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Note by the editor:

The following sections are still to be completed:

para 11.3 to check with the definition of assets in chapter 3 when this is completed

Paragraphs of the 1993 SNA version ,moved to other chapters

16-19 to chapter 3

20-24 to chapter 12

29-30 to chapter 3

44-46 to chapter 18

53, 56-61 to chapter 25

| ± 65 to chapter 12

103-111 tp chapter 25

Significant changes in the text

SDR s have liabilities

Unallocated metal accounts

Inter-bank deposits

Breakdown of equity and connection with reinvested earnings

Super-dividends and capital injections

Investment fund shares

Consequences of changes to insurane, annuities, pensions and standardised guarantees

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Chapter 11: The Financial Account

A. Introduction

19.1. The financial account is the final account, in the full sequence of accounts, that records transactions between institutional units. Net

saving is the balancing item of the use of income account, and net saving plus net capital transfers receivable/payable can be used to accumulate non-financial assets. If they are not exhausted in this way, the resulting surplus is called net lending. Alternatively, if net saving and capital transfers are not sufficient to cover the net accumulation of non-financial assets, the resulting deficit is called net borrowing. This surplus or deficit, net lending or net borrowing, is the balancing item that is carried forward from the capital account into the financial account. The financial account does not have a balancing item that is carried forward to another account, as has been the case with all the accounts discussed in previous chapters. Instead, the net balance of the financial account is equal in magnitude, but on the opposite side of the account, to the balancing item of the capital account.

19.2. The financial account records transactions that involve financial assets and liabilities and that take place between resident institutional units and between resident institutional units and the rest of the world. The left-hand side of the account (table 11.1) records acquisitions of financial assets less disposals, while the right-hand side records incurrence of liabilities less their repayment.

19.3. Reprise of definition of financial asset and liability. It will be drawn from and consistent with the definition to appear in chapter 3.

19.4. The accounting rules of the System, explained in chapter 3, describe how the quadruple principle of accounting is implemented. When a good, service or asset

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is sold by one institutional unit to another, two pairs of entries are recorded. The first pair records the supply of the item by one unit and the acquisition by the other. The

second pair records the second

party supplying the means of payment for

the item, (or a claim on a future means of payment), and the first party receiving this.

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Similar quadruple entries are required in respect of transactions involving property income and transfers. The second pair of entries always appears in the financial account. In all cases except the provision of a financial asset or settlement of a financial liability, the first pair of entries appears in one or more of the non-financial accounts. In the case of the exchange of a financial instrument, all four entries appear in the financial account.

19.5. There are thus two reasons for entries in the financial account. The first reason is as counterpart to entries in other accounts; the second is to record transactions involving the exchange of financial assets and liabilities

only, in which case, both the original and the counterpart pairs of entries are recorded in the financial account.

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1. Counterparts of non-financial transactions

19.6. Transactions involving the change, of ownership of a good or non-financial asset, or

the provision of a service, a labour service or a property income, entail a

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counterpart entry in the financial account for means of payment or claims on future means of payment. Even transactions in kind, such as barter sales and transfers in kind, conceptually lead to entries in the financial account. If unit A provides a product of value x to unit B, expecting another product of the same value in return, A has a financial claim of x on B. This financial claim is settled and thus no longer needs to be recorded when B fulfils delivery of the

product promised. Entries in the financial account are needed when all elements of the in-kind transaction are not completed

in the same accounting period.

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19.7. The sale of a good, service, or asset, or the provision of a property income, may have

as its counterpart a change in currency or transferable deposit. Alternatively, the counterpart may be reflected in the financial account in a trade credit or other accounts receivable/payable. More rarely, a transaction may have its counterpart in other types of financial asset, such as the provision of fixed assets for long-term indebtedness, and the liability may be evidenced by a loan or security.

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2. Exchanges of financial assets and liabilities

19.8. Whenever one financial asset is exchanged for another or when a liability is repaid with an asset, transactions are recorded only in the financial account. These transactions change the distribution of the portfolio of financial assets and liabilities and may change the totals of both financial assets and liabilities, but they do not change the difference between total financial assets and liabilities. For example, trade credits are extinguished by exchanging means of payment. The claim represented by the trade credit no longer exists when the debtor provides means of payment to the creditor. The resulting four entries in the financial account are (a) the creditor reduces its holdings of trade credits and increases its means of payment (currency or transferable deposits); and (b) the debtor reduces its liabilities (in the form of trade credits) and reduces its financial assets (in the form of means of payment).

19.9. When existing financial assets are exchanged for other financial assets, all entries take place in the financial account and only affect assets. For example, if an existing bond is

sold by one institutional unit to another on the secondary market, the seller reduces his holdings of securities and increases his holdings of means of payment by an equal amount. The purchaser increases his holdings of securities and decreases his holdings of means of payment. (Note that, in principle, in such cases, entries should ideally be made in the internal flow-of-funds tables of the issuer of the security (assuming this is not one of the two parties to the secondary market transaction) and of the issuer (bank) of the means of payment concerned, if the old and new counterparties are in different institutional sectors. In practice, these are not made on an ongoing basis, and such reassignments are detected (if at all) only at the time of drawing up the balance sheets).

19.10. When a new financial asset is created through the incurrence of a liability by an institutional unit, all related entries are also made in the financial account. For example, a corporation may issue short-term securities in exchange for means of payment. The financial account of the corporate sector accordingly shows an increase in liabilities in the form of securities and an increase in financial assets in the form of means of payment; the financial account of the purchasing sector shows a reduction in means of payment and an increase in securities.

3. Net lending

19.11. In any given accounting period, some sectors or sub-sectors are net lenders while others are net borrowers. When institutional units engage in financial

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Table 11.1: The financial account- concise form

Changes in assets	S.11	S.12	S.13	S.14	S.15	S.1	Transactions and balancing items	Non-financial
corporations	Financial							
corporations	General							
government	Households	NPISHs	Total economy	Rest of the				

worldGoods and
servicesTotalNet acquisition of financial assets/ 71 237 120 181 32 641 50 691Net
incurrence of liabilities
Monetary gold and SDRs- 1- 11 0
Currency and deposits 17 15 7 68 12 119 11 130
Debt securities 18 53 26 29 12 138 5 143
Loans 27 167 45 5 244 10 254
Equity and investment fund shares23363 442 46
Insurance, pension and standardised guarantee schemes 0 36 36 36
Financial derivatives and employee stock options
Other accounts receivable/payable 7 6 40 8 61 21 82

transactions with each other, the surplus resources of one sector can be made available, by the units concerned, for the use of other sectors. The financial account indicates how deficit, or net borrowing, sectors obtain the necessary financial resources by incurring liabilities or reducing assets and how the net lending sectors allocate their surpluses by acquiring financial assets or reducing liabilities. The account also shows the relative contributions of various categories of financial assets to these transactions.

19.12. The evolution of net lending can be seen clearly in table 11.1. Non-financial corporations are shown to have a net borrowing requirement of 69. This requirement is financed by incurring liabilities of 140 and acquiring financial assets of 71; the difference between the two equals net borrowing. Similarly, the household sector, which has a net lending balance of 148 **[Comment: table currently shows 146]**, achieves this result by acquiring financial assets of 181 and incurring liabilities of 33.

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19.13. Although much borrowing and lending is routed through financial intermediaries, some borrowers can transact directly with non-financial lenders. For example, governments can issue securities in the market; these securities can be purchased by households, non-financial corporations, and the rest of the world. In many other cases, financial intermediaries have as their special function the creation of a financial market that links lenders and borrowers indirectly. The financial institution incurs liabilities to net lenders through taking deposits or issuing securities and providing the financial resources thus mobilized to borrowers, for example in the form of loans, holding of debt securities and holdings of equity securities. Thus, their transactions in financial assets and

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liabilities will be comparatively large relative to other sectors and to the size of their own net lending/borrowing. In table 11.1, the financial corporations sector has a net borrowing balance of 5, which is financed by net incurrence of liabilities of 232 and net acquisition of financial assets of 237.

19.14. An examination of the financial transactions of the sub-sectors of the financial corporations sector, in addition to those of the consolidated financial sector, is often useful.

[Comment: not clear what this very short paragraph is saying, or what, if anything, it leads on to. Give some examples? Is it not also true (although for different types of analysis) for the sub-sectors of government?]

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19.15. It is important to note that, for each institutional sector, the financial account indicates the types of financial instruments utilized by that sector to incur liabilities and acquire financial assets. The financial account does not, however, indicate to which sectors the liabilities are incurred and on which sectors the assets indicate financial claims. A more detailed and complex analysis of financial flows between sectors is discussed in chapter 26. The analysis there illustrates debtor/creditor relationships by type of financial asset.

