EUROPEAN UNION

THE EUROPEAN PARLIAMENT **THE COUNCIL**

Brussels, 3 April 2013
(OR. en)

2010/0374 (COD)

PE-CONS 77/12
ADD 20

STATIS 106
ECOFIN 1090
UEM 345
CODEC 3081
OC 768

LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject:	REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the European system of national and regional accounts in the European Union (ESA 2010) - (Annex A - Chapter 20) **COMMON GUIDELINES** **Consultation deadline for Croatia: 17.4.2013**

CHAPTER 20
THE GOVERNMENT ACCOUNTS

INTRODUCTION

20.01 The activities of government are presented separately from those of the rest of the economy because the powers, motivation, and functions of government are different from those of other sectors. This Chapter presents general government sector accounts and a government finance statistics (GFS) presentation that gives an integrated picture of government economic activities: revenue, expenditure, deficit/surplus, financing, other economic flows and balance sheet.

20.02 Governments have powers to raise taxes and other compulsory levies and to pass laws affecting the behaviour of economic units. The principal economic functions of government are as follows:

(a) to provide goods and services to the community, either for collective consumption such as public administration, defence, and law enforcement, or individual consumption such as education, health, recreation and cultural services, and to finance their provision out of taxation or other incomes;

(b) to redistribute income and wealth by means of transfer payments such as taxes and social benefits;

(c) to engage in other types of non-market production.

20.03 The GFS presentation of general government economic activities presents the usual sequence of accounts in a manner that is more suitable for government finance analysts and policymakers. The GFS presentation uses aggregates and balancing items defined in terms of the ESA concepts, definitions, classifications, and accounting rules so that they are measured consistently with other macroeconomic variables, and with the same measures in other countries. Items such as saving and net lending/net borrowing are already available in the sequence of accounts. Other items, such as total revenue, total expenditure, the tax burden and total debt, are not shown explicitly.

20.04 Additional rules on some more difficult issues of classification and measurement for the general government sector are given in the section 'Accounting issues relating to general government'.

DEFINING THE GENERAL GOVERNMENT SECTOR

20.05 The general government sector (S.13) consists of all government units and all non-market non-profit institutions (NPIs) that are controlled by government units. It also comprises other non-market producers as identified in paragraphs 20.18 to 20.39.

20.06 Government units are legal entities established by political process which have legislative, judicial or executive authority over other institutional units within a given area. Their principal function is to provide goods and services to the community and to households on a non-market basis and to redistribute income and wealth.

20.07 A government unit usually has the authority to raise funds through compulsory transfers from other institutional units. In order to satisfy the basic requirements of an institutional unit, a government unit must have funds of its own either raised by income from other units or received as transfers from other government units, and must have the authority to disburse such funds in the pursuit of its policy objectives. It must also be able to borrow funds on its own account.

Identification of units in the government

Government units

20.08 In all countries, there is a core entity, notably inside the central government that exercises national executive, legislative and judiciary powers. Its revenues and expenditures are directly regulated and controlled by a Ministry of Finance, or its equivalent, by means of a general budget approved by the legislature. Despite its size and diversity, this entity is usually a single institutional unit. Ministerial departments, agencies, boards, commissions, judicial authorities, and legislative bodies are part of this core central government unit. The separate ministries within it are not recognised as separate institutional units as they do not have the authority to own assets, incur liabilities, or engage in transactions in their own right.

20.09 General government subsectors such as state and local governments can include such primary core government units as described in paragraph 20.08, each related to a given level of government and geographic area.

20.10 In addition to this primary unit, there are government entities with separate legal identities and substantial autonomy, including discretion over the volume and composition of their expenditures and a direct source of revenue, such as earmarked taxes. Such entities are often established to carry out specific functions, such as road construction or the non-market production of health, education or research services. These entities are considered to be separate government units where they maintain full sets of accounts, own goods or assets in their own right, engage in non-market activities for which they are held accountable at law, and are able to incur liabilities and enter into contracts. Such entities (together with non-profit institutions controlled by government) are known as 'extra-budgetary units' because they have separate budgets, receive substantial transfers from the main budget, and their primary sources of finance are supplemented with own sources of revenue that fall outside the main budget. These extra-budgetary units are classified to the general government sector unless they are predominantly market producers controlled by another government unit.

20.11 The general budget of any government level can include unincorporated enterprises that are market producers and quasi-corporations. If they qualify as institutional units, such enterprises are not considered to be part of general government, but classified to the non-financial or financial corporations sector.

20.12 Social security funds are government units devoted to the operation of social security schemes. Social security schemes are social insurance schemes covering all or a large part of the community as a whole, which are imposed and controlled by government. A social security fund is an institutional unit if it is organised separately from the other activities of government units, holds its assets and liabilities separately, and engages in financial transactions on its own account.

NPIs classified to the general government sector

20.13 Non-profit institutions (NPIs) that are non-market producers and are controlled by government units are units of the general government sector.

20.14 Governments may choose to use some NPIs rather than government agencies to carry out government policies because they are seen as more detached, objective, and less subject to political pressures. For example, research and development and the setting and maintenance of standards in fields such as health, safety, the environment, and education are areas in which NPIs may be more effective than government agencies.

20.15 Control of a NPI is defined as the ability to determine the general policy or programme of the NPI. Public intervention in the form of general regulations applicable to all units working in the same activity is irrelevant when deciding whether the government holds control over an individual unit. To determine whether a NPI is controlled by the government, the following five indicators of control should be considered:

(a) the appointment of officers;

(b) other provisions of the enabling instrument, such as the obligations in the statute of the NPI;

(c) contractual agreements;

(d) degree of financing;

(e) risk exposure.

