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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

Employee stock options

FDI memo items

## Chapter 11: The Financial Account

### A. Introduction

- 11.1 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.
- 11.2 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.
- 11.3 *Reprise of definition of financial asset and liability. It will be drawn from and consistent with the definition to appear in chapter 3.*
- 11.4 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 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 of entries records the second party supplying the means of payment for the item, and the first party receiving this. 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.
- 11.5 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, so both the original and the counterpart entries are recorded in the financial account.
- ### 1. Counterparts of non-financial transactions
- 11.6 Transactions involving the transfer of ownership of a good or non-financial asset, or the provision of a service or labour, entail a 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 simultaneously.

11.7 The sale of a good, service, or asset 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 assets, such as the provision of fixed assets for long-term indebtedness, and the liability may be evidenced by a loan or security.

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).

11.9 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.

## 2. Exchanges of financial assets and liabilities

11.8 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

11.10 When a new financial asset is created through the incurrance 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

11.11 Some sectors or sub-sectors are net lenders while others are net borrowers. When institutional units engage in financial

**Table 11.1: The financial account- concise form**

Changes in assets									
	S.11	S.12	S.13	S.14	S.15	S.1			
	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
<b>Transactions and balancing items</b>									
Net acquisition of financial assets/	71	237	120	181	32	641	50		691
Net incurrance of liabilities									
Monetary gold and SDRs		- 1				- 1	1		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 shares	2	3	36	3		44	2		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.

11.12 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, achieves this result by acquiring financial assets of 181 and incurring liabilities of 33.

11.13 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 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.

11.14 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.

11.15 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**

Transactions and balancing items	S.11 S.12 S.13 S.14 S.15						Changes in liabilities and net worth			
	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total	
<i>Net lending (+) / net borrowing (-)</i>	- 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										
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	26	13			4	43	3		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	

11.16 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 borrowing for the total economy to the rest of the world is therefore 38.

#### 4. Contingent assets

11.17 Many types of contractual financial arrangements 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. One-off guarantees of payment by third parties are contingencies since payment is only required if the principal debtor defaults. Lines of credit provide a guarantee that funds will be made available but no financial asset exists until funds are actually advanced. Letters of credit constitute promises to make a payment conditional upon the presentation of certain documents specified by contract. Underwritten note issuance facilities (NIFs) provide a guarantee that a potential debtor will be able to sell short-term securities (notes) that he issues and that the bank or banks issuing the facility will take up any notes not sold in the market or will provide 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.

11.18 Certain financial derivatives are not treated as contingent financial assets but as actual assets. These are described in section C below. Standardised guarantees are also treated as giving rise to actual and not contingent liabilities. A standardised guarantee is one where many guarantees of 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.

11.19 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.

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

11.21 There are other circumstances where future payments are not treated as asset, 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**

11.22 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.

11.23 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 assets are monetary gold and shares. 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 financial participation are treated as having liabilities by convention. However, these liabilities do not have fixed redemption values, as is the case for many other financial assets, but represent claims by the share holders on the net worth of the corporation.

11.24 Table 11.2 shows an elaboration of table 11.1 incorporating the classification of financial instruments. The exact coverage and definition of each of the items is described in **section C** below. The remainder of this section deals with general matters of classification and the application of the accounting rules of the System as they apply to transactions in financial instruments.

11.25 The detail in which the classification is employed depends on the institutional sector to be analysed. The types of financial assets 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.

- 11.26 The standard items in the classification of financial assets and liabilities provides 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](#).
- 11.27 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).

## 2. Valuation of transactions

- 11.28 The payments required under a contract relating to financial assets and liabilities

almost always represent more than one transaction in the sense used in the System. Payments of interest on loans and deposits, as 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. Foreign currency and shares are bought and sold at different prices; 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. .

- 11.29 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.
- 11.30 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

- 11.31 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.

11.32 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.

11.33 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. 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 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

11.34 As described in chapter 3, netting is a process whereby entries on alternate sides of the account for the same transaction item and same institutional unit are offset against one another. In general the preference of the System is to avoid netting where possible but this may not always be possible and for some particular analyses, not always desirable.