Table 11.1: The financial account- concise form

	S.11	S.12	S.13	S.14	S.15	Total
Changes in liabilities and net worth						
Non-financial items						
Financial corporations						
General corporations						
government						
Households						
NPISHs						
Total economy						
Rest of the world						
Goods and services						
Total						
Net lending (+) / net borrowing (-)	69	5	50	146	4	36
Net acquisition of financial assets	36	36	0			

Net incurrence of liabilities 140 232 170 33 28 603 88 691
Monetary gold and SDRs
Currency and deposits 130 2 132- 2 130
Debt securities 6 53 64 123 20 143
Loans 71 0 94 28 24 217 37 254
Equity and investment fund shares 26134 433 46
Insurance, pension and standardised guarantee schemes 36 0 36 36
Financial derivatives and employee stock options
Other accounts receivable/payable 37 10 5 52 30 82

19.16. In the hypothetical case of a closed economy in which resident institutional units do not engage in transactions with non-residents, the total net lending and total net borrowing of the various sectors would have to be equal since the net borrowing requirements of deficit sectors would be met by net lending of surplus sectors. For the economy as a whole, net lending or borrowing would have to be zero. This equality reflects the symmetric nature of financial assets and liabilities. When residents engage in transactions with non-residents, the sum of the net lending and net borrowing of each of the sectors making up the total economy must equal the economy's net lending to, or borrowing from, the rest of the world. In table 11.1 the total economy has acquired financial assets of 641 and incurred liabilities of 603. Net

lending [?] for the total economy to the rest of the world is therefore 38 [Comment: 36 in the table]

4. Contingent assets

19.17. Many types of contractual financial arrangement between institutional units do not give rise to unconditional requirements either to make payments or to provide other objects of value; often the arrangements themselves do not have transferable economic value. These arrangements, which are often referred to as contingencies, are not actual current financial assets and should not be recorded in the System. The principal characteristic of contingencies is that one or more conditions must be fulfilled before a financial transaction takes place. Some examples are as follows. [Comment: I suggest using italics to identify the subject of each example.] *One-off guarantees of payment by third parties* are contingencies since payment is required only if the principal debtor defaults. [Comment: perhaps insert a reference to the different treatment of standardised guarantees, dealt with in the next paragraph?] *Lines of credit* provide a guarantee that funds will be made available, but no financial asset exists

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until funds are actually advanced. *Letters of credit* constitute promises to make a payment conditional upon the presentation of certain documents specified by contract.

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Underwritten note issuance facilities (NIFs)

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provide a guarantee that a potential debtor will be able to find a buyer for short-term securities (notes) that he issues: in the absence of a market buyer, the bank or banks issuing the facility stands ready to, take up any unsold notes, or to, provide

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equivalent advances. The facility itself is contingent, and the creation of the facility gives rise to no entry in the financial account. Only if the underwriting institution is requested to make funds available will it acquire an actual asset, which is recorded in the financial account.

19.18. Certain financial derivatives are not treated as contingent financial assets but as actual assets. These are described in section C

below. [Comment: perhaps a new paragraph at this point, since the rest of this one deals with standardised guarantees?] Standardised guarantees, unlike the one-off guarantees described in para 11.17, are also

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treated as giving rise to actual and not contingent liabilities. A standardised guarantee is one where many guarantees with, similar characteristics are issued. Even though the probability of any one guarantee being called is uncertain, the fact that there are many similar guarantees means that an accurate estimate of the number of calls under the guarantee can be made. Liabilities of this sort, where the size of the liability may be determined probabilistically, are often described as *provisions*. The term *liability* is used when the fact that payment will be required and the size of the payment is known. The term *provision* is used when the fact that payment will be required is certain but there is some uncertainty about the size of the payment. A contingent liability is one where the size of payment may or may not be known with certainty but there is uncertainty about whether there will be a payment required or not.

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19.19. For the purposes of the System, the treatment

of contingencies is simple. Any payments of fees related to the establishment of contingent arrangements are treated as payments for services. Transactions are recorded in the financial account only when an actual financial asset is created or changes ownership. However, by conferring certain rights or obligations that may affect future decisions, contingent arrangements obviously produce an economic impact on the parties involved. Collectively, such contingencies may be important for financial programming, policy, and analysis. Therefore, where contingent positions are important for policy and analysis, it is recommended that supplementary information be collected and presented as supplementary data. Even though no payments may eventually be due for contingent liabilities, the existence of a high level of them may indicate an

undesirable level of risk on the part of those units offering them.

19.20. Country practices vary in determining which instruments are considered contingent and which are considered actual assets to be recorded in the balance sheet. An example, which is quantitatively important in trade

financing, is the bankers' **[Comment: decide whether to use the singular or plural form of the apostrophe - singular is probably better]** acceptance. A

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banker's acceptance involves the acceptance by a financial institution of drafts or bills of exchange and the unconditional promise to pay a specific amount at a specified date.

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The banker's acceptance represents an unconditional claim on the part of the holder and an unconditional liability on the part of the accepting bank; the bank's counterpart asset is a claim on its customer. For this reason, the banker's acceptance is treated as an actual financial asset in the System even though no funds may have been exchanged. Flexibility in the application of this recommendation will be required to take national practices and variations in the nature of these instruments into account.

19.21. There are other circumstances where future payments are not treated as assets, even though both the size of the payment and the fact that it will be paid are known with certainty. One example is that although a bank loan may be granted to an individual using the fact that he is in permanent employment with a regular wage as security, the promise of future earnings is not recognised as a financial asset. Nor are future receipts from sales for an enterprise nor a stream of future tax revenue for government.

B. Transactions in financial assets and liabilities

1. The classification of financial assets and liabilities

19.22. Because of the symmetry of financial claims and liabilities, the same classification can be used to portray both assets and liabilities. Further, the same classification is used in all

accumulation accounts for financial transactions. Within the System, the term “instrument” may be used to relate to the asset or liability aspect of an item on the financial balance sheet. In monetary statistics, some off-balance sheet items may also be described as instruments. The use of the same term in the System is for convenience only and does not imply an extension of the coverage of assets and liabilities to include these off-balance-sheet items.

19.23. Two classes of financial assets that cannot properly be equated with identified claims over other designated institutional units are included in the classification of financial

instruments. These two classes of asset are monetary gold and shares. ~~[Comment: should this read “equity”?].~~ Monetary gold is owned by monetary authorities and others subject to the authorities’ effective control and held as a financial asset and as a component of foreign reserves. There is no matching liability for monetary gold. Shares, other corporate equity securities, and

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financial participation are by convention treated as liabilities ~~of the units that have issued them~~. However, these liabilities do not have fixed redemption values, as is the case for many other financial

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assets, but represent claims by the shareholders on the net worth of the corporation.

19.24. Table 11.2 is similar to Table 11.1, but with a breakdown of the instruments in the full detail used in the System. The exact coverage and

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definition of each of the items is described in section C below. That section will also, for some instruments, make reference to some supplementary classifications that, although not formally specified in the System, may be of analytical value for some purposes. The remainder of this

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incorporating the classification of financial ¶ instruments

section deals with general matters of instrument classification and the application of the accounting rules of the System as they apply to transactions in financial instruments.

19.25. The detail in which the instrument classification is employed depends on the institutional sector to be analysed. The types of financial asset

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in which households transact are more limited than those for other sectors, and sources of information are generally more limited than those for other sectors. Financial

corporations, on the other hand, transact in the full range of instruments, and information on their operations is often the most detailed and timely of any institutional units.

Consequently, a detailed breakdown may be developed for financial corporations. Blanks, rather than zeros in table 11.2 show where entries are conceptually impossible; zeros show that entries are possible but expected to be small.

19.26. The standard items in the classification of financial assets and liabilities provide a useful basis for international comparison of national data. Presentation of data for individual countries, however, must be tailored to meet their analytical needs and to reflect national practices. This may reflect differing institutional arrangements, the extent and nature of national financial markets, the complexity of financial assets available, and the degree of regulation and other financial control exercised. For this reason, a number of supplementary items are suggested for use in addition to the standard components of the System. These are described together with the standard items in section C. **[Comment/reminder: ensure that items are clearly labelled as standard or supplementary]**

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19.27. The classification of financial transactions has become more difficult because of financial innovation that has led to the development and increased use of new and often complex financial assets and other financial instruments to meet the needs of investors with respect to maturity, yield, avoidance of risk, and other factors. The identification issue is further complicated by variations in characteristics of financial instruments across countries and variations in national practices on accounting and classification of instruments. These factors tend to limit the scope for firm recommendations with respect to the treatment of certain transactions within the System. Thus, a substantial amount of flexibility, particularly with regard to further breakdowns, is required to match the classification scheme to national capabilities, resources and needs. In particular, further breakdowns of the standard items are

desirable for many countries to distinguish important types of assets within categories (such as short-term securities included in measures of money).

[Comment: it is not clear whether this paragraph is a justification of the promised mentions of supplementary items, or whether it is signalling that there may be yet other desirable breakdowns, that will not actually be further described in the text. If the latter, then some such phrase such as “additional to or as alternatives to the standard and supplementary items” might be useful.]