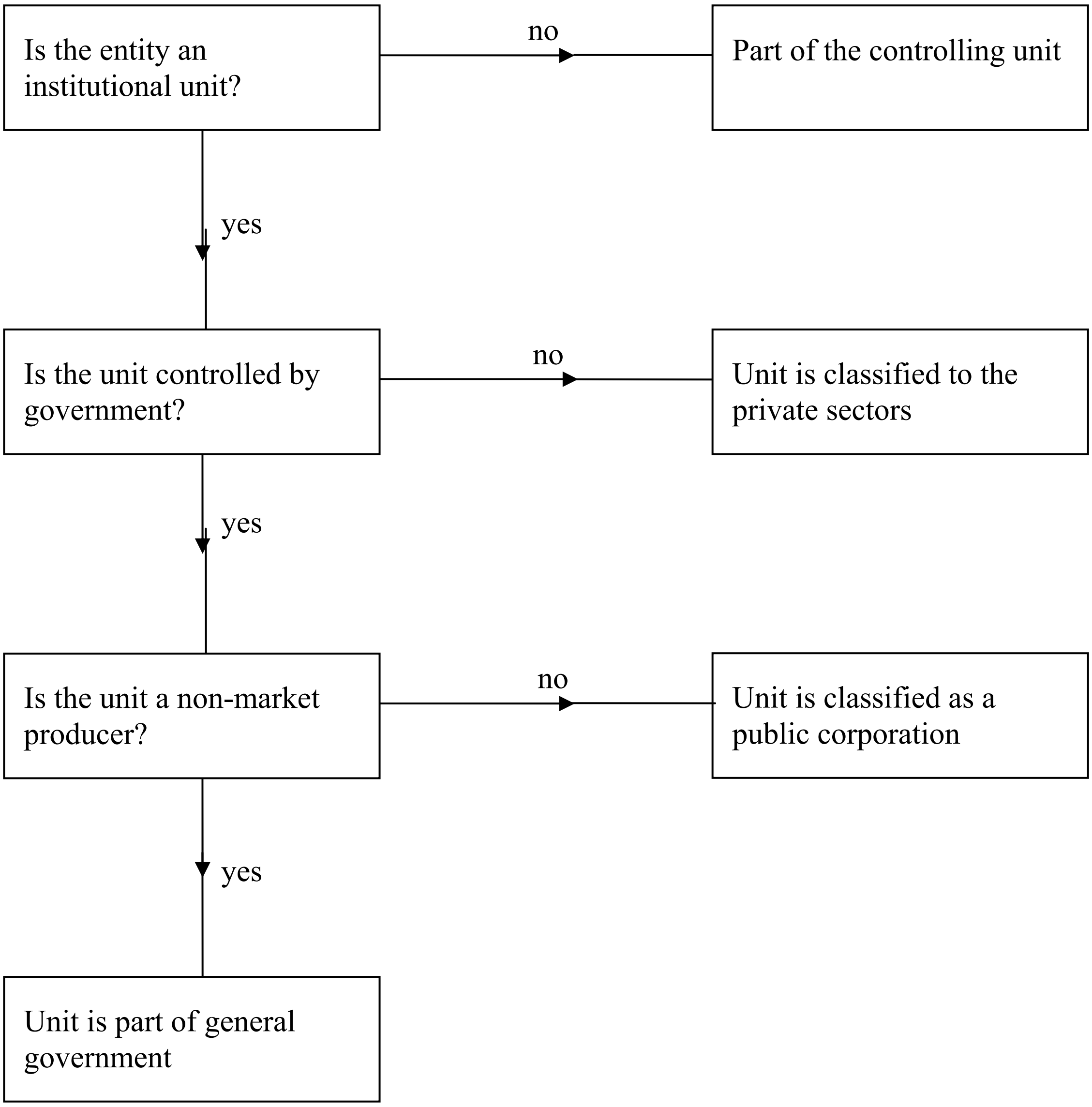
A single indicator can be sufficient to establish control. However, if a NPI that is mainly financed by government remains able to determine its policy or programme to a significant extent along the lines mentioned in the other indicators, then it would not be considered as being controlled by government. In most cases, a number of indicators will collectively indicate control. A decision based on these indicators will be judgmental in nature.

20.16 The non-market characteristic of an NPI is determined in the same way as for other units of general government.

Other units of general government

20.17 It can be difficult to decide on the classification of producers of goods and services that operate under the influence of government units. The alternatives are to classify them as general government or, if they qualify as institutional units, as public corporations. For such cases, the following decision tree is used.

Diagram 20.1 — Decision tree



Public control

20.18 Control over an entity is the ability to determine the general policy or programme of that entity. In order to determine the existence of control by government, the criteria used are those used for corporations liable to be public corporations, as set out in paragraph 2.32.

Market/non-market delineation

Notion of economically significant prices

20.19 Non-market producers provide all or most of their output to others free of charge or at prices that are not economically significant. Economically significant prices are prices which have a substantial influence on the amounts of products producers are willing to supply and on the amounts of products that purchasers wish to acquire. It is the criterion that is used to classify output and producers as market or non-market, thus deciding whether an institutional unit in which government has a controlling interest is to be designated as a non-market producer and so classified in the general government sector, or as a market producer and so classified as a public corporation.

20.20 Whereas the assessment of whether a price is economically significant is carried out at the level of each individual output, the criterion determining the market/non-market character of a unit is applied at the level of the unit.

20.21 When the producers are private corporations, it can be presumed that prices are economically significant. By contrast, when there is public control, a unit's prices may be established or modified for public policy purposes, which may cause difficulties in determining whether the prices are economically significant. Public corporations are often established by government to provide goods and services that the market would not produce in the quantities or at the prices to meet government policy. For such public units enjoying government support, the sales may cover a large part of their costs, but they will respond to market forces differently from private corporations.

20.22 To analyse the difference between a market and a non-market producer, in relation to changes in market conditions, it is useful to specify which units are the consumers of the goods and services in question and whether the producer actually competes on the market or is the only supplier.

Criteria of the purchaser of the output of a public producer

The output is sold primarily to corporations and households

20.23 Economically significant prices normally result when two major conditions are fulfilled:

(1) the producer has an incentive to adjust supply either with the goal of making a profit in the long run or, at a minimum, covering capital and other production costs, including consumption of fixed capital, by sales; and

(2) consumers are free to choose on the basis of the prices charged.

