual property products”; and “Other intangible fixed assets” remains as a catchall heading now called “Other intellectual property products”.



### **Question**

- (c) Does AEG agree with this breakdown of fixed assets?

### **Inventories**

465. The proposed structure for inventories is:

*Materials and supplies*  
*Work in progress*  
*Work in progress on cultivated assets*  
*Other work in progress*  
*Finished goods*  
*Government military and strategic inventories*  
*Military inventories*  
*Strategic inventories*  
*Goods for resale.*

466. The main issue here is whether Government military and strategic inventories should be separately identified or merged with materials and supplies.

### **Question**

- (d) Does the AEG agree with the breakdown of inventories?

### **Valuables**

467. The proposed structure for valuables is:

*Precious metals and stones*  
*Antiques and other art objects*  
*Other valuables*

### **Question**

- (e) Does the AEG agree with the breakdown of valuables?

### **Natural resources**

468. The breakdown proposed for natural resources is:

*Natural land*  
*Natural land under buildings and structures and associated surface water*  
*Natural land under cultivation and associated surface water*  
*Natural recreational land and associated surface water*  
*Other natural land and associated surface water*  
*Subsoil assets*  
*Coal, oil and mineral gas reserves*  
*Metallic mineral reserves*  
*Non-metallic mineral reserves*  
*Non-cultivated biological resources*  
*Natural forests*

*Other crop and plant resources*  
*Wild stocks of fish and aquatic mammals*  
*In national waters including EEZ*  
*Outside EEZ*  
*Water resources*  
*Aquifers*  
*Other*  
*Other natural resources*  
*Radio spectra*  
*Other.*

469. The presenter noted this proposal is not consistent with SEEA, which shows recreational land as an “of which” of all other categories. The separation of land improvements also creates a break with the SEEA classification

470. The highest level would be standard with the more detailed components to be supplementary items.

### **Question**

- (f) Does the AEG agree with the detailed categories proposed for natural resources?  
Does the AEG agree that only first level should be standard and the rest supplementary?  
Does the AEG consider a parallel classification between land improvements and natural land is desirable?

### **Contracts, leases and licences**

471. The proposal regarding contracts, leases and licences as follows:

*Third party property rights*  
*Marketable operating leases*  
*Permissions to use natural resources*  
*Entitlement to future goods and services on an exclusive basis*  
*Of nominated legal persons*  
*Of future production*

472. Leases would be classified as “Marketable operating leases” only if they are not financial assets. Similarly, permissions to use natural resources do not include any such permissions treated as taxes.

### **Question**

- (g) Does the AEG provisionally agree with this classification?

### **Capital account**

473. The proposal regarding capital is as follows:

*Gross fixed capital formation*  
*Acquisitions less disposals of fixed assets*  
*Acquisition of new fixed assets*  
*Acquisition of existing fixed assets*

*Disposal of existing fixed assets*  
*Cost of ownership transfer on natural resources*  
**Depreciation**  
*Changes in inventories*  
*Acquisition less disposal of valuables*  
*Acquisition less disposals of non-produced assets.*

**Question**

- (h) Does the AEG agree with this format of the capital account entries?  
 Does the AEG wish to suggest a greater disaggregation?

**Other changes in volume of assets account (OCVA)**

<p><b><i>Entries applying to a restricted number of assets</i></b></p> <p><i>Economic recognition of produced assets (K4)</i></p> <p>Public monuments</p> <p>Valuables</p> <p><i>Increase in the value of natural resources</i></p> <p>Discoveries and upwards reappraisals of sub-soil resources (K3)</p> <p>Natural growth of uncultivated biological resources (K5)</p> <p><i>Decrease in the value of natural resources</i></p> <p>Extractions and downwards reappraisals of sub-soil resources(K61)<sup>9</sup></p> <p>Harvesting of uncultivated biological resources</p> <p><i>Initiation of contract, leases and licences (K3)</i></p> <p>Relating to third party property rights</p> <p>Fixed assets</p> <p>Natural resources</p> <p>Relating to the entitlement to future goods and services</p> <p><i>Termination of contracts, leases and licences (K62)</i></p> <p>Relating to third party property rights</p> <p>Fixed assets</p> <p>Natural resources</p> <p>Relating to the entitlement to future goods and services</p> <p><i>Changes in the value of goodwill and marketing assets(K62)</i></p> <p><b><i>Entries applying to all classes of assets</i></b></p> <p><i>Catastrophic losses (K7)</i></p> <p><i>Uncompensated seizures (K8)</i></p> <p><i>Other volume change (K9 and K10)</i></p>
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<sup>9</sup> The word extraction has been used here to replace depletion. This is in keeping with usage in the SEEA where extraction is used for total removals and depletion for the net effect on the level of reserves.

## **Question**

- (i) Does the AEG agree with this restructuring of the account? (Note: entries for financial assets and liabilities are not yet included.)

## **Discussion**

474. The AEG agreed with recommendations (a) and (b), with no discussion.

475. There was a lengthy discussion on recommendation (c) (the breakdown of fixed assets), with most of the comments associated with the proposal to include and specifically identify military assets.

476. Several participants agreed with a comment made that, by introducing the term “military assets”, we are introducing a functional classification based on end use. Military assets used for civilian purposes should be left where they are currently classified. Perhaps it might be better to be more explicit about what is actually included in military assets by using a term like “military offensive weapons”. An alternative would be to split military assets into “weapons systems” and “other”. In any case, we should drop the term “offensive” from military weapons.

477. The discussion moved to some practical implications of the proposal. A lot of countries have problems obtaining the data to split out the weapons component of military assets and that aspect of the classification could cause problems in practice. On practical grounds, offensive weapons could be part of machinery and equipment (either merged or as a separate category). Even countries that can report total military expenditure may have difficulty in obtaining data for the suggested split. On the other hand, data issues should not be a main driver for the classification even though the practical application of the proposed classification could create problems of consistency in some cases. Most participants agreed that a conceptually correct classification is required despite potential practical problems.

478. Comments on other parts of the assets classification were:

- for some analysis it would be necessary for all government assets to be taken out and not just military expenditures;
- the classification should be by type of asset so a “military assets” category is not appropriate;
- it will be useful to have the ICT equipment split out;
- the word “expenditure” should be deleted from the “R&D expenditure” category because it is the output of R&D;
- the category “other intellectual property products” should be dropped;
- the “Intellectual property products” terminology and classification are sensible;
- where is the boundary of “other intellectual property products” (e.g. is a marketing plan an asset)?

479. The Chair’s summary was that the AEG broadly agreed with recommendation (c), but a significant majority was against including “Other intellectual property products” as a non-defined category. If some specific content can be defined for this category then its proposed deletion can be reconsidered. Other qualifications to the general agreement were that the term “military assets”

should be changed to “weapons systems”, the word “products” should be dropped from “Intellectual property products” and the word “expenditure” should be dropped from “Research and development expenditure”.

480. The discussion on recommendation (d) (inventories) was relatively brief. Suggestions were to keep “military stocks” separate from “strategic stocks” and to continue to classify strategic stocks in a different category (perhaps “work in progress”?) because strategic stocks could be oil or food and there is no sense in having them with military stocks.

481. The AEG eventually decided to accept recommendation (d) but with the “Government military and strategic inventories” item becoming just “military inventories” and with strategic stocks being allocated to other components of the classification, based on the nature of the products concerned.

482. There was little discussion on recommendation (e). In response to a question about what would go into “Other valuables” and whether it should be dropped, the Editor said that stamp or coin collections would be classified there. The AEG accepted recommendation (e).

483. An alternative approach was proposed at the start of the discussion. “Natural land” is split into “land use” and “land cover” in SEEA. The classification should be based on land by type of cover rather than by use. Wild stock, fish and aquatic animals would be classified under “Aquatic animals”; “Surface water” and “Ground water” would be terms to replace “Aquifers”. There was little support for this proposal.

484. The AEG considered the links between the SNA and SEEA. Most speakers supported the idea that, in principle, it is important to align the SNA and SEEA classifications as far as possible. Others considered that it would be useful to align these classifications where possible but it is less important than aligning with the BPM and GFSM. SEEA is a satellite system so consistency/reconcilability is more important rather than having complete alignment.

485. The AEG agreed that the first level of the Natural resources classification underlying recommendation (f) should be standard in the SNA and that the lower levels will be supplementary. The Editor will work with the UNSD to achieve the best alignment possible between the SNA and SEEA.

486. The AEG postponed consideration of recommendation (g) until leases and licences have been finalised.

487. The discussion on recommendation (h) focussed almost entirely on the proposal to use the term “depreciation” rather than “consumption of fixed capital” in the updated SNA. To date, this issue has not been considered by the AEG although it was debated extensively by the Canberra II Group. The main reason the Canberra II Group made the recommendation to change was that international accounting standards now refer to current-cost depreciation as “depreciation”. Many users of national accounts do not understand what is meant by consumption of fixed capital. There was a good reason to adopt the term “consumption of fixed capital” in the 1993 SNA and there is now a good reason to change because it could be too easily confused with consumption of capital services. In addition, in the non-English versions of the 1993 SNA “consumption of fixed capital” was commonly translated as the equivalent of “depreciation”.

488. Several arguments were advanced against the proposed change. A lot of effort went into educating users about what consumption of fixed capital means and most now understand the

distinction between it and depreciation, so a new education program will be required if a change is made. “Depreciation” led to confusion with provisions and moving to consumption of fixed capital overcame the confusion. It will be difficult to convince users of any benefits of changing back. There will also be a problem with the perception amongst users that the concept is being changed.

489. An alternative suggestion that attracted some support was that “economic depreciation” would be a better term. In developing countries the data required to calculate consumption of fixed capital is not available and depreciation is commonly used in practice as a proxy for consumption of fixed capital in the national accounts.

490. The AEG was reminded that, if there is no agreement on a change to the 1993 SNA then there should be no change. A show of hands indicated a small majority in favour of changing the label to depreciation.

491. The Project Manager said it was clear there were firmly-held and divergent views and there was not sufficient consensus to make a change from the 1993 SNA.

492. The AEG accepted the format of the capital account entries under recommendation (h), but rejected the proposal to change “Consumption of fixed capital” to “Depreciation”

493. The AEG agreed with recommendation (i).

## **Summary conclusion**

### ***Questions***

494. Does the AEG agree with:

- (a) The highest level of the classification?
- (b) The high level structure for produced and non-produced assets?
- (c) The breakdown of fixed assets?
- (d) The breakdown of inventories?
- (e) The breakdown proposed for valuables?
- (f) The detailed categories proposed for natural resources? Does the AEG agree that only first level should be standard and the rest supplementary? Does the AEG consider a parallel classification between land improvements and natural land is desirable?
- (g) The proposal regarding contracts, leases and licences?
- (h) The format of the capital account entries? Does the AEG wish to suggest more disaggregation?
- (i) The proposals for the “Other changes in volume of assets account”?

## **Outcomes**

- (a) The AEG agreed.
- (b) The AEG agreed.
- (c) The AEG was in broad agreement. Changes required from the proposal presented are:
  - “military assets” should be changed to “weapons systems”
  - the word “expenditure” should be dropped from “research and development”
  - the “Other intellectual property products” category should be re-examined as noted above.
- (d) The AEG agreed with the breakdown with one exception: “Military and strategic inventories” should be changed to “Military inventories”; the strategic inventories component (e.g. oil, food) will be allocated to other relevant parts of inventories as now.
- (e) The AEG agreed.
- (f) The AEG agreed with the proposed classification at the top level; the more detailed levels will be optional, depending on the situation in individual countries. The Editor and the UNSD will work together to obtain the best alignment possible between the SNA and SEEA classifications.
- (g) The AEG postponed discussion of this section pending further work on the issue on contracts, leases and licences.
- (h) The AEG agreed with the format and did not wish to have any greater disaggregation. The AEG also agreed that the 1993 SNA term “Consumption of fixed capital” should not be changed to “Depreciation” as recommended by the Canberra II Group.
- (i) The AEG agreed.

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## **Country comments on recommendations made by the July 2005 AEG meeting**

### **Paper SNA/M1.06/43; for information**

#### **Presentation**

495. The paper for this session (document number SNA/M1.06/05; Issue 16) was written by the UNSD and presented by Ivo Havinga. The session was chaired by Adriaan Bloem (IMF).

## **Presentation**

496. Ivo Havinga presented the main results from the UNSD's consultation with countries. He indicated there is overwhelming support for the AEG work. Full details of the responses are available for consultation.

## **Discussion**

497. The Project Manager suggested that countries need to check the table and comments to ensure their responses have been correctly recorded because some problems could arise in interpretation.

498. The Chair congratulated the UNSD on a very successful outreach project and the very accessible website set up as part of the process. The AEG has provided a good means for countries to present their views.

## **Summary conclusion**

### ***Outcomes***

499. The AEG noted the country comments on the recommendations made by the AEG at its July 2005 meeting.

500. The Project Manager suggested that the UNSD should ask all countries to check the summary table and the comments to ensure that no problems have arisen in the UNSD's interpretation of the responses to the questionnaire.

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## **Non-market producers' owned assets - Cost of capital services**

### **Issue 16; Paper SNA/M1.06/07; for decision**

#### **Description of the issue**

*When summing costs to measure non-market output, the 1993 SNA recommends that the value of the services provided by a producer's own non-financial assets should be measured as consumption of fixed capital. This means that neither a return on capital to these assets nor, equivalently, an opportunity cost of capital is recognized. This leads to an inconsistency with the rental that would have to be paid if the assets were rented. Should the SNA recommendation be changed and the cost of consumption of fixed capital be replaced with capital services (consumption of fixed capital, expected holding gains/ losses and the capital or interest costs)?*

#### **Presentation**

501. The paper for this session (document number SNA/M1.06/07; Issue 16) was written by Carol Carson and Anne Harrison and presented by Anne Harrison. The session was chaired by Adriaan Bloem.



## ***Background***

502. The AEG approved in principle including a return to capital on assets used in non-market production. Several countries have expressed reservations with some opposed in principle but most of the opposition being on practical grounds. The paper has been prepared as part of a search for a compromise.

503. The Project Manager has undertaken some consultations and made some further clarifications to clear up misunderstandings. The main issues involved have been the rate of return and the justification for it, and the assets selected for inclusion in the scope of these estimates should give heavy weight to practical considerations.

## ***Conceptual and practical issues***

504. Including a return to capital on assets used in non-market production would affect net operating surplus, increase output, and increase final consumption by the same amount; saving and the financial accounts are unaffected.

505. The logic behind including this return to capital for non-market producers is that it brings them into line with the treatment of the equivalent assets held/used by market producers. The measure of capital services should be applied symmetrically for market and non-market producers. Capital services are included in operating surplus. “Non-market” is not synonymous with “non-profit”. Market NPIs do include a profit and a return to capital in their operating surplus.

## ***Imputations***

506. It is important to recognise the difference between imputing a transaction and imputing a value for a transaction. Estimating output as the sum of costs (including consumption of fixed capital and employers’ social insurance contributions) is an imputation of a value not an imputation of a transaction. If consumption of fixed capital is estimated by a rule of thumb it simply requires a slight change in the assumptions to convert this to an estimate of capital services.

## ***Which rate of return?***

507. Several options are available regarding the rate of return to be selected. The rate of return estimated endogenously for market producers is not recommended because of its volatility. The rate on government bonds is more stable. However, this would not be simply the present rate; rather it would be the implicit rate on all bonds outstanding, taking account of their average term structure and smoothing the effects of changes. A question that needs to be considered is whether countries with very high rates on bonds actually have high capital services. On balance, it seems that we should use the **real** rate of return in all cases to apply to nominal capital stock values. Even with high nominal rates, real rates are likely to be more comparable across countries.

508. An example demonstrates the effect. Consider an asset worth 1000 and a rate of inflation of 2 per cent per month. The mid year value of the asset is 1126. If the return on government bonds is 30 per cent and inflation is 27 per cent (i.e. 2 per cent per month compounded), then the return to capital is 34.1 (3 per cent of 1126). A conservative estimate of the consumption of fixed capital is 112.

### ***Range of assets to be included***

509. There are four broad groups of assets that should be considered for inclusion:

- (a) those used by civil servants (e.g. computers, vehicles);
- (b) those providing benefits to the whole economy (e.g. roads);
- (c) those providing benefits to the whole community (e.g. city parks);
- (d) land.

510. It is clear that computers etc should be included. Roads and infrastructure should ideally be included but to be as conservative as possible they might be excluded. For city parks etc, it is highly likely that data would be unavailable, so they could be notionally included but adopt the convention of no return on the capital invested (and not even estimate consumption of fixed capital). Land improvements should be treated in the same way as computers as should land under buildings included with the buildings. By convention, though, a return to capital on other land could be excluded.

511. The consequences of these treatments would be that GDP would be increased by including a rate of return on computers and roads. Conceptually excluding city parks and land would decrease GDP by excluding even consumption of fixed capital on these assets..

512. Excerpts from the Project Manager's note included in SNA/M1.06/07, which was prepared following discussion of this issue in the AEG meetings of December 2004 and July 2005.

The responses to the country consultations do not fit easily into the simple categorization of "agree" or "disagree;" there was a spectrum of comments in between that dealt with conceptual, practical, and other considerations. Some responses called for further discussion, and some indicated less than full understanding of the issue. (The paper presented at the July 2005 meeting was intended to be responsive to these comments.) The Project Manager subsequently spoke to representatives of 15 countries about the issue and their country's response. The single most often mentioned aspect was the need to settle on a rate of return to be used in the calculation. As well, scope was mentioned.

### ***Questions***

- (a) Should a rate of return on assets used by non-market producers be taken to be the real rate of return of interest on all outstanding government bonds?
- (b) Should a rate of return for all assets such as computers, vehicles and buildings used by the employees of non-market producers in their regular work be included in the measurement of the output of the non-market producer?
- (c) Should a rate of return for assets such as roads and other infrastructure be included in the value of output of government?
- (d) Should the SNA acknowledge that because data on such assets as city parks and historical monuments are often poor or non-existent, by convention no estimates of either consumption of fixed capital or a return to capital should be made for these assets?

- (e) Similarly should the SNA recommend a return to capital in respect of land under buildings and structures be included in the measurement of output of non-market producers where such information is available separately from the buildings and structures involved, but as a convention neither estimates of return to capital nor of consumption of fixed capital should be made in respect of other land held by government?

## Discussion

513. The discussion opened with a question about the consistency between the interest rate used in capital stock estimation and the government bond rate proposed to be used for these non-market producers. The interest rates used are asset specific rather than industry specific. Should this go on the research agenda? The AEG accepted an explanation that, in practice, this is the best way to go.

514. The main issue discussed on question (a) was whether a nominal or a real interest rate should be used. One possibility would be to use the rate of return on government bonds as an indicator but this is valid only when the government is not controlling interest rates. Some countries do not have government bonds and in such cases perhaps domestic currency bonds could be used. The issue of real versus nominal interest rates is tied up with expectations about holding gains/losses. Double counting would occur if nominal interest rates are used rather than real ones. This is most obvious if an example is put together under high inflation and with high interest rates. In the Canberra II Group paper, the pros and cons of using the nominal and real rates of interest are discussed. By focussing on a rate of return, the issue has been oversimplified because the effects of holding gains/losses should be included, for example.

515. A study in Canada showed the rate of return on government capital turned out to be very similar to the long-term government bond rate.

516. The Chair indicated that a majority agreed to question (a), i.e. using the real rate of return, supplemented if necessary by other indicators of the cost of capital to government, particularly if there is a thin bond market or a negative real rate of interest.

517. The next 2 questions (i.e. (b) and (c)) were considered together. A number of AEG members agreed with a comment that, in concept, all capital assets should be included but, by convention, parks, monuments, etc should be excluded (although roads should be included). The only comment opposing this view was that increasing GDP this way is dangerous because such significant imputation is required. The Eurostat participant indicated that Eurostat is in favour but a number of EU member states do not agree.

518. The Chair summed up that most AEG members agree with estimating a return on at least computers, vehicles etc, and a lot of them with a broader scope but the practical problems need to be recognised.

519. The discussion moved to question (d). A suggestion was made to draw the border at fixed produced assets (e.g. a sport stadium in a park would be included but the land itself would not). There was general agreement that the measure should be restricted to fixed assets. It may be necessary to separate fixed assets from their heritage element, although the AEG noted that historical monuments are included in the French national accounts via their (large) maintenance costs which feed into consumption of fixed capital.

520. The Chair summed up that the AEG agreed to question (d), i.e. to estimate a return on fixed produced assets but to exclude city parks, heritage assets etc, by convention unless such assets are included in government accounts.

521. Most speakers on question (e) considered that land improvements should be included and that open land should be excluded. There was some disagreement as to whether land under buildings should be included in the rate of return.

522. The main argument in favour of including all land (including that under buildings) was that if government leases a building its rent would include the price of the value of the land. The main argument against the proposal was that it is difficult in practice to make an overall estimate of the value of the land and building (e.g. if the PIM is used to estimate capital stock then you have the value of buildings but not the land).

523. The AEG agreed that different data sources would inevitably lead to differences in treatment in different countries. For practical reasons, countries could include or exclude land under buildings depending on whether they use PIM or direct valuation for their estimates.

524. The Chair noted that no-one was in favour of including open land. There was no agreement on land under buildings but most of those who spoke prefer not to include it at all although it may be difficult for some to exclude it. Therefore, by convention it should be excluded but in practice it may not be possible to do so. Land improvements should be included.

525. This was the third discussion on this topic and there is now far more agreement than previously. The Project Manager said we will need to include some of the Editor's material in explaining to countries the background to the AEG's recommendations. If anyone has comments on Anne Harrison's paragraphs 2.3 to 2.8 they should send written comments to Anne.

## **Summary conclusion**

### ***Outcomes***

- (a) The AEG agreed that the expected real rate of return on government bonds is an appropriate indicator. If necessary, it should be supplemented by other indicators of the cost of capital to government, particularly if a country has a thin bond market or a negative real rate of interest.
- (b)-(d) The AEG did not consider this breakdown of assets was helpful and preferred to say that a return to capital should appear for all fixed assets. This means that a rate of return should be calculated for computers, vehicles, etc used by employers and for roads and infrastructure and for city parks and historical monuments to the extent that they are included in fixed assets. By convention, no return to capital would be applied to other classes of assets.
- (e) The AEG did not favour including a rate of return on "open land". On balance, the AEG agreed that a rate of return should not be estimated on land under buildings. However, the AEG acknowledged that it may be difficult for some countries to exclude it, given their estimation methods. Therefore the AEG recommended that, by convention, it should be excluded but, in practice, it may be impossible to do so.

The AEG agreed that since land improvements should be included in fixed assets, a rate of return was appropriate for them.