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2. Valuation of transactions

19.28. The payments required under a contract

relating to financial assets and liabilities (by contrast with those used to settle transactions in goods or non-financial services)

very often [?] represent more than one transaction in the sense used in the System.

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For example, payments of interest on loans and deposits, as

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specified by financial institutions, involve both interest as recorded in the System and a service fee, which is the service payment to the financial institution for making the loan or deposit available.

A second example is the difference between the buying and selling prices of foreign currency or securities;

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the difference between the buying and mid-price represents a service provided to and charged to the buyer and the difference between the mid-price and selling price a service provided to and charged to the seller. For some financial instruments, for example bonds, the difference in prices over time are taken to represent interest, not simply a price increase in the value of the asset. In some cases more than one adjustment may be needed to the apparent transaction value to identify and re-route both the service charge and interest associated with the asset.

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19.29. It is essential that the value of the transactions in financial instruments recorded in the financial account carefully excludes these service charges and interest payments. Section X of chapter 17 describes the adjustments necessary to make these exclusions on an instrument-by-instrument basis.

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19.30. Financial transactions with respect to proprietors' net additions to the accumulation of quasi-corporate enterprises and changes in

households' claims on insurance enterprises and pension funds raise complex issues of valuation that are referred to in the relevant item under classification of these categories below, and more extensively in chapter 17.

3. Time of recording

19.31. In principle, the two parties to a financial transaction should record the transaction at the same point in time. When the counterpart to an entry in the financial account is in another account, the time of recording of financial claims is to be aligned with the time of recording in the other accounts of the transactions that gave rise to the financial claim. For example, when sales of goods or services give rise to a trade credit, the entries in the financial accounts should take place when ownership of the goods is transferred or

when the service is provided. Similarly, when accounts receivable/payable arise from transactions related to taxes, compensation of employees, and other distributive transactions, the entries in the financial account should take place when the entries are made in the relevant non-financial account.

19.32. When all entries relating to a transaction pertain only to the financial account, they should be recorded when the ownership of the asset is transferred. This point in time is usually clear when the transaction involves the sale of existing financial assets. When the transaction involves the incurrence or redemption of a liability, both parties should record the transaction when the liability is incurred or redeemed. In most cases, this will occur when money or some other financial asset is paid by the creditor to the debtor or repaid by the debtor to the creditor.

19.33. In practice, the two parties to a financial transaction may perceive the transaction as being completed at different points in time.

This is especially true when trade credits or other accounts payable/receivable are extinguished by final payments and there is a lag between the point in time when payments are made and received, ceating a “float”.

There are several stages at which creditors and debtors could record a transaction. The debtor could record the liability as being extinguished when the cheque or other means

of payment is issued to the creditor. However, a substantial period of time may elapse before the creditor receives the means of payment and records the payment in his accounts.

There may then be further time-lags between presentation of a cheque to a bank, cheque clearance, and final settlement of the transaction. Asymmetries in time of recording of this transaction are, therefore, likely to emerge unless the debtor records his transaction on a “cheques cleared” basis, a fairly uncommon accounting procedure. A

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financial claim exists up to the point that the payment is cleared and the creditor has control of the funds; this would be the optimal point in time for recording the transaction. The float, in practice, may be very large and may affect, in particular, transferable deposits, trade credits, and other accounts receivable. This effect is especially pronounced in countries where the postal system and bank clearing procedures are weak. When the float is significant and accounts for large discrepancies in reporting, it is necessary to develop estimates of the size of the float in order to adjust the accounts.

4. Netting and consolidation

Netting

19.34. As described in chapter 3, netting is a process whereby entries on alternate sides of the account (i.e. acquisitions and disposals) for transactions by a given institutional unit in the same type of instrument, are offset against one another. In general the preference of the System is to avoid netting, but this may not always be possible and, for some particular analyses, may not always be desirable.

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19.35. The degree of netting with which transactions in financial assets and liabilities should be recorded depends to a great extent on the analysis for which the data are to be used. In practice, the degree of netting will depend on how data can be reported, and reporting may vary substantially for different classes of institutional units. If detailed information on financial transactions is maintained and reported, gross presentations are possible; if transactions must be inferred from balance sheet data, a certain level of netting is inevitable. A number of degrees of netting can be identified:

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(a) no netting (i.e. fully gross reporting): purchases and sales of assets of the same type are separately recorded, as are incurrences and repayments of liabilities;

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(b) netting within a given specific asset,

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such as subtracting sales of bonds of a given set of characteristics (denomination, issuer, maturity etc) from acquisition of similar bonds and redemption of bonds of a given set of characteristics from new incurrences of similar liabilities;

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of bonds

(c) *netting within a given category of asset*, such as subtracting all disposals of debt securities from all acquisitions of such assets;

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(d) *netting transactions in liabilities against transactions in assets* in the same asset category; and

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(e) netting transactions *in groups of liability categories* against transactions in assets in the same groups.

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In the balance sheets (see Chapter 13) [Comment: and in the asset accounts also?] nettings of types (a) and (b) are also usually applied, and nettings of types (c), (d) and (e) are sometimes applied.

19.36. Transactions recorded in the financial account represent net acquisition of assets and net incurrence of liabilities. However, it is clear that, when data are collected on a gross basis as possible, they can be netted to whatever degree is necessary for a particular use; when data are collected net, they cannot be grossed up. In general, netting beyond the level described in (c) above hinders the usefulness of the financial accounts for tracing how the economy mobilizes resources from institutional units with positive net lending and transmits them to net borrowers. For detailed flow of funds analysis, in which transactions (or positions) of each sector against each other sector are distinguished – see Chapter NN, gross reporting or netting at level (b) above is desirable, particularly for analysis of securities, but netting at level (c) above still provides useful information on financial flows.

Consolidation

19.37. Consolidation in the financial account refers to the process of offsetting transactions in assets for a given group of institutional units against the counterpart transactions in liabilities for the same group of institutional units. Consolidation can be performed at the level of the total economy, institutional sectors, and sub-sectors. Different levels of consolidation are appropriate for different

types of analysis. For example, consolidation of the financial accounts for the total economy emphasizes the economy's financial position with the rest of the world since all domestic financial positions are netted on consolidation. Consolidation for sectors permits the tracing of overall financial movements between sectors with positive net lending and those with net borrowing and the identification of financial intermediation. Consolidation only at the sub-sector level for financial corporations can provide much more detail on intermediation and allow, for example, the identification of the central bank's operations with other financial intermediaries. Another area where consolidation can reveal useful basic information is within the general government sector when transactions between the various levels of government are consolidated.

C. Recording of individual financial instruments

In this section, definitions are given for each financial instrument, in some cases illustrated by examples. Reference is sometimes also made to other items with which the standard items can sometimes be confused. [Comment: would it be useful to associate each definition in this section with its standard code ((A)F.1, (A)F.2 etc?]

[Comment: would it be useful (possible?) to distinguish between standard items and supplementary items? It would perhaps be sufficient to indicate the supplementary status only for the supplementary items?]

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1. Monetary gold and SDRs

19.38. Monetary gold, and Special Drawing Rights (SDRs) issued by the IMF, are assets that are normally held only by monetary authorities. Monetary gold

19.39. Monetary gold is gold owned by monetary authorities and others subject to the authorities' effective control that is held as a financial asset and as a component of foreign reserves. Only gold that is held as a financial asset and as a component of foreign reserves is classified as monetary gold. Therefore, except in limited institutional circumstances, gold can be a financial asset only for the central bank or central government. Transactions in monetary gold

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consist of sales and purchases of gold among monetary authorities. Purchases (sales) of monetary gold are recorded in the financial account of the domestic monetary authority as increases (decreases) in assets, and the counterparts are recorded as decreases

(increases) in assets of the rest of the world. (As indicated in para 11.23 above, gold, including even monetary gold, is not classified as a liability of any unit or sector.)

Transactions of other sectors in non-monetary gold (including non-reserve gold held by the authorities and all gold held by financial institutions other than the monetary authorities) are treated as acquisitions less disposals of valuables (if the sole purpose is to provide a store of wealth) and otherwise as final or intermediate consumption, change in inventories, exports or imports. 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. A discussion on the treatment of allocated and unallocated gold accounts appears under currency and deposits.

19.40. Monetary gold normally takes the form of coins, ingots, or bars with a purity of at least 995/1,000; it is usually traded on organized markets or through bilateral arrangements between central banks. Therefore, valuation of transactions is usually not a problem.

SDRs

19.41. Special Drawing Rights (SDRs) are international reserve assets created by the International Monetary Fund and allocated to its members to supplement ~~their other~~ reserve assets. Transactions in SDRs are recorded in the financial accounts of the monetary authorities and the rest of the world, respectively. SDR allocations are to be recognised as liabilities to the IMF, since IMF members to whom SDRs are allocated do have an actual (unconditional) liability to repay their SDRs allocations in the event of their giving up its membership of the IMF. SDRs are held exclusively by official holders, which are normally central banks, and are transferable among participants in the IMF's Special Drawing Rights Department and other holders designated by the IMF (central banks and certain other international agencies). SDRs represent each holder's assured and unconditional right to obtain other reserve assets, especially foreign exchange. The value of the SDR is determined daily on the basis of a basket of currencies. The basket and the weights are revised from time to time. Valuation of transactions in SDRs raises no difficulties since they are used only in official transactions with a determined daily

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exchange rate.