11.35 The degree of netting at 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:

- (a) no netting or fully gross reporting in which purchases and sales of assets are separately recorded, as are incurrences and repayments of liabilities;
- (b) netting within a given specific asset, such as subtracting sales of bonds from acquisition of bonds and redemption of bonds from new incurrences of liabilities in the form of bonds;
- (c) netting within a given category of assets, such as subtracting all disposals of debt securities from all acquisitions of such assets;

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

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

11.36 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 as gross a 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, 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

11.37 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

### 1. Monetary gold and SDRs

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

#### Monetary gold

11.39 *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.* 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 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. 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.

- 11.40 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

- 11.41 *Special Drawing Rights (SDRs) are international reserve assets created by the International Monetary Fund and allocated to its members to supplement existing 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 exchange rate.
- 11.42 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

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

### Currency

- 11.44 *Currency comprises those notes and coins in circulation that are commonly used to make payments.* (Commemorative coins that are not actually in circulation should be excluded.) Distinctions should be drawn 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

- 11.45 *Transferable deposits comprise all deposits that are:*
- (a) *exchangeable on demand at par, without penalty or restriction;*
  - (b) *freely transferable by cheque; and*
  - (c) *otherwise commonly used to make payments.*

Transferable deposits should be cross-classified according to:

- (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.

**Table 11.2: The financial account – full detail**

Changes in assets									
	S.11	S.12	S.13	S.14	S.15	S.1			
	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
<b>Transactions and balancing items</b>									
Net acquisition of financial assets/	71	237	120	181	32	641	50		691
Net incurrence of liabilities									
Monetary gold and SDRs		- 1				- 1	1		0
Monetary gold		- 1				- 1	1		
SDRs		0				0	0		
Currency and deposits	17	15	7	68	12	119	11		130
Currency	5	15	2	10	2	34	3		37
Transferable deposits	10		4	41	7	62	2		64
Interbank positions									
Other transferable deposits									
Other deposits	2		1	17	3	23	6		29
Debt securities	18	53	26	29	12	138	5		143
Short-term	15	4	11	22	2	54	2		56
Long-term	3	49	15	7	10	84	3		87
Loans	27	167	45	5		244	10		254
Short-term	16	63	1	3		83	3		86
Long-term	11	104	44	2		161	7		168
Equity and investment fund shares	2	3	36	3		44	2		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		1	11		18	18		36
Pension entitlement funding									
Other accounts receivable/payable	1		5	29	8	43	3		46

### Inter-bank deposits

11.46 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 deposit position is to be

**Table 11.2: The financial account – full detail**

							Changes in liabilities and net worth		
	S.11	S.12	S.13	S.14	S.15	S.1			
	Non-financial corporations	Financial corporations	General government	Households	NPISHs	Total economy	Rest of the world	Goods and services	Total
<b>Transactions and balancing items</b>									
<i>Net lending (+) / net borrowing (-)</i>	- 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				35	2		37
Transferable deposits		63	2			65	- 1		64
Interbank positions									
Other transferable deposits									
Other deposits		32				32	- 3		29
Debt securities	6	53	64			123	20		143
Short-term	2	34	15			51	5		56
Long-term	4	19	49			72	15		87
Loans	71	0	94	28	24	217	37		254
Short-term	16		32	11	17	76	10		86
Long-term	55		62	17	7	141	27		168
Equity and investment fund shares	26	13			4	43	3		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	8		6	4		18	18		36
Pension entitlement funding									
Other accounts receivable/payable	29		4	1		34	12		46

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

### Other deposits

11.47 *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.* 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, as are overnight and very short-term

repurchase agreements if they are considered part of the national definition of broad money. 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 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. The unallocated gold account does not give the holder the title to physical gold but provides a claim against the account provider denominated in gold. In effect, therefore, it is a deposit denominated in gold. They are thus treated as deposits 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 for different precious metals, are also possible 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.

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.

### 3. Debt securities

11.50 *Debt securities are assets that are normally traded in financial markets and that give the 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 (bonds and 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. *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, i.e., payment of interest is not dependent on earnings of the 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 description of these and other types of financial instruments can be found in [MFSM and the MFSM Compilation Guide](#)

11.51 *Securitisation is a process whereby existing assets such as loans, mortgages, credit card debt, or other assets (including 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 financial account and the new assets should be classified as debt 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](#).

11.52 Loans that are traded and for which there is evidence of a market with quotations in the market are reclassified to debt securities. (A loan which is only traded once is not necessarily to be reclassified.) Preferred stocks or shares that pay a fixed income but do not provide for participation in the distribution of the residual value of an

incorporated enterprise on dissolution are included in debt securities. Mortgages are not classified as bonds; they are included under loans.