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## **Liability aspects of SDRs and international reserves**

### **Issue 44; Paper SNA/M1.06/22; for decision; Paper SNA/M1.06/36; for information**

#### **Description of the issue**

##### *Monetary gold and SDRs*

*(a) Should monetary gold be treated as a financial asset rather than as a valuable?*

*(b) The 1993 SNA classifies Special Drawing Rights (SDRs) as assets without corresponding liabilities arguing that IMF members do not have an unconditional liability to repay their SDR allocations. However, SDR allocations have attributes of liabilities because interest is payable on them and a country terminating IMF membership would be required to repay its obligations including any SDR allocations. Also, the IMF Monetary and Financial Statistics Manual recommends that the value of allocated SDRs be shown both on the assets and liabilities side of the balance sheets of central banks, which is in accordance with the IMF's SDR Department's guidance to member countries. Should SDR allocations be considered liabilities in the SNA?*

#### **Presentation**

526. The paper for discussion at this session (document number SNA/M1.06/22; Issue 44) was written by the Antonio Galicia-Escotto and presented by Robert Heath. The session was chaired by Adriaan Bloem (IMF).

##### ***Introduction***

527. the 1993 SNA recommends that member countries of the IMF classify the SDR allocation as an asset, but not as a liability because there is no actual (unconditional) liability to repay their SDR allocation. The IMF has been approached to reconsider this treatment, and to regard the SDR allocation as a liability. The IMF's Finance Department, the overseer of the SDR instrument, supports this proposed change.

528. The SDR is an unusual instrument, creating difficulty in the determination of its treatment in the accounts. SDR holdings clearly meet the definition of an asset because ownership rights can be enforced, economic benefits are derived by the owners by holding them or using them over a period of time, and they are stores of value (the 1993 SNA paragraph 11.16). SDR holdings can be acquired either through transactions in existing SDR holdings in which economic value is exchanged and a transaction is recorded in the system, or through an allocation of holdings. In the latter case, no transaction is recorded because it is considered that a corresponding liability is not created; rather it is treated as an other change in volume.

## ***Nature of the SDR***

529. SDRs function under a cooperative arrangement among the members and other participants. Thus, the SDR allocation is the liability of a member to the membership, for whom it is an asset. In the most unlikely event of any losses, these would be borne by the SDR holders, as the value of their claims would be reduced.

530. Countries are required to pay the SDR interest rate, a market rate of interest, to the SDR department in the IMF on the full amount of the allocation they have received. From an accounting perspective of the SDR Department this is paid on a net basis. If a country sold its entire holdings of SDRs, it would be making gross payments on the allocation it received. If these amounts are not paid, arrears on SDRs arise. If a country left the membership of the IMF it would be required to repay its obligations including any allocation of SDRs. The need to pay interest and repay the allocation if a member left the IMF seems to be sufficient to create a liability. If so, then there is a strong argument to record the creation of the liability on a gross basis as a transaction at the time of the allocation.

## ***Transactions***

531. Transactions are recorded when economic value is created (the 1993 SNA paragraph 3.94) and are considered to have taken place when the creditor and debtor enter the claim and liability, respectively, in their books (paragraph 3.97). The SDR is considered to be a store of economic value. The liability is recorded in the books of the participant to the SDR Department when the allocation is made, and not when the participant starts transactions in the holding, so the liability is created at the same time as the asset. A helpful comparison would be with central banks' reciprocal swap arrangements (BPM5 paragraph 434). Similarly transactions should be recorded if a member left the IMF and repaid their SDR allocation. Indeed, if they had no SDR holdings but simply a gross allocation, they would need to pay some economic value. If the repayment of an allocation is not a transaction, there would be no counterpart entry to the payment.

532. In the 1993 SNA there is already an instrument category *Monetary Gold and SDRs* in which the SDR is included (AF1). Assets and liabilities could be separately identified on a gross basis. It should be made clear there are no liabilities associated with monetary gold.

## ***Consensus for Change***

533. The relevant departments in the IMF and the members of the IMF Committee on Balance of Payments Statistics and the newly formed Reserves Asset Technical Expert Group were consulted. There is overwhelming support for change as described above. On the issue of the classification of the SDR as debt/equity or other, there have been some requests from balance of payments experts for further discussion and also some similar requests from the monetary statistics community. There should be no practical difficulties in collecting data on SDR allocations.

## ***Questions***

- (a) Should countries recognise SDR allocations as gross liabilities in the System?
- (b) Should the allocation and cancellations of SDRs be classified as transactions?
- (c) If so, should SDRs continue to be treated as an instrument in the SNA, with assets and liabilities separately identified?

## Discussion

534. The first speaker opposed the first recommendation. He indicated that the last Financial Accounts Working Party at the OECD concluded that SDR allocations are liabilities. It seems the decision is being based on the need to handle some exceptional cases which could be handled another way.

535. Several other speakers supported all three recommendations. The key factor is having to pay interest on the instrument, which is consistent with the fact the IMF considers it has a claim on countries that borrow via SDRs.

536. The Chair said that almost all who have spoken are in agreement with all three recommendations, with only one speaking against recommendation (a). Therefore, the AEG agreed with all three recommendations.

## Summary conclusion

### Outcomes

- (a) The AEG agreed to recognise SDR allocations as gross liabilities.
- (b) The AEG agreed to classify the allocation and cancellations of SDRs as transactions.
- (c) The AEG agreed to continue to treat SDRs as an instrument, showing the assets and liabilities separately.

537. The paper on international reserves (SNA/M1.06/22) was an information item and was not discussed by the AEG for lack of time. Comments would still be welcome and should be addressed to the ISWGNA.

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## Debt concessionality

### Issue 43c; Paper SNA/M1.06/20; for decision

#### Description of the issue

*Loans with concessional interest rates could be seen as providing a transfer from lender to borrower. Should such transfers be recognized in the SNA? Although there is no clear definition of what is a concessional loan, the guidance in the **External Debt Guide** suggests features such as an intention to convey a benefit and occurrence in a noncommercial setting (usually government-to-government). If concessional loans are not recognized in the core accounts, should the concessional amounts be considered as supplementary information where they are significant?*

#### Presentation

538. The paper for this session (document number SNA/M1.06/20; Issue 43c) was written by Andrew Kitili and presented by Robert Heath. The session was chaired by Ivo Havinga (UNSD).

## ***Background***

539. Debt concessionality has gained increasing importance in the development arena relating to debt relief to the HIPC Initiative (heavily indebted poor countries). The 1993 SNA hardly discusses the issue, although it recognizes a subsidy element in concessional loans to employees (paragraph 7.42), as does GFSM 2001 (paragraph 6.14). BPM5 recognizes that concessional loans encompass a transfer element (paragraph 104) but it falls short of providing guidance on how such transfers should be measured or recorded. The paper sets out five possible ways of treating debt concessionality for non-commercial official lending. It concludes that the measurement of debt concessionality for these loans be recorded in a supplementary item and be in line with the approach used by those measuring debt relief.

540. The demand for data has increased tremendously since the 1993 SNA. Examples include:

- The Millennium Development Goals incorporate debt relief and concessional lending among its indicators for monitoring debt sustainability.
- The HIPC debt sustainability discussions focus on specific amounts of debt concessionality.

541. We need to develop a consistent definition regardless of whether the debt is new or being rescheduled.

542. BoPTEG discussed this issue in December 2004, and considered that further investigation was required given the issues that arose during the discussion. IMF staff undertook further work consulting those with a policy interest in the IMF, government finance experts, and the debt experts from the relevant international agencies on the Task Force on Financial Statistics. BOPCOM considered the issue in June 2005 but did not reach a consensus on including transfers arising from concessionality into the core accounts. The preference was to treat it as a supplementary item, but BOPCOM was divided as to whether such transfers should be current or capital. The BOPCOM paper was presented to the OECD's Working Party on Financial Accounts in October 2005 but few comments were received.

## ***Current practice***

543. The OECD Development assistance Committee (DAC) calculates concessionality as the difference between the nominal value and the present value of the debt service as of the date of disbursement based on a discount rate applicable to the currency of the transaction and expressed as a percentage of the nominal value. At the Paris Club, debt reduction in present value terms is calculated as the difference between the nominal value of the applicable debt and its present value using a market-based interest known as the OECD's Commercial Interest Reference Rate (CIRR). As noted by the World Bank and others, transfers arising from concessionality are not limited to interest rate alone; they include the grace period, the frequency of payments and the maturity period.

## ***Options***

544. There are five possible alternative treatments:

- (a) Record concessional debt in nominal value without accounting for the transfer element in interest rate.



- (b) Record concessional debt in nominal value but account for the difference between the market interest rate and the contractual interest rate on the debt as an ongoing current transfer.
- (c) Record concessional debt in nominal value but account for the concessional interest by recording a capital transfer at the point of loan origination equal to the present value of interest cost savings.
- (d) Record concessional debt in nominal value but record one-off transfers at the point of loan origination equal to the difference between the nominal value of the debt and its present value using a relevant market discount rate, as a supplementary item.
- (e) Record concessional debt at market-equivalent value but account for the concessionality element by recording one-off capital transfer at the point of origination.

545. Option (a) provides no change on the status quo but it was never seriously considered by any group that discussed the topic.

546. Option (b) has the logic that the debtor is accruing less in interest than would be the case at the market rate. The market rate could be fixed at the time of the contract which means the problem of recording the transfer based on market rates is no longer relevant. An alternative would be to allow the market rate to change with market conditions. After a period of time the loan may not be concessional, which means a switch between concessional or not, but the two parties remain locked into the same loan. If there are no conditions attached to the stream of future interest payments (BPM5 paragraph 546) it is plausible to say that transfers arising from interest concessionality occur at the time of the debt contract.

547. Under option (c) for a new loan the value of the transfer is calculated as the present value of the difference between two streams of interest payments, one of which is based on the market interest rate and the other on the contractual interest rate. Such transfers could be recorded in the year they occur (i.e. when the contract becomes effective) as a memorandum item. This option is simple to implement and consistent with the SNA concept of change of economic ownership. However, transfers do not arise from interest rates alone but are determined by many variables including the grace period, frequency of payments and maturity period.

548. Option (d) would include transfers arising from concessional loans as a supplementary item. The transfer value is calculated as a capital transfer the same as for DAC and the Paris Club (see Table 1 in the paper). If a loan is retired before maturity and replaced by a new loan, the previously recorded transfers value has to be adjusted. This approach is consistent with the practice described above and is also supported within the IMF by the Policy and Review Department. However, there is a problem in selecting an appropriate discount rate. Possibilities include the CIRR used in the HIPC debt sustainability calculations. Treating it as a supplementary item allows these transfers to be measured and data disseminated, and compilers can develop their approaches over time. The IMF favours option (d).

549. Option (e) would result in the loan being recorded at market-equivalent value. In the standard presentation two credit entries for the debtor would need to be recorded - one under loans (equal to the present value of the concessional debt) and the other under capital transfers (equal to the difference between the nominal value of the debt and its the present value using the market-

equivalent rate as a discount factor). Interest on the loan would accrue at the market-equivalent rate as opposed to the contractual instrument rate. Such an approach is contrary to the principle that loans are valued at nominal value.

### **Questions**

- (a) Is the approach of defining debt concessionality based on the intention of the creditor to convey a benefit in a non-commercial setting, such as government-to-government loans, acceptable?
- (b) Would option (d) (following) be an acceptable outcome?
- Option (d): to record concessional debt in nominal value but record, as a supplementary item, one-off transfers at the point of loan origination equal to the difference between the nominal value of the debt and its present value using a relevant market discount rate. This option has the advantage of considering all the possible sources of transfers in debt concessionality—maturity period, grace period, frequency of payments as well as the interest rate—and is consistent with nominal valuation of loans.
- (c) Does the AEG consider that further work should be encouraged to obtain better measures of appropriate market equivalent rates to be used as the discount factor, but regard the commercial interest reference rate (CIRR) as an acceptable proxy in the absence of other information given its wide use in debt reorganization?

### **Discussion**

550. The discussion commenced with a series of questions put to the presenter:

**Question** Is the proposal to have a capital transfer upfront inconsistent with the SNA, which would deal with such transfers on a period by period basis, and should FISIM be included on borrowing by international institutions?

**Answer** In the debt world, debt concessionality is treated as an upfront discount provided conditions are not going to change; in effect, both parties are locked in, particularly regarding conditions that have to be met.

**Question** The proposal relates to official-to-official loans. Does this mean it is restricted to the government?

**Answer** Official creditors are broader than just government. It includes multi-national lending institutions, for example.

**Question** What are the national accounts implications?

**Answer** A discussion of concessionality is currently restricted to the BoP; the AEG needs to consider the possibility of how/why it might be extended into the national accounts

**Question** Is it a one-sided entry or is a capital transfer imputed?

**Answer** It will be treated as one-sided because it is only a supplementary item.

Question Would a supplementary item be optional?

Answer Supplementary items are included in the BoP only if they can provide extra useful information.

Question Would government debt or liabilities be affected by the approach of defining debt concessionality based on the intention of the creditor to convey a benefit in a non-commercial setting, such as government-to-government loans?

Answer It is a non-commercial situation so debt will be recorded at nominal value in the national accounts if it is a loan.

551. The discussion of question (a) followed. The AEG was told that this is an issue mainly for developing countries. One participant expressed concern that the recommendation could lead to inconsistencies between internal and external aspects of the economy. Unless we want to change some fundamental principles of the accounts it should be handled outside the core of the SNA. The discussion moved to a view that all concessional debt should be examined and then a choice should be made about what may or may not be included depending on whether or not it is at arms length. Option (b) may be relevant in some cases while option (d) may be in others, but (d) is not a comprehensive system of recording. Option (e) records the value at something other than the nominal value. Several AEG members expressed some reluctance to rush in and include debt concessionality in the core accounts. Rather it should be handled as part of the long-term research program rather than rushing it through in time for the SNA update.

552. There was some support for option (b). The presenter agreed that any decision should be carefully considered so it did not violate core national accounts principles. The proposals need to be refined over time but concessionality could be handled via a supplementary item in the core system in the meantime.

553. The AEG agreed the issue should be put on the long-term research agenda.

## **Summary conclusion**

### ***Outcomes***

- (a) The AEG was concerned that the proposals presented could potentially run counter to some core national accounting principles. The approach needs to be presented further refined and, as an interim step, debt concessionality should be handled via supplementary items and only concern official-to-official lending.
- (b) The AEG was reluctant to make a definitive decision on the preferred option because different options appear to be applicable in different situations. The AEG agreed that option (b) (see following paragraph) is preferred until further research is undertaken to set out the characteristics of the different options and the situation(s) in which each may or may not be applicable. In addition, it was noted that option (d) does not provide a comprehensive system of recording. The AEG considered that further research is required.

Option (b): to record concessional debt in nominal value but account for the difference between the market interest rate and the contractual interest rate on the debt as an on-going current transfer. While this option is consistent with nominal

valuation of loans, its key weakness is that it uses an interest rate that is likely to be out of line with evolution of market interest rates.

- (c) The AEG agreed that debt concessionality should be put on the long-term research agenda.

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## **Debt reorganization**

### **Issue 43e; Paper SNA/M1.06/35; for information**

#### **Description of the issue**

#### **Summary conclusion**

##### ***Outcome***

554. This was an information item and was not discussed by the AEG for lack of time. Comments would still be welcome and should be addressed to the ISWGNA.

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## **Classification and terminology of financial assets and liabilities in the updated SNA**

### **Issue 44; Paper SNA/M1.06/21; for decision**

#### **Description of the issue**

*Continued innovation in financial markets since the 1993 SNA was written means a review of the classification used for financial instruments is appropriate. Suggestions for change arise for most of the present categories.*

##### ***Monetary gold and SDRs***

*(a) Should monetary gold be treated as a financial asset rather than as a valuable?*

*(b) The 1993 SNA classifies Special Drawing Rights (SDRs) as assets without corresponding liabilities arguing that IMF members do not have an unconditional liability to repay their SDR allocations. However, SDR allocations have attributes of liabilities because interest is payable on them and a country terminating IMF membership would be required to repay its obligations including any SDR allocations. Also, the IMF Monetary and Financial Statistics Manual recommends that the value of allocated SDRs be shown both on the assets and liabilities side of the balance sheets of central banks, which is in accordance with the IMF's SDR Department's guidance to member countries. Should SDR allocations be considered liabilities in the SNA?*

##### ***Deposits and loans***

*(c) The criteria to make the distinction between deposits and loans are not clear. Recent financial innovations raise questions about the continuing analytical usefulness of the distinction. A particular problem is when a position between two*

*parties, especially financial institutions, is seen as a deposit by one party and a loan by the other. Should the SNA maintain a distinction between loans and deposits?*

*(d) When and under what circumstances do loans that are traded become securities? This is important because virtually all loans are tradable and trading has increased. It also affects market valuation since securities are valued at market price in the SNA and loans at nominal values.*

#### ***Securities other than shares***

*(e) With financial derivatives treated as a separate instrument in the 1993 SNA, it would be appropriate to introduce the term “debt securities” to replace “securities other than shares”.*

#### ***Financial derivatives***

*(f) Should there be a distinction between different types of financial derivatives, for example between forwards and options as well as the inclusion of employee stock options (see issue 3) in this category?*

## **Presentation**

555. The paper for this session (document number SNA/M1.06/21; Issue 44) was written and presented by Reimund Mink. The session was chaired by Barbro Hexeberg (World Bank).

### ***Background***

556. The subject of classification and terminology of financial assets and liabilities in the updated SNA is one of the SNA review issues (item 44). This issue linked to other issues (repurchase agreements (item 1), nonperforming loans (item 4), guarantees (item 37) and some clarification issues.

557. A paper was prepared on this issue by the Balance of Payments Committee (BOPCOM) and forwarded to the Advisory Expert Group (AEG) meeting for discussion in July 2005. Several papers linked to this issue have also been presented at this AEG meeting and at the previous meeting for discussion or for information (traded loans, index-linked debt instruments, and the distinction between loans and deposits).

558. A suggestion was put forward in the July 2005 AEG meeting to “write a paper exploring possible options for changes in the classification of financial instruments more generally”.

559. The main reasons for changing the classification and terminology in the 1993 SNA are new developments on the financial markets (financial innovation and integration), developing policy and analytical needs in the monetary area and financial stability areas. There is also scope to make the terminology easier to use and more descriptive of the various financial assets and liabilities on which statistics are produced.

### ***Decisions taken so far***

560. AEG papers have been prepared on:

- classification of financial instruments;
- distinction between deposits and loans;

- reverse transactions;
- traded loans;
- non-performing loans;
- SDRs; and
- granting and activation of guarantees.

561. Clarifications have been discussed on:

- the breakdown of shares and other equity; and
- the valuation of unquoted shares and other equity.

562. The proposed classification of financial assets and liabilities in the new SNA is set out in the table on the next page.

## Proposed classification of financial assets and liabilities in the new SNA

Financial instrument (transaction)	New SNA code	Remarks
<b>Monetary gold and special drawing rights (SDRs)</b> Monetary gold Special drawing rights (SDRs)	<b>F.1</b> F.11 F.12	Split into monetary gold and SDRs
<b>Currency and deposits</b> Currency Deposits Transferable deposits Other deposits	<b>F.2</b> F.21 F.22 F.221 F.222	Retain the distinction between deposits and loans
<b>Loans</b> Short-term Long-term	<b>F.3</b> F.31 F.32	
<b>Debt securities</b> Short-term Long-term	<b>F.4</b> F.41 F.42	AEG decision: debt securities instead of securities other than shares
<b>Equity</b> Quoted shares Unquoted shares Other equity	<b>F.5</b> F.51 F.52 F.53	Equity instead of shares and other equity; breakdown according to 1995 ESA
<b>Investment fund shares/units</b> [o/w Money market fund shares/units Bond fund shares/units Equity fund shares/units Real estate fund shares/units Mixed fund shares/units Hedge fund shares/units Funds in funds shares/units]	<b>F.6</b>	Optional split by type of investment fund shares/units
<b>Financial derivatives and employee stock options</b> Financial derivatives [Forwards and options: both o/w in terms of risk category Interest rate Equity Foreign exchange Credit-linked Other commodity] Employee stock options	<b>F.7</b> F.71      F.72	An (optional) split of financial derivatives into forwards and options and by risk category might be considered  AEG decision in Feb 2004
<b>Insurance technical reserves</b> Net equity of households in life insurance reserves and in pension funds Net equity of households in life insurance reserves Net equity of households in pension funds Prepayment of premiums and reserves against outstanding claims Reserves for calls on standardised guarantees	<b>F.8</b> F.81 F.811 F.812 F.82 F.83	Inclusion of 'reserves for calls on standardised guarantees'
<b>Other accounts receivable / payable</b> Trade credit and advances Short-term Long-term Other	<b>F.9</b> F.91 F.911 F.912 F.92	Original maturity split of trade credit and advances

Memorandum items:		
Direct foreign investment		
Equity		
Debt		

### ***Recommendations***

563. The recommendations considered by the AEG were:

- (a) To divide the category monetary gold and SDRs;
- (b) To introduce the term debt securities to replace securities other than shares;
- (c) To replace the term “shares and other equity” by “equity” and split it further into the sub-categories “quoted shares”, “unquoted shares” and “other equity”;
- (d) To separate investment fund shares/units from ‘shares and other equity’ and form a new category investment fund shares/units;
- (e) To consider distinguishing various types of investment fund shares/units (e.g. money market, bond, equity, real estate, mixed fund, and perhaps hedge fund shares/units) either as an “of which” additional split (in the case of shares/units in money market funds, with a view to providing a link with monetary aggregates) or as a non-mandatory memorandum item (for the other categories of investment fund shares/units);
- (f) To consider a split of financial derivatives into risk categories;
- (g) To broaden the category insurance technical reserves by introducing a sub-category reserves for calls on standardised guarantees;
- (h) To introduce a box linking measures of money to the balance sheets and the financial accounts; and
- (i) To include a box in the new SNA on debt.

564. Recommendations (b) and (c) had been addressed in an earlier meeting and were not reopened.

### **Discussion**

565. The discussion opened with concerns being expressed on a number of the proposals

- it would be better to not have “investment fund shares” (which is equity) as a top level;
- “Equity” should be the top level then split into “investment fund shares” and “other equity”;
- the proposed currency and deposits split could present a problem in practice;



- the distinction between short-term/long-term for loans and debt securities is not as important as one based on the size and/or type of account;
- splitting out investment funds is a sensible idea but it needs to be made clear that they are a form of equity;
- concerns with splitting investment fund shares into different types;
- financial derivatives should not be shown in their own right because they are a form of debt (although it was noted this is contrary to current international standards);
- the breakdowns of investment funds and of financial derivatives will be difficult to implement in practice and so they should be optional (perhaps using an “of which” approach);
- the distinction between loans and deposits could be problematical.

566. Several AEG members commented on a number of these concerns. Monetary gold and SDRs were shown together because they have no associated liabilities. Perhaps they should now be split in view of the AEG discussions on SDRs earlier in the meeting. Banks have a convention regarding deposits/loans and assets/liabilities. The difference between inter-bank loans and inter-bank deposits is based on a convention – an asset is treated as a deposit and a liability is treated as a loan. This convention was queried by one participant who said that it could lead to asymmetries because loans and deposits are separate items; practical problems should not override getting the correct conceptual treatment.

567. The AEG agreed that it will need to look again at these issues as a result of other decisions at this meeting and some further refinement of the classification based on this discussion.