19.42. The mechanism by which SDRs are created (referred to as allocations of SDRs) and extinguished (cancellations of SDRs) is to be recorded as a transaction. At the time an allocation is made, a claim is entered by the IMF SDR Department against the member country receiving the allocation and the member country records a liability towards the IMF. These transactions are to be recorded at the gross amount of the allocation.

2. Currency and deposits

19.43. The total of currency, inter-bank deposits, transferable deposits, and other deposits should always be calculated. If separate data are considered useful for individual countries, they should be compiled for each of these components.
Currency

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19.44. Currency consists of those notes and coins in circulation that are commonly used to make payments. (Commemorative coins that are not actually in circulation should be

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excluded.) Distinctions should be drawn [Comment: where is this distinction required? Not in any of the standard tables, surely? Is it a recommendation to assist the compiler in valuing holdings accurately, so that (s)he can make proper allowance for exchange rate movements?]

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between domestic currency and foreign currencies, that is, currency that is the liability of resident units, such as central banks, other banks and central government, and currencies that are liabilities of non-resident units, such as foreign central banks, other banks and governments. All sectors may hold currency as assets, but only central banks and government may issue currency.
Transferable deposits

19.45. Transferable deposits comprise all deposits that are:

(a) exchangeable on demand at par, without penalty or restriction; [and?]

(b) freely transferable by cheque; and

(c) otherwise **[Comment: not clear what this is otherwise to!]** commonly used to make payments.

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Transferable deposits should be **[Comment: in what set of standard tables is this called for?]** cross-classified according to:

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(a) whether they are denominated in domestic currency or in foreign currencies; and

(b) whether they are liabilities of resident institutions or the rest of the world.

Within the item “transferable deposits” there are two reasons to distinguish *interbank* **[Comment: should this be hyphenated as in the text below?]** deposits from other transferable deposits (i.e. transferable deposits belonging to non-bank units). These are now discussed.

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Table 11.2: The financial account – full detail

Inter-bank deposits

19.46. Chapter 26 describes how a full analysis of the debtor and creditor sector for each instrument can be portrayed. Such an analysis is known as a detailed flow of funds table. However, not all countries are able to provide these tables on a timely basis. When these tables are not available, there may be ambiguity about whether an amount due to one bank from another is a loan by the first or a deposit of the second. This distinction is not relevant when looking at borrowing and lending across sectors and even across financial sub-sectors. This is one reason to consider separating banks loans and deposits to other banks from other loans and deposits. A second reason concerns the calculation of the charge for financial intermediation service indirectly measured (FISIM). This calculation depends on knowing the level of loans and deposits extended by banks to non-bank customers and calculating the difference between the interest the banks receive or pay and a reference rate applied to the same levels of loans and deposits. The reference rate is assumed to be the inter-bank rate, implying that there is, in general, no FISIM payable between banks. For both these reasons, bank loans and deposits should be separated from other loans and deposits. By convention, the net interbank deposit/loan position is to be

Changes in assetsS.11S.12S.13S.14S.15S.1Transactions and balancing itemsNon-financial corporationsFinancial corporationsGeneral

	government	Households	NPISHs	Total economy	Rest of the world
Goods and services					
Total	71	237	120	181	32
Net acquisition of financial assets/	641	50	691		
Net incurrence of liabilities					
Monetary gold and SDRs-	1-	11	0	Monetary gold-	1-
				SDRs	0
					0
Currency and deposits	17	15	7	68	12
	119	11	130	Currency	515
				2102	343
Transferable deposits	1044	17	622	64	Interbank positions
					Other transferable deposits
					Other deposits
					21173
					236
					29
Debt securities	18	53	26	29	12
	138	5	143	Short-term	1541
				1222	542
				56	Long-term
					34915710
					843
					87
Loans	27	167	45	5	244
	10	254	Short-term	1663	13
			833	86	Long-term
					11104442
					1617
					168
Equity and investment fund shares	233	63	442	46	Equity
					Listed shares
					Unlisted shares
					Other equity
Investment fund shares/units					Money market fund shares/units
					Other investment fund shares/units
Insurance, pension and standardised guarantee schemes	0	36	36	36	
Non-life insurance technical provisions	3				
Life insurance and annuity entitlements	22	22	22		
Pension entitlements	11	11	11		
Provisions for calls under standardised guarantees	0	0	0	0	
Financial derivatives and employee stock options					
Financial derivatives					
Options					
Forwards					
Employee stock options					
Other accounts receivable/payable	7	6	40	8	61
	21	82			
Trade credits and advances	6	11	18	18	36
Pension entitlement funding					
Other accounts receivable/payable	15	298	433	46	

Table 11.2: The financial account – full detail

shown under transferable deposits. *Inter-bank deposits* therefore records deposits less loans between resident banks or between resident and non-resident banks.

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Other deposits

19.47. Other deposits include all claims, other than transferable deposits, on the central bank, other deposit-taking institutions, government units and, in some cases, other institutional units, that are represented by evidence of deposit. **[Comment: would the remark in para 11.49 about the sectors that take liabilities be better (or also?) placed here, to lead into the list of typical forms?]**

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Typical forms of deposits that should be included under this classification are non-transferable savings deposits, term deposits and non-transferable deposits denominated in foreign currencies. The category also covers shares or similar evidence of deposit issued by savings and loan associations, building societies, credit unions and the like. These shares or deposits are legally, or in practice, redeemable on demand or at relatively short notice. Claims on the IMF that are components of international reserves and are not evidenced by loans should be recorded in other deposits. (Claims on the IMF evidenced by loans should be included in loans.) Repayable margin payments in cash related to financial derivative contracts are included in other deposits (see para 11.96), as are overnight and very short-term

Changes in liabilities and net worthS.11S.12S.13S.14S.15S.1
Transactions and balancing items
Non-financial corporations
Financial corporations
General

government	Households	NPISHs	Total economy	Rest of the world
Goods and services	Total	Net lending (+) / net borrowing (-)	69 5- 50 146 4 36- 36 0	Net acquisition of financial assets/
Net incurrence of liabilities	140 232 170 33 28 603 88 691			
Monetary gold and SDRs	Monetary gold	SDRs		
Currency and deposits	130 2 132- 2 130	Currency	35 352 37	Transferable deposits
1 64	Interbank positions	Other transferable deposits	Other deposits	32 32- 3 29
Debt securities	6 53 64 123 20 143	Short-term	23415 515 56	Long-term
Loans	71 0 94 28 24 217 37 254	Short-term	16321117 7610 86	Long-term
168	Equity and investment fund shares	26134 433 46		
Equity	Listed shares	Unlisted shares	Other equity	
Investment fund shares/units	Money market fund shares/units	Other investment fund shares/units		
Insurance, pension and standardised guarantee schemes	36 0 36 36			
Non-life insurance technical provisions	3			
Life insurance and annuity entitlements	22 22 22			
Pension entitlements	11 11 11			
Provisions for calls under standardised guarantees	0 0 0 0			
Financial derivatives and employee stock options				
Financial derivatives				
Options				
Forwards				
Employee stock options				
Other accounts receivable/payable	37 10 5 52 30 82			
Trade credits and advances	864 1818 36			
Pension entitlement funding				
Other accounts receivable/payable	2941 3412 46			

repurchase agreements if they are considered

part of the national definition of broad money (see para 11.55). Other repurchase agreements should be classified under loans. It will often be useful to cross-classify the other deposits category according to:

(a) whether the deposits are

denominated in domestic currency or in foreign currencies, and

(b) whether they are liabilities of

resident institutions or of the rest of the world.

11.48 It is possible to hold accounts for both

“allocated gold” and “unallocated gold”. The distinction is precise, practical and recognised in the balance sheets of units

holding these accounts. An allocated gold account gives full outright ownership of the gold and is equivalent to a custody record of title. An 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, therefore, it is a deposit denominated in gold. In the System, it is therefore,

treated as a deposit in foreign currency. Accounts that are held for allocated gold, on the other hand, are treated as holdings of valuables. Similar accounts, distinguishing between unallocated and allocated accounts,

are also

possible for some other types of precious metal, and should be treated in a similar way; those for unallocated metals are deposits in foreign currency, those for allocated accounts are holding of valuables. If the practice of using commodities in this way extends beyond metals, it will be for consideration whether to extend this practice by all sectors.

11.49 Transferable and other deposits may be held by all sectors. Deposits are most often

accepted as liabilities by financial corporations but institutional arrangements in some countries permit non-financial corporations and households to accept

deposits. [Comment: perhaps transfer or add this to 11.47 above?]