The output is sold only to government

20.24 Some services are typically required as ancillary services. They include activities such as transportation, financing and investment, purchasing, sales, marketing, computer services, communications, cleaning, and maintenance. A unit that provides this type of services exclusively to its parent unit or to other units in the same group of units is an ancillary unit. It is not a separate institutional unit and is classified with its parent unit. Ancillary units provide all of their output to their owners for use as intermediate consumption or gross fixed capital formation.

20.25 If a public producer sells only to government and is the only supplier of its services, it is presumed to be a non-market producer unless it competes with a private producer. A typical case is tendering for a contract with government on commercial terms and therefore government payments are only for services delivered.

20.26 If a public producer is one of several suppliers to government, it is considered a market producer if it competes with other producers on the market and its prices satisfy the general criteria to be economically significant, as defined in paragraphs 20.19 to 20.22.

The output is sold to government and others

20.27 If a public producer is the only supplier of its services, it is presumed to be a market producer if its sales to non-government units are more than half of its total output or its sales to government fulfils the tendering condition of paragraph 20.25.

20.28 If there are several suppliers, a public producer is a market producer if it competes with the other producers through tendering for a contract with government.

The market/non-market test

20.29 The sector classification of core government units, engaged in the provision of goods and services on a non-market basis and/or in the redistribution of income and wealth, is straightforward.

For other producers that operate under the control of government, an assessment of their activity and resources is necessary. In order to decide if they are market units, and charge economically significant prices, the criteria as set out in paragraphs 20.19 to 20.28 are to be checked. In summary the conditions are as follows:

(a) the producer is an institutional unit (a necessary condition; see also the decision tree in paragraph 20.17);

(b) the producer is not a dedicated provider of ancillary services;

(c) the producer is not the only supplier of goods and services to government, or, where that producer is, it has competitors; and

(d) the producer has an incentive to adjust supply to undertake a viable profit-making activity, to be able to operate in market conditions and to meet its financial obligations.

The ability to undertake a market activity will be checked notably through the usual quantitative criterion (the 50 % criterion), using the ratio of sales to production costs (as defined in paragraphs 20.30 and 20.31). To be a market producer, the public unit shall cover at least 50 % of its costs by its sales over a sustained multi-year period.

20.30 For the market/non-market test, sales of goods and services correspond to sales receipts, in other words to the market output (P.11) increased by payments for non-market output (P.131), if any. Own-account production is not considered as part of sales in this context. Sales exclude also all payments received from government unless they are granted to other producers undertaking the same activity.

20.31 Production costs are the sum of intermediate consumption, compensation of employees, consumption of fixed capital and other taxes on production. For the purpose of the market/non-market test, production costs are increased by the net interest charge and decreased by the value of any imputed production, notably own-account production. Subsidies on production are not deducted.

Financial intermediation and the government boundary

20.32 The case of units engaged in financial activities needs special consideration. Financial intermediation is the activity in which units acquire financial assets and at the same time incur liabilities on their own account by engaging in financial transactions.

20.33 A financial intermediary places itself at risk by incurring liabilities on its own account. For instance, if a public financial unit manages assets but does not place itself at risk by incurring liabilities on its own account, it is not a financial intermediary and the unit is classified in the general government sector rather than in the financial corporations sector.

20.34 Applying the quantitative criterion of the market/non-market test to public corporations involved in financial intermediation or in managing assets is generally not relevant, because their earnings arise from both property income and holding gains.

Borderline cases

Public head offices

20.35 Public head offices are entities whose main function is to control and direct a group of subsidiaries under the control of a government unit. Two cases are distinguished.

(a) To the extent that the public head office is an institutional unit and is engaged in the management of market producers, it is classified according to the main activity of the group, in sector S.11 if the main activity is to produce goods and non-financial services, or in sector S.12 if it produces mainly financial services (see also paragraphs 2.23 and 2.59).

(b) If the public head office is not an institutional unit, and so sometimes known as a 'shell', or acts as a government agent for public policy purposes, such as channelling funds amongst subsidiaries, and organising privatisation or defeasance, it is classified to the general government sector.

20.36 The term 'public head office' used here covers units which are also known under the label of 'public holding companies'.

20.37 Subsidiaries forming part of the group, engaged in production and keeping a full set of accounts, are deemed to be institutional units even if they have partially surrendered some of their autonomy of decision to the central body (see paragraph 2.13). The market/non-market test is applied to individual units. It may thus happen that one subsidiary, but not others, is recognised as non-market and classified to the general government sector.

Pension funds

20.38 Employers' pension schemes are arrangements set up to provide retirement benefits to participants, based on a contractual employer-employee relationship. They include funded, unfunded, and partly funded schemes.

20.39 A defined-contribution funded scheme, established by a government unit, is not treated as a social security scheme, where there is no government guarantee on the level of pensions due, and the level of pensions is uncertain because it depends on asset performance. As a consequence, the unit identified as managing the scheme — as well as the fund itself, if it is a separate institutional unit — is considered a financial corporation, classified in the insurance corporations and pension funds subsector.

Quasi-corporations

20.40 Quasi-corporations are unincorporated enterprises that function as if they were corporations. Quasi-corporations are treated as corporations: that is, as separate institutional units from the units to which they belong in recognition of their distinct economic and financial behaviour. Thus, market establishments controlled by government units and recognised as public quasi-corporations are grouped with corporations in the non-financial or financial corporations sectors.

20.41 A government establishment or a group of establishments engaged in the same kind of production under common management is treated as a public quasi-corporation if:

(a) it charges prices for its outputs that are economically significant;

(b) it is deemed to have autonomy of decision; and

(c) a complete set of accounts exists that enables its operating balances, savings, assets and liabilities to be separately identified and measured, or it is possible to construct such a complete set of accounts.

20.42 The amount of income withdrawn from a quasi-corporation during a given accounting period is decided by the owner. Such a withdrawal is equivalent to the payment of a dividend by a corporation to its shareholders. Given the amount of the income withdrawn, the amount of earnings retained within the quasi-corporation is determined. The owner may invest more capital in the enterprise or withdraw capital from it by disposing of some of its assets, and such flows of capital shall also be identifiable in the accounts whenever they occur. Investment and property income flows in the quasi-corporation are recorded in the same way as similar flows in corporations. In particular, investment grants are recorded as capital transfers.