568. The Chair indicated that the IMF and the ECB will continue work on the classification.

## **Summary conclusion**

### ***Outcomes***

- (a) The AEG agreed that the effect of the decision on SDRs earlier in the meeting needs to be taken into account in making a decision. The AEG agreed that this category should be retained in the short term and that the possibility of splitting it should be considered during consultations with financial statisticians on the classification of financial assets.
- (b) The AEG agreed.
- (c) The AEG agreed.
- (d) The AEG agreed that investment fund shares/units should be separately identified as “Investment fund shares” under the heading “Equity and investment funds”; the sub-categories will be as follows:

Equity and investment fund shares

Equity

Quoted shares  
Unquoted shares  
Other equity

Investment fund shares.

- (e) The AEG agreed these should be supplementary items. Money market funds might be a standard item.
- (f) The AEG agreed on the split between options and forwards (and employee stock options). A split by risk categories would be too detailed for most countries and should be supplementary. There is unfinished business here; another look at the breakdown of financial derivatives will be needed when the issues coming from leases and licences are resolved.
- (g) The AEG agreed.
- (h), (i) The AEG agreed to include the sort of information suggested. The Editor will consider the exact format of this sort of information throughout the text.

569. The proposed classification of financial instruments is the following:

***Financial assets and liabilities***

*Monetary gold and SDRs*

*Currency and deposits*

*Currency*

*Transferable deposits*

*Other deposits*

*Debt securities*

*Short-term*

*Long-term*

*Loans*

*Short-term*

*Long-term*

*Equity and investment fund shares*

*Equity*

*Quoted shares*

*Unquoted shares*

*Other equity*

*Investment fund shares*

*Insurance technical provisions and provisions for calls under standardised guarantees*

*Insurance technical provisions*

*Net equity of households in life insurance provisions and pension funds*

*Provisions for unearned premiums and for claims outstanding*

*Provisions for calls under standardised guarantees*

*Financial derivatives and employee stock options*

*Financial derivatives*

*Options*

*Forwards*  
*Employee stock options*  
*Other accounts receivable/payable*  
*Trade credit and advances*  
*Other accounts receivable/payable*

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## **Classification and terminology of financial corporations in the updated SNA**

### **Issue C30; Paper SNA/M1.06/24; for decision**

#### **Description of the issue**

*Proposal for sub-sectoring the financial corporations sector.*

#### **Presentation**

570. The paper for this session (document number SNA/M1.06/24; Issue C30) was written and presented by Reimund Mink. The session was chaired by Barbro Hexeberg (World Bank).

#### ***Background***

571. The main reasons for proposing changes in the classification and terminology of financial corporations in the updated SNA 93 are that more precise and detailed descriptions of financial corporations are set out in the 1995 ESA and in the 2000 GFSM. They can form the basis for improving the current presentation in the 1993 SNA. Recent legislative work and developments on the financial markets should also be taken into account for the SNA update. Policy and analytical needs in the context of monetary and financial stability analysis are also of some importance on how to define and classify financial corporations. Financial innovation in terms of also developing new institutions is seen as an ongoing process within a dynamic and efficient economy.

#### ***Progress achieved so far***

572. In the context of the SNA review, unincorporated entities and branches, SPEs, and non-resident SPVs established by general government have all been covered in the AEG paper on units. There are five types of institutions in the other financial intermediaries sub-sector:

- Investment funds (IFs);
- Financial vehicle corporations created to hold securitised assets (FVHs);
- Financial corporations engaged in lending (FCLs);
- Financial holding corporations (FHCs);
- Security and derivative dealers (SDDs).

573. The remainder are grouped as “other”.

574. Based on the 1995 ESA Manual on Government Deficit and Debt, FHCs securitising government assets would be treated as SPVs (privatisation and restructuring agencies).

### Proposed classification of financial corporations in the new SNA

<i>Financial corporation</i>	<i>Present SNA code</i>	<i>Proposed SNA code</i>
<b>Monetary financial intermediaries</b>	<b>S.121, S.122</b>	<b>S.121</b>
Central bank	S.121	S.1211
Commercial monetary financial intermediaries	S.122	S.1212
Of which: Money market funds	S.123	S.1212.1
<b>Investment funds</b>	<b>S.123*</b>	<b>S.122</b>
<b>Insurance corporations and pension funds</b>	<b>S.125</b>	<b>S.123</b>
Insurance corporations		S.1231
Pension funds		S.1232
<b>Miscellaneous financial intermediaries</b>	<b>S.123*</b>	<b>S.124</b>
<b>Financial auxiliaries</b>	<b>S.124</b>	<b>S.125</b>

575. The proposed classification of financial corporations in the updated SNA will treat monetary financial intermediaries as financial corporations provided they have at least some monetary liabilities (specifically liabilities that form part of broad money). Central banks are monetary financial intermediaries. “Deposit corporations” is proposed instead of the term “other depository corporations”. However, the term “deposit money corporations” may still be appropriate for institutions with liabilities included in narrow money, where countries want to make that distinction. Splitting out investment funds reflects their importance (about 75 per cent of total balance sheets value for other financial intermediaries in the euro area) and the ECB’s plans to collect harmonised statistical data on them by regulation (this aspect of the proposal may reflect a European bias). An alternative would be to have them as an optional category within other financial intermediaries.

576. “Investment funds” is wider than mutual funds, since it includes closed-end investment companies which issue equity. Cash or money market funds are part of Other depository corporations. Within investment funds there may be interest in separate data for funds specialising in equities, bonds, real estate, and mixed funds (based on the OECD request on financial and non-financial assets of households and institutional investors) and perhaps for hedge funds. Listing these (and perhaps other) types of institutions as separate sub-categories would risk overloading it.

### ***Proposed definition and classification of investment funds in the updated SNA***

577. It is proposed to use the ESA definition of investment funds which is as follows:

Investment funds are collective investment undertakings investing in financial and/or non-financial assets with the sole objective of investing capital raised from the public by issuing shares or units. Some funds may be open to certain investors only. Investment funds include undertakings whose shares/units are repurchased at the request of the holders, or redeemed directly or indirectly out of the undertaking’s assets, and undertakings with a fixed share capital, where investors entering or leaving the fund must buy or sell existing shares. Investment funds may be constituted: (i)

under the law of contract (as common funds managed by management companies), or (ii) under trust law (as unit trusts), or (iii) under a statute (as investment companies), or (iv) otherwise with similar effect.

578. Pension funds are not included in the category “investment funds”. The category may also exclude cash or money market funds whose shares/units may form part of broad money and which may be classified in the monetary financial intermediaries sub-sector.

579. No further breakdown is suggested for the remaining corporations, which are part of other financial intermediaries. For these corporations, “miscellaneous financial intermediaries” may be a slightly better term than “other financial intermediaries”. Some of these categories comprise a mixture of institutions which some countries may wish to identify. Miscellaneous financial intermediaries include (to name only a few types):

- financial vehicle corporations set up to hold securitised assets (SPV);
- financial holding corporations (see also AEG paper on units);
- security and derivative dealers;
- financial corporations engaged in lending (financial leasing, factoring, mortgage lending, mutual guarantee, consumer lending and other type of lending).

580. These and other miscellaneous financial intermediaries may be of considerable importance in some countries, and of much interest for policy analysis, but may not exist, or be important, everywhere

581. It is further proposed to describe the following terms in “boxes” in the updated SNA:

- financial corporations and financial intermediation;
- monetary financial intermediaries;
- investment funds and (selected) miscellaneous financial intermediaries; and
- financial auxiliaries.

### ***Recommendations***

582. The main recommendations are to

- (a) Classify financial corporations into the five sub-sectors monetary financial intermediaries, investment funds, insurance corporations and pension funds<sup>10</sup>, miscellaneous financial intermediaries, and financial auxiliaries; and to
- (b) Present the terms financial corporations and financial intermediation, monetary financial intermediaries, investment funds, miscellaneous financial intermediaries, and financial auxiliaries in boxes in the new SNA.

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<sup>10</sup> In addition, splitting up pension funds and insurance corporations could enable a richer analysis of different types of collective investment schemes.

## Discussion

583. The following comments were made on the proposals:

- the updated SNA will not be looking at intermediation per se; rather it will be financial services, so the term “intermediaries” should be replaced by “corporations”;
- real estate investment units need to be included in the same category as investment funds because units involved in various aspects of real estate (financing versus management) would prefer to show them in the financial sector (practical problems of this proposal were acknowledged, but a split could be based on shares of activity);
- real estate investment funds should be included as part of other financial investment funds;
- money-market funds should be included in the investment funds category; and
- should include real estate investment funds as part of financial corporations

584. The presenter said he was not sure about giving up the distinction between intermediaries and auxiliaries. He also explained that having money-market funds in the financial intermediaries sector was because of the nature of their liabilities; if we shift them we should show them separately in a subcategory. The AEG agreed.

585. The Editor pointed out that it is confusing to have the same word describing the instrument and the controlling institution (e.g. “pension funds”). Also, the proposal presented has used a separate set of codes that overlap the old ones. The codes need to be changed to make them unique between the current and updated versions of the SNA. It is premature to propose codes at this stage and perhaps the ISWGNA should look at it once the structure of the classification has been finalised.

586. While there was some sympathy for this view, one participant pointed out that “Investment funds corporations” sounds clumsy. The Editor agreed but said the point still stands and she is open to suggestions for an alternative.

587. The Project Manager pointed out that “Boxes” are to draw attention to a particular set of information and the Editor should have discretion as to options in this regard.

588. The presenter pointed out that the definition of investment funds will be covered as part of the consultation process.

## Summary conclusion

### *Outcomes*

589. The AEG agreed to the following changes to the proposals presented in the paper:

- Money-market funds should be shifted from “Monetary financial [institutions]” into the “Investment funds” category and shown explicitly.
- Using the same term to describe an instrument and the controlling institution (e.g. “Pension funds”) is confusing. The AEG considered that a term like “Pension

fund corporations” is clumsy and suggestions for alternative descriptions should be sent to the Editor.

- The specific codes used should be changed in the updated SNA to avoid confusion between the current System and the updated one (e.g. the 1993 SNA code of S.121 refers to the “Central Bank” while, in this paper S.121 is proposed for a higher level item “Monetary financial institutions”). The AEG agreed that the updated system should use a new set of codes, at the discretion of the ISWGNA.

590. The AEG agreed that the Editor should look at possible alternatives to make a distinction between the terminology of “Miscellaneous financial institutions” and “Financial auxiliaries”.

591. The definition of “Investment funds” will be considered as part of the consultations mentioned.

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## **Drafting and review phase of the update, including outreach**

### **Presentation**

592. There was no paper for this session. Carol Carson, Project Manager, gave a presentation setting out the key points associated with the drafting and review phase of the SNA update. The session was chaired by Barbro Hexeberg (World Bank).

### ***Introduction***

593. The plan is designed to deliver on the Statistical Commission (UNSC) schedule and in the spirit of its mandate to the ISWGNA. The key features have been agreed among the ISWGNA and more specifics are being pinned down at ISWGNA meetings held in conjunction with the AEG meeting in Frankfurt.

### ***Basic structure of SNA Rev. 1***

594. The basic structure will not be changed; new material will be introduced throughout existing chapters and major new topics will have stand-alone chapters, introduced so as to limit disruption. Opportunities to shorten existing text will be exploited but, so far, it has not been easy to identify any. A record will be made of changes to the existing text.

### ***Roles: Editor and reviewers***

595. The Editor will be responsible for new text and will draft most of it. For text contributed by others, the Editor will bring that text into harmony in style and substance, providing the authors with a record of changes made. A degree of latitude will be provided to edit the existing text.

596. The ISWGNA will provide a reviewer’s role and support the Editor by “eagle eye” review that will involve a substantive review of all chapters. The AEG will review all chapters which will possibly involve organizing AEG members into teams (to be discussed). Of course, chapters will be posted on the Project website for comment by countries.

### **Organization of drafting/review**

597. Most chapters will go through at least four review stages:

- (0) existing text or contributions as provided;
- (1) draft from Editor, followed by “eagle eye” review by ISWGNA;
- (2) draft from Editor ready for substantive, wide review and comment;
- (3) redraft from Editor, followed by “eagle eye” and substantive review by ISWGNA;
- (4) draft ready for UNSC.

598. The overall scheme will be to divide chapters into roughly two equal tranches and proceed through with one and then the other. The first tranche will include those chapters that are the “heart” of the SNA to permit a timely review and approval of the “heart”. The Editor will work on blocks of related chapters within a tranche and, when work on a block is completed, turn it over for review.

### **Intermediate products, dates**

599. The initial set of recommendations with updated descriptions of issues will be available in early 2006. Views on consistency, etc. will be sought from April-September 2006. Opportunities will be taken to discuss update issues during the Joint National Accounts Meeting in Geneva in April 2006 and at the IARIW SNA Update sessions in Finland in August.

600. A set of recommendations will be presented to the UNSC in late 2006. A draft of the “heart” of *Rev. 1* will be prepared for an AEG meeting in early 2007. A draft of the rest of *Rev. 1* for the AEG and for a wider meeting on implementation will be ready in late 2007. The final step will be a final draft of *the 1993 SNA, Rev. 1* being provided to the UNSC in late 2007.

### **Monitoring progress**

601. There will be three levels for monitoring progress, each with a different purpose. A public website will present a matrix showing summary chapter by issue, with cells changing color to show progress through stages (it will contain links to any draft chapters ready for review). The ISWGNA website will present a more detailed matrix. For the review stages, more traditional project management procedures will be used to track tasks and assignments. All three will be based on a database maintained by UNSD, with updates for the first two being fed by the Editor.

### **Risks and fallbacks**

602. The key risks are:

- the recommendations on specific issues unwind or do not coalesce;
- specific steps (e.g. eagle-eye review) do not achieve results on a timely basis;
- there is a budget shortfall.

603. The fall back will be a strategic adjustment, depending on the problem.



604. The key next steps will be to package the recommendations and focus on consistency. The issue x chapter matrix will be put in place as the basic organizing framework for the drafting and review phase, while holding firm about the end of the issue-oriented phase, and commence formalizing the research agenda.

## **Discussion**

605. There was a brief discussion. One participant said he would prefer to look at drafts etc on the basis of issues rather than by chapter. The Project Manager indicated that the way things are being set up will facilitate this to some extent, although it will probably have to be a chapter-by-chapter process in most cases because it would be increasing the chances of having to redo work if an issue-by-issue approach were adopted. A suggestion was made that, since the topics after chapter 14 have not been set down for review, they could be put into a handbook or perhaps cross-referenced to the current SNA manual. The Editor said she will need to look at what could be deleted. It is not possible to “freeze” chapters 14 on because some issues raised in earlier chapters impact on these (e.g. BoP, input-output, labour market).

606. The Statistics Canada participant pointed out that language will be important and style will help for the translation into the official languages. The Project manager acknowledged that assistance from statistical offices will be very important. Any opportunities for regional meetings to be sponsored by a statistics office would be appreciated. It will also be important for statistical offices to consider plans for implementing the updated SNA.

607. Training will be required because a lot of statistical offices do not have sufficient expertise to implement the SNA and some have still not implemented the 1993 SNA yet, or at least have not done so fully. The UNECE participant said that the ECE has funds for work on the underground economy in Central Asia. Several workshops are planned and the SNA update could be included on the agenda in these workshops.

608. In response to a comment that it will be necessary to tightly control the links between the SNA and BPM drafts, the Editor said that one glossary will be produced for all the manuals (SNA, BPM, GFSM and Money and Banking). A list will be produced of the discrepancies between GFS (which is not being updated) and the other (updated) manuals.

## **Summary conclusion**

### ***Outcomes***

609. The AEG noted the information provided in the Project Manager’s presentation.

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## Units in the 1993 SNA

### Issues 25a, 25b, 25d; Paper SNA/M1.06/11; for decision

#### Description of the issues

##### *Ancillary units*

*The 1993 SNA specifies that units conducting only a specified list of activities designated as “ancillary” should not be treated as separate units but their costs should be consolidated with the units they serve. This means that when accounts for a region are compiled, head offices and other ancillary units located there are excluded if the units they serve are located outside the region. This results in a difference between ancillary units located abroad, which are treated as separate units, and those that are resident but distant from their related enterprises. Should the principle of not treating ancillary units as separate units be changed and what are the consequences throughout the accounts?*

##### *Holding companies, special purpose entities, trusts*

*As part of the innovation in financial markets and asset management over the last decade, several forms of separate entities have come into existence that only hold assets or liabilities but do not engage in production. Such entities are separate new or existing legal structures assigned for specific purposes such as specialized portfolio management of assets and debts, restructuring agencies, special purpose entities, shell companies, limited liability partnerships or trusts. Should these entities be treated as ancillary and merged with their related enterprises, or should they be treated as separate units? If they are separate units, to which sector should they be allocated?*

##### *Treatment of multi-territory enterprises*

*The 1993 SNA follows the **Balance of Payments Manual** in allowing for a single enterprise run as a seamless entity with substantial operations in two or more economic territories to be regarded as having a centre of economic interest in each of the countries where it is recognized by the tax and licensing authorities, but only when the activity is operating mobile equipment such as ships, aircraft and railways. In these cases, the possibility is for all the enterprise’s transactions to be allocated to the countries of registry in proportion to the financial capital that the countries have contributed or their share of equity in the enterprise. Should this treatment be extended to other activities, for example hydro-electric schemes on border rivers and pipelines? Should reference be made to joint sovereignty zones and zones of joint jurisdiction?*

##### *Non-resident unincorporated units*

*The **Balance of Payments Manual (BPM)** indicates that establishments of enterprises located in a country different from the country of residence of the parent should be treated as notional units, resident in the country where located under certain conditions. The SNA discusses non-resident unincorporated enterprises rather than establishments. Should the SNA and **BPM** be more closely aligned?*

### *Non-resident SPEs controlled by government*

*Is special treatment required for non-resident units established abroad by government for fiscal purposes?*

#### **Presentation**

610. The paper for this session (document number SNA/M1.06/11; Issues 25a, 25b, 25d) was written by the UN Statistics Division and presented by Ivo Havinga. The session was chaired by Charles Aspden (OECD).

#### **Introduction**

611. This presentation reviewed the treatment of:

- ancillary activities;
- ancillary corporations;
- holding companies;
- special purpose entities (SPEs);
- trust funds and investment funds;
- restructuring agencies; and
- output of ancillary units.

612. The 1993 SNA treats ancillary activities (i.e. “not for own sake but in support of the enterprise being served” – see paragraph 5.13 of the 1993 SNA) and ancillary corporations as an integral part of the establishments or enterprises that they serve, for the following reasons:

- production processes can be recorded according to whether producers undertake these activities themselves or outsource them;
- structural differences are recorded as specialization and integration of production processes, changes over time;
- creation of artificial units for such activities would suggest structural changes in the economy that did not take place in reality.

613. However, there are some disadvantages with the the 1993 SNA treatment and there are several reasons for the changes proposed. All economic activities should be shown in the accounts, whether principal, secondary or ancillary, to show the structure of GDP by economic activity explicitly. Also, the proposed changes would enable regional GDP to be recorded correctly when the ancillary activity and the unit(s) it serves are in different regional economies.

614. The thrust of the recommendations on specific types of units follows from the basic recommendations, namely:

- units undertaking ancillary activities should be recognised as establishments only if the unit meets the criteria to classify it as an establishment; and
- . ancillary corporations should be recognised as institutional units only if the unit meets the criteria to classify it as an institutional unit.

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## **Presentation - Ancillary activities**

615. There are two types of units relevant to this discussion – enterprises and establishments. The key features of an enterprise are that it can engage in principal and secondary activities with outputs delivered to other institutional units while those for an establishment are that it has a single location and principal activity.

616. Ancillary activities are supporting activities providing services for intermediate consumption by establishments within the same enterprise.

617. There are several advantages in treating the units associated with ancillary activities as production units:

- it is easier to calculate the contribution to and structural decomposition of GDP by economic activities;
- it is easier to estimate the input-output structure of production;
- it is easier to estimate regional GDP when the establishment(s) the ancillary unit serves is located in a different region(s) within the country;
- it is easier to record BoP transactions in those cases when the ancillary unit(s) is non-resident.

618. The two alternatives available are:

- to abandon the concept of ancillary activities altogether and to always treat them as secondary production;
- to recognize units undertaking ancillary activities as separate establishments only when they satisfy the conditions to be identified as establishments.

## ***Recommendations***

- (a) Units undertaking ancillary activities should be recognised as separate establishments (ancillary units) when they satisfy the conditions to be an establishment and should be classified according to their own economic activity.
- (b) Output of an ancillary unit should be valued by sum of costs plus a proportional allocation of the operating surplus of the establishments it serves. Operating surplus of establishments it serves may be allocated to the ancillary unit in proportion to indicators such as their output, value added or employment.
- (c) Output of ancillary units should be allocated as intermediate consumption to establishments they serve in proportion to indicators such as their output, value added, or employment of the establishments using their services.

## **Discussion - Ancillary activities**

619. The AEG broadly supported recommendations (a), (b) and (c). However, some concerns were raised about the proposals concerning the allocation of operating surplus. Several speakers

pointed out the need for flexibility in the ways suggested for allocating operating surplus because different countries will face different situations, particularly with their requirements for producing regional accounts.

620. The USA has practical experience in using the approaches underlying the recommendations relating to ancillary activities, using them in the NAICS classification, and has found they lead to improved estimates, particularly of regional economies.

621. Several AEG members expressed concerns about the potential implications of recommendation (a), particularly with respect to the practical issues. An establishment is an “observable unit” for which data can be collected and the nature of production processes is that they need ancillary activities. Therefore, some degree of flexibility is required in applying recommendation (a) in practice.

622. In response to a question as to the consistency between the recommendations and the rules in the new ISIC, the UNSD participant responded that the recommendations were based around the idea of identifying units in a way that would enable them to be classified to an industry, no matter what industrial classification is being used (e.g. whether it is ISIC or NAICS or NACE).

623. Other points made during the discussion were:

- a return on capital should be imputed for ancillary activities, provided the circumstances are appropriate;
- only relevant costs should be attributed to ancillaries;
- the 1993 SNA is a compromise between concepts and practice and ancillary units should be recognised as establishments;
- head offices should have some of the operating surplus from the enterprises they serve allocated to their operations;
- a debate is needed on the practicalities and implications of proportional allocation;
- some of the operating surplus will not be able to be attributed to establishments (e.g. within multi-nationals).

624. The Chair summed up that there is broad agreement with these three recommendations but the wording of the first recommendation needs refining. Also there is a need for more flexibility in allocating operating surplus than would be the case if the indicators shown were the only ones to be used. A proposal on potential additional indicators should be developed for the AEG’s consideration.

## **Summary conclusion – Ancillary activities**

### ***Outcomes***

- (a) The AEG agreed with this recommendation subject to some of the wording being refined, particularly in relation to the units needing to be observable for statistical purposes
- (b) The AEG agreed that in deriving a value for output, costs should include the cost of the capital used by the unit. Reservations were expressed with the idea of

allocating operating surplus from the establishments it serves and the AEG agreed that a degree of flexibility should be permitted in the allocation.