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3. Debt securities

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[Comment: would it be useful to insert a sentence or two about registered and unregistered (bearer) securities, and the practical problems of recording transactions in the latter and allocating holders to sectors? Maybe this is somewhere else already?]

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11.50 Debt securities are assets that are normally traded in financial markets and that give the

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holders the unconditional right to receive stated fixed sums on a specified date (such as bills) or the unconditional right to fixed money incomes or contractually determined variable money incomes, and usually also a fixed or contractually variable sum at a specified date (bonds and

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debentures). Examples of short-term securities are bills, bonds, debentures, negotiable certificate of deposit, banker's acceptances, commercial paper, negotiable securities backed by loans or other assets, preferred stocks or shares that pay a fixed income but do not provide for participation in the residual earnings or value of a corporation, and bonds that are convertible into shares.

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Bills are defined as securities that give the holders the unconditional rights to receive stated fixed sums on a specified date; bills are issued and traded in organized markets at discounts that depend on the rate of interest and the time to maturity. Bonds and debentures are securities that give the holders the unconditional right to fixed

money incomes or contractually determined variable money incomes (in other words, the payment of the income is not dependent

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debtors). With the exception of perpetual bonds, bonds and debentures also give holders the unconditional rights to fixed sums as repayments of principal on a specified date or dates. Further descriptions of these and other types of financial instrument can be found in MFSM and the MFSM Compilation Guide.

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11.51 Securitisation is a process whereby existing

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assets such as loans, mortgages, credit card debt, or other assets (such as, accounts receivable) are repackaged in such a way as to provide backing for new negotiable securities. The creation of the new assets gives rise to entries in the instrument *debt securities* in the financial accounts of the issuer and of the acquirer(s) of the securities. The previously existing assets will continue to be reported on the balance sheet of the institutional units that hold them. The special case of securitisation within the public sector is discussed in chapter 20.

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and the new assets should be classified as ¶
debt securities

11.52 *Loans that are traded, and for which there is*

evidence of a market (with quotations), are reclassified to debt securities. (A loan which is only traded once is not necessarily to be reclassified.) *referred* *stocks or shares* that pay a fixed or contractually determined income, but that do not provide for participation in the distribution of the residual value of an incorporated enterprise on dissolution, are

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included in debt securities. (Those that do provide for participation in the residual value are classified as equity – see para 11.68.) Mortgages are not classified as bonds; they are included under loans.

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11.53 Zero-coupon bonds are long-term securities

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that do not involve periodic interest payments during the life of the bond; instead, they are sold at a discount from par value and the full par value is paid at maturity.

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Deep-discount bonds pay some interest during the life of the instrument but the amount is substantially below market interest. For both of these asset types, the

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difference between the discounted issue price and the price at maturity is substantial. In the System, that difference is treated as interest and is recorded as accruing over the life of the bond rather than when due for payment. This treatment requires that the difference between issue price and the price at maturity be converted into a series of payments (quarterly or annual) recorded as interest (property income). The counterpart of this interest flow is entered in the financial account, under debt securities and the effect

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is that the interest is viewed as having been reinvested by the recipient in the purchase of an additional amount of the security. This treatment has the advantage that the costs of providing the finance are matched to the periods for which the finance is provided.

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11.54. Index-linked securities are instruments for

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which either the coupon payments (interest) or the principal are linked to a price index, the price of a commodity, or to an exchange rate index. The objective is to conserve the

purchasing power of the principal during a period of inflation or of exchange rate variation, in addition to earning interest income. When the coupon payments are index-linked they are treated entirely as interest, as is the case with any variable interest rate financial asset. When the value of the principal is indexed to an indicator that moves in line with a broad-based measure of

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inflation, the issue price of the security is recorded as the principal and the index payment paid periodically and at maturity is treated as interest. The payment owing to indexation should be recorded as interest (property income) over the life of the security and the counterpart should be recorded under debt securities in the financial account.

When a security is indexed to a commodity and thus may be subject to large price fluctuations, a variation on this procedure is recommended. It is explained in detail in

section xx of chapter 18. [Comment: is a sentence or two needed about handling exchange rate movements?]

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19.55. **Repurchase agreements are arrangements whereby an institutional unit sells securities (whether newly issued by itself or pre-existing securities issued by itself or by a third party),**

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at a specified price to another unit under a commitment to repurchase the same or similar securities at a fixed (higher) price on a specified future date (usually very short-term, e.g., overnight or one day) or at a date subject to the discretion of the purchaser.

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On the face of it, such an arrangement appears to involve two separate transactions in financial assets.

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However, its economic nature is similar to that of a collateralized loan, in that the purchaser of the securities is providing to the seller advances backed by the securities for the period of the agreement and is receiving a return from the margin between the two prices when the repurchase agreement is reversed. Therefore,

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in the System, a repurchase agreement is treated as giving rise to a newly created

financial asset in a different instrument class from the underlying securities. The choice of instrument class depends on whether the funds advanced are classified in the national

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definition of broad money: if so, the advances are classified under Other deposits (see

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para 11.47); otherwise, under Loans (There is discussion in chapter 26 of the relationship of money measures to the SNA).

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19.56. **Foreign exchange and gold swaps are a form of repurchase agreement commonly undertaken between central banks or between a central bank and banking**

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institutions in a country. Foreign exchange and gold swaps are not to be confused with interest rate or currency swaps discussed in paragraph 11.38 below. Swaps between central banks involve an exchange of deposits and, for each of the two parties, the acquisition of a financial asset (the deposit at the foreign central bank) and the incurrence of a liability (the deposit by the foreign central bank). Swaps between central banks should be recorded as transactions in the financial account. When a central bank acquires foreign exchange from a domestic bank in return for a deposit at the central bank and there is a commitment to reverse the transaction at a later date, this transaction should be treated as a new financial instrument (a loan from the central bank) and recorded as such in the financial account. [Comment: the sequence of sentences in this para is not very clear. Not clear whether some sentences explain others or are qualify (“however”) others]

Supplementary classifications of debt securities

19.57. A supplementary sub-classification of debt securities by maturity into short-term and long-term should be based on the following criteria.

19.58. Short-term debt securities are those that have an original maturity of one year or less, even if they are issued under long-term facilities such as note issuing facilities.

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19.59. Long-term debt securities are those that have an original maturity of more than one year. Claims with optional maturity dates, the latest of which is more than one year away, and claims with indefinite maturity dates should be classified as long-term.

19.60. In addition, it may sometimes be useful to distinguish listed debt securities from unlisted ones, or to classify them according remaining maturity. **[Comment: make clear that this is not a requirement or even a fundamental recommendation of the System?]**

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4. Loans

19.61. Loans include all financial assets that:

(a) are created when creditors lend funds directly to debtors;

(b) are evidenced by non-negotiable documents; or

(c) for which the lender receives no security evidencing the transaction.

[Comment: not clear how (a), (b) and (c) are linked by “or’s and/or “and’s”]

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This category includes all loans and advances (apart from trade credit and advances receivable or payable) extended to corporations, government, households, NPISHs and non-residents. The category includes instalment loans, hire-purchase credit and loans to finance

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trade credit. Claims on the IMF that are evidenced by loans should be included in this category. Repurchase agreements not included in the national definition of broad money (see para 11.55), as well as financial leases and similar arrangements (see next paragraph), should also be classified as loans. It is useful **[Comment: but not shown in table 11.2?]** to subdivide the category of loans according to the resident sectors and the rest of the world for debtors and creditors, respectively. All sectors may acquire assets and incur liabilities in the form of loans. **[Comment: move this sentence further up the paragraph? Or else delete the list of sectors in the sentence near the start?]**

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19.62. When goods are acquired under a *financial lease*, a change of economic ownership from the lessor to the lessee is deemed **in the System to have taken place, even though no legal change of ownership has occurred.** The change of economic ownership may be **detected** by the fact that all the risks and rewards of ownership are transferred from the legal owner of the good, the lessor, to the user of the good, the lessee. The lessee contracts to make payments that enable the lessor, over the period of the contract, to recover all, or virtually all, of his costs, including **a return, in the form of an imputed interest amount, on the value of the asset and his costs.** The System recognises this de facto change in ownership by **imputing** a loan **from** the lessor to the lessee; the lessee uses this loan to acquire the asset; and the payments by the lessee to the lessor represent not rentals on the asset but payments of interest and repayments of principal on the imputed loan. In **each accounting period over the term of the lease,** the payments made by the lessee must **therefore** be divided into interest and a financial service charge. Interest is recorded as property income payable/receivable and debt repayment is recorded in the financial account as reducing the value of the asset (loan) of the lessor and the liability of the lessee. There is more extensive discussion of financial leases in

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chapter 17.
Supplementary classifications of
loans

19.63. Loans may be divided, on a supplementary
basis, between short- and long-term loans.

19.64. Short-term loans are those that
normally **[Comment: ???]** have an original maturity of one
year or less. All loans repayable on demand
should be classified as short-term even when
they are expected to be outstanding for
more than one year.