20.43 The producer entities that are not treated as quasi-corporations remain integrated with the government units that own them. While units of government consist largely of non-market producers, market establishments can exist within a government unit. The sales of these market establishments are in addition to incidental sales, which are secondary output sold by non-market establishments at economically significant prices. As a result, a non-zero net operating surplus is possible for a government unit: the net operating surplus generated by market establishments.

Restructuring agencies

20.44 Some public units are involved in the restructuring of corporations. Such corporations may or may not be controlled by government. The restructuring agencies may be long-standing public units or agencies created for this special purpose. Government funds the restructuring in various ways, either directly through capital injections such as capital transfers, loans or acquisition of equity, or indirectly, through granting guarantees. The major criteria determining sector classification of restructuring agencies are whether such entities are financial intermediaries, the market character of the main activity and the degree of risk assumed by the public agency. In many cases, the degree of risk taken by the restructuring agency is low due to the fact that it acts with public financial support and on behalf of the government. Restructuring agencies can handle privatisation or defeasance.

Privatisation agencies

20.45 The first type of restructuring agency manages privatisation of public sector units. There are two cases.

(a) The restructuring unit, whatever its legal status, acts as a direct agent of the government or has a limited lifespan. Its main function is to redistribute national income and wealth, channelling funds from one unit to the other. The restructuring unit is classified in the general government sector.

(b) The restructuring unit is a holding company controlling and managing a group of subsidiaries, and only a minor part of its activity is dedicated to conducting privatisation and channelling funds from one subsidiary to the other on behalf of the government and for public policy purposes. The unit is classified as a corporation, and any transactions made on behalf of the government should be rerouted through the general government.

Defeasances structures

20.46 The second type of restructuring agency deals with impaired assets, and may be set up in a banking or other financial crisis. Such agencies are referred to as defeasance structures or 'bad banks'. A restructuring agency shall be classified according to the degree of risk it assumes, considering the degree of financial support of the government.

In the most common case, the restructuring agency purchases assets above market prices with the direct or indirect financial support of government. Its activities result in redistribution of national income and wealth. If the defeasance structure does not place itself at risk, it is classified to the general government sector.

Special purpose entities

20.47 Special purpose entities (SPEs), also called special purpose vehicles (SPVs), may be set up for financial convenience by governments or by private entities. The SPE may be involved in fiscal operations, including securitisation of assets, borrowing on behalf of government, etc. Such SPEs are not separate institutional units when resident. These entities are classified according to the principal activity of the owner, and SPEs performing fiscal operations are classified to the general government sector.

20.48 Non-resident SPEs are recognised as separate institutional units. All flows and stock positions between the general government and the non-resident SPE are recorded in the general government and SPE accounts. In addition, when such non-resident SPEs undertake government borrowing or incur government outlays abroad, even when there are no flows recorded between the government and the SPE related to those fiscal activities, transactions are imputed in the accounts of both the government and the non-resident entity to reflect the fiscal activities of the government. If a non-resident SPE engages in a securitisation operation without a sale of asset, the operation is considered to be a borrowing transaction of the government. The economic substance of this transaction is accounted for by imputing general government borrowing from the non-resident SPE for the same value and at the same time the SPE incurs a liability to the foreign creditor.

Joint ventures

20.49 Many public units enter into arrangements with private entities or other public units to undertake a variety of activities jointly. The activities can result in market or non-market output. Joint operations can be structured broadly as one of three types: jointly controlled units, referred to here as joint ventures; jointly controlled operations; and jointly controlled assets.

20.50 A joint venture requires the establishment of a corporation, partnership or other institutional unit in which each party has joint control over the activities of the unit. As an institutional unit, the joint venture may enter into contracts in its own name and raise finance for its own purposes. A joint venture maintains its own accounting records.

20.51 Normally, the percentage of ownership will be sufficient to determine control. If each owner owns an equal percentage of the joint venture, the other indicators of control must be considered.

20.52 Public units can also enter into joint operating arrangements that are not run by separate institutional units. In this case, there are no units requiring classification, but care must be taken to ensure that the ownership of assets is recorded correctly and sharing arrangements of revenues and expense are made in accordance with the provisions of the governing contract. For example, two units may agree to be responsible for different stages of a joint production process or one unit may own an asset or a complex of related assets but both units agree to share revenues and expenses.

Market regulatory agencies

20.53 Public agencies acting in the field of agriculture engage in two types of activity:

(a) either to buy, hold and sell agricultural and other food products on the market; or

(b) to be exclusively or principally a distributor of subsidies or other transfers to producers.

In the first case, given that it acts as a market producer, the institutional unit is classified in the non-financial corporations sector (S.11). In the second case, the institutional unit is classified in the general government sector (S.13).

20.54 Where the market regulatory agency performs both activities described in paragraph 20.53, it is split into two institutional units, according to the principal activity, one being classified in the non-financial corporations sector (S.11), the other in the general government sector (S.13). In the case where it would be difficult to split the agency in this way, a convention is to adapt the usual sector classification test applying a 'principal activity' criterion on the basis of costs. If the costs of the unit are very significantly linked to the market managing activity, the unit is classified in the non-financial corporations sector. An 80 % threshold of costs to sales ratio is recommended. If the costs to sales ratio linked to the regulatory activity are less than this threshold, the unit is classified in the general government sector (S.13).

Supranational authorities

20.55 Some countries are part of an institutional agreement whereby the countries form part of a supranational authority. Normally such an arrangement implies monetary transfers from the member countries to the supranational authority and the reverse. The supranational authority will also engage in non-market production. In the national accounts of the member countries, the supranational authorities are non-resident institutional units that are classified to a specific subsector of the rest of the world.

The subsectors of general government

20.56 Depending on the administrative and legal arrangements, there is generally more than one level of government within a country. In Chapter 2, three levels of government are specified: central, state (or regional) and local, with a subsector for each level. In addition to these levels of government, the existence and size of social security and its role in fiscal policy require that statistics for all social security units be compiled as a fourth separate subsector of general government. Not all countries have all levels; some may have only a central government or a central government and one lower level. In countries that have more than three levels, the various units should all be classified to one of the levels above.