- (c) The AEG agreed.

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## **Presentation - Ancillary corporations**

625. The treatment of ancillary corporations is related to that of ancillary activities. The 1968 SNA states: “some individual legal entities may not be viable economic agents; they may have been established for convenience only.” The incidence of such “convenience” legal entities expanded significantly in the 1980s and has now taken on a global dimension. They were initially created with the view of using them to record outsourced ancillary activities. However, new arrangements for production and financing have developed, with the result that ancillary corporations exist which have no significant production or employment.

626. Ancillary corporations are legal entities setup for specific purposes such as managing the operations of companies and portfolios of assets and liabilities. They cover activities such as head offices, restructuring agencies, special purpose entities, shell companies, or limited liability partnerships or trusts. Ancillary corporations are not institutional units in the 1993 SNA; rather they are treated as an integral part of the parent company. In practice, their accounts are generally consolidated with those of the parent to form a set of accounts for a single institutional unit. It is important to note that no output is generated by the ancillary corporations. They are regarded as artificial units created to avoid taxes, to minimize liabilities in the event of bankruptcy, or to secure other technical advantages under the tax or corporation legislation in force in a particular country.

627. In the light of the proposed change in the treatment of ancillary activities, the existing principles on ancillary corporations should be reviewed. The 1993 SNA recognizes subsidiary corporations as institutional units even though they may be wholly owned and subject to control by another company, and also holding companies providing services to their subsidiaries.

628. The recommendation regarding ancillary activities is:

### ***Recommendation***

- (d) Ancillary corporations should be recognized as institutional units and should be classified in their own right when they satisfy the criteria for qualifying as institutional units.

## **Discussion - Ancillary corporations**

629. The discussion opened with several participants expressing concern about recommendation (d) because of potential clashes with accounting standards and problems in identifying such units, particularly where an enterprise group is concerned. Within complex business structures, it is not always possible to determine whether a unit provides services only to other units of the same group. A legal unit set up to provide services to a parent company can be considered as an enterprise in some circumstances and these need to be set out in the SNA. On the other hand, the 1993 SNA does not treat as an enterprise a unit that does not have any output, staff or separate accounting records. The 1993 SNA has a carefully-considered compromise between these issues and it is important to avoid creating the problem of artificial, legal labelling overriding the

economic reality behind business structures. There is no real need to change the definition in the present SNA.

630. The enterprise group has become a key structure now, but this causes problems because of the way enterprise groups spread across country borders. Statistically, it is important to not split up an enterprise group but this leads to practical problems. In particular, units from an enterprise group should be recognised as separate institutional units if they are in another country, for consistency with the BoP. In theory similar principles should apply for regional accounts. Domestically, it probably does not make much difference for sectoral splits other than for the financial/non-financial split, which can be significant. For example, much of the profits of car manufacturers comes from financial activities, particularly providing loans to consumers to purchase cars. Exceptional cases will have to be treated separately which implies having to identify different types of activities within an enterprise group, so it is essential to define units that can provide detailed data.

631. One participant commented that the AEG had already decided that FISIM should not be allocated to non-financial corporations and queried whether recommendation (d) is consistent with this decision. The debate then moved on to distinguishing the differences between an ancillary activity and a subsidiary activity. The AEG agreed that a motor vehicle manufacturer who also finances car leasing/purchase is engaging in two separate types of activities, with the financing part being the function of a separate enterprise which should be allocated to the financial sector if its activities are significant. One of the criteria that could be useful in classifying such units is whether or not they are subject to banking laws. Once a unit is providing outward-oriented services then it is not an ancillary unit. Artificial units created for legal purposes normally should not be recognised as separate institutional units. The AEG concluded that such activities are not ancillary activities and so are outside the scope of this recommendation.

632. The Chair summed up that the AEG agreed the scope of ancillary corporations is limited. Units providing finances to purchasers should generally be treated as a separate unit, classified to the financial sector in its own right. Non-residential ancillary corporations should be separately identified.

## **Summary conclusion - Ancillary corporations**

### ***Outcomes***

- (d) The AEG noted that the scope of ancillary activities was limited and that lending to customers, for example, though widespread is not an ancillary activity. Units undertaking these activities are financial institutions. For purely ancillary corporations, the AEG agreed that an institutional unit needs to be separately identified when it is non-resident.

The AEG noted the original rationale for the treatment of ancillary corporations as integral to the units they serve was when they represent artificial units created for legal or tax reasons. In these circumstances, the 1993 SNA treatment should stand.

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## **Presentation - Holding companies**

633. The SNA defines holding companies those companies whose main activity is to control and direct subsidiary companies (1993 SNA paragraph 4.37). The 1993 SNA treats holding companies as separate institutional units but “looks through” them to the operations of their subsidiaries when determining their sector classification as financial or non-financial. However the main activity of a holding company is predominantly financial intermediation.

### ***Recommendation***

- (e) Parent companies without significant production recognized as holding companies should be classified as “other financial intermediaries”.

## **Discussion - Holding companies**

634. The AEG strongly supported recommendation (e). The discussion mainly covered classification issues with the key points being as follows:

- “orphan” holding companies should be excluded (they are often owned by government and so have different characteristics from private holding companies);
- in ISIC rev 4, holding companies are classified as financial intermediaries because they incur liabilities to obtain assets;
- holding companies should be referred to as “financial holding companies”;
- parent companies should be classified according to their main activities.

635. The discussion moved on to whether or not there should be a separate sub-category under “financial intermediaries” to cover holding companies and whether they should be classified based on their function or on the basis of the main function of the enterprise group. One participant pointed out that there is a degree of ambiguity about what holding companies do so would it not make sense to have a separate category for them. While they raise funds, they do so for internal purposes rather than for lending outside.

636. The Chair summed up by saying there was strong support for recommendation (e) but there is still some vagueness about what sort of financial institution holding companies are and, therefore, how they should be classified.

## **Summary conclusion - Holding companies**

### ***Outcome***

- (e) The AEG agreed but noted this category would be described as “miscellaneous financial institutions”. The ambiguity of treating a publicly controlled holding company without significant production as a separate institutional unit was noted.

NOTE: Jacques Magniez agreed to look at the implications of this terminology for the French translation.



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## **Presentation - Special purpose entities (SPEs)**

637. SPEs are set up to carry out activities or series of transactions directly related to the specific purpose for which they are formed. They commonly engage in activities such as providing asset management, corporate treasury services, trusts, public-private partnerships and securitization programs. Some key characteristics of holding companies are that they have little or no physical presence or employment, and many are set up in economies other than that of the parent company.

### ***Recommendations - resident SPEs***

638. Recommendations regarding resident SPEs are:

- (f) SPEs should be treated as institutional units when they satisfy the criteria for qualifying as institutional units and their output should be valued at cost if no market valuation method is available.
- (g) There is no need for a separate classification of SPEs as they undertake a range of economic activities. The activities should be examined on a case by case basis and classified by existing industrial and institutional sector classifications.
- (h) The term “securitization vehicles” should be used for institutional units that undertake securitization of assets only and such institutional units should be classified as “other financial intermediaries”.

639. Special considerations apply to non-resident SPEs created by government to undertake quasi-fiscal activities. It is recommended that all transactions between a government unit and an SPE be recorded. In some instances it will be necessary to impute transactions to reflect these activities appropriately in the government accounts so that the fiscal activities of general government are captured appropriately.

### ***Recommendations - non-resident SPEs***

640. Recommendations regarding non-resident SPEs are:

- (i) All flows and stock positions between the general government and the non-resident SPE should be recorded in the general government and SPE accounts when they occur.
- (j) If securitization is based on a future stream of general government revenue it is not the sale of an asset, but a borrowing transaction of the government. The economic substance of this transaction is best accounted for by imputing general government borrowing from the non-resident SPE for the same value and at the same time that the SPE incurs a liability to the foreign creditor.
- (k) When government creates non-resident entities, such as SPEs, to undertake government borrowing and/or incurring government outlays abroad with no economic flows between the government and the SPEs related to these fiscal

activities, transactions should be imputed in the accounts of both the government and the non-resident entity to reflect the fiscal activities of the government.

## Discussion - Special purpose entities (SPEs)

641. The discussion started with a proposal to strengthen recommendation (f). The AEG agreed to reword the first part of this recommendation it as:

“**Resident** SPEs should **not** be treated as institutional units **unless** ~~when~~ they satisfy the criteria for qualifying as institutional units; .....

642. There was some discussion about the need to specifically refer to government SPEs but the AEG concluded that excluding an SPE created by government should follow logically from the changes agreed to for recommendation (f) (see previous paragraph).

643. The AEG agreed with recommendations (g) and (h). The only discussion related to recommendation (h) and concerned the nature of the borrowing of SPVs. The AEG concluded that securing an asset against future revenue constitutes borrowing by the owner of the SPV and this is sufficiently common that such SPVs should be termed “securitization vehicles” and classified within “miscellaneous financial institutions”.

644. The final three recommendations on SPEs ((i), (j) and (k)) were discussed together.

645. The discussion opened with a comment that such long recommendations show the need to recognise government operations abroad, which is not necessarily a requirement of the SNA. Rather it should be covered in detail in the updated BPM. Some others agreed, with one pointing out that there is a danger of finishing up with a patchwork principle of “operations on behalf of government”. Then their operations have to be input to government. Another participant suggested the amount of detail might appear to be excessive but the recommendations are an elaboration of general principles rather than setting out principles in their own right.

646. Other points raised during the discussion on recommendations (i), (j) and (k) were:

- should add in “observed” before “economic flows” in recommendation (k), (but there was no support for this suggestion);
- recommendation (j) should not be government specific, the updated SNA should make it clear that we are doing something special with SPEs and we would not want to reroute private SPE (or SPV) transactions;
- the treatment of government SPEs being discussed is a clear exception to the general rule and this should be explicitly stated (another participant pointed out that such exceptions are covered in Chapter 3 of the 1993 SNA);
- non-government SPEs should be treated in the same way as is being recommended for government SPEs;
- it is not necessary to impute transactions back to the domestic economy for the private sector;
- if government raises money abroad and purchases goods (e.g. military equipment) which remain abroad then we would need to impute government transactions (not reroute them);

- a critical element in identifying how to handle these transactions is to determine if a private company has a liability or not;
- we need to be able to work out the “true and actual” debt of the units, no matter whether they are government or private;
- such transactions need to be recorded from an economic point of view and this means the government and private sectors have to have different criteria applied to them.

647. The Chair summed up that the AEG agreed with the aim of the recommendations but it is important to separate the statement of a principle and the application of that principle.

## Summary conclusion - Special purpose entities (SPEs)

### Outcomes

- (f) The AEG agreed with the broad thrust of the recommendation. However, the AEG felt it would be better to express the recommendation as follows:
- Resident** SPEs should **not** be treated as institutional units **unless when** they satisfy the criteria for qualifying as institutional units; their output should be valued at cost if no market valuation method is available.
- (g) The AEG agreed.
- (h) The AEG agreed that securing an asset against future revenue constituted borrowing by the owner of the SPV. This is a sufficiently common form of SPV that they should be termed securitization vehicles and classified within miscellaneous financial institutions.
- (i) The AEG agreed.
- (j) The AEG agreed with the aim of this recommendation. However, the AEG felt it would be useful to separate the statement of the principle and the application of that principle. Although this principle has general validity it will be applied only for non-resident SPEs created by government.
- (k) The AEG agreed with the aim of this recommendation. However, the AEG felt it would be useful to separate the statement of the principle and the application of that principle.

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## Presentation - Trust funds and investment funds

648. In light of the recommendations about ancillary units and corporations, the Expert Group Meeting on Industrial Statistics made the following recommendations for the treatments of trust funds and investment funds:

## ***Recommendation***

- (1) Trust funds and investment funds that are created as legal entities, even without employment, should be treated as institutional units. Their output should be valued at cost if no market valuation of their output is available. These units should be classified, separately from securitization vehicles, in the industry classification and as other financial intermediaries in the institutional sector classification.

## **Discussion - Trust funds and investment funds**

649. The AEG agreed with recommendation (1) because it was consistent with an earlier discussion.

## **Summary conclusion - Trust funds and investment funds**

### ***Outcome***

- (1) The AEG agreed.
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## **Presentation - Restructuring agencies**

650. Restructuring can be divided into four types of economic activities:

- reviewing the rehabilitation plans and overseeing the liquidation or reorganization process of corporations (financial advisory services);
- reviewing the rehabilitation plans and overseeing the restructuring of non-financial production processes of corporations (management consultancy services);
- controlling and directing the rehabilitation plans and overseeing the liquidation or reorganization process of corporations by acquiring the assets and liabilities of the corporations (parent company services);
- securing financial stability through transactions in financial assets by acquiring, managing, and disposing of impaired assets of financial corporations (asset management services on own-account).

651. Restructuring agencies may serve public or private sector objectives. Restructuring agencies for public purposes are concerned with the restructuring of public sector enterprises, such as privatizations or financial rescue operations in order to prevent a collapse of the financial system. Such operations are fiscal activities of government rather than financial intermediation and should be reflected in statistics accordingly.

652. The two types of restructuring being considered here are:

- restructuring the public sector, which entails selling off corporations or subsidiaries, or selling off non-financial assets, or reorganizing establishments and changes in their management;

- defeasance of impaired assets, which involves managing impaired assets, their sale and the financing of the process.

653. Guidance is needed on how to establish whether the unit is publicly controlled and then whether it falls into the government sector directly or if it is to be treated as a publicly-controlled financial corporation. Government's involvement in the process could range from merely initiating a restructuring process to fully bearing all the risks. To be classified as an institutional unit, a restructuring agency must be entitled to own assets, incur liabilities and engage in economic transactions with other units. It must also have a complete set of accounts. If it is established specifically to implement government policy then there is clear evidence of government control. Agencies operating on a market basis should be treated as public corporations. Those operating on a non-market basis should be treated as units within general government.

654. A restructuring agency would be treated as a general government unit if:

- the risk is assumed by government;
- the agency operates at the behest of government;
- the agency has a pre-determined set of fiscal policy objectives.

655. A restructuring agency may have some common characteristics with financial intermediation, but one defining characteristic is that it is not putting itself at risk. If there is a mismatch between the assets and liabilities then government will have a commitment to assume the ultimate liability.

656. In some circumstances, transactions directly with government are rerouted. The criteria for rerouting are:

- the economic substance of the transaction determines the value and timing of recording;
- it is possible that a single entity controlled by government may undertake the restructuring of a number of enterprises which would then appear as subsidiaries of the entity; and
- transfers of funds or assets from one of these subsidiaries to another should be recorded as transactions between the government and the subsidiary directly and not routed via the entity.

### ***Recommendations***

657. Recommendations regarding restructuring agencies are:

- (m) If the restructuring agency acts only to implement pre-specified government policy and bears no risk in the transformation of financial instruments connected with the restructuring, the agency is regarded as a non-market unit and part of the general government sector.
- (n) If the restructuring agency puts itself at risk in the transformation of the assets and liabilities of the units in difficulty and if it can determine the costs it can charge for the restructuring activity, it is treated as a financial corporation. Whether it is

publicly controlled or purely private financial corporation is determined using the usual criteria.

- (o) When government uses a restructuring unit to channel funds to a unit in financial difficulties and the restructuring unit derives its main resources from activities other than acting as an agent of government, these funds should be shown as payable and receivable by the government and unit concerned directly and not routed via the restructuring agency.

## **Discussion - Restructuring agencies**

658. One participant complained that there was too much detail set out in recommendations (m), (n) and (o). However, it was pointed out by some other participants that this text has been tied in with that in the GFSM and so paraphrasing it could lead to an inconsistency between the updated SNA and the GFSM.

659. The AEG agreed with the three recommendations, as written.

## **Summary conclusion - Restructuring agencies**

### ***Outcomes***

- (m) The AEG agreed.
- (n) The AEG agreed, but with the qualification that it needs to be made clear that a public sector unit cannot put itself “at risk” in the same sense that a private sector unit can.
- (o) The AEG agreed.

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## **Presentation - Output of ancillary units**

### ***Market or non-market production?***

660. The output of NPIs serving businesses is treated as market output. Ancillary units that serve businesses could be treated similarly. In such a case, the production of an ancillary unit would be regarded as market output if the unit is recognised as an institutional unit and if it is classified as a corporation. When such a unit is classified in the general government sector, its production would be regarded as non-market output.

### ***Recommendation***

661. The recommendation regarding the output of ancillary units is:

- (p) Output of ancillary units should be recorded as market output when it is classified as part of the financial or non-financial corporations sector and non-market output when it is classified in the general government sector.

## Discussion

### *Output of ancillary units*

662. There was little discussion on recommendation (p). In reply to a question on why the criterion of selling at “economically significant prices” is not used in the recommendation, the UNSD participant said that it would cause confusion in cases where ancillary output is not being sold at market prices.

## Summary conclusion - Output of ancillary units

### *Outcomes*

(p) The AEG agreed.

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## Public-private partnerships

### Issue 24; Paper SNA/M1.06/10; for decision

#### Description of the issue

*Public-Private Partnerships (PPPs) are complex legal arrangements designed to share the control and the risks and rewards of a set of fixed assets between a private enterprise and a public unit, normally a unit of the general government sector. In most PPPs, the assets are legally owned and used by the private enterprise to produce a specified category of services for several years, and then the government gains operational control and legal ownership of the assets, often without payment. The 1993 SNA treatment of operating and financial leases are not sufficient to derive an appropriate accounting treatment for PPPs and there are no other guidelines given about PPPs. There are two major issues to be resolved. The first is to decide whether the private enterprise or the government is the economic owner of the fixed assets. The second is to decide the appropriate recording for transactions between the private enterprise and the public unit during the period covered by the PPP arrangement.*

#### Presentation

663. The paper for this session (document number SNA/M1.06/10; Issue 24) was written by Brett Kaufmann, Robin Lynch, Christoph Maier, and John Pitzer and presented by Robin Lynch. The session was chaired by Ivo Havinga (UNSD).

### **Background**

664. A public-private partnership (PPP) arises when government and a private corporation combine to provide a public service through the creation and use of new assets for a set period. PPPs can bring private sector best practice to government service delivery to achieve best value for money. The financial arrangements allow raising money in the market free from fiscal policy and public finance constraints.

665. If the government requires a new prison, the usual arrangements would be that the government borrows money, pays to get a prison built and then runs the prison service. Under a

PPP arrangement, a private firm borrows money and builds the prison, and the government pays the firm to run the prison service on behalf of the government and then hands over ownership of the prison after, say, 20 years.

### ***Accounting issues***

666. There are several accounting issues involved

- Who is the economic owner of the asset?
- How do we score the payments from government to the private operator?
- How do we record the transfer of the asset back to government at the end of the agreement?
- Who is the economic owner of the asset?
- Who bears the risks?
- Who reaps the rewards?
- Who is in control?

### ***Economic ownership issues***

667. It is clear that the private unit is the legal owner and user of the assets even though the government unit prescribes the use of the asset, and takes it over at the end. We need to identify the best criteria to apply to determine who is the economic owner of the assets and whether the lease is a financial lease or an operating lease.

668. In practice, we would determine the economic owner using the same principles as for any other asset. The outcome depends on the final agreed treatment of the leases and the definition of an asset. The Canberra II Group did not come to a conclusion on a single best way to determine economic ownership. There was general agreement about risks and control being very important but there was no agreement on a single set of criteria. Given we have decided who owns the asset then how should we score the payments from government to the private unit over the term of the partnership?

669. The Interpretations Committee (IFRIC) of the International Accounting Standards Board is developing financial accounting standards for PPPs. The complexity of PPPs and the dependence of national accountants on government financial accounting data make it highly desirable to have a common treatment of PPPs in the SNA and in the accounting standards. IFRIC has not reached a decision about either major PPP problem. The disagreement is sufficiently sharp that the project may be referred to the parent International Accounting Standards Board. Statistical offices may not have the resources to evaluate each PPP.

### ***Conclusion***

670. Detailed rules for the transactions resulting from a PPP are not possible. National accountants will have to recognize their dependence on financial accountants, but still ensure that SNA principles are followed. The IASB/IFRIC standards should be evaluated for consistency with SNA principles, taking into consideration all of the facts and circumstances. The treatment used should bring out the underlying economic relationships.



## Questions

- (a) Are PPPs sufficiently important to include a description of them in the revised SNA? Is the description included [in paper SNA/M1.06/10] acceptable?
- (b) Given that there is no consensus on how to decide which unit is the economic owner of the fixed assets associated with a PPP, is it sufficient to list several of the indicators that are likely to be important in making that decision? Is the list suggested here acceptable?
- (c) Given that there is no consensus on the accounting treatment to apply to certain events that are likely to occur with PPPs, is a broad description of these events sufficient?

## Discussion

671. The AEG acknowledged John Pitzer's work in setting out the issues so well. The Canberra II Group discussion was also an important step forward in setting out all the issues, even though no final agreement was achieved. In addition, Eurostat's decisions on PPPs have been a useful part of the process.

672. The AEG generally agreed with all the questions but there was a discussion about different aspects of PPPs with the criteria required to classify them correctly being a recurring theme.

673. Accountants acknowledge that PPPs exist but do not recommend guidelines for treating them. The paper leans towards risks as the main criterion in classifying PPPs rather than a more balanced view of risks and rewards. The debate is about looking at control and at rewards; the former gives a clearer view. In the updated SNA do we forecast what the accountants are likely to do and then change as required or do we produce text on the basis of the current situation even though it is clear it will change? One participant felt the abbreviation "PPPs" is confusing and it would be best to switch to another abbreviation. A suggestion was made that it may be better to call them "Private financing INitiatives" (PFIs) in the updated SNA but there was no agreement on this point.

674. The Eurostat participant said that Eurostat cannot wait several years for the accounting profession to make up its mind. The issues are being faced regularly and some guidelines are required now. Nothing would be better than saying PPPs exist and defining them but, in practice, we do not know what they are. The Canberra II Group considered the Eurostat decision tree and one problem was that identifying a PPP providing services to the public resulted in it being classified to the private sector, which is too rigid.

675. the 1993 SNA does not cover PPPs and so some guidance is definitely required in the updated SNA. It is clear that they are significant and so they should be included in the updated SNA. The criteria set out by the Canberra II Group are important not just here but also for determining the classification of other government assets. It will be necessary to look at PPPs on a case-by-case basis and apply a set of principles to determine their classification.

676. There is sufficient material to produce text for the updated SNA on the underlying principles and the main issues. It would be useful to build on the practical experience in the EU in this regard. In the Canberra II Group the Europeans tended to support Eurostat criteria while others favoured an approach based more on "indicators". There were several comments to the effect that

the updated SNA needs to keep things general and so should focus on general recommendations and principles; the criteria used by Eurostat can be more specific if need be for EU regulatory purposes.

677. The Editor said it is clear that we need something in SNA. The explanation would include something along the lines that it has not been possible to reach a conclusion because it is a live topic with standards still being developed. The SNA should include the European position, the alternative view, and set out the state of play with the international accounting standards.

678. Several AEG members (ABS, ONS, IMF) volunteered to continue to monitor developments in international accounting standards on this issue and to produce an annex for the updated SNA.