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19.65. Long-term loans are those that normally [Comment:???] have an original maturity of more than one year. It may also be useful to distinguish loans that though taken out for a period longer than a year have, in the accounting period considered, less than one year to maturity as well as loans secured by mortgages.

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19.66. There is a discussion of the memorandum items to be shown for non-performing loans in chapter 13.

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5. Equity and investment fund shares

Equity

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[Comment: the sequence of original paras .67 and some of the parts of .68 is a bit lumpy. This attempt may not be much of an improvement]. 19.67? Equity comprises

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all instruments and records acknowledging claims to the residual value of corporations. The value of this residual claim is expressed not as the right to a pre-determined income or to a fixed sum on dissolution of the corporation, but rather to a proportionate share of the value of the corporation after the claims of all creditors have been met. Ownership of equity is usually evidenced by shares, participation, or similar documents. Those preferred shares that provide for participation in the distribution of the residual value on dissolution of an incorporated enterprise, in addition to a fixed or contractually variable income, are included in equity. (Preferred shares that do not provide for such a participation are classified as debt securities – see para 11.52).

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19.67. Equity is disaggregated into listed shares, ¶
unlisted shares and other equity. (Listed ¶
shares are sometimes referred to as quoted ¶
shares and unlisted shares as unquoted.
No ¶
change in content is intended by the change ¶
in terminology. Although shares are ¶
sometimes referred to as stocks, the word ¶
stocks is generally used in the System as the ¶
alternative to flows.) ¶
19.68.

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all creditors have been met, claims to the ¶
residual value of corporations

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19.68. In the standard classification in the System, equity is disaggregated into three classes: listed shares, unlisted shares and other equity. (Listed shares are sometimes referred to as quoted shares and unlisted shares as unquoted. No difference in content is intended by the two terminologies. Although shares are sometimes referred to as stocks, the word stocks is generally used in the System as the alternative to flows.)

All equity of corporations with

shares is classified to,
listed or, unlisted shares as appropriate, **[Comment: is this statement is a bit
redundant?]** The value of
equity in corporations without shares and in quasi-corporations
is included in other equity.

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value of

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19.69. Transactions in equity in the financial
account cover three different groups of
transaction, **[Comment: The three types described all seem to refer to transactions
between shareholders and the corporation. Does explicit mention not also need to be
made of secondary market transactions, to which the corporation is not itself a
party?]** The first is the simplest and
most obvious; **[Comment: Is not the first, logically, the issue of new shares, whether
on the stock exchange or otherwise? Does this transaction need to be described? And
if it does, does redemption need a sentence or two also?]** it is the recording of the
value

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of shares bought and sold on the stock
exchange. **[Comment: as written, this refers to secondary market transactions, but it
has little to do with the following sentences about bonus issues! It should probably
read: "... it relates to the issue of new shares (original or additional) and the
redemption of existing shares].** Some transactions that at face value seem to constitute
transactions in shares are not treated as such in the System. For example, from time to

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time corporations

restructure their shares and may offer
shareholders a new number of shares for each
share previously held. These bonus shares
are not however treated as transactions but as
a form of redenomination, since the value of
the new number of shares times the new price
is equal to the old number of shares times the
old price. In such cases no entries need to be made in the accounts of either the issuer or
the shareholder.

19.70. A second group, of transactions concerning
equity relates to capital injections or,
withdrawals of equity by the
owners of resident corporations or quasi-corporations. How to classify these depends in
part on the purpose and characteristics of the transaction. [Comment: perhaps start a
new paragraph here?] The case of dividends and other withdrawals is perhaps less
complex than that of injections. The recording of dividends in the
distribution of primary income account gives the appearance of their, always having been
paid out of the operating
surplus that was earned in the current period. However,
enterprises, especially those whose shares are widely held, often, aim to have a
smooth track record of dividend payments
and will therefore sometimes pay out more
than the current operating surplus and

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sometimes rather less. In such routine cases, the System accepts the payments as dividends in the distribution of primary income account, and carries the balance

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through to the accumulation accounts by way of saving (which might be negative).

However, if the dividends paid out are significantly in excess of recent average earnings, then they should no longer all be recorded in the distribution of primary income account but should be regarded as a withdrawal of equity by the owners and be reflected under this item. [Comment: is it intended that only the excess over a

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“normal” dividend (or over that year’s operating surplus?) should be reclassified to the financial account? If so, this should be explicitly stated. The word “all” does not convey this precisely enough.] Equally,

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liquidating dividends paid to shareholders when an enterprise becomes bankrupt should be recorded as withdrawal of equity. [Comment: do liquidating dividends arise only

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when the enterprise becomes bankrupt? What about an orderly winding-up?]

Withdrawals, whether labelled in the business accounts as dividends or otherwise, may take

the form of proceeds from sales of fixed or other assets, transfers of fixed and other

assets from the quasi-corporation [Query: Only from a quasi-corporation?] to the owner and funds taken from accumulated retained savings and reserves for the

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consumption of fixed capital. [Comment: this sentence has been moved from the original para .71, where it seemed out of place. Maybe it in fact belongs closer to the top of this para?]

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19.71. The treatment of the injection of finance into an enterprise by the owners is more complex. The most important criterion is the purpose behind the injection, and transactions that are booked in the business accounts as equity injections may have to be reclassified in the System. Important examples are as follows. If the enterprise is publicly controlled

Deleted: Conversely, owners may inject extra finance ¶ into an enterprise

[Comment 1: is this intended to be the same as publicly owned - check terminology with other chapters. Comment 2: Does all of the discussion in this and the following two (three?) sentences refer to these types of enterprise? If so (and I think it does – it is hard to envisage some of these sorts of payment, especially the recurring subsidy-type payment, in the case of privately-owned companies, even within an enterprise group?) then an introductory sentence to this effect is warranted. Comment 3: Need to make clear if all statements apply equally to quasi-

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corporations] and, as a matter of government economic or social policy, runs a regular deficit

each year that is covered by a receipt from government.

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the payment is to be regarded as a subsidy. If

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a payment from government is irregular but clearly designed to cover accumulated losses,

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it is treated as a capital transfer. If government makes an investment grant to a public corporations, this also is to be recorded as a capital transfer (in exactly the same way as a similar payment by government to a private enterprise). **[Comment: consider a new paragraph here, to distinguish transactions that are to be treated as equity injections?]** However, there

may be cases where the owners (public or private) agree to make new finance available to permit expansion, say, and where the payments represent not just a reduction of debt **[Comment: does this mean debt to the owner?]** but a positive addition

to the enterprise's net worth. The finance consists of funds for use by the enterprise in purchasing fixed assets, accumulating inventories, acquiring financial assets or redeeming liabilities. Such injections are to be treated as financial transactions, and classified to equity, in the form of listed shares, unlisted shares or other equity as appropriate. Transfers of fixed and other assets by owners to their quasi-corporations **[Comment: why not also to corporations?]** are also included as additions to

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fixed and other assets
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equity. Such payments are to be included in this item as an acquisition of equity, even if no new shares are issued in response to the financial contribution. **[Comment: this text has been relocated to 11.70 above].** (The particular

case of payments between government and public enterprises is discussed **in more detail** in chapter 20.)

19.72. **A third group** of transactions concerning equity is the special case of equity addition and withdrawal that happens in respect of the reinvestment of earnings of foreign direct investment enterprises. In the distribution of primary income account, **an imputation entry is made to record the allocation to the direct investor of his** share of operating surplus, **after payment of dividends**, proportionate to **his** share of **the equity**. **The imputation entry is classified to the item** reinvested earnings. Because **no cash transaction occurs to match this imputation, an imputed financial accounts transaction is also made, in the form of an equity injection of the same amount, classified in the equity category corresponding to the investor's interest (listed, unlisted, other).**

19.73. Notional resident units are treated in the same manner as quasi-corporations. For example, an extension to a holiday home of a non-resident is recorded as an increase in the value of a **non-financial** asset owned by a resident notional unit, with a matching increase in the equity of the non-resident owner **in the notional unit**. In addition, the imputed rent of an owner-occupied dwelling may lead to reinvested earnings when the dwelling is treated as a notional resident unit and the owner is actually a resident of another country. **[Comment: does this rather throw-away sentence need some elaboration?]**

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Investment fund shares

19.74. Investment funds, which include mutual funds and unit trusts, are a means of pooling other financial instruments so that those **(usually, but not always, institutional units other than financial enterprises)** acquiring shares in the funds spread their risk across all the instruments in the fund. In a detailed flow of funds table, the acquisition of instruments by the investment funds is

shown separately from the acquisition of shares in the funds and a full analysis of the from whom to whom transactions captures the holdings of instruments via investment funds without needing to have a separate category for it. However, as noted in connection with the category of inter-bank deposits, timely flow of fund tables are not always available. Therefore, in order to distinguish when non-financial units acquire instruments such as securities and equities directly and when they are acquired via investment funds, the latter are shown

separately. [Comment: I'm not sure I follow this argument. What I think it is saying is something like this: Investment funds are institutional units. Nevertheless, they are not shown as such in the ordinary sector accounts (but surely they are, in fact, under the sector classification proposed for this edition?), but only in the less readily available flow of funds accounts. Therefore, to allow analysts to distinguish direct acquisitions/holdings by investors of end-product securities (shares, bonds etc) from those that they acquire via their holdings in investment funds, it makes sense to distinguish the latter as a distinct type of asset class. Is this the correct understanding? Is there a confusion in the original wording between investment funds (a class of institutional unit) and investment fund shares (an asset class). Would some or all of the argument belong to the institutional unit chapter?]