11.53 ***Zero-coupon bonds are long-term securities 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 return is paid at maturity. Deep-discount bonds pay some interest during the life of the instrument but the amount is substantially below market interest.*** For both of these assets, the 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 is that the interest is reinvested. This treatment allows the costs of providing the finance to be matched to the periods for which the finance is provided.

11.54 ***Index-linked securities are instruments for 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 purchasing power or wealth during a period of inflation 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 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.**

11.55 ***Repurchase agreements are arrangements whereby an institutional unit sells securities at a specified price to another unit under a commitment to repurchase the same or similar securities at a fixed 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. The arrangement appears to involve two separate transactions in financial assets. 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 fixed price when the repurchase agreement is reversed. Therefore, in the System, a repurchase agreement is treated as giving rise to a newly created financial asset that is not related to the underlying securities. Repurchase agreements are to be classified under loans unless they are classified in the national definition of broad money. In the latter case, repurchase agreements are classified under other deposits. (There is discussion **in chapter 26** of the relationship of money measures to the SNA).

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

## Supplementary classifications of debt securities

- 11.57 A supplementary sub-classification of debt securities by maturity into short-term and long-term should be based on the following criteria.
- 11.58 Short-term debt securities include those securities that have an original maturity of one year or less. Securities with a maturity of one year or less should be classified as short-term even if they are issued under long-term facilities such as note issuing facilities.
- 11.59 Long-term debt securities include those securities 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.
- 11.60 In addition, it may sometimes be useful to distinguish listed debt securities from unlisted ones and to record them according remaining maturity.

## 4. Loans

- 11.61 *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.*

This category includes all loans and advances (apart from trade credit and advances receivable or payable) extended to corporations, government, NPISHs and households. The category includes instalment loans, hire-purchase credit and loans to finance 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, as well as financial leases and similar arrangements, should also be classified as loans. It is useful 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.

- 11.62 When goods are acquired under a financial lease, a change of economic ownership from the lessor to the lessee is deemed to take place. The change of economic ownership may be distinguished 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 interest. This de facto change in ownership is recorded by assuming a loan is made by 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 subsequent periods, the payments made by the lessee must 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 chapter 17.

## Supplementary classifications of loans

- 11.63 Loans may be divided, on a supplementary basis between short- and long-term loans.
- 11.64 Short-term loans comprise loans that normally have an original maturity of one year or less. All loans repayable on demand should be classified as short-term even when these loans are expected to be outstanding for more than one year.
- 11.65 Long-term loans comprise loans that normally 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.

- 11.66 There is a discussion of the memorandum items to be shown for non-performing loans in [chapter 13](#).

## 5. Equity and investment fund shares

### Equity

- 11.67 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.)

- 11.68 *Equity comprises all instruments and records acknowledging, after the claims of all creditors have been met, claims to the residual value of corporations. The value of this residual claim is not expressed as the right to a pre-determined income or to a fixed sum on dissolution of the corporations.* Ownership of equity is usually evidenced by shares, participation, or similar documents. Preferred stocks or shares, which also provide for participation in the distribution of the residual value on dissolution of an incorporated enterprise, are included. All equity of corporations with shares should be included in the value of listed and unlisted shares. The value of equity in corporations and quasi-corporations without shares is included in other equity.

- 11.69 Transactions in equity in the financial account cover three different types of transactions. The first is the simplest and most obvious; it is the recording of the value of shares bought and sold on the stock exchange. From time to 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.

- 11.70 The second type of transaction concerning equity is capital injections by the owners or, on occasion, withdrawals of equity by the owners. Dividends are recorded in the distribution of primary income account as if they were always paid out of operating surplus earned in the current period. An enterprise, though, usually aims to have a smooth track record of dividend payments and will therefore sometimes pay out more than the current operating surplus and sometimes rather less, the balance carrying 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. Equally, liquidating dividends paid to shareholders when an enterprise becomes bankrupt should be recorded as withdrawal of equity.