679. The Chair summed up that the AEG agreed with all three questions. It is clear that anything done on PPPs will still be work in progress. We will need a definitive list of criteria but it may be necessary to fall back to a case-by-case list to assist in making judgements. We need to flag the likelihood of the SNA needing to be revised fairly quickly, given the speed of developments in the area.

## **Summary conclusion**

### ***Questions***

- (a) Are PPPs sufficiently important to include a description of them in the revised SNA? Is the description included [in paper SNA/M1.06/10] acceptable?
- (b) Given that there is no consensus on how to decide which unit is the economic owner of the fixed assets associated with a PPP, is it sufficient to list several of the indicators that are likely to be important in making that decision? Is the list suggested here acceptable?
- (c) Given that there is no consensus on the accounting treatment to apply to certain events that are likely to occur with PPPs, is a broad description of these events sufficient?

### ***Outcomes***

680. The AEG acknowledged John Pitzer's contribution in advancing the work on this complex topic in the difficult situation of not having any firm international accounting standards to draw on.

- (a) The AEG agreed that a description is required and the one included in the paper is satisfactory.
- (b) The AEG agreed that a list of indicators would be useful. However, the AEG also agreed that it is necessary to examine specific arrangements on a case-by-case basis.
- (c) The AEG acknowledged that although a general description of the issues would be useful, this issue is very complex, with the development of this type of partnership spreading rapidly and with many different variations being introduced. It was therefore proposed that the material might appear in an annex to the updated SNA. It will be noted that the annex may need updating within a relatively short time of

the update being released. The ABS, ONS and IMF offered to draft text for an annex on this subject and to keep abreast of developments in international accounting standards.

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## **The general government and public sectors**

### **Issue C15; Paper SNA/M1.06/41; for information**

#### **Description of the issue**

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

#### **Presentation**

681. The paper for this session (document number SNA/M1.06/41; Issue C15) was written by John Pitzer and Jean-Pierre Dupuis and was presented by Jean-Pierre Dupuis. The session was chaired by Ivo Havinga (UNSD).

#### **Background**

682. The Task force on Harmonisation of Public Sector Accounting (TFHPSA) was set up in late 2003 to develop a chapter for the updated SNA dedicated to government and public sector issues. The aim was to have a chapter similar to the one dedicated to the Rest of the World in the 1993 SNA (chapter XIV). A detailed proposal was approved by the AEG meeting in Bangkok in July 2005.

683. The main inputs to the draft Chapter are the ESA95 *Manual on government deficit and debt* (2nd edition 2002, and additions), the GFS Manual (2001) and the TFHPSA conclusions on the five priority issues considered by the TFHPSA:

- delineation of government and public sectors;
- recording of tax and tax credits;
- earnings and capital injections to public corporations;
- privatisation/restructuring/SPEs, and
- guarantees.

684. Other inputs were pensions, military expenditure, non-performing loans etc.

685. The chapter is split into three parts:

Part I: The government sector (composition, accounts, specific activities);

Part II: The public sector (composition, accounts);

Part III: Relationships between government and corporations.

686. An Annex describes the relationship between the SNA and other related manuals (GFSM2001, EMGDD, Revenue Statistics, IPSAS).

687. There are two authors producing the draft, John Pitzer (IMF) and Jean-Pierre Dupuis (OECD). Part of the first draft was submitted to the TFHPSA at its meeting in October 2005 and to the AEG meeting in February 2006 meeting, for information.

### ***One example in part I***

688. The draft concentrates on principles rather than guidelines. For example, two possible methods have been identified for the accrual recording of tax revenue. The first is the use of assessments (preferably accrual based), while the second is the use of cash (time-adjusted). In the first case, uncollectible taxes should not be recorded in the tax revenue and in the capital transfers or coefficient. Payable tax credits should be recorded as government expenditure, which involves grossing up the tax revenue. The presentation should cater for showing tax credits on a net basis also.

### ***Two examples in part III***

689. A typical case of privatisation involves reshuffling assets (e.g. shares. against cash) in the balance sheet, which is a financial transaction. Only the purchase of financial services, recorded as intermediate consumption has an impact on net lending/borrowing. For an indirect sale of assets with the sale through a public holding company, the payment to government of all or part of the proceeds of the sale is a financial transaction.

690. There are two possible methods of recording nationalisation (government taking control over a corporation). The first is via the purchase of shares, at fair value, which is a financial transaction (there is a symmetry with privatisation: cash for equities). The second is appropriation/confiscation in which case either no payment is made to the owner or any payment made is far from fair value. This should be recorded as an uncompensated seizure in the other changes in volume account.

### ***The way forward:***

691. The draft chapter will be discussed section by section in the TFHPSA meeting at the OECD, from 8-10 March 2006). In mid-March 2006, a final version will be sent to the ISWGNA for review and integration into the updated SNA by the Editor.

## **Discussion**

692. There were several questions about the status of the draft and its relationship with the paper written for this AEG meeting (“The general government and public sectors” - SNA/M1.06/41). The presenter said there will be a TFHPSA meeting in 10 days time and the issues covered in the draft will be discussed there. A paper was distributed last week.

693. Further questions related to the process for the AEG to validate what will ultimately be in this chapter, whether the discussion of the TFHPSA will take full account of the AEG's deliberations and how does this sit with the section-by-section discussion by the TFHPSA, and when will the ISWGNA be asked to clear the chapter.

694. The IMF participant on the TFHPSA said that the 1993 SNA will be the starting point for the final chapter, modified as required to take account of outcomes on these issues from both the Task Force and the AEG. The redraft will be available by mid March. There is a general paragraph covering PPPs. It will be up to the editor to ensure consistency.

695. The Chair summed up that the AEG has noted the developments and that the outcomes of the AEG meeting that impact on this chapter will be discussed, in general terms, at next week's TFHPSA meeting. The draft will be presented to the Editor by mid March; it will take account of the AEG decisions on the five priority issues. Any ISWGNA members who wish to make detailed comments are encouraged to do so.

## **Summary conclusion**

### **Outcomes**

696. The AEG noted the developments and that the proposals set out in the partial draft chapter on this topic will be discussed, in general terms, at the TFHPSA meeting in March. The AEG will be provided with a copy of the draft chapter before the meeting and encouraged to provide detailed comments. A revised draft of the chapter will be provided to the Editor around mid March. It will take account of the AEG decisions on the five priority issues of the TFHPSA.

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## **Consistency of recommendations**

### **Description of the issue**

*The Project Manager provided a note (SNA/M1.06/44) about how consistency issues will be dealt with in the coming months.*

*The Editor provided a paper (SNA/M1.06/45) which described where, in a number of cases, it was already apparent that the resolutions to the list of 44 issues to be considered in the update presented problems of consistency. These could be (a) where recommendations on one issue are in conflict with recommendations in another, (b) where recommendations on one issue have consequences for another not yet recognised, (c) where there are unexplored consequences of previous recommendations, (d) where the rationale for a recommendation is complicated and does not sit easily with usual SNA accounting rules, (e) possible "inconsistencies" in the existing text. Attention needed to be drawn to both inconsistency within the SNA and inconsistency with other manuals and handbooks related to the SNA.*

### **Presentation**

697. The paper for this session (document number SNA/M1.06/45) was written and presented by Anne Harrison. The session was chaired by Adriaan Bloem (IMF).

## ***Introduction***

698. Consistency issues arise in the accounts when decisions in one area conflict with decisions in another or where a decision in one area has implications in another area but it may not yet be recognised that this is the case. There are a number of “inconsistencies” in the existing text. Generally, the consequences are unexplored.

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## **Presentation - Decision tree**

699. The paper on the delineation of the public sector suggests a decision tree to allocate units between the various sub-sectors included in the public sector according to the nature of their production. A generalisation showing the allocation of all production units to sector was produced (attached) and the AEG was asked if this would be a useful chart to incorporate in chapter IV.

### ***Question***

- (a) Would the decision tree be a useful chart to incorporate in chapter IV?

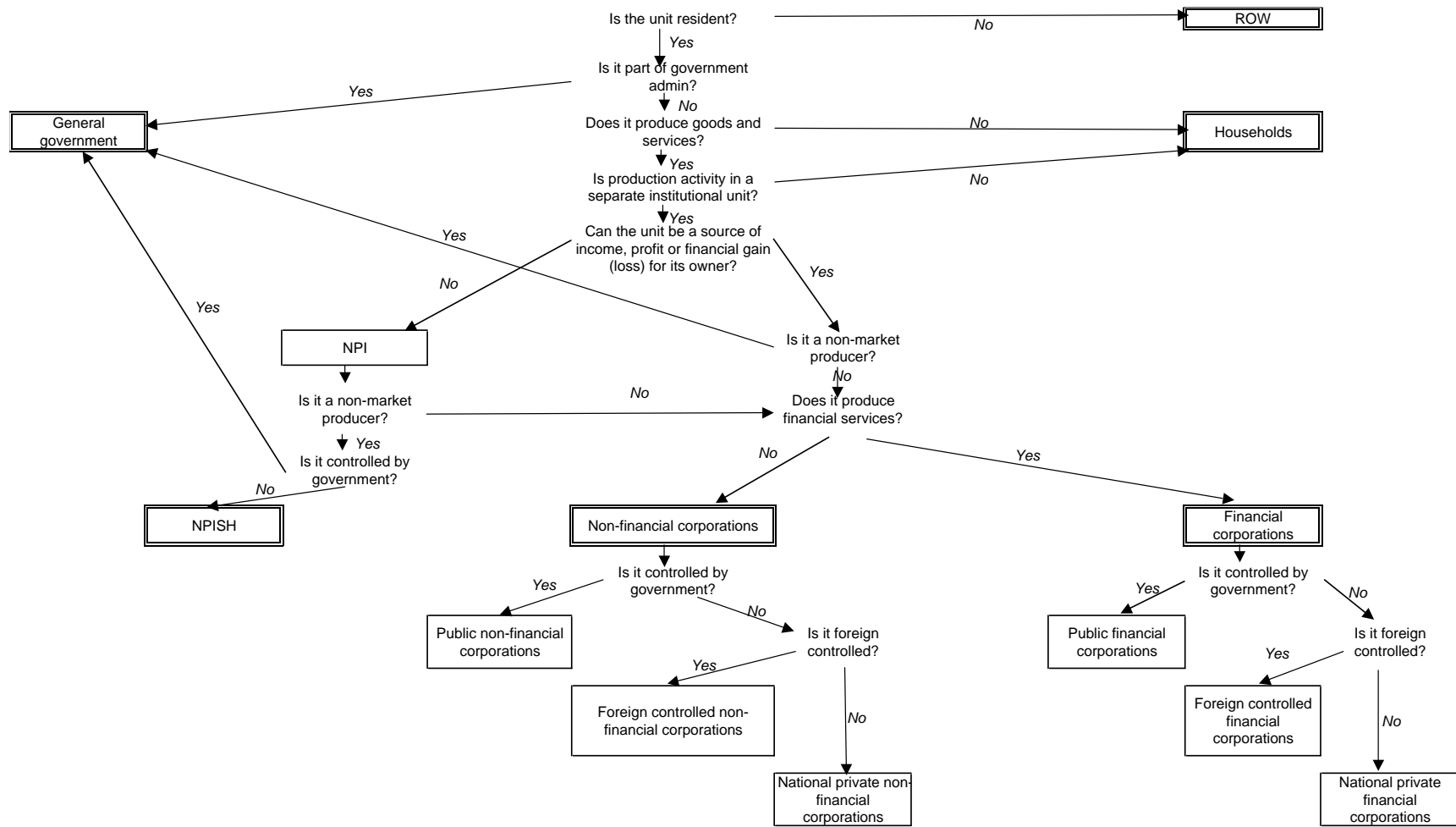
## **Discussion – Decision tree**

700. The decision tree was thought useful but it was pointed out it was useful in deciding the allocation of a unit between sectors rather than determining sectorisation as such.

## **Summary conclusion – Decision tree**

### ***Outcome***

- (a) The AEG agreed it would be useful to include the decision tree in the SNA in addition to the description of sectoring according to function to illustrate the role of production within sectoring.



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## Presentation - Market/non-market

701. Papers prepared on a number of issues present market/non-market as a dichotomy, whereas SNA has a trichotomy: market, non-market, and other non-market (production for own final consumption). Given there is still some ambiguity about whether and when production for own final use should be treated as market and when as non-market, would an exposition of four rather than three types of production (distinguishing whether products are supplied to other units or not and whether or not they have economically significant prices) allow for a consistent approach to delineating production by government units, ancillary units and informal production?

		Are prices economically significant?	
		Yes	No
Are the products supplied to other units?	Yes	“Market” production	Individual consumption
	No	Own account	Collective consumption

### **Question**

- (b) Does this exposition of four rather than three types of production allow for a consistent approach to delineating production by government units, ancillary units and informal production?

## Discussion - Market/non-market

702. The discussion centred on the difference between a split of marketed, non-marketed, and own-production. The AEG accepted that this split is ambiguous because own-production can be either marketed or non-marketed. The correct split is market, non-market, and other non-market (production for own final consumption) but further work is required on precisely defining the market/non-market split.

## Summary conclusion - Market/non-market

### **Outcome**

- (b) The AEG agreed further work is required to refine the issues underlying the market/non-market distinction.



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## **Presentation - Non-profit institutions**

703. Several levels of consistency are required for NPIs:

- consistency with the NPI handbook;
- consistency with other subsectoring;
- consistency between the definition of NPI and BPM rules on reinvested earnings;
- consistency with the original view of NPI activity .

704. Given the interest in implementing the handbook on NPIs, a number of questions arise for the identification of key characteristics of them.

### ***Questions***

- (c) Should the sector classification include identifying NPIs within government and the corporation sectors for ease of compilation of an NPI satellite account? If so, would this extra information be included as standard or supplementary items? If either, would the identification within corporations appear before or after distinguishing the public, foreign controlled and national private sub-sectors?
- (d) Would it be desirable to suggest that NPISHs should be sub-sectored into foreign controlled and national private elements? If so, should this be a standard or supplementary breakdown?
- (e) Do the rules on recording reinvested earnings for foreign-controlled units apply to foreign-controlled NPIs?
- (f) Should it be possible that some NPISH consumption is recorded as collective consumption rather than the default assumption of individual consumption?

## **Discussion - Non-profit institutions**

705. The following points arose in the discussion:

- the last two questions (i.e. (e) and (f)) should be closely examined because they involve changing current concepts;
- the updated SNA should show reinvested earnings for NPIs because they cannot be a source of earnings for their owners;
- the issue of NPIs delivering collective consumption is a new one and so is outside the scope of the current update.

## **Summary conclusion - Non-profit institutions**

### ***Outcomes***

- (c) The AEG agreed with the first point but came to no conclusion on the second or third points.

- (d) The AEG agreed with the first point but came to no conclusion on the second point.
  - (e) The AEG agreed there is a need for clarification on reinvested earnings in relation to NPIs.
  - (f) The issue of NPIs delivering collective consumption is a new one and so is outside the scope of the current update.
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### **Presentation - Unpaid labour (including volunteers)**

706. There are three paragraphs in the 1993 SNA that refer explicitly to whether an imputation should be made for the value of unpaid work, especially in unincorporated enterprises in the household sector and in NPISHs. These are paras 6.86, 7.8 and 7.21, which appear somewhat contradictory.

Par 6.86 “Make an estimate for labour inputs into communal construction projects.”

Par 7.8 “Mixed income includes remuneration for work done by the owner or members of a household.”

Par 7.21 “No compensation of employees is payable in respect of unpaid work .... including work done by members of a household.”

### **Question**

- (g) Should the contradictory statements in paragraphs 6.86, 7.8 and 7.21 stand? If so, what rationalisation for the difference can be given?

### **Discussion - Unpaid labour (including volunteers)**

707. The following points arose in the discussion:

- volunteers should not be included in the core accounts;
- there is no inconsistency if the 1993 SNA is read carefully but a cursory read could be misleading, so we need a clarification.

### **Summary conclusion - Unpaid labour (including volunteers)**

#### **Outcome**

- (g) The AEG agreed that the statements should be elaborated to provide better clarification on this issue. The value of volunteer labour should not be included in the core accounts.

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## **Presentation - Rerouting**

708. Paragraphs 3.31 to 3.33 in the 1993 SNA are headed “recognising the principal party to a transaction”. On occasion these have been interpreted as providing a licence for new forms of rerouting. One example is included in the discussion on government SPVs. An alternative view is that these paragraphs were intended to describe certain limited cases where some rerouting of transactions was desirable. It is clear that these paragraphs are currently being treated as a means for some creative accounting.

### ***Question***

- (h) What are the implications for paragraphs 3.31 to 3.33 in the light of the units discussion?

## **Discussion - Rerouting**

709. The following points arose in the discussion:

- the principal agent issue is a common one and sometimes the SNA must say that someone is acting as an agent and so rerouting is required; it is necessary to examine these on a case-by-case basis;
- a distinction needs to be made between imputation and rerouting and specific guidance given on the updated SNA on the differences;
- very hesitant about rerouting, particularly across borders because it will lead to inconsistencies between countries;
- employer/employee/social security contribution is a common example of rerouting and it is clear this is quite different from imputation.

## **Summary conclusion - Rerouting**

### ***Outcome***

- (h) The AEG said there was an important distinction between rerouting and imputation of flows. There could not be an exhaustive list of reroutings; many reroutings will have to be identified as such on a case-by-case basis.

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## **Presentation - Unincorporated joint ventures**

710. The key issue is one of consistency with international accounting standards. The Canberra II Group was reluctant to accept joint ownership of assets. However, petroleum companies have some complicated sharing arrangements. Do we push the SNA into compliance with international accounting standards here or is it a case where the SNA should diverge from these standards? Note that the International Accounting Standards Board has a more pragmatic approach, recommending partitioning in certain cases, one of which is the case of unincorporated joint ventures with joint ownership of assets.

## **Question**

- (i) For consistency with international accounting standards, should the SNA consider apportioning the ownership of assets across different enterprises as is done in the IASB recommendations?

## **Discussion - Unincorporated joint ventures**

711. The following points arose in the discussion:

- the SNA should diverge from international accounting standards on UJVs;
- the SNA should follow international accounting standards on UJVs;
- the Canberra II Group reluctance to accept joint ownership was related to economic ownership issues but legal joint ownership is a different issue;
- the problem can be non-trivial because a UJV can have several parties, each keeping completely separate books and agreeing on sharing arrangements;
- UJVs should be treated as a multi-national enterprise;
- the issue should be explored further because the AEG does not have sufficient background documentation to be able to make a decision.

## **Summary conclusion - Unincorporated joint ventures**

### **Outcome**

- (i) The AEG considered it did not have sufficient information on which to base a conclusion. The issue of the consistency between IASB and SNA is important but extensive. It may need exploring outside the context of the update.

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## **Presentation - Guarantees**

712. A number of questions were raised where the treatment proposed for standardised guarantees in issue paper SNA/M1.06/18 were inconsistent with the treatment of insurance even though an earlier AEG discussion had favoured treating these “like insurance”. What is meant by “like insurance”? Is the proposal in the paper on guarantees consistent with the national accounts?

### **Questions**

- (j) Should the treatment of standardised guarantees reflect the considerations developed for insurance on the time output is delivered, the treatment of property income earned by those providing the service, the current/capital nature of calls on the guarantees and the relationship between the fees payable and the liabilities of the guarantor?

The inclusion of loans at nominal value and assets representing the degree of default on the loans represents double counting in the national balance sheet. Is

this inconsistency sufficient to reconsider the recording of loans at nominal value?  
If not, how is the asset held by the beneficiary of the guarantee to be described?

## **Discussion – Guarantees**

713. The discussion was postponed to the more substantive discussion on guarantees.

## **Summary conclusion - Guarantees**

### ***Outcome***

- (j) This was postponed until the full discussion on guarantees on Wednesday afternoon.

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## **Presentation - Own funds**

714. the 1993 SNA mentions own funds only in the context that lending own funds is not production. Neither the SNA nor the International Accounting Standards Board define own funds. Any change will affect insurance and financial services. Do we need a definition of own funds?

### ***Questions***

- (k) Does the SNA need to define a concept of own funds and if so how?
- (l) Should own funds be excluded from the calculation of property income to be redistributed by insurance companies if the AEG agrees not to exclude own funds from the calculation of financial services?

## **Discussion - Own funds**

715. The following points arose in the discussion:

- own funds need to be defined (this is important in the case of money lenders);
- need to distinguish between the use of own funds and the situation in which FISIM arises (which is not the case in insurance company output);
- the concept of own funds needs to be elaborated in the context of insurance companies (own funds are relevant but FISIM is not for insurance companies).

## **Summary conclusion - Own funds**

### ***Outcomes***

- (k) The AEG agreed that own funds need to be defined and their treatment elaborated.
- (l) The AEG confirmed that own funds should be excluded from the calculation of property income for insurance companies, but FISIM should be calculated for lending from own funds.

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## **Presentation - Life insurance**

716. Life insurance is ignored in the list of issues for consideration in the update of the 1993 SNA; it is not included under non-life insurance, nor financial services, nor pensions. The updated SNA must make life insurance consistent with other financial services.

### ***Question***

- (m) When agreement is reached on the appropriate treatment of private pension funds, should recommendations for life insurance be brought into line with these recommendations and those for non-life insurance?

## **Discussion - Life insurance**

717. The following points arose in the discussion:

- more work is required to ensure life insurance is treated consistently with other financial services;
- reinsurance should be made consistent with life and non-life (casualty) insurance;
- need to check what is covered when the SNA says “for insurance” - whether it covers life or non-life insurance or both;
- the correct conceptual treatment should follow from the agreement on pensions, and on life and non-life insurance being treated consistently.

## **Summary conclusion - Life insurance**

### ***Outcome***

- (m) The AEG agreed.

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## **Presentation - Redistribution of property income**

718. Are we really consistent about the treatment of holding gains and losses within the redistribution of property income? The SNA explicitly says we will exclude holding gains and losses from property income being distributed. The property income from a pension fund is separate from the way in which the funds are generated (e.g. through capital gains or through property generating income). Should we consider that when we talk about the redistribution of property income we are talking about the cost of money being tied up and we should track this rather than the property income – i.e. consider from the point of view of the asset holder? Will relevant components be dividends? interest? insurance property income? pensions?

### **Question**

- (n) Should the amount of property income distributed to insurance policy holders (for both life and non-life insurance) represent the opportunity costs of money to the policy holders of having financial claims on the insurance companies?

### **Discussion - Redistribution of property income**

719. The following points arose in the discussion:

- there are two types of property income – direct such as interest, where it does not matter how the debtor gets the funds, and distributive such as dividends and for which holding gains/losses should be excluded;
- the issue is too complex to solve in the short term;
- the view should be to make a change to the SNA in the longer term;
- given the lack of time to resolve this issue, the decision should be to retain the existing concepts but put the definition of income on the long-term research agenda;
- property income is not treated fully consistently in the accounts;
- holding gains should not enter income but can be associated with production.