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19.75. Investment fund are divided into money market funds (MMF) and non-MMF

investment funds, and shares in the funds are labelled as *Money market fund shares* and *Other investment fund shares* respectively. The fundamental difference between them is that MMFs

typically invest in money market instruments (i.e. debt securities that have a residual [Comment/query: is residual fully intended here? Is a long-term bond close to maturity a money market instrument?] maturity of less than one year),

are often transferable and are often regarded as close substitutes for deposits. Non-MMF investment funds typically invest in longer-term financial assets and possibly real estate. They are not transferable and are typically not regarded as substitutes for deposits.

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Money market fund shares

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19.76. Money market fund shares or units represent a claim on a proportion of the value of an established money market fund.

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Other investment fund shares

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19.77. Other investment fund shares or units represent a claim on a proportion of the value of an established investment fund other than a money market fund.

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Supplementary classifications of investment fund shares

19.78. It may be useful to distinguish listed from unlisted investment fund shares.

6. Insurance, pension and standardised guarantees schemes

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19.79. Insurance, pension and standardised guarantees schemes all function as a form of income redistribution mediated by financial institutions. The redistribution may be between individual institutional units in the same period, or for the same institutional unit over different periods, or a combination of the two. Units participating in the schemes contribute funds to them and may receive benefits (or have claims settled) in the same or later

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periods. While they hold the funds, insurance corporations and pension funds invest them on behalf of the participants. The part, if any, of the investment income earned by the scheme that is not distributed to the participants as property income is recorded in the system, by means of a series of imputations, as if it has been paid to the participants and returned to the schemes as extra contributions. In all cases, [Comment/query: why is this phrase needed?] net contributions or premiums are defined as actual contributions or premiums plus distributed property income less the service charge retained by the financial institution concerned. However, net contributions does not of itself constitute an item in the System. The only entries in the financial account, therefore, [Comment: what does the “therefore” follow from?] are net contributions or net premiums paid to the schemes less benefits and claims paid out. Significant other additions to the provisions of the schemes come via other changes in the volume of assets and especially holding gains. There is more extensive discussion on the recording of all these schemes in chapter 17.

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Non-life insurance technical provisions

19.80. Non-life insurance technical provisions consist of prepayments of net premiums and provisions to meet outstanding non-life insurance claims.

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The only transaction for non-life insurance technical provisions recorded in the financial account is difference between net premiums receivable and claims payable.

[Comment: text should say which is subtracted from which. It is not obvious that premiums will always and everywhere be greater than claims, especially if the reader is thinking of a single policy-holder. Perhaps worth mentioning somewhere that this item (and many others in this area) is usually not observable at the level of the individual institutional unit, and is an aggregate constructed by the compiler.]

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Life insurance and annuities entitlements

19.81. **Life insurance and annuities entitlements**

show the extent of financial claims policy holders have against an enterprise offering life insurance or the provision of annuities.

The only transaction for life insurance and annuity entitlements recorded in the financial account is difference between net premiums receivable and claims payable. **[Comment: same as for 11.80]**

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▲ Pension entitlements

19.82. **Pension entitlements show the extent of financial claims both existing and future pensioners hold against either their employer or a fund designated by the employer to pay pensions earned as part of a compensation agreement between the employer and employee.**

The only transaction for pension entitlements recorded in the financial account is difference between net contributions receivable and benefits payable. **[Comment: same as for 11.80 and 11.81]** The transaction (increase) in pension entitlements

shown in the financial account matches and is in the same amount as the entry (D.8) in the use of income account for the change in pension entitlements (see para 9.21 to 9.24).

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Provisions for calls under standardised guarantees

19.83. **Provisions for calls under standardised guarantees consist of prepayments of net premiums and provisions to meet outstanding claims under standardised guarantees.**

The only transaction for provisions for calls under standardised guarantees recorded in the financial account is the net premiums receivable less claims payable.

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7. Financial derivatives and employee stock options

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Financial derivatives

19.84. Financial derivatives are financial instruments that are linked to a specific financial instrument or indicator or commodity, through which specific financial risks can be traded in financial markets in their own right or offset by other instruments. The value of a financial derivative derives from the price of the underlying item: the reference price. The reference price may relate to a commodity, a financial asset, an interest rate, an exchange rate, another derivative or a spread between two prices. The derivative contract may also refer to an index or a basket of prices.

19.85. No specific standards are recommended for sub-classifying financial derivatives. Compilers may select the classifications best suited for their purposes. The distinction may be associated with different market behaviours, different data collection methods, different valuation procedures, etc. In some cases, derivatives are classified by instrument; the basic types of derivatives (forwards and options) or market risk classification (e.g., currency swaps, interest rate swaps, etc.). Details of several of these are given in the following paragraphs.

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19.86. An observable market price or an index for the underlying item is essential for calculating the value of any financial

derivative. If a financial derivative cannot be valued because a prevailing market price or index for the underlying item is not available, it cannot be regarded as a financial asset. Unlike debt instruments, no principal amount is advanced to be repaid and no investment income accrues. Financial derivatives are used for a number of purposes including risk management, hedging, arbitrage between markets and speculation. Financial derivatives enable parties to trade specific financial risks (such as interest rate risk, currency, equity and commodity price risk and credit risk, etc.) to other entities who are more willing, or better suited, to take or manage these risks, typically, but not always, without trading in a primary asset or commodity. The risk embodied in a derivatives contract can be “traded” either by trading the contract itself, such as with options, or by creating a new contract that embodies risk characteristics that match, in a countervailing manner, those of the existing contract owned. The latter is termed offsetability and is particularly common in forward markets or where there are no formal exchanges through which to trade derivatives.

19.87. Financial derivative instruments that can be valued separately from the underlying item to which they are linked should be treated as financial assets, regardless of whether “trading” occurs on- or off-exchange. Transactions in financial derivatives should be treated as separate transactions, rather than as integral parts of the value of underlying transactions to which they may be linked. The two parties to the derivatives may have different motives for entering into the transaction. One party may be hedging, while the other may be dealing in derivative instruments or acquiring the derivative as an investment. Even if both parties are hedging, they may be hedging transactions or risks that involve different financial assets or even

transactions in different accounts, **[Comment: not immediately obvious, what this reference to different accounts means.]** Therefore,

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if derivative transactions were treated as integral parts of other transactions, such treatment would lead to asymmetries of measurement in different parts of the accounts or to asymmetries of measurement between institutional sectors.

19.88. Any commissions paid to or received from brokers or other intermediaries for arranging options, futures, swaps and other derivatives contracts are treated as payments for services in the appropriate accounts. Financial derivatives transactions may take place between two parties directly, or through an intermediary, **[Comment/query: is this the same as the broker in the first sentence of this para?]** In the latter case, implicit or explicit service charges may be involved.

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However, it is usually not possible to distinguish the implicit service element. Net settlement payments under derivative contracts are therefore recorded as financial transactions. However, where possible, the service charge component should be separately recorded. Financial derivatives contracts are usually settled by net payments of cash. This often occurs before maturity for exchange-traded contracts such as commodity futures. Cash settlement is a logical consequence of the use of financial derivatives to trade risk independently of ownership of an underlying item. However, some financial derivative contracts, particularly involving foreign currency, are associated with transactions in the underlying item. A transaction in an asset underlying a financial derivative contract that goes to delivery should be recorded at the prevailing market price for the asset with the difference between the prevailing price and the price actually paid (times quantity) recorded as a transaction in financial derivatives.

19.89. There are two broad classes of financial derivative; forward-type contracts, and

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option contracts. Under a *forward contract*, the two counterparties agree to exchange a specified quantity of an underlying item (real or financial) at an agreed contract price (the “strike” price) on a specified date. *Futures contracts* are forward contracts traded on

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organized exchanges. **A forward contract is**

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an unconditional financial contract that represents an obligation for settlement on a specified date. Futures and other forward contracts are typically, but not always, settled by the payment of cash or the provision of some other financial instrument rather than the actual delivery of the underlying item and therefore are valued and traded separately from the underlying item. [Comment: does this bit of text not repeat something said elsewhere already?]

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At the inception of the contract, risk exposures of equal market value are exchanged and hence the contract has zero value. Some time must elapse for the market value of each party’s risk to differ so

that an asset (creditor) position is created for one party and a liability (debtor) position for the other. The debtor/creditor relationship may change both in magnitude and direction during the life of the forward contract.