Central government

20.57 The central government (excluding social security) subsector (S.1311) consists of all government units having a national sphere of competence, with the exception of social security units. The political authority of a country's central government extends over the entire territory of the country. The central government can impose taxes on all resident institutional units and on non-resident units engaged in economic activities within the country. Central government typically is responsible for providing collective services for the benefit of the community as a whole, such as national defence, relations with other countries, public order and safety, and for regulating the social and economic system of the country. In addition, it may incur expenditure on the provision of services, such as education or health, primarily for the benefit of individual households, and it may make transfers to other institutional units, including other levels of government.

20.58 The compilation of statistics for central government is important because of the special role it plays in economic policy analysis. It is mainly through central government that fiscal policy impacts on inflationary or deflationary pressures within the economy. It is generally at the central government level that a decision-making body formulates and carries out policies directed toward nationwide economic objectives.

20.59 The central government subsector is a large and complex subsector in most countries. It is generally composed of a central group of departments or ministries that make up a single institutional unit plus miscellaneous bodies operating under the control of the central government with a separate legal identity and enough autonomy to form additional central government units.

20.60 The main central group or primary central government is sometimes called budgetary central government emphasising the fact that an essential of its key reporting statement is the 'budget'. This suggests that the budget provides an implicit delimitation of this underlying institutional unit of central government. It is sometimes called the 'State', which should not be confused with the notion of state government such as provinces, *Länder*, cantons, republics, prefectures, or administrative regions in a federal system of government. When drawing up the complete sequence of accounts for budgetary central government, it is often appropriate to include the activities of extra-budgetary funds, when they are not institutional units, and generally all treasury operations not reported in the budget.

20.61 The other component of central government consists of other central government bodies, also called extra-budgetary units, which comprise extra-budgetary agencies or entities that qualify as institutional units, non-market public enterprises with legal status and non-market public controlled NPI.

20.62 Central government can be partitioned into two components: budgetary central government and other central government bodies. This partition is a matter of judgment and can be influenced by practical considerations. An important criterion is the institutional coverage of the 'budget'. However, the exact composition should be precisely known and agreed between compilers at the national level, to reinforce the consistency of source data. The ability to draw a complete sequence of accounts for these two 'subsectors' of central government is important in assessing the quality of the data.

State government

20.63 The state government (excluding social security) subsector (S.1312) consists of all government units in a federal system of government having a state or regional sphere of competence, with the possible exception of social security units. A state is the largest geographical area into which the country as a whole is divided for political or administrative purposes. Such areas are known by terms such as provinces, *Länder*, cantons, republics, or administrative regions. They all enjoy the sufficient level of power required in a federal system of government. The legislative, judicial, and executive authority of a state government extends over the entire area of an individual state, which usually includes numerous localities, but does not extend over other states. In many countries, state governments do not exist. In federal countries, considerable powers and responsibilities may be assigned to state governments, and compiling a state government subsector is appropriate in such cases.

20.64 A state government usually has the fiscal authority to levy taxes on institutional units that are resident in, or engage in economic activities in, its area of competence. To be recognised as a government unit, the entity must be able to own assets, raise funds, and incur liabilities on its own account, and it must also be entitled to spend or allocate at least some of the taxes or other income that it receives according to its own policies. The entity may, however, receive transfers from the central government that are tied to certain specified purposes. A state government is able to appoint officers independently of external administrative control. If a government entity operating in a state is entirely dependent on funds from central government, and if central government also dictates the ways in which those funds are to be spent, then the entity is an agency of central government.

Local government

20.65 The local government (excluding social security) subsector (S.1313) consists of government units having a local sphere of competence (with the possible exception of social security units). Local governments typically provide a wide range of services to local residents, some of which may be financed out of grants from higher levels of government. Statistics for local government cover a wide variety of governmental units, such as counties, municipalities, cities, towns, townships, boroughs, school districts, and water or sanitation districts. Often local government units with different functional responsibilities have authority over the same geographic areas. For example, separate government units representing a town, a county, and a school district have authority over the same area. In addition, two or more contiguous local governments may organise a government unit with regional authority that is accountable to local governments. Such units are classified to the local government subsector.

20.66 The legislative, judicial, and executive authority of local government units is restricted to the smallest geographic areas distinguished for administrative and political purposes. The scope of a local government's authority is generally much less than that of the central or a state government, and such governments may or may not be entitled to levy taxes on institutional units or economic activities taking place in their areas. They are often dependent on grants from higher levels of government, and act as agents of central or state governments to some extent. To be treated as institutional units, however, they must be entitled to own assets, raise funds, and incur liabilities by borrowing on their own account. They must also have discretion over how such funds are spent, and they should be able to appoint their own officers independently of external administrative control.

Social security funds

20.67 The social security funds subsector (S.1314) consists of all social security units, regardless of the level of government that operates or manages the schemes. If a social security scheme does not meet the requirements to be an institutional unit, it would be classified with its parent unit in one of the other subsectors of the general government sector. If public hospitals provide a non-market service to the community as a whole and if they are controlled by social security schemes, they are classified to the social security funds subsector.

THE GOVERNMENT FINANCE PRESENTATION OF STATISTICS

Framework

20.68 Experience has shown that for government, an alternative presentation to the ESA sequence of accounts in the central framework is better suited to certain analytical requirements. This alternative is known as the government finance statistics ('GFS') presentation. It gives a different but still integrated picture of government accounts with the following measures of government economic activity: revenue, expenditure, deficit/surplus, financing, other economic flows and balance sheet levels.

20.69 The ESA based GFS presentation consists of transactions recorded in the various ESA current accounts, capital account and financial account, rearranged for non-financial transactions into a single account presentation more appropriate to fiscal analysis.