### **Summary conclusion - Redistribution of property income**

#### **Outcome**

- (n) The AEG concluded that property income is not treated in a fully consistent manner in the SNA. Expected price increases may affect decisions taken by producers but holding gains and losses themselves do not enter production. There are occasions where property income flows may reflect holding gains and losses but there are no general specifications about when this may or may not happen. Peter Harper volunteered to lead a group to pursue this further.

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### **Presentation - Ownership of financial assets**

720. Who owns the assets of pension funds, insurance companies, mutual funds etc? In practice, it is the relevant financial institution but it has a liability to the beneficiary/policy holder/investor. Should estimates of liabilities be considered as “provisions”?

#### **Questions**

- (o) Should the SNA make clearer the distinction between assets available to meet the liabilities of certain financial corporations and the liabilities themselves?
- (p) Does the recognition that some of these liabilities are based on the expected value of payments due make these provisions rather than liabilities? If so, does this change the asset boundary?

## Discussion - Ownership of financial assets

721. The following points arose in the discussion:

- the SNA already recognises some of these provisions;
- there seems to be a view that an insurance corporation has something different occurring on the asset and liability sides, but their operations are similar to banking operations;
- the technical reserves booked by the non-life insurance corporations are shown as liabilities but the life insurance corporations show them as provisions;
- they are not provisions despite being based on expected payments;
- terms like “provisions” are used carefully by accountants but not by the SNA – the SNA needs to be more precise in its usage;
- insurance companies have a significant amount of own funds to cater for disasters and this should be classified as a provision;
- “insurance technical reserves” is not a well-understood concept; the terminology needs to be sorted out;
- the issues associated with provisions should go on the long-term research agenda.

## Summary conclusion - Ownership of financial assets

### *Outcomes*

- (o) The AEG agreed.
- (p) The AEG noted that the value of some liabilities may be based on expected claims but thought the question of provisions should be put on the research agenda. The OECD volunteered to take the lead on this issue, taking into account the practices of insurance companies and international accounting standards.

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## Presentation - Very large insurance claims

722. The Editor is still working through the consequences of the recommendations. Difficult issues involve identifying when payments are due, when they are paid, and handling the problem with asymmetries (e.g. a large claim for one country may not be large for a bigger country, with a similar problem for claims involving large and small insurers). These issues will be followed up via e-discussion.

### *Questions*

- (q) Should exceptionally large claims be recorded on the basis of the time at which agreement on amounts payable and paid are reached rather than always on the basis of the time at which the event giving rise to the claim occurred?



- (r) What steps can be taken to avoid asymmetric recording of exceptionally large insurance claims as current transfers by one party and capital transfers by the other?

### **Discussion - Very large insurance claims**

723. The following points arose in the discussion:

- the time of recording should be the time of the disaster despite potentially lengthy lags in payment, and the revisions that may result;
- if the reinsurer is in another country then there is an impact on BoP;
- agree that we do not want to change timing from the current SNA;
- the main consistency issue is with the BoP side;
- it is impossible to have the coordination required to ensure consistency internationally (e.g. the current versus capital transfer issue ensures international consistency is impossible);
- should show as an “of which” in the BoP to identify potential current/capital transfer issues between different countries.

### **Summary conclusion - Very large insurance claims**

#### ***Outcomes***

- (q) The AEG thought the rule of recording claims at the time the event to which they relate occurred should be preserved.
- (r) The AEG agreed that inconsistencies in treatment will arise due to the relative importance of catastrophic events in countries of significantly different sizes. In particular, there will be inconsistencies in the classification of transfers as either current or capital based on their relative size.

Jacques Magniez agreed to produce a note setting out the consequences of these issues.

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### **Presentation - Annuities**

724. Annuities provide an important means of providing pensions on a private basis. It is necessary to set out the implications of the way annuities are recorded in the accounts because the current SNA view that an annuity is entirely a withdrawal from savings is wrong. Associated issues are how annuities relate to pension recording and insurance recording.

#### ***Question***

- (s) Should the SNA elaborate on the case of private pension provision via the mechanism of annuities?

## **Discussion - Annuities**

725. There was no discussion on this issue.

## **Summary conclusion - Annuities**

### ***Outcomes***

- (s) The AEG agreed that this issue should be clarified by e-discussion.
- 

## **Presentation - Discount rates**

726. It is necessary to set out the relationship between the rate of return on capital, the discount rate for guarantees, the FISIM reference rate, and the interest rate on bonds. Do we assume there are links between these rates or that they are completely independent of each other?

### ***Question***

- (t) Should there be some brief discussion in the SNA on the possible relationship between the factors associated with discount rates?

## **Discussion - Discount rates**

727. The following points arose in the discussion:

- some related issues will be discussed in the chapter on capital services and this could be the place to explain the different concepts and their relationships;
- it will be important to distinguish differences in the glossary;
- similarities/links should be compared in a “box”.

## **Summary conclusion - Discount rates**

### ***Outcome***

- (t) The AEG agreed that the links should be set out in a special section (“box”) in the relevant chapter of the SNA.
- 

## **Presentation - Inventories**

728. The consistency paper noted two aspects of the treatment of changes in inventories where clarification on the treatment of changes in the value of products in inventories would be helpful. One concerns products (currently wine and crops) where part of the increase in value is deemed to be production of a “storage” activity without a very clear description of how to separate the results of storage from holding gains and losses (the wording developed by the Canberra II Group is a good starting point). The other concerns partitioning the value of work in progress spanning

several accounting periods. The AEG should send the Editor any comments on the specific wording via the e-discussion on this topic.

729. Other issues are associated with cases in which an expected increase in price exceeds the expected increase in general price level over a pre-determined period, and capital services on work in progress.

### **Questions**

- (u) Are the clarifications set out in the paper on the treatment of storage acceptable?  
Is the clarification of the valuation of work in progress useful?

### **Discussion - Inventories**

730. The following points arose in the discussion:

- a clarification would be useful;
- comments on the wording set out in Anne Harrison's paper should be made via an e-discussion.

### **Summary conclusion - Inventories**

#### **Outcome**

- (u) The AEG agreed that such clarifications would be useful. Comments on the wording set out in the paper should be sent to the Editor.
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### **Presentation - Maintenance**

731. The consistency paper suggested that defining capital maintenance as that which prevented a shortening of asset life rather than actively prolonging it would be more consistent with the capital services approach to the income generated by similar assets. Further, treating more maintenance as capital rather than current would avoid the anomaly whereby current maintenance reduces GDP when done by an enterprise and increases it when done by a non-market producer.

#### **Question**

- (v) Is the proposed change to the definition of capital maintenance acceptable?

### **Discussion – Maintenance**

732. The following points were made in discussion:

- this issue did not receive much support in the Canberra II Group for both conceptual and practical reasons;
- capital repairs generally have an effect that last more than a year;

- there is a distinction between current maintenance and capital repairs, so major repairs should be recorded as capital;
- this is a new issue that was not resolved in the Canberra II Group so the AEG should not consider it any further.

## Summary conclusion

### **Outcomes**

- (v) The AEG thought that this is a new issue and, as such, outside the scope of the current update.

## The treatment of the informal sector

### Issue 32; Paper SNA/M1.06/15; for decision

#### Description of the issue

*An extract from the resolution on statistics of employment in the informal sector adopted by the Fifth International Conference of Labour Statisticians (January 1993) is reproduced as an annex to chapter IV in the 1993 SNA. The resolution, among other things, provides an international statistical definition of the informal sector. However, the SNA does not amplify on the definition or provide guidance on its application in a national accounting context. Given that the informal sector accounts for a substantial portion of production in many countries, such guidance has often been requested. The review should consider whether the updated SNA can provide guidance drawing on work by the Delhi Group on Informal Sector Statistics and by ILO, UNECE, IMF, the Commonwealth of Independent States, and OECD in preparing **Measuring the Non-observed Economy: A Handbook**.*

#### Presentation

733. The paper for this session (document number SNA/M1.06/15; Issue 32) was written and presented by Ivo Havinga and Carol Carson. The session was chaired by Dieter Glatzel (Eurostat).

#### Presentation – Context

##### **Introduction**

734. The informal sector is an important issue for the update of the 1993 SNA because of its policy relevance, calls from analysts for statistical guidelines, and substantial developments since 1993. There are differences between the International Conference of Labour Statisticians Resolution (International Labour Organization) and the SNA framework regarding the definition of the informal sector and the concepts of employment in the informal sector/informal employment.

735. A draft annotated outline has been prepared of a chapter on the informal sector in the 1993 SNA, *Rev.1*. A work plan has been set up to prepare the recommendations on the informal sector.

736. Links have been identified to development objectives on income generation, employment creation, poverty reduction, and to the design and monitoring of targeted support programs. The informal sector's contribution to non-agricultural GDP is:

- 27 percent in northern Africa;
- 41 percent in Sub-Saharan Africa;
- 29 percent in Latin America;
- 31 percent in Asia.

### ***Developments in methods and practice since 1993***

737. A number of initiatives have resulted in important outputs on the informal sector since 1993:

- papers have been produced for the deliberations of the Delhi Group on Informal Sector Statistics;
- a UN handbook, *Household Accounting: Experience in Concepts and Compilation, Volume 1: Household Sector Accounts*, has been produced;
- *Measuring the Non-observed Economy: A Handbook* has been released by the OECD, IMF, ILO and CISSTAT;
- a UNECE manual has been prepared on *The Non-observed Economy in National Accounts*.

### ***Calls for guidelines***

738. The informal sector was an issue in the work on preparing the 1993 SNA but it was placed on the research agenda. In 2004, the UN Statistical Commission reiterated the importance of the collaboration between UNSD and the Delhi Group on the informal sector. A forthcoming publication *Surveys of the Informal Sector and Informal Employment* has been the result of a collaborative effort of the ILO and members of the Delhi Group. It contains a chapter on uses of informal sector data for national accounts purposes.

### ***Questions***

- (a) Does the AEG confirm that there are strong reasons why guidance on the treatment of the informal sector should be added to the updated *1993 SNA*?
- (b) Does the AEG agree that there seems to be a substantial body of methodological literature and of practical experience available to serve as a foundation on which to prepare guidance on the treatment of the informal sector within the national accounts framework?
- (c) Does the AEG recommend any other sources to be consulted, or do they commend any in particular of those mentioned?

### **Discussion – Context**

739. The AEG welcomed the proposals to include a section in the updated SNA on the informal economy. Several definitions of the informal sector are currently circulating. It is important that

the updated SNA to contain not only detailed guidance on measuring the informal sector but also that the definition of the scope of the informal sector be standardised. An additional source of guidance on measuring the informal sector is a new edition of a UNECE manual on the informal economy, to be released in early April.

740. A number of other speakers supported to three questions.

### **Summary conclusion - context**

#### **Outcomes**

- (a) The AEG agreed.
- (b) The AEG agreed.
- (c) Several suggestions were made, including the work of Women in Informal Employment Globalizing and Organizing (WIEGO).

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### **Presentation - Definition of the informal sector**

741. There are differences between the International Conference of Labour Statisticians (ICLS) and the SNA in terminology, in segmenting the economy, in the use of enterprise-based criteria and in the universe of household enterprises. The key points are as follows:

- the ICLS use of “sector” does not match the definition in the SNA;
- the word “informal” has several meanings; it may imply a formal/informal sector distinction between household enterprises or it can refer to the exhaustiveness of data collection practices as well as a production unit with specific characteristics;
- the ICLS use of “households” is narrower than the meaning in the national accounts framework;
- national accountants consider the “formal” segment of enterprises to be confined to institutional sectors other than the household sector.

#### **Question**

- (d) Should the different meanings of “sector,” “informal,” “households,” and “formal” be clarified and explained in the updated SNA?

### **Discussion - Definition of the informal sector**

742. The AEG members who spoke on this issue were all in agreement with the proposal because it should lead to more consistent estimates of the informal sector. Misunderstandings with users are often associated with confusion with the concepts. Borderline issues need to be covered in detail, but data issues are equally important and should not be overlooked.

743. There was some discussion on the term “informal sector” which is not consistent with the SNA concept of sector. In response to a question as to whether the ILO would accept “informal economic activities” rather than “informal sector”, the ILO participant indicated that the term

“Informal sector” has been used for 40 years or more by the ILO; it is embedded in the ICLS Resolution so it cannot be changed.

744. The AEG agreed that reconciliation of the ILO and SNA definitions is necessary.

### **Summary conclusion - Definition of the informal sector**

#### ***Outcome***

(d) The AEG agreed.

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### **Presentation – identifying informal enterprises**

745. The ICLS uses non-registration to identify informal enterprises within household enterprises. In many countries this may coincide with the lack of legal status and the lack of accounts. The ICLS refers only to production units that engage labour as input; the national accounts refer also to those that do not use labour inputs from outside the household concerned.

#### ***Question***

(e) Does the AEG agree that the updated SNA should describe the differences between the ICLS and SNA definitions of the types of production units and where possible reconcile the differences?

### **Discussion – identifying informal enterprises**

746. The ICLS aim is to identify businesses outside the legal framework in a country. In developed countries, some businesses are part of the household sector, but some are regarded as quasi-corporate because they have a full set of accounts. The SNA is used more widely in many developing countries than the ICLS standards on the hidden economy. A compromise is essential. The differences between the SNA and the ICLS Resolution should be explicitly set out. For a national accountant, the informal sector is a subset of the household sector. The national accounts are concerned with both production and associated flows for the informal sector.

747. The Editor indicated that the proposal does not mean that definitions will have to be changed. Rather, bridge tables are needed to reconcile the two data sets.

748. One participant said that we do not want to identify a heterogeneous group of units as part of the household sector and call it the informal sector. They should be separated out of the household sector (and the corporations sector, if there are any).

749. There was concern that if only bridge tables are available then there will be a problem in determining what concepts to use in surveys. The Chair indicated that a chapter in the updated SNA will set out a clear description of the concepts.

## Summary conclusion – identifying informal enterprises

### **Outcome**

- (e) The AEG agreed that the differences between the ICLS and SNA definitions of the types of production units should be reconciled via bridge tables.
- 

### **Presentation - Use of enterprise-based criteria**

750. The criterion for market production in the SNA is that market producers are those that sell “most or all” of their production on the market at economically significant prices. On the other hand, the ICLS uses the phrase “some or all”. There are conceptual and practical advantages of the “some or all” criterion. A possible grouping for macroeconomic statistics on the informal sector is:

Household enterprises with employment

    Enterprises with market production

        Informal sector enterprises

        Other household enterprises

    Enterprises with only production for own final use

Household enterprises without employment

### **Questions**

- (f) Does the AEG agree that there are advantages to the ICLS “some or all” criterion in identifying market producers? If so, could it be developed as an application for analytical and policy oriented purposes? Which option is preferred — in the core household production account or in a supplementary presentation?
- (g) AEG views are sought on the question of comparability? Should further attempts be made ... to identify groupings of household enterprises, including the informal sector, in the SNA household production account that have a greater degree of international comparability, especially to facilitate the preparation of macroeconomic indicators on household production that are internationally comparable and consistent with the SNA?

### **Discussion - Use of enterprise-based criteria**

751. The discussion commenced with a clarification that units that produce for own final use are not necessarily non-market. There was a view that the proposal to change “most or all” to “some or all” [of their production on the market at economically significant prices] was too broad a definition. We should not try to change the definition of market employment because of the widespread ramifications for the accounts. A contrary view was that all production is included in the system and the importance of the market/non-market distinction is only in determining the method used to value the outputs. Changing from “most or all” to “some or all” would imply a higher proportion would be valued at market prices than is currently the case.



752. A comment was made that the application of economically significant prices is not very clear in this context. Another comment was that it will be necessary to determine if a unit is market or non-market and then value the whole of the output at market prices or at cost depending on how the unit is classified. However, several AEG members disagreed with this comment. For example, in the case of a tailor who makes 10 units, sells 1 and retains 9, we value the whole output of 10 at the market price for the 1 and the tailor is classified as a market producer. We do not need to change the SNA definitions.

753. Other comments were:

- need to change the term “other non-market producers”;
- the proposed classification “enterprises with only production for own final use” is under the broader heading “Household enterprises with employment”; would any units actually fall into this sub-category?
- the proposal does not involve changing the definition of market production;
- no “other non-market producers” will be in the household sector – only market and non-market producers;
- a large proportion of households does not have any employment so the proposed classification does not make sense;
- need to clarify the definition – should it be “with employment” or “with employees”?

754. The Chair summed up that there was some confusion regarding question (f) and further work is required. Question (g) is a first attempt and it will be refined in consultation with other agencies.

### **Summary conclusion - Use of enterprise-based criteria**

- (f) This referred again to the question of the market/non-market distinction raised under “Consistency” and will be considered in that context.
- (g) The AEG considered that the issues underlying this question need to be refined further, in consultation with agencies that have an interest in the issue.

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### **Presentation - Universes of household enterprises**

755. There are two key differences between the SNA and the ICLS definitions. The first is that the SNA refers to units with and without labor input while the ICLS definition is restricted to units with labor inputs. The second is that all economic activities are covered by the SNA versus only non-agricultural activities in the ICLS Resolution.

#### ***Question***

- (h) Should a bridge table be developed, in coordination with the ILO and Delhi Group, between the informal sector special cases and their SNA counterparts for inclusion in the updated SNA?

## **Discussion - Universes of household enterprises**

756. The ILO participant explained that the ILO could not harmonise the full definition of the scope so they defined a core set of informal activities from which data could be supplied.

## **Summary conclusion - Universes of household enterprises**

### ***Outcome***

- (h) The AEG agreed.
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## **Presentation - Draft outline of chapter**

757. The key sections in the chapter will be:

1. Introduction
2. The informal sector: a broad statistical perspective
3. Definition of the informal sector
4. Other concepts
5. Measurement.

### ***Questions***

- (i) Are there relevant topics that are missing from the outline?
- (j) What are the AEG's views about the approach of tracing with broad brush strokes the evolution of the subject as a frame within which to explain differences in terminology and differing analytical needs?
- (k) What are the AEG's views about the balance struck between being too much and too little?

## **Discussion - Draft outline of chapter**

758. The only comment on the draft outline was that international comparability is problematical at the moment and it needs to be covered in detail so a longer text would be preferred to avoid confusion.

## **Summary conclusion - Draft outline of chapter**

### ***Outcomes***

- (i) The AEG suggested that a section on issues associated with international comparability be added.

- (j) The AEG did not express a view on this topic.
- (k) The AEG noted the need for the chapter to provide a good introduction to the subject without attempting to reproduce all the material of a Handbook.

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### **Presentation - Work plan, 2006**

759. The key elements of the work plan are for a sub-group of the AEG to look at the issues, to collaborate with the ILO and the Delhi Group, and to identify forums to test preliminary drafts (e.g. the National Accounts meeting being held at UNECE in April, the Delhi Group, regional meetings).

#### **Questions**

- (l) Are there AEG members who would like to volunteer for the sub-group to be set up to provide advice and review progress on the development of a recommendation on the informal sector?
- (m) Are there forums - groups or meetings - in addition to the Delhi Group whose views should be sought or that can be used to test preliminary proposals?

### **Discussion - Work plan, 2006**

760. There was no discussion.

### **Summary conclusion - Work plan, 2006**

#### **Outcomes**

- (l) Mr Peter Pariag (Trinidad and Tobago, Chair), Mr Omar Hakouz (Jordan), Mr Akhilesh C. Kulshreshtha (India), Mr Jacques Magniez (France), Mr Roberto Ramos (Brazil) and Ms Lidia Bratanova (UNECE) volunteered.
- (m) The Joint National Accounts meeting to be held at the UNECE in Geneva in April 2006 was mentioned as a possibility.

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## **Review of the outcome of e-discussion – The concept of persons in the 1993 SNA Rev. 1**

### **Issue C11; Papers SNA/M1.06/32.1, SNA/M1.06/32.2; for information**

#### **Description of the issue**

*Chapter 17 of the 1993 SNA seems to reject the concept of persons from the national accounts. This is in contradiction with the practice of many countries, which publish and transmit data in terms of persons in the framework of national accounts. The objective of*

*this clarification would be to be less restrictive than the current SNA on the concept of persons. ESA's approach, which presents both concepts, would inspire this clarification.*

## **Presentation**

761. The papers for this session (document numbers SNA/M1.06/32.1, SNA/M1.06/32.2; Issue C11) were written by the UNSD. The session was chaired by Adriaan Bloem (IMF).

## **Summary conclusion**

762. Two questions were put to the members of the AEG:

### **Questions**

- (a) Does the AEG support the introduction of the concept of persons employed in the new SNA?
- (b) Does the AEG support that the new SNA should be based on the existing paragraphs of the ESA95 defining employment, self-employment and unemployment?

### **Outcome**

763. The AEG members participating in the e-discussion supported all the proposed recommendations.

764. The AEG noted the recommendations agreed to in the e-discussion on the concept of jobs and the concept of persons in the SNA.

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## **Working time measurement**

### **Issue C16; Paper SNA/M1.06/38; for information**

#### **Description of the issue**

*Chapter XVII of 1993 SNA (Population and labour inputs) includes several references to existing ILO Resolutions. One of these Resolutions, the 1962 Resolution concerning statistics on hours of work, may be revised at the next ICLS (possibly in 2008). The new ILO Resolution on working time measurement could have some impact on the revised SNA. The proposed changes to the Resolution include a revised definition of hours worked and improving the methodologies recommended for measurement, etc., in the light of the increased incidence of alternative working time arrangements. The revised Resolution will also cover the estimation of annual hours worked and labour input. Paris Group discussions have highlighted a small number of grey areas that could benefit from further clarification in the revised SNA. In this context, the Paris Group will provide further details in a more formal submission to the ISWGNA regarding Chapter XVII, possibly proposing clarifications to the revised SNA needed to accommodate a revised Resolution.*

## **Presentation**

765. The paper for this session (document number SNA/M1.06/38; Issue C16) was written by the Bureau of the Paris Group and presented by Charles Aspden. The session was chaired by Dieter Glatzel (Eurostat).

### ***Paris Group discussions***

766. The Paris Group has been working on a revision to the 1962 International Conference of Labour Statisticians (ICLS) Resolution on working time measurement at its last two meetings (2003, 2004). The 2004 meeting identified a number of problem areas. Detailed reports on these issues can be found on the INSEE website (the address is shown in the paper). The Paris Group will meet in May 2006 to discuss the text of the draft revised Resolution, expected to be ready at the end of February. Based on this draft, a revised Resolution will be put to the next ICLS meeting, probably in 2008, for adoption.

767. During the revision process, Paris Group members have identified a number of grey areas in the 1993 SNA, particularly in Chapter XVII. A synthesis of the issues is presented in the paper. Most concern “true” clarifications, but there are some that are more substantive in nature, e.g. the Italian proposal to consider owner-managers of incorporated enterprises as self-employed and the Swedish proposal to change the industry to which the employees of employment agencies should be allocated from that of the employment agency to the industry where the employees work.

768. A goal of the Paris Group is to maximise the consistency between the ICLS Resolution and the SNA. Members of the Group welcome input from the ISWGNA and the AEG. A central theme in the draft will be the measurement of actual hours worked.