19.90. Common forward-type contracts include interest rate swaps, forward rate agreements (FRA), foreign exchange swaps, forward foreign exchange contracts and cross-currency interest rate swaps.

a. **An interest rate swap contract involves an exchange of cash flows related to interest payments, or receipts, on a notional amount of principal, which is never exchanged, on one currency over a period of time.** Settlements are often made through net cash payments by one counterparty to the other.

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b. **A forward rate agreement (FRA) is an arrangement in which two parties, in order to protect themselves against interest rate changes, agree on an interest rate to be paid, at a specified settlement date, on a notional amount of principal that is never exchanged.** FRAs are settled by

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net cash payments. The only payment that takes place is related to the difference between the agreed forward rate agreement rate **[Comment: is there a surplus word or two here?]** and the prevailing market interest rate at the time of settlement. The buyer of the forward rate agreement receives payment from the seller if the prevailing rate exceeds the agreed rate; the seller receives payment if the prevailing rate is lower than the agreed rate.

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c. **A foreign exchange swap is a spot sale/purchase of currencies and a simultaneous forward purchase/sale of the same currencies.**

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d. **A forward foreign exchange contract involvse two counterparties who agree to transact in foreign currencies at an agreed exchange rate in a specified amount at some agreed future date.**

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e. **A cross-currency interest rate swap, sometimes known as a currency swap, involves an exchange of cash flows related to interest payments and an exchange of principal amounts at an agreed exchange rate at the end of the contract.**

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19.91. There might also be an exchange of principal at the beginning of the contract and, in these circumstances, there may be subsequent repayments, which include both interest and principal, over time according to the predetermined rules. Streams of net settlement payments resulting from swap arrangements are to be recorded as transactions in financial derivatives and repayments of principal are to be recorded under the relevant instrument item in the financial account (see paragraphs 11.40 and 11.44 for the valuation of transactions in underlying assets).

19.92. **Options are contracts that give the purchaser of the option the right, but not the obligation, to buy (a “call” option) or to sell (a “put” option) a particular financial instrument or commodity at a predetermined price (the “strike” price) within a given time span (American option) or on a given date**

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(European option). Many options contracts, if exercised, are settled by a cash payment rather than by delivery of the underlying assets or commodities to which the contract relates. Options are sold or “written” on many types of underlying bases such as equities, interest rates, foreign currencies, commodities and specified indexes. The buyer of the option pays a premium (the option price) to the seller for the latter’s commitment to sell or purchase the specified amount of the underlying instrument or commodity on demand of the buyer. While the premium paid to the seller of the option can conceptually be considered to include a service charge, in practice, it is usually not possible to distinguish the service element.

The full premium should therefore be recorded as the acquisition of a financial asset by the buyer and as the incurrence of a liability by the seller.

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However, where possible, the service charge component should be separately recorded. A major difference between forward and option contracts is that, whereas either party to a forward contract is a potential debtor, the buyer of an option contract acquires an asset and the option writer incurs a liability. However, option contracts frequently expire without worth; options are exercised only if settling a contract is advantageous for the option holder.

19.93. The timing of premium payments on options varies. Depending on the type of contract, premiums are paid when the contracts begin, when the options are exercised, or when the options expire. The value of an option at inception should be recorded at the full price of the premium. If the premiums are paid after the purchase of an option, the value of the premium payable is recorded as an asset at the time the derivative is purchased, financed by a loan from the writer. Subsequent purchases and sales of options are also to be recorded in the financial account. If an option based on a financial asset is exercised or if a commodity based option proceeds to delivery, the acquisition or sale of the underlying asset should be recorded at the prevailing market price in the appropriate accounts with the difference between this amount and the amount actually paid recorded as transactions in financial derivatives.

19.94. Warrants are a form of options that are treated in the financial account in the same way as other options. **Warrants are tradable instruments giving the holder the right to buy, under specified terms for a specified period of time, from the issuer of the warrant (usually a corporation) a certain number of shares or bonds.** There are also currency warrants based on the amount of one currency required to buy another and

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cross-currency warrants tied to third currencies. They can be traded apart from the underlying securities to which they are linked and therefore have a market value. The issuer of the warrant incurs a liability, which is the counterpart of the asset held by the purchaser.

19.95. The financial derivatives described in the previous paragraphs are related to market risk, which pertains to changes in the market prices of securities, commodities, interest and exchange rates. **Credit derivatives are**

financial derivatives whose primary purpose is to trade credit risk. They are designed for trading in loan and security default risk.

Credit derivatives take the form of both forward-type and option-type contracts and

like other financial derivatives, **[Comment: does this imply that standard legal agreements etc have been described earlier somewhere? If so, I didn't spot it.]** they are

frequently drawn up under standard master legal agreements and involve collateral and margining procedures, which allow for a means to make a market valuation.

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19.96. Margins are payments of cash or collateral that cover actual or potential obligations under financial derivatives, especially futures or exchange-traded options. Repayable margins consist of deposits or other collateral deposited to protect a counterparty against default risk, but which remain under the ownership of the unit that placed the margins. Although its use may be restricted, a deposit is classified as repayable if the depositor retains the risks and rewards of ownership, such as the receipt of income or exposure to holding gains and losses. Repayable margin payments in cash are transactions in deposits (see para 11.47), not transactions in a financial derivative. The depositor has a claim on the exchange or other institution holding the deposit. Some compilers may prefer to classify these margins within other accounts receivable/payable in order to reserve the

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term deposits for monetary aggregates. When repayable margin payments are made in noncash assets, such as securities, no entries are required because the entity on whom the depositor has a claim (the issuer of the security) is unchanged. Nonrepayable margins reduce a financial liability created under a financial derivative contract. The entity that pays a nonrepayable margin no longer retains ownership of the margin nor has the right to the risks and rewards of ownership, such as the receipt of income or exposure to holding gains and losses. A payment of nonrepayable margin is normally recorded as a decline in currency and deposits with a counter entry in the reduction in financial derivative liabilities and the receipt of nonrepayable margin is recorded as an increase of holdings of currency and deposits with the counter entry in the reduction in financial derivative assets.

Employee stock options

19.97. **An employee stock option is an agreement made on a given date (the “grant” date) under which an employee may purchase a given number of shares of the employer’s stock at a stated price (the “strike” price) either at a stated time (the “vesting” date) or within a period of time (the “exercise” period) immediately following the vesting date.**

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Transactions in employee stock options are recorded in the financial account as the counterpart to the element of compensation of employees represented by the value of the stock option. The value of the option should be spread over the period between the grant date and vesting date.

Thereafter, transactions are recorded at exercise date or, if they are tradeable and are actually traded, between the vesting date and the end of the exercise period. [Comment: I think this description is a bit too succinct, especially the last two sentences. How can a “value” be spread over time?]

8. Other accounts receivable/payable

Trade credit and advances

19.98. This category comprises trade credit for goods and services extended by suppliers to customers (corporations, government, NPISHs, households and the rest of the world), and advances by principals to contractors for work that is in progress (if classified as such under

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inventories) or is to be undertaken. [Comment: Why is this exhaustive list of sectors given? What purpose does it serve? What is distinctive about this item to require it?] Trade

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credits and advances do not include loans which the supplier draws down to finance his extending of trade credit to this customer.; these retain their nominal classification as,

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loans. It may be valuable to separate short-term trade credits and advances from long-term trade credit and advances by employing the same criteria used to distinguish between

| other short- and long-term financial assets.

Pension entitlement funding

19.99. An employer may contract with another unit to manage the pension funds for his employees. Depending on the nature of the agreement between them, the contractor may have an obligation to repay any surplus funds or, more probably, have a claim on the employer for any deficit. When this **[Comment: not clear what “this” is.]** occurs, it is treated as a form of accounts receivable/payable under this heading.

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| Other accounts receivable/payable

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19.100. This category includes accounts receivable and payable, other than those described previously. In other words, the amounts are not related to the provision of goods and services. It covers amounts related to **[Comment: insert “such as”, or is the list exhaustive?]** taxes, dividends, purchases and sales of securities, rent, wages and salaries, and social contributions. Interest that accrues but is not paid is included in this item only if the accrued interest is not added to the value of the asset on which the interest is payable (as is usually the case).

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19.101. This category does not include statistical discrepancies. **[Comment: A slightly plaintive note? Should/can the reader be led to a discussion of these somewhere else?]**

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9. Memorandum item: foreign direct investment

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19.102. Transactions in financial assets and liabilities arising from the provision of, or receipt of, foreign direct investment are to be recorded under the appropriate categories: debt securities, loans, equity, trade credit or other. However, the amounts of foreign direct investment included within each of those categories should also be recorded

separately as memorandum items. Foreign direct investment is discussed further in chapters 17 and 24.

19.103. When they are important it may be useful to group all arrears of interest and repayment under a memorandum item.