20.70 In the GFS system, revenue is defined as the aggregate of all transactions recorded under positive resources in the ESA central framework, and subsidies receivable in the current accounts as well as capital transfers receivable recorded in the capital account. Expenditure is an aggregate of all transactions recorded under positive uses and under subsidies payable in the current accounts as well as capital expenditure — gross capital formation plus capital transfers payable — recorded in the capital account. These measures of revenue and expenditure are specific to the GFS presentation, but the underlying transactions are those of the ESA.

20.71 The difference between revenue and expenditure, equivalent to the surplus/deficit, is the net lending/net borrowing (B.9). The financing of the surplus/deficit is shown in the financial account, where net acquisitions of financial assets and net incurrence in liabilities are recorded. Expenditure and revenue entries have a counterpart entry in the financial account. Financial transactions may also lead to two entries in the financial account. This reflects the double entry principle where every transaction has a matching transaction in the financial account. In principle, the net lending/net borrowing can be derived also from transactions in financial assets and liabilities.

20.72 The GFS presentation is shown below:

Government finance statistics presentation	
	Revenue
	Taxes
	Social contributions
	Sales of goods and services
	Other current revenue
	Capital transfer revenue
less	Expenditure
	Intermediate consumption
	Compensation of employees
	Interest
	Subsidies
	Social benefits
	Other current expenditure
	Capital transfer expenditure
	Investment expenditure
equals	Net lending/net borrowing
equals	Net financial transactions

20.73 Additional accounts in the GFS system are for other economic flows, and balance sheets, coherent with the ESA sequence of accounts. Such accounts allow a complete reconciliation of the change in balance sheet and the flows taking place during the accounting period. For each asset or liability, the following identity holds:

	opening balance sheet
plus	transactions
plus	revaluations
plus	other changes in volume
equals	closing balance sheet

20.74 The balance sheet shows total asset levels — non-financial and financial — as well as liabilities stocks outstanding, which enables the following to be derived: net worth as total assets minus total liabilities, and financial net worth as total financial assets minus total liabilities.

20.75 Government finance statistics presents the financial performance of general government and its subsectors, or any grouping of government units, and also individual institutional units such as the budgetary central government.

Revenue

20.76 A revenue transaction is one that increases net worth, and has a positive impact on net lending (+)/net borrowing (–). Government revenue is usually dominated by compulsory levies imposed by government in the form of taxes and social contributions. For some levels of government, transfers from other government units and grants from international organisations are a major source of revenue. Other general categories of revenue include property income, sales of goods and services, and miscellaneous transfers other than grants. The total government revenue of an accounting period is calculated by summing transactions that are receivable, as follows:

Total revenue	=	total taxes	D.2 + D.5 + D.91
	+	total social contributions	D.61
	+	total sales of goods and services	P.11 + P.12 + P.131
	+	other current revenue	D.39 + D.4 + D.7
	+	other capital revenue	D.92 + D.99

Taxes and social contributions

20.77 Total taxes comprise taxes on production and imports (D.2), current taxes on income and wealth, etc. (D.5) and capital taxes (D.91). Total social contributions consist of actual social contributions (D.611) and imputed social contributions (D.612).

20.78 Estimating taxes and social contributions can be difficult. The problems involved and the recommended solutions are described in the section 'Accounting issues relating to general government' of this Chapter. While taxes are recorded in several of the accounts of the ESA central framework, in the government finance statistics presentation all taxes are presented as one category of revenue, with sub-classifications according to the base on which the tax is levied. Capital taxes are shown as revenue taxes in the government finance statistics presentation.

20.79 Tax and social contributions revenue data[1] are used to compile total tax or fiscal burden ratios, such as the ratio of total tax to the level of GDP, used in international comparisons. In this context, compulsory social contributions are presented simultaneously with tax statistics and are included in the measures of fiscal burden or compulsory levies.

---

[1] The ESA based total tax and social contributions revenue measure is consistent with that of the OECD Revenue Statistics, except for the recording of payable tax credits and of imputed social contributions. The ESA recording of taxes and social contributions is also harmonised with the IMF government finance statistics presentation, with some differences in breakdowns.

Sales

20.80 Total sales of goods and services consist of market output (P.11) and payments for non-market output (P.131). They also include — except when they are used for the market/non-market test (see paragraph 20.30) — output for own final use (P.12). Most of the output produced by general government consists of goods and services that are not sold, or that are sold at prices that are not economically significant. The distribution of a non-market output does not accord with the concept of revenue. For goods and services, only actual sales and some specific imputed sales are included in revenue.

20.81 Market output (P.11) of government comprises:

(a) the market output of market establishments included in government, such as a weapons factory that is part of the ministry of defence, or canteens set up by government units for their employees, that charge economically significant prices;

(b) secondary market products sold by non-market establishments, sometimes referred to as 'incidental sales', such as those arising from research and development contracts between public universities and corporations, or publications sold by government units at economically significant prices.

20.82 The above-quoted 'incidental sales' are distinct from the token museum entrance fees paid by visitors, which are usually partial payments for non-market output (P.131). Other significant partial payments include payments to hospitals or schools, when these are non-market.

20.83 The value of own-account capital formation is considered revenue in the ESA based government finance statistics, and included under sales. Sales include also the value of goods and services produced and provided as compensation of employees in kind or as other payment in kind.

20.84 Sales revenue in the ESA based government finance statistics takes an output perspective: they do not differ from output, whereas actual sales to customers differ by changes in inventories. However such changes in inventories are likely to be small for government units and other non-market producers, mostly engaged in the production of services rather than in the production of goods. Sales are valued at basic prices.