## **Discussion**

769. The ILO participant explained that there is no consensus on this issue as yet within the Paris Group. Individual country practices are being examined as part of the process of identifying the key characteristics that should be considered (e.g. the Italian proposal). Some concern was expressed about the implications of the Swedish proposal. The critical issue in determining the industry is who pays the wages of the employee – the employment agency or the business in which the person is working.

770. The ILO participant explained that the so-called “Italian proposal” is not just Italian; it describes a common practice. The current resolution is over 40 years old and is in urgent need of updating. It concentrates on employees and ignores the self-employed. The framework of the new Resolution encompasses the concept of hours actually worked and then looks at related measures. Also it will need to consider alternative working time arrangements such as working from home.

771. Many countries calculate hours worked using employment data. Actual hours worked is the preferred labour input measure for productivity analysis – employment (i.e. numbers employed) is simply a step on the way. One of the implications is that SNA chapter XVII will have to be changed to talk about both numbers employed and hours worked.

772. The OECD will draft a response which will be circulated to the AEG for comment.

## Summary conclusion

### **Outcomes**

773. The AEG agreed to work with the Paris Group to harmonise the SNA with the ICLS Resolution to the greatest extent possible. The AEG agreed that the updated SNA should discuss hours worked as well as numbers employed and supported the ICLS and the Paris Group in their emphasis on actual hours worked.

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## Government/public sector/private sector delineation issues

### Issue 36; Paper SNA/M1.06/17; for decision

#### Description of the issue

*According to the 1993 SNA, two factors determine whether a corporation or non-profit institution is controlled by government and thus falls into the public sector. One factor is the degree of control exercised by government. Concern has been expressed about the “mainly financed” phrase cited in respect of non-profit institutions. The determination of control in respect of special purpose vehicles (SPVs), notably created in the context of public private partnerships (PPPs) or securitization, is not always clear cut. The second factor is about “economically significant prices.” Concern has also been expressed over possible ambiguity in this concept. Is it possible to give greater content to the description without going so far as to prescribe a fixed proportion of costs to be covered by sales?*

#### Presentation

774. The paper for this session (document number SNA/M1.06/17; Issue 36) was written by the Task Force on Harmonisation of Public Sector Accounting (TFHPSA) and presented by Jean-Pierre Dupuis. The session was chaired by Adriaan Bloem (IMF).

#### **Background**

775. The issue being considered is whether the AEG thinks the SNA should be clarified to improve the consistency of the application of current SNA principles in the delineation of government/public/private sector units.

776. The paper prepared for this session covered three major points:

- the use of a decision tree to assist the process;
- additional guidance on the criterion of control;
- additional guidance on what constitutes economically significant prices.

#### **Decision tree**

777. Recommendation 1 is to use a decision tree to assist in the delineation process. Three questions need to be answered in making a decision:

1. is the entity an institutional unit?

2. is the institutional unit part of the public sector?
3. is the public institutional unit market or non-market?

778. The public sector is defined in the SNA (Chapter 19) as the national, regional, and local governments plus institutional units controlled by government units. Problems can arise at times in identifying such units and further clarification is recommended.

### ***Control by government***

779. Recommendation 2 is to identify a set of criteria for determining whether or not government is effectively exercising control over a corporation. Government control is an important criterion in deciding on the sector to which they should be classified. Control is the ability to determine the general corporate policy of an entity. Eight major indicators are used to determine control:

1. ownership of the majority of the voting interest;
2. control of the board or other governing body;
3. control of the appointment and removal of key personnel;
4. control of key committees of the entity;
5. golden shares and options;
6. regulation and control;
7. control by a dominant customer;
8. control attached to borrowing from the government.

780. Recommendation 3 relates to a set of indicators that assist in determining whether government has control over non-market NPIs. The five major indicators are:

1. Appointment of officers;
2. Other provisions of enabling instrument;
3. Existence of contractual agreements;
4. Degree of financing by government;
5. Level of risk exposure.

### ***Economically significant prices***

781. Recommendation 4 provides guidance on using the criterion of whether the prices charged for a unit's output are economically significant to assist in answering the question as to whether the unit is market (i.e. a public corporation) or non-market (i.e. a government unit). This recommendation needs to be applied in conjunction with recommendations 5 and 6.

782. For a public unit whose production is sold primarily to corporations and households to qualify as a market producer, the general rule is that the majority of the production costs are expected to be covered by the value of the sales (over a sustained multi-year period). However, no numerical rule is agreed on at international level. In principle, this assessment is to be made for each institutional unit individually.

783. For public units whose production is sold only to government, two cases may be considered:

- the public entity provides ancillary services in which case the accounts will be consolidated;
- the public entity is an institutional unit that can be either:
  - the only supplier, in which case it is always treated as a non-market unit (unless it competes in tendering for contract on commercial terms);
  - one of several producers, in which case it is treated as a market producer if prices are economically significant and if it competes with other producers.

784. Recommendation 5 relates to the definition of sales to assist in implementing the assessment of whether or not prices are economically significant. It incorporates the business notion of sales, excluding taxes on products and subsidies on products (except subsidies granted to all producers including private ones for this type of activity), and excluding own-account production.

785. Recommendation 6 relates to the definition of production costs, which are defined as the sum of:

- intermediate consumption
- compensation of employees
- costs of capital services (or consumption of fixed capital)
- other taxes on production (other subsidies on production are not deducted).

### **Questions**

- (a) Does the AEG agree with the TFHPSA recommendation 1 to use a decision tree relevant for the delineation government/public/private?
- (b) Does the AEG agree with the additional guidance on control over corporations and over NPIs, as set out in the TFHPSA recommendations 2 and 3 respectively?
- (c) Does the AEG agree with the additional guidance on economically significant prices set out in TFHPSA recommendation 4, supported by TFHPSA recommendations 5 and 6 [about the definition of sales and production costs respectively]?

### **Discussion**

786. The AEG discussed a range of issues related to the usefulness of the decision tree approach (question (a)). Some complications that can arise in classifying a unit are:

- units can be owned by several levels of government;



- it is possible to have units that appear to be controlled by general government but which act like corporations;
- units can have a mix of market/non-market production;
- quasi-corporations can be a problem - does it make sense to have a market quasi-corporation being allocated to government?
- cannot have own-account producers in a sector other than the household sector so, by convention, quasi-corporations can be formed when market producers are involved;
- confusion can arise between types of units and institutional sectors (first have to identify a government unit as such and then determine which sector it should be put into).

787. There was some debate about the best starting point. Views differed with one participant commenting that the starting point for classifying a unit is its type of production (market/non-market) but this decision tree appears to start at the other end and another pointed out that the decision tree is talking about public first, then government, whereas the normal path would be to determine if it is government then whether it is public. A third commented that it appears the decision tree is not intended to define the sector; rather it is designed to classify units within the definition set out in chapter 4 so the first step is to decide if something is an institutional unit. The SNA starts with government and so control should be the starting point. There was some support for the view that it is possible to use different paths to get to the same result, because the decision tree works by exclusion rather than by inclusion. An extra indicator suggested was whether or not the unit can borrow independently of government.

788. The Project Manager said that the AEG needs to make a decision on the path required while the Editor asked for clarification as to whether or not the AEG is proposing that the process of decision making regarding public/government should be described in chapter 4 in the SNA or only in the chapter on the public sector. She also reiterated a point made in an earlier debate that production can be allocated three ways (market/non-market/other) rather than just two.

789. The presenter emphasised that the decision tree is aimed at elaborating SNA issues rather than changing definitions.

790. The Chair indicated that the AEG agreed that the decision tree should be included in the updated SNA; it should be in the government chapter.

791. The discussion on question (b) commenced with a question on whether the list of eight indicators is in priority order. The response was that it is just a list which is indicative, not prescriptive. A couple of participants commented that having a list of indicators is an acceptable approach but the proposed text is four or five pages, which is too long. There was also some adverse comment about criterion 7 being far too broad to be useful. A suggestion was made to simply list the indicators plus paragraphs 65 and 66 from the paper as the only text in the SNA. Criterion 7 should not be taken as an indicator in its own right but it could be useful in tipping the balance in conjunction with other criteria.

792. There was general agreement that a single indicator should not be used to make a decision. The approach based on a list of indicators is useful and they should be used in conjunction with each other to make a decision. Other comments were

- the non-financial corporate sector can include NPIs as can the financial sector;
- control was a contentious issue in the NPI handbook and we need to take the handbook recommendations into consideration in setting out the SNA approach; and
- another useful criterion would be along the lines of whether or not the government benefits from the liquidation of a unit.

793. The Chair summed up that the AEG agreed that the indicator approach is useful but that it should be made clear in the SNA that the indicators have to be used in conjunction with each other. The text in the TFHPSA paper will need to be shortened significantly for incorporation into the updated SNA.

794. The only discussion on question (c) centred on the definition of economically significant prices. One participant felt that the 50 per cent rule, if applied rigidly, can result in a unit flipping from market to non-market or vice versa, which can affect comparability over time. It can also disguise the nature of cost structures. Another considered the current recommendation is ambiguous (summarised as “use the 50 per cent rule unless you do not want to use it”). Economically significant prices are not definitive but the characteristics underlying them are important. The only other comment was that it should be made clear that public holding companies are not publicly listed companies; rather they are holding companies in the public sector.

795. The Chair summed up that the AEG generally agreed with notion of economically significant prices but the criteria need to be used in conjunction with each other. There was no support for a specific threshold (such as the 50 per cent rule in ESA95).

## **Summary conclusion**

### ***Outcomes***

- (a) The AEG agreed. The description of the decision tree, which relates to units and not production, should be set out in the chapter on government and the public sector. Further elaboration is required for quasi-corporations.
- (b) The AEG agreed that the list of indicators is useful, but emphasised that they should be used in conjunction with each other in reaching a decision on control, rather than any one of them necessarily being definitive in its own right. The AEG felt that the text set out in the TFHPSA paper was too long to be incorporated directly into the SNA.
- (c) The AEG agreed with the guidance set out to determine what constitutes “economically significant prices”. The AEG felt the SNA should avoid being prescriptive in relation to the use of a specific threshold (such as the ESA95 50 per cent rule).

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## **Government dividends and capital transactions with public corporations in the updated SNA**

### **Issue 34; Paper SNA/M1.06/16; for decision**

#### **Description of the issue**

*The 1993 SNA treatment of withdrawals from quasi-corporations differs from that of payment of dividends from corporations. Dividends are always assumed to be from current earnings, but withdrawals from quasi-corporations may not be. Public corporations are often quasi-corporations and the treatment accorded quasi-corporations allows government to manage the pattern of withdrawals from one year to another for political reasons. Should the SNA be amended to limit this possibility and if so which of two possibilities is recommended?*

*The first option is to bring the treatment for quasi-corporations more into line with that for corporations in respect of large and exceptional payments (like super-dividends) as well as of capital injections made by the government as the owner.*

*The second option would be to adopt an approach for public corporations similar to that for direct investment enterprises and show redistributed earnings (or losses) of public corporations as accruing in the government accounts and then reinvested in (or withdrawn from) the equity of the corporation.*

#### **Presentation**

796. The paper for this session (document number SNA/M1.06/16; Issue 34) was written by the Task Force on Harmonisation of Public Sector Accounting and presented by Lucie Laliberté. The session was chaired by Adriaan Bloem (IMF).

#### ***Introduction***

797. The Task Force on Harmonization of Public Sector Accounting considered the issues associated with government dividends and capital transactions with public corporations. The SNA currently does not provide sufficient guidelines for transactions between government and public corporations (e.g. dividends, equity transactions and capital transfers). Issues arise concerning the government's ability to determine payments made to and from public corporations or quasi-corporations.

798. The July 2005 AEG suggested that the TFHPSA should investigate two potential options:

- clarification based on GFSM2001 and EMGDD (the result would be minor amendments to the SNA);
- change the definition of income to align with that for foreign direct investment (paragraphs 7.120 and 14.152) (the result would be a significant change to the SNA).

### ***Dividends and withdrawal of income***

799. For corporations, dividends are viewed as the distribution of profits, but the relevant period or the composition of the profits is not clear. For quasi-corporations, withdrawal of income is out of the current period income derived from entrepreneurial income. The inference to be drawn is that dividends are from current profits, and profits refer to entrepreneurial income.

### ***Capital and equity transactions***

800. For corporations, capital transfers can be in the form of investment grants or payments for financing operating deficits over two or more years (SNA10.141). For quasi-corporations, additions to the equity are made for capital investment purposes (SNA11.87) or funds provided by the owner to acquire assets or to reduce its liabilities are considered additions to equity (SNA 7.118).

801. An ambiguity arises in these cases because the the 1993 SNA recommends different treatments for similar transactions.

### ***Proposed changes in the updated SNA***

802. The first proposal involves amending the 1993 SNA. Dividends paid by corporations and the withdrawal of income from quasi-corporations should be considered as being paid out of entrepreneurial income derived from productive activities. Withdrawal of equity would be confined to large and exceptional payments based on accumulated reserves or the sale of assets. An injection of funds would be a financial transaction if the funds are received in a commercial context (e.g. a new issuance of shares and a valid expectation of dividends). A capital transfer would be recorded if the injection of funds is to cover accumulated losses.

803. The second proposal involves changing the approach set out in the 1993 SNA. The controlling owners can decide the timing and amount of the distribution of accrued earnings, with the result that current profits (or losses) of public corporations can be accrued to the government at a time that is most convenient for recording them. All other flows to/from owners would be classified as financial transactions, inclusive of capital transactions.

### ***Pros and cons***

804. The pros of amending the SNA are that it is a pragmatic solution to present inconsistency of treatments and the outcome is consistency with other sectors in that dividends are treated as property income. The cons are that the timing of the dividends is not always consistent with the timing of when the income is earned, and its application is not always clear in practice.

805. The pros of changing the SNA are that a consolidated view is presented across all sectors, income is recorded when earned, and capital injections and irregular dividends have a neutral effect on net worth. The cons are that boundary between government and the public sector becomes blurred, the issue of debt assumption/cancellation remains problematic and difficulties arise in assessing equity capital.

## Questions

- (a) Does the AEG agree to record exceptional payments by public corporations to government funded from accumulated reserves or sales of assets as withdrawal of equity?
- (b) Does the AEG agree to record exceptional payments by government to public corporations and to public quasi-corporations intended to offset accumulated losses - or as investment grants - as capital transfers? (this is a change in the SNA for public quasi-corporations)?
- (c) Does the AEG agree to record exceptional payments by government to public corporations and to public quasi-corporations for commercial reasons (new issuance of shares and valid expectation of dividends) and leading to increases in government's claims on shares or other equity in the unit as addition to equity? (this is an amendment in the SNA for public corporations)?
- (d) Does the AEG agree to recommend that the “reinvested earnings” approach to payments between government and public corporations and quasi-corporations be mentioned in the dedicated chapter as a conceptual reference (but not as a guideline), and be added to a research agenda?

## Discussion

806. Questions (a), (b) and (c) were considered in conjunction with each other. It is clear that a government can manipulate the statistics by not paying out dividends from public corporations for several years and then paying a very large dividend, which should not be treated as a dividend in practice. A reinvested earnings approach overcomes this problem. It is possible that the above situation (of a large dividend paid in one year) could occur as a result of actual changes in the profitability of the public corporation, with no manipulation being involved. On the other hand, manipulation can potentially occur if reserves have been built up from prior period profits.

807. The issue is that when the public corporation pays a dividend it is assumed to be from its operating surplus, whether it is from the current period or not, as is the case for private corporations paying dividends to households. The SNA needs to ensure consistent treatment between private and public corporations. It should be noted that the question talks about “exceptional payments”. The definition of “exceptional” is based on the dividends paid compared with accumulated earnings. There was general agreement that the SNA should not be so restrictive as to insist the dividends have to be from current period earnings. A reinvested earnings approach would be preferable but, in the present situation, we are not able to properly adopt it (see discussion on question (d) below).

808. The Chair summed up that there was general support within the AEG for the proposals set out in questions (a), (b) and (c).

809. The discussion on question (d) started with a participant pointing out that the balance sheets are the same under both methods of recording but the individual flows can be different. One participant felt that an exceptional payment should be treated as an injection of equity. The discussion covered the possibility of treating such payments as reinvested earnings. It would involve a case-by-case approach to making decisions. The TFHPSA considered there are both conceptual and practical problems associated with a treatment as reinvested earnings and several

AEG members agreed with this view. The idea of 100 per cent control being required is very restrictive and it lacks consistency (in effect, 51 per cent control is as good as 100 per cent control). (It was noted that the TFHPSA considered 100 per cent control as indicative rather than being an absolute requirement.) It is difficult to define what constitutes exceptional dividends. If a public corporation consistently accrues losses then it is creating a liability for the government, which ultimately has to provide subsidies and so the losses should be shown at the time they occur. An important factor to consider is consistency with the treatment of similar flows in private corporations (e.g. dividends paid out of reserves need to be treated consistently whether paid by private or public corporations). The principles of reinvested earnings could be adopted in estimating the flows.

810. The Chair summed up that, at this time, the AEG is not ready to adopt the reinvested earning approach because of both conceptual and practical problems but the principle underlying reinvested earnings should be used as guidelines. However, there was a fair degree of support for leaving the reinvested earnings option as a possibility in the SNA, perhaps on a case-by-case basis. The door should be left open for implementation at a later date, with the SNA text indicating that the possibility of a retained earnings approach is a longer-term option. In the meantime, it should be put on the short-term research agenda.

811. The Project Manager pointed out that there are two sorts of issues to go on the research agenda – the long-term ones and those topics that require immediate resolution.

812. Peter Harper, Jacques Magniez, Brent Moulton and Peter van de Ven volunteered to assist the ISWGNA in the short-term research.

## **Summary conclusion**

### ***Outcomes***

- (a) The AEG agreed, with the emphasis on *exceptional* payments.
- (b) The AEG agreed.
- (c) The AEG agreed.
- (d) The AEG was attracted to the “reinvested earnings approach” in concept but was concerned about both some conceptual aspects and the practical implications. The AEG agreed that the text of the updated SNA should refer to the possibility of using this approach when considering what transactions should actually be recorded under the three points above.

The AEG agreed that this issue should be put on the short-term research agenda starting from the BPM treatment and seeing how far these principles could be applied directly to publicly controlled enterprises. An AEG team will work with the ISWGNA to support the research; volunteers for the team were Peter Harper, Jacques Magniez, Brent Moulton and Peter van de Ven.

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## Granting and activation of guarantees in an updated SNA

### Issue 37; Paper SNA/M1.06/18; for decision

#### Description of the issue

*Loan guarantees have a significant impact on economic behaviour, especially when issued by government. The 1993 SNA treats guarantees as contingent liabilities and thus has no record of the existence of the guarantee until it is activated. Further, the treatment of flows arising at the activation is not explicit. Should obligations arising from guarantees be recognized when guarantees are granted, particularly regarding those guarantees for which it is possible to make reasonable estimates of expected future claims?*

#### Presentation

813. The paper for this session (document number SNA/M1.06/18; Issue 37) was written by Reimund Mink and presented by Reimund Mink and Manik Shreshta. The session was chaired by Barbro Hexeberg (World Bank).

#### **Introduction**

814. Guarantees have a significant impact on the behaviour of economic agents by influencing their decisions on production, income, investment or saving and by modifying the lending and borrowing conditions on financial markets. Some borrowers would have no access to loans in the absence of guarantees, while others would benefit from comparatively low(er) interest rates than they would otherwise have to pay.

815. Guarantees are particularly significant for general government and for the public sector as government activities are often linked with the issuance or activation of guarantees. The 1993 SNA indicates that only guarantees that are classified as financial derivatives should be recorded in the core accounts, with supplementary information to be provided where contingencies are important for policy and analysis.

816. The treatment of stocks and flows arising from the granting and activation of guarantees should be modified for three reasons

- supplementary information to be provided is not reported;
- need to delineate across economic events that lead to guarantees;
- convergence with international accounting standards that quantify the underlying liability, notably in the public sector.

#### **Recommendations - general**

817. Fourteen recommendations are proposed and one question is raised:

**Rec 1:** The proposed treatment of guarantees should distinguish between

- guarantees as financial derivatives;

- standardised guarantees; and
- one-off guarantees.

### ***Guarantees as financial derivatives***

**Rec 2:** Guarantees that meet the definition of financial derivatives should be treated as **financial derivatives**. This should be clarified within the updated SNA by also specifying such types of guarantees as a sub-category of financial derivatives.

### ***Standardized guarantees***

818. The issue is to treat the provision for standardized guarantees as financial assets and liabilities. It would require a new financial instrument (“provisions for calls under standardized guarantees”) to be created under insurance technical reserves. Standardized guarantees are assets of creditors and liabilities of guarantors.

819. Two options are being considered. The first is treat guarantees in a manner similar to insurance (premiums and claims treated as current transfers). The second is to treat them simply as financial instruments. The output of the guarantor, property income, and balance sheet positions are the same under both options. The main differences relate to the recording of premiums and claims. The insurance approach would require entries in the current and financial accounts while the financial instrument approach would require entries in the financial and other flows accounts. As a result, net lending/borrowing will differ under the options. The financial position of the lender is overstated where the guaranteed instrument is valued at nominal value and the loan will be at nominal value plus expected loss.

**Rec 3:** The provision of standardised guarantees should be treated as in a manner that records a financial instrument equal to the net present value of the expected cost of calls on the guarantee<sup>11</sup>. There are two possibilities to do so: Option A: use the current transfers insurance premiums and insurance claims; and Option B: do not use insurance premiums and insurance claims. In both cases financial transactions are recorded in the financial instrument, but in different ways. The balance sheets, output, and property income are the same for both options.

**Question:** Should standardised guarantees be recorded with or without the use of the insurance premiums and insurance claims?<sup>12</sup>

**Rec 4:** A new sub-category of insurance technical reserves should be created and identified as ‘provisions for calls under standardised guarantees’.

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<sup>11</sup> The authors have in mind a guarantee that covers default risks over a number of years for one initial premium payment.

<sup>12</sup> Both methods can provide coherent and consistent recording in the accounts. The method using insurance premiums and insurance claims requires more source data but over the life of a policy the impact on net borrowing is the total payment of claims rather than the initial estimate of that amount which is the case with the simpler method. In effect insurance premiums and insurance claims would bring balance sheet movements in the liability above net worth like the movement in provisions observed when applying IAS 37 to guarantees.