- 11.71 Conversely, owners may inject extra finance into an enterprise. If the enterprise is publicly controlled and runs a regular deficit each year as a matter of government economic or social policy that is covered by a receipt from government to match this deficit, the payment is to be regarded as a subsidy. If the payment from government is irregular but clearly designed to cover accumulated losses, it is treated as a capital transfer. If government makes an investment grant to a public corporation, this also is to be recorded as a capital transfer. However, there may be cases where the owners (public or private) agree to make new finance available to permit expansion, say, and represent not just a reduction of debt 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. Transfers by owners of fixed and other assets to the quasi-corporation are also included as addition to 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. Withdrawals may take the form of proceeds from sales of fixed or other assets, transfers of fixed and other assets from the quasi-corporation to the owner and funds taken from accumulated retained savings and reserves for the consumption of fixed capital. (The particular case of payments between government and public enterprises is discussed in [chapter 20](#).)

- 11.72 The third type of transaction 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, the share of operating surplus proportionate to the foreign direct investor's share of equity is shown as being withdrawn and distributed to him as reinvested earnings. Because it is not actually withdrawn, it is returned to the net worth of the enterprise by a recording under this heading in the financial account.
- 11.73 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 an asset owned by a resident notional unit with a matching increase in the equity of the non-resident owner. 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.

### Investment fund shares

- 11.74 Investment funds, which include mutual funds and unit trusts, are a means of pooling other financial instruments so that those 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.

- 11.75 Investment fund are divided into money market funds (MMF) and non-MMF investment funds. The fundamental difference between them is that MMFs typically invest in money market instruments with a residual 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.

### *Money market fund shares*

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

### *Other investment fund shares*

- 11.77 *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.***

### Supplementary classifications of investment fund shares

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

## **6. Insurance, pension and standardised guarantees schemes**

- 11.79 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 to them and may receive benefits (or have claims settled) in the same or later periods. While they hold the funds, insurance corporations invest them on behalf of the

participants. The part of the investment income that is distributed to the participants as property income is returned as extra contributions. In all cases, 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. The only entries in the financial account, therefore, 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**.

#### Non-life insurance technical provisions

11.80 *Non-life insurance technical provisions consist of prepayments of net premiums and provisions to meet outstanding non-life insurance claims.* The only transaction for non-life insurance technical provisions recorded in the financial account is difference between net premiums receivable and claims payable.

#### Life insurance and annuities entitlements

11.81 *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.

#### Pension entitlements

11.82 *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. The increase in pension entitlements shown in the financial account matches the entry in the use of income account for the change in pension entitlements.

#### Provisions for calls under standardised guarantees

11.83 *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.

### 7. Financial derivatives and employee stock options

#### Financial derivatives

11.84 *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.* 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.

11.85 No specific standards for sub-classifications of financial derivatives are recommended. 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.).

11.86 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.

11.87 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 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. Therefore, 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.

11.88 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. In the latter case, implicit or explicit service charges may be involved. 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.

11.89 There are two broad classes of financial derivatives: forward-type contracts, and 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 organized exchanges. ***A forward contract is 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.*** 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.

11.90 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.
- 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 net cash payments. The only payment that takes place is related to the difference between the agreed forward rate agreement rate and the prevailing market 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.
- c. *A foreign exchange swap is a spot sale/purchase of currencies and a simultaneous forward purchase/sale of the same currencies.*
- d. *A forward foreign exchange contract involve two counterparties who agree to transact in foreign currencies at an agreed exchange rate in a*

*specified amount at some agreed future date.*

- e. *A cross-currency interest rate swap, sometimes known as a currency swas, involve 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.*

11.91 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).

11.92 *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 (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 price should be recorded as acquisition of a financial asset by the buyer and as incurrence of a liability by the seller. 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.

11.93 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.


11.94 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 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.

11.95 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, 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.

11.96 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, 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 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

- 11.97 *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.* 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. 

## 8. Other accounts receivable/payable

### Trade credit and advances

- 11.98 This category comprises trade credit for goods and services extended to corporations, government, NPISHs, households and the rest of the world, and advances for work that is in progress (if classified as such under inventories) or is to be undertaken. Trade credits and advances do not include loans to finance trade credit, which are classified as 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

- 11.99 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 occurs, it is treated as a form of accounts receivable/payable under this heading.

### .Other

- 11.100 This category includes accounts receivable and payable, other than those described previously, that is the amounts are not related to the provision of goods and services. It covers amounts related to 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).

- 11.101 This category does not include statistical discrepancies.

## 9. Memorandum item: foreign direct investment

- 11.102 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.**

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