Box 20.1 — From the ESA central framework to GFS transactions and aggregates

ESA resources		ESA GFS revenue
P.1	Output, of which	
	Market output (P.11)	Sales of goods and services
	Output for own final use (P.12)	Sales of goods and services
	Non-market output (P.13), of which:	
	— Payments for non-market output (P.131)	Sales of goods and services
	— Non-market output, other (P.132)	Not accounted for in Total revenue
D.2	Taxes on production and imports (receivable)	Total taxes
D.3	Subsidies (receivable)	Other current revenue
D.4	Property income	Other current revenue
D.5	Current taxes on income and wealth	Total taxes
D.61	Social contributions	Total social contributions
D.7	Other current transfers	Other current revenue
D.91r	Capital taxes (receivable)	Total taxes
D.92r	Investment grants (receivable)	Other capital revenue
D.99r	Other capital transfers (receivable)	Other capital revenue

ESA uses and capital transactions		ESA GFS expenditure
P.2	Intermediate consumption	Intermediate consumption
D.1	Compensation of employees	Compensation of employees
D.2	Taxes on production and imports (payable)	Other current expenditure
D.3	Subsidies (payable)	Subsidies
D.41	Interest	Interest
D.4	Property income (excluding D.41)	Other current expenditure
D.5	Current taxes on income	Other current expenditure
D.62	Social benefits other than social transfers in kind	Social benefits other than ST in kind
D.632	Social transfers in kind via market producers	Social transfers in kind via market producers
D.7	Other current transfers	Other current expenditure
D.8	Adjustment for the change in pension entitlements	Other current expenditure
P.31	Individual consumption expenditure on market output	Social transfers in kind via market producers
P.31	Individual consumption expenditure on non-market output	Not accounted for in Total expenditure
P.32	Collective consumption expenditure	Not accounted for in Total expenditure
P.5	Gross capital formation	Capital expenditure
NP	Acquisition less disposal of non-produced assets	Capital expenditure
D.92p	Investment grant (payable)	Capital expenditure
D.99p	Other capital transfers (payable)	Capital expenditure

In the ESA central framework, net lending/net borrowing (B.9) is the balancing item of the capital account. The balancing item of general government in the ESA GFS presentation is identical to the net lending/net borrowing (B.9). This box explains why.

The ESA central framework

The first account is the production account, and therefore the first resource of an institutional sector in the ESA is its output. As the majority of services provided by government are not sold at economically significant prices and so are non-market, government output is measured by convention as the sum of production costs.

Similarly, final collective consumption expenditure, consisting of services provided to the community by government such as general services, defence, safety and public order, are measured as the sum of production costs. Also by convention, collective consumption expenditure (P.32) is equal to the actual final consumption (P.4) of government.

Final individual consumption expenditure of households provided directly by government on a non-market basis is also measured by its production costs.

As a result, two types of flows are 'imputed' in the ESA accounts of government:

(1) on the resources side, the non-market output, other (P.132) recorded in the production account;

(2) on the uses side, the actual final consumption (P.4) and the social transfers in kind — non-market production (D.631). They are recorded in the redistribution of income in kind account, and in the use of adjusted disposable income account.

Each imputed flow is equal to the sum of actual flows: the production costs. These two types of imputed flows, on the resource side and on the uses side, balance in the ESA sequence of accounts.

The ESA GFS presentation of statistics

The same basic transaction categories are used in the ESA GFS presentation, but mainly on the basis of actual monetary flows, to obtain the total revenue and the total expenditure of government. Only a selection of imputed flows is taken into account: imputed social contributions and capital transfers in kind.

Eliminating from the resources side the non-market output (P.132) to obtain total revenue, and eliminating from the uses side the actual final consumption (P.4=P.32) and the social transfers in kind — non-market production (D.631) to obtain total expenditure, results in the same balancing item: the net lending/net borrowing (B.9).

The only social transfers in kind that are accounted for in the GFS aggregate total expenditure of government are social transfers in kind provided to households via market producers (D.632), as they are subject to real payments of government units. Those transactions are also to be added to the sum of production costs (equal to non-market output, other — P.132) to obtain the final consumption expenditure of the general government.

P.3 = P.132 + D.632

Other revenue

20.85 Other current revenue consists of property income (D.4), other subsidies on production (D.39) and other current transfers (D.7).

20.86 Property income comprises interest (D.41), distributed income of corporations (dividends and withdrawals from income of quasi-corporations) (D.42) and, more marginally, reinvested earnings on foreign direct investment of government (D.43), other investment income (D.44) and rent (D.45).

20.87 Other current transfers (D.7) include mainly intra-government transfers. They shall be consolidated when drawing up the accounts of the sector as a whole.

20.88 Other capital revenue comprises investment grants (D.92) and other capital transfers (D.99) received from other units, predominantly from other government units (although consolidation carried out when presenting statistics may reduce their apparent size) and EU institutions, but also from other various units, reflecting transactions such as repayment by a debtor subsequent to the activation of a guarantee.

20.89 Grants, which are sometimes defined in other statistical systems as transfers other than subsidies received by one government unit from another government unit or an international organisation, are not an ESA category. Their amount should be equivalent to the sum of the following transfer revenue: D.73 + D.74 + D.92, together with D.75 + D.99 in some cases.

20.90 Subsidies received by government units consist only in other subsidies on production. When received by producing entities belonging to general government, subsidies on products are included in the valuation of the output and sales at basic prices.

Expenditure

20.91 An expenditure transaction is one that has a negative impact on net lending (+)/net borrowing (–). Total expenditure consists of current and capital expenditure. Current expenditure includes production related expenses (compensation of employees and intermediate consumption); property income payable (which is mainly interest); and transfer payments (such as social benefits, current grants to other governments, and miscellaneous other current transfers).

20.92 The total government expenditure of an accounting period is calculated using the following equation, summing transactions which are payable:

Total expenditure	=	intermediate consumption	P.2
	+	compensation of employees	D.1
	+	interest	D.41
	+	social benefits other than social transfers in kind	D.62
	+	social transfers in kind via market producers	D.632
	+	subsidies	D.3
	+	other current expenditure	D.29 + (D.4 – D.41) + D.5 + D.7 + D.8
	+	capital expenditure	P.5 + NP + D.92 + D.99

Compensation of employees and intermediate consumption

20.93 Compensation of employees and intermediate consumption are costs of production for units of government.

20.94 Compensation of employees (D.1) includes wages and salaries (D.11) paid as well as employers' social contributions (D.12), including imputed social contributions, that are viewed in the ESA as uses of households and as resources of government, and thus not to be consolidated. Compensation is recorded on an accrual basis, at the time the work is done, and not at the time the wage is due for payment or paid. Wages include bonus and other lump sums (due to arrears or contract renewal) paid, and the relevant time of recording can be difficult to determine: when covering long periods of employment, it is often the time of determination of the bonus rather than the time period that the bonus is nominally intended to cover.

20.95 Intermediate consumption (P.2) comprises the goods and services consumed during the accounting period in the production process. It differs in concept from purchases, and other possible kinds of acquisitions: any acquisition enters inventories prior to being removed upon consumption. Goods and services may be acquired by market and non-market establishments of government as well.

20.96 In concept, the time of recording of intermediate consumption is clear: at the time the product is used up in the production process. The time of recording of purchases and other acquisitions is in concept the delivery, although there may be cases when delivery can be difficult to ascertain.

Social benefits expenditure

20.97 Social benefits expenditure consists of social benefits other than social transfers in kind (D.62), that, in turn, consist mainly of cash payments, and of social transfers in kind provided to households via market producers (D.632). Social transfers in kind via market producers are government expenditure financing goods and services provided to households by market producers. Typical examples are health care, and goods and services provided by doctors and pharmacists, financed by government units, through social security schemes or social assistance programmes.

20.98 Social benefits expenditure excludes social transfers in kind provided to households by non-market producers of government. Governments often produce services and goods and distribute them for free or at prices that are not economically significant. To avoid duplication, in the government finance statistics presentation, the relevant costs of production of these goods and services are recorded only once as expenditure — intermediate consumption, compensation of employees, other taxes on production — and as revenue — other subsidies on production. In the ESA sequence of accounts, these costs are balanced by a resource under non-market output, and recorded again as a use under final consumption expenditure (P.3) to be distributed as social transfers in kind. It can be relevant, for analytical purposes, to calculate a broader aggregate of social transfers to include the latter: social benefit in cash (D.62) plus social transfers in kind (D.63).

20.99 In the ESA, even when retirement benefits paid to government employees are considered as the liquidation of a government liability (see section 'Accounting issues relating to general government'), they are also recorded as a payment of current expenditure and the related contributions are included as revenue. However, when the scheme is funded, such contributions and benefits are considered to be financing, and so an adjustment for the change in pension entitlements (D.8) is added to expenditure: it is equal to social contributions received as pensions or other retirement benefits less social benefits paid for pensions or other retirement benefits for those schemes the obligations of which are recognised as liabilities.

Interest

20.100 Interest expenditure includes what is due for the cost of incurring liabilities, notably on loans, bills, notes and bonds, but also on deposit liabilities or other instruments that are liabilities of government. Interest is recorded on an accrual basis (see section 'Accounting issues relating to general government').

20.101 Interest expenditure is adjusted for FISIM in the ESA-based government finance statistics. Interest paid to financial institutions on loans and deposits is partitioned into a service component, which is recorded as intermediate consumption, and a property income component which is recorded as interest paid. The same adjustment applies to government interest revenue paid by financial institutions on deposits or loans.

Other current expenditure

20.102 Other current expenditure comprises other taxes on production (D.29), property income other than interest (D.4-D.41), current taxes on income and wealth etc. (D.5), other current transfers (D.7) and the adjustment for the change in pension entitlements (D.8).

20.103 Whereas other taxes on production paid by units of government are recorded as government expenditure, taxes on products are not separately shown as government expenditure. This is because, on the one hand, such taxes, not being a resource for market producers of government, whose output is valued at basic prices, do not appear under their uses, and, on the other hand, taxes on products entering intermediate consumption of government are included in its valuation at purchasers' prices.

Capital expenditure

20.104 Capital expenditure comprises capital transfers, in the form of investment grants (D.92) and other capital transfers (D.99), as well as investment expenditure: gross capital formation (P.5, which consists of gross fixed capital formation — P.51g, plus changes in inventories — P.52, and acquisitions less disposals of valuables — P.53); and acquisitions less disposals of non-produced non-financial assets (NP). Disposals of non-financial assets, such as buildings, are not recorded as revenue, but as negative capital expenditure, making the net lending/net borrowing (B.9) more positive.

Link with government final consumption expenditure (P.3)

20.105 Making the link between total government expenditure and its components with government final consumption expenditure (P.3) is important for users of fiscal and other macroeconomic statistics.

20.106 Final consumption expenditures by general government are equal to the total of their output (P.1), plus the expenditure on products supplied to households via market producers (i.e. social transfers in kind — D.632), minus the sales of goods and services (P.11+P.12+P.131).

20.107 The output of government — market output, own account capital formation and non-market output — is equal to the sum of its costs of production (compensation of employees, intermediate consumption, consumption of fixed capital, and taxes on production paid net of subsidies on production received), plus the net operating surplus (B.2n) generated by market establishments of government.

20.108 Thus, the following calculation gives final consumption expenditures using selected items of government expenditure and revenue, as well as the net operating surplus (B.2n):

	compensation of employees (D.1)
plus	intermediate consumption (P.2)
plus	consumption of fixed capital (P.51c1)
plus	other taxes on production, payable (D.29 U)
less	other subsidies on production, receivable (D.39 R)
plus	operating surplus, net (B.2n)
equals	output (P.1)

and:

	output
less	sales of goods and services (P.11+P.12+P.131)
plus	social transfers in kind via market producers (D.632)
equals	final consumption expenditure (P.3)

Government expenditure by function (COFOG)

20.109 A classification of expenditure transactions using the classification of functions of government (COFOG) is integral to the government finance presentation: it is a major analytical instrument of government expenditure, especially useful for international comparisons. This classification shows the purpose for which expenditure transactions are undertaken. Such purposes differ from the administrative arrangement of governments, for example an administrative unit responsible for health services can undertake activities with an educational purpose, such as training of medical professionals. A cross presentation of government transactions by economic nature (the usual ESA classification) and according to functions is requested.

20.110 The COFOG classification describes government expenditure according to ten major functions set out below, and according to two additional levels of increased detailed breakdown not presented here. As an example, the second level is necessary to provide information on research and development expenditure, as well as to provide information on government expenditure dedicated to the risks and social needs of social protection.

20.111 The COFOG classification is consistent with the distinction