- Rec 5:** The financial instruments for ‘standardised guarantees’ are the assets of the creditor benefiting from the guarantee and the liability of the guarantor. When fees are paid by borrowers, the amount equal to the value of guarantee is rerouted through the creditor as a capital transfer from the borrower to the creditor for the value of the financial asset. The consumption element of the fee is not rerouted and remains the borrower’s consumption.
- Rec 6:** The fee paid to the guarantor covers a consumption element (as intermediate consumption or final consumption of the unit paying the fee) and the purchase of a financial asset. In addition, if treated like insurance (Option A), there would be a current transfer payable to the guarantor.
- Rec 7:** The unit paying the fee receives imputed property income from the guarantor earned on the financial asset acquired when paying the fee. This is returned to the guarantor as the acquisition of more of the financial asset. The resulting increase in the balance sheet liability arises from the unwinding of the discount in the net present value.
- Rec 8:** If a publicly controlled market guarantor sells the guarantee for a premium that does not cover the administration costs and the expected calls under the guarantee, a subsidy from government to the guarantor should be imputed for the amount relating to the administration costs and a capital transfer for amounts relating to the expected costs of calls.<sup>13</sup>
- Rec 9:** The activation of a standardised guarantee should be recorded as a financial transaction in provisions for calls under standardised guarantees. Under the insurance option (Option A) a current transfer would be recorded from the guarantor to the creditor.
- Rec 10:** For standardised guarantees, under the insurance option (Option A), where a one-off premium provides cover for a number of years, an insurance premium would be imputed each year paid by the creditor to the guarantor equal to the value of the expected calls during that year. A financial transaction in provisions for calls under standardised guarantees (disposal of asset by creditor, reduction in liability of guarantor) would also be recorded for the same amount as the insurance premium, representing the expiry of the risk relating to that year. In effect, accruing insurance premiums would be imputed in cases where a one-off payment provides cover over several accounting periods.

### ***One-off guarantees***

- Rec 11:** One-off guarantees should be recorded outside the core accounts, either in a memorandum item or, preferably, in a supplementary set of accounts, where a consistent recording of the involved flows and stocks would be provided.
- Rec 12:** As in the case of provisions on non-performing loans, a sufficiently prominent status should be given to this information to ensure that it is reported in practice

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<sup>13</sup> The precise method for allocation between subsidy and capital transfer, when the fee covers part of the costs, is explained in the text.

**Rec 13:** The specific flows arising from the activation of a one-off guarantee should be recorded on the basis of contractual arrangements and specific circumstances (such as when the unit concerned no longer exists) either as a capital transfer or a financial transaction (including increases in existing equity participation) or other changes in volume of assets.

**Rec 14:** Some guidance should be provided on how to record in the standard accounts one-off guarantees given to corporations in certain well-defined financially distressed situations.

## Discussion

820. In relation to recommendation (a), the presenter was asked whether credit insurance, based on annual premiums, would be covered. The presenter said this would not be the case if the government provides the guarantee to the lender.

821. The AEG agreed to both recommendations (a) and (b) without further discussion.

822. The discussion on recommendation (c) started with one participant stating a preference to treat guarantees inside the scope of existing financial instruments. The Editor recalled that, at the Bangkok AEG meeting, the AEG looked at treating standardised guarantees in the same way as insurance. The paper does not elaborate going down the insurance route; even though we do not know about any individual transaction we could make a reasonable estimate at a broad level. Several participants agreed with the Editor. One expressed concern that we have guarantee activities that look like insurance but actually relate to credit and queried why these should be treated differently from insurance. Another participant said they should be recorded as insurances. This would not use premiums and claims in the way they would be for standard insurance transactions. Treating everything in the financial accounts is superficially attractive but it may lead to some odd results in handling payouts.

823. The Editor said that option (a) does not adequately cover the insurance route. However, others argued that if it looks like insurance then we should treat it as such (similarly if it looks like a financial derivative). Coming from the opposite angle, it could be argued that if a guarantee looks like a derivative then it should be treated as financial. The point was made that those treated as financial derivatives are not just like financial derivatives, they actually are financial derivatives.

824. The Chair concluded that the AEG agreed to the option within recommendation (c) to treat guarantees similarly to insurance. The team will continue to research the issue to set out criteria and circulate an updated proposal to the AEG.

825. The Editor proposed that “Provisions for claims under standardised guarantees” would be a better term than “Standardised guarantees” in recommendation (d). A question about whether it would be a standard or a supplementary item was answered along the lines that amounts recorded will be small and it can probably be folded it into one of the other two categories. The Editor suggested that the best solution would be to have a single item “provision for claims – insurance and standardised guarantees” with an option to split into the two components, if necessary.

826. The discussion on recommendation (e) started with the AEG agreeing that previous decisions meant the assets and liabilities will be separately identified. They will be recorded as current rather than capital transfers if the insurance route is followed. It will be a consumption expenditure of whoever takes out the guarantee, whether it is the creditor or debtor. One of the

implications of this approach is that it will lead to transfers between corporations and it is not clear if there is anything else going on that needs to be recorded.

827. The AEG agreed that whoever is paying for the guarantee is the beneficiary. Rather than imputing a transfer between corporations it would be better to show a rerouting at the end.

828. The AEG decision to treat standardised guarantees as a form of insurance forced a change in direction of this recommendation. In effect, it became pointless to continue discussion on recommendations (f) to (j).

829. The AEG discussed the remaining recommendations ((k) to (n)) together. There was general agreement that the value of these one-off guarantees should be calculated as the net present value of the income stream. As is the case with insurance, an event will give rise to claims so, in practice, the value will be the provision. A claim on the debtor changes the relationship between the guarantee and the debtor. The guarantee has to be paid out in some circumstances but there is a possibility the government does not allow the guarantee to be called. One view was that we do not know the probability they will be called so they will have to be measured in retrospect while an alternative was that we have to show a nominal value. If a number of one-off guarantees have been entered into then we will have to assign a probability to enable an estimate of the value to be made. On one hand it is difficult to estimate a value of the guarantees' expected claims. However, we do know the maximum exposure (the total value of the guarantees).

830. The AEG agreed that it would be preferable to show guarantees in a memorandum item rather than a full supplementary set of accounts and that their valuation should be on the basis of expected claims.

## **Summary conclusion**

### *General*

### ***Recommendations/questions***

- (a) The proposed treatment of guarantees should distinguish between
  - guarantees [covered by] financial derivatives;
  - standardised guarantees; and
  - one-off guarantees.
- (b) Guarantees that meet the definition of financial derivatives should be treated as financial derivatives. This should be clarified within the updated SNA by also specifying such types of guarantees as a sub-category of financial derivatives.

### ***Outcome***

- (a) The AEG agreed.
- (b) The AEG agreed.

## *Standardized guarantees*

### **Recommendations/questions**

- (c) The provision of standardised guarantees should be treated as in a manner that records a financial instrument equal to the net present value of the expected cost of calls on the guarantee. There are two possibilities to do so: Option A: use the current transfers insurance premiums and insurance claims; and Option B: do not use insurance premiums and insurance claims. In both cases financial transactions are recorded in the financial instrument, but in different ways. The balance sheets, output, and property income are the same for both options.
- (e) The financial instruments for 'standardised guarantees' are the assets of the creditor benefiting from the guarantee and the liability of the guarantor. When fees are paid by borrowers, the amount equal to the value of guarantee is rerouted through the creditor as a capital transfer from the borrower to the creditor for the value of the financial asset. The consumption element of the fee is not rerouted and remains the borrower's consumption.
- (f) The fee paid to the guarantor covers a consumption element (as intermediate consumption or final consumption of the unit paying the fee) and the purchase of a financial asset. In addition, if treated like insurance (Option A), there would be a current transfer payable to the guarantor.
- (g) The unit paying the fee receives imputed property income from the guarantor earned on the financial asset acquired when paying the fee. This is returned to the guarantor as the acquisition of more of the financial asset. The resulting increase in the balance sheet liability arises from the unwinding of the discount in the net present value.
- (h) If a publicly controlled market guarantor sells the guarantee for a premium that does not cover the administration costs and the expected calls under the guarantee, a subsidy from government to the guarantor should be imputed for the amount relating to the administration costs and a capital transfer for amounts relating to the expected costs of calls.
- (i) The activation of a standardised guarantee should be recorded as a financial transaction in provisions for calls under standardised guarantees. Under the insurance option (Option A) a current transfer would be recorded from the guarantor to the creditor.
- (j): For standardised guarantees, under the insurance option (Option A), where a one-off premium provides cover for a number of years, an insurance premium would be imputed each year paid by the creditor to the guarantor equal to the value of the expected calls during that year. A financial transaction in provisions for calls under standardised guarantees (disposal of asset by creditor, reduction in liability of guarantor) would also be recorded for the same amount as the insurance premium, representing the expiry of the risk relating to that year. In effect, accruing insurance premiums would be imputed in cases where a one-off payment provides cover over several accounting periods.

### *Standardized guarantees*

#### **Outcome**

- (c) The AEG agreed and clarified that standardised guarantees should be treated in the same way as insurance; in respect of output, property income and the recording of premiums and claims.
- (d) A new sub-category of insurance technical reserves should be created and identified as “standardised guarantees”.

The AEG agreed that the category of insurance technical reserves, now to be called “insurance technical provisions,” should be extended to be “provisions for insurance claims and calls under standardised guarantees” with an optional breakdown to distinguish insurance reserves from provisions for calls on standardised guarantees.

- (e) The AEG specified a number of aspects under this question flowing from the decision to treat standardised guarantees as insurance:
  - The assets of those benefiting from the guarantees are those matching the liability and not the itemised assets of the guarantor.
  - The consumption item is attributed to the unit taking out the guarantee, the creditor or debtor as appropriate.
  - If the guarantee is taken out by the debtor, all transactions with the guarantor are recorded as being with the debtor up until the call is paid to the creditor.

Because of the change in direction of the AEG’s recommendation, recommendations (f) to (j) were not discussed. A new reworking of the tables will be prepared and checked for any remaining questions for discussion.

### *One-off guarantees*

#### **Recommendations/questions**

- (k) One-off guarantees should be recorded outside the core accounts, either in a memorandum item or, preferably, in a supplementary set of accounts, where a consistent recording of the flows and stocks involved would be provided.
- (l) As in the case of provisions on non-performing loans, a sufficiently prominent status should be given to this information to ensure that it is reported in practice.
- (m) The specific flows arising from the activation of a one-off guarantee should be recorded on the basis of contractual arrangements and specific circumstances (such as when the unit concerned no longer exists) either as a capital transfer or a financial transaction (including increases in existing equity participation) or other changes in volume of assets.

- (n) Some guidance should be provided on how to record in the standard accounts one-off guarantees given to corporations in certain well-defined financially distressed situations.

### **Outcome**

- (k) The AEG preferred the memorandum item approach rather than having a set of supplementary accounts. Valuation should be at nominal value and on an expected net present value, if possible.
- (l) The AEG agreed.
- (m) The AEG agreed, with the qualification that the guarantor always makes a capital transfer or has a financial claim. It should be treated as a capital transfer unless there is a genuine financial claim.
- (n) The AEG agreed.

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## **Summary conclusions and wrap-up**

831. The Project Manager noted that all were aware that this meeting marked the end of the issue oriented meetings and that the agenda was long and included several issues recognized as difficult. She believed that participants deserved high marks for professionalism, cooperation, and other attributes that help provide the kind of atmosphere needed for sound and thoughtful discussion. The meeting completed an extraordinary amount of work. Recommendations were reached on almost all issues, and, in the few cases where they were not, the meeting identified a time-bound way forward. Discussions were opened on consistency, a focus for the months immediately ahead.

832. Thanks are due to many individuals and groups:

- the task force and EDG members and secretariats, who prepared many of the papers;
- AEG members, who clearly put in substantial time and effort to prepare and then spend almost two weeks in Frankfurt;
- the ISWGNA (and staff back in their offices) and Editor, who drafted and reviewed papers and chaired sessions;
- the Rapporteur, who had recommendations ready for review the next day; and
- especially the ECB, which provided excellent facilities and warm hospitality.

## **Evaluation at the end of this phase**

833. In terms of the UN Statistical Commission's mandate, the SNA update is about on schedule, the AEG remains focused on all the 44 agreed issues and conducted full and professional discussions. The AEG has lived up to the expectations that it would function at the top of the "expert pyramid". There has also been wide involvement on the part of the international statistical community.

## Looking ahead

834. The next steps are to produce the short and long reports of the meeting (by Friday 17 February for the former and some time in March for the latter). A full set of provisional recommendations will be circulated, along with updated descriptions of the issues. The schedule for the drafting and review phase will be set out. Websites will be set up to enable progress to be made on the consistency issues and for the long-term research agenda. The Project Manager's Progress Report will be presented to the Statistical Commission in early March.

835. The long-term research agenda will concentrate on issues that were outside the scope and/or timeframe of the SNA update. The ISWGNA will provide the infrastructure but others need to take the lead in the substantive work required in the near-term to advance this agenda.

836. AEG members' continued involvement in the coming months will focus on:

- electronic discussion of consistency issues;
- participation in the review of the draft chapters;
- specific tasks, such as the informal sector sub-group.

837. It will be several months before the venues and dates for the remaining two AEG meetings will be pinned down. Meanwhile, AEG members will serve as ambassadors in regional discussions and in meetings such as IARIW.

## Agenda

### Fourth Meeting of the Advisory Expert Group on National Accounts

30 January – 8 February 2006

at the European Central Bank, Frankfurt

Monday, 30 January
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9.00 – 12.30 Chair: Barbro Hexeberg, World Bank

#### Opening of the meeting by the European Central Bank

##### Approval of the agenda

*Document:* SNA/M1.06/01

##### Leases and licences, part 1 and part 2 (Issue 21)

*Papers for decision:* SNA/M1.06/09.1 and SNA/M1.06/09.2

##### Contracts and leases: Government permits (Issue 21)

*Paper for decision:* SNA/M1.06/08

##### Amortization of intangible non-produced assets (Issue 28)

*Paper for decision:* SNA/M1.06/13

*Background paper:* Attachment tables for the amortization of intangible non-produced assets

14.00 – 17.30 Chair: Charles Aspden, OECD

##### Merchanting (Issue 41)

*Paper for decision:* SNA/M1.06/19

##### Satellite accounts (Clarification C13)

*Paper for information:* SNA/M1.06/37

##### Interest under high inflation (Issue 8)

*Paper for information:* SNA/M1.06/34

##### Review of the outcome of e-discussions (Issues 18, 31, 33; Clarifications C10, C12)

*Papers for information:* SNA/M1.06/26.1, SNA/M1.06/26.2, SNA/M1.06/27.1, SNA/M1.06/27.2, SNA/M1.06/28.1, SNA/M1.06/28.2, SNA/M1.06/31.1, SNA/M1.06/31.2, SNA/M1.06/33.1, SNA/M1.06/33.2



**Tuesday, 31 January**

**9.00 – 12.30** Chair: Carol S. Carson, Project Manager

**The treatment of employer pension schemes and other defined benefit pension schemes**  
(Issue 2)

*Paper for decision:* SNA/M1.06/03.1

*Background paper:* Unfunded employer and social security pension schemes (Eurostat)

**Pension schemes** (Issue 2)

*Paper for decision:* SNA/M1.06/03.2

**14.00 – 17.30** Chair: Dieter Glatzel, Eurostat

**Definition of economic assets** (Issue 30)

*Paper for decision:* SNA/M1.06/14

**Summary of previous day's discussions – AEG recommendations**

**Review of the outcome of e-discussions** (Issues 4a, 42, 44)

*Papers for information:* SNA/M1.06/25.1, SNA/M1.06/25.2, SNA/M1.06/29.1,  
SNA/M1.06/29.2, SNA/M1.06/30.1, SNA/M1.06/30.2

**Wednesday, 1 February**

**9.00 – 12.30** Chair: Ivo Havinga, UNSD

**Output of central banks** (Issue 6b)

*Paper for decision:* SNA/M1.06/05

**The production of financial corporations and price/volume measurement of financial services and non-life insurance services** (Issue 6a)

*Paper for decision:* SNA/M1.06/04

*Background paper:* Note by A.C. Kulshreshtha on Treatment of informal sector financial activities including own money lenders in the SNA

**14.00 – 17.30** Chair: Charles Aspden, OECD

**Equity** (Clarification C9)

*Paper for decision:* SNA/M1.06/23

**Summary of previous day's discussions – AEG recommendations**

**Treatment of currency unions** (Clarification C26)

*Paper for information:* SNA/M1.06/39

*Background paper:* Numerical example for the treatment of currency unions

*Background paper:* Summary of the Currency Union Technical Expert Group (CUTEG) meeting, 27 June – 1 July 2005

**Direct investment** (Clarification C28)  
*Paper for information:* SNA/M1.06/40

**Globalization: A progress report** (Issue 25c)  
*Paper for information:* SNA/M1.06/42

<b>Thursday, 2 February</b>
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**9.00 – 12.30** Chair: Dieter Glatzel, Eurostat

**Assets boundary for intangible non-produced assets - Other intangible fixed assets** (Issues 13, 29)  
*Paper for decision:* SNA/M1.06/06

**Classification and terminology of non-financial assets** (Issue 27)  
*Paper for decision:* SNA/M1.06/12

**14.00 – 17.30** Chair: Adriaan Bloem, IMF

**Country comments on recommendations made by the July 2005 AEG meeting**  
*Paper for information:* SNA/M1.06/43

**Non-market producers' owned assets - Cost of capital services** (Issue 16)  
*Paper for decision:* SNA/M1.06/07

**Summary of previous day's discussions – AEG recommendations**

**Liability aspects of SDRs and international reserves** (Issue 44)  
*Paper for decision:* SNA/M1.06/22  
*Paper for information:* SNA/M1.06/36

<b>Friday, 3 February</b>
---------------------------

**9.00 – 12.30** Chair: Ivo Havinga, UNSD

**Debt concessionality** (Issue 43b)  
*Paper for decision:* SNA/M1.06/20

**Debt reorganization** (Issue 43b)  
*Paper for information:* SNA/M1.06/35

**Classification and terminology of financial assets and liabilities in the updated SNA** (Issue 44)  
*Paper for decision:* SNA/M1.06/21

**14.00 – 17.30** Chair: Barbro Hexeberg, World Bank

**Classification and terminology of financial corporations in the updated SNA** (Clarification C30)

*Paper for decision:* SNA/M1.06/24

**Summary of previous day's discussions – AEG recommendations**

**Drafting and review phase of the update, including outreach**

*Discussion based on oral presentations*

*Background paper:* Minutes of OECD/ECE Working Party

<b>Monday, 6 February</b>
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**9.00 – 12.30** Chair: Charles Aspden, OECD

**Units in the 1993 SNA** (Issues 25a, 25b, 25d)

*Paper for decision:* SNA/M1.06/11

**14.00 – 17.30** Chair: Ivo Havinga, UNSD

**Public-private partnerships** (Issue 24)

*Paper for decision:* SNA/M1.06/10

**Summary of previous day's discussions – AEG recommendations**

**The general government and public sectors** (Clarification C15)

*Paper for information:* SNA/M1.06/41

**Key features of the editing and review phase of the SNA update**

*Presentation for information*

<b>Tuesday, 7 February</b>
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**9.00 – 12.30** Chair: Adriaan Bloem, IMF

**Consistency of recommendations**

*Discussion based on oral Presentation*

**14.00 – 17.30** Chair: Dieter Glatzel, Eurostat

**The treatment of the informal sector** (Issue 32)

*Paper for decision:* SNA/M1.06/15

**Summary of previous day's discussions – AEG recommendations**

**Review of the outcome of e-discussion** (Clarification C11)

*Papers for information:* SNA/M1.06/32.1, SNA/M1.06/32.2

**Working time measurement (Clarification C16)**

*Paper for information: SNA/M1.06/38*

<b>Wednesday, 8 February</b>
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**9.00 – 12.30** Chair: Adriaan Bloem, IMF

**Government/ public sector /private sector delineation issues (Issue 36)**

*Paper for decision: SNA/M1.06/17*

**Government dividends and capital transactions with public corporations in the updated SNA (Issue 34)**

*Paper for decision: SNA/M1.06/16*

**14.00 – 17.30** Chair: Barbro Hexeberg, World Bank

**Granting and activation of guarantees in an updated SNA (Issue 37)**

*Paper for decision: SNA/M1.06/18*

**Summary conclusions and wrap-up**

**Closing of the meeting**

## **List of participants**

### **Fourth Meeting of the Advisory Expert Group on National Accounts**

**30 January – 8 February 2006**

**at the European Central Bank, Frankfurt**

Mr Ole Berner  
Denmark

Mr Meshesha Getahun  
Ethiopia

Mr Peter Harper  
Australia

Mr Omar Hakouz  
Jordan

Mr Jan Heller  
Czech Republic

Mrs Mariam Cover Jiminez  
Costa Rica

Mr Andrey Kosarev  
Russian Federation

Mr Akhilesh C. Kulshreshtha  
India

Mr Robin Lynch  
United Kingdom

Mr Jacques Magniez  
France

Mr Reimund Mink  
European Central Bank

Mr Brent R. Moulton  
USA

Mr Peter Pariag  
Trinidad and Tobago

Mr Johan Prinsloo  
South Africa

Mr Roberto Ramos  
Brazil

Mr John Ruser  
USA

Ms Irena Tvarijonavičiūtė  
Lithuania

Mr Peter van de Ven  
Netherlands

Ms Karen Wilson  
Canada

**Project Manager**

Ms Carol Carson

**Editor**

Ms Anne Harrison

**Intersecretariat Working Group on National Accounts**

**Organisation for Economic Cooperation and Development**

Mr Charles Aspden

Mr Jean-Pierre Dupuis

Mr François Lequiller

**International Monetary Fund**

Mr Adriaan Bloem

Mr Cornelius Gorter

Mr Robert Heath

Ms Lucie Laliberté

Mr Manik Shreshta

**World Bank**

Ms Barbro Hexeberg

**UN Economic Commission for Europe**

Ms Lidia Bratanova

**UN Statistics Division**

Mr Ivo Havinga

Mr Viet Vu

**Eurostat**

Mr Dieter Glatzel

**International Labour Organization**

Mr Ralf Hussmanns

Ms Sophia Lawrence

**Apologies**

Ms Heidi Arboleda  
The Philippines

Ms Chellam Palanyandy  
Malaysia

## **National Accounts and Related Manuals**

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

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

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

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

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

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

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

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

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



## Acronyms

BoP	Balance of payments
BOPCOM	IMF's Balance of Payments Committee
BPM5	Balance of Payments Manual 1993 (fifth edition)
CPC	Central product classification
COICOP	Classification of individual consumption by purpose
COFOG	Classification of the functions of government
COFC	Consumption of fixed capital
CPI	Consumer Price Index
Eurostat	Statistical Office of the Commission of the European Communities
FISIM	Financial intermediation services indirectly measured
FRA	Forward rate agreement
GDP	Gross domestic product
GFCF	Gross fixed capital formation
GFS	Government Finance Statistics
GFSM2001	Manual of Government Finance Statistics (2001 edition)
GNI	Gross national income
GOS	Gross operating surplus
IMF	International Monetary Fund
I-O	Input-output
ISIC	International Standard Industrial Classification of All Economic Activities
MFP	Multifactor productivity
NDP	Net domestic product
NPI	Non-profit institution
NPISH	Non-profit institutions serving households
NPL	Non-performing loan

NPV	Net present value
OECD	Organisation for Economic Cooperation and Development
PIM	Perpetual inventory method
PPP	Public/private partnerships OR
PPP	Purchasing power parity
R&D	Research and development
SAM	Social accounting matrix
SDRs	Special drawing rights
the 1993 SNA	System of National Accounts (1993 edition)
S-U	Supply-use (tables)
UNSD	United Nations Statistical Division
VAT	Value added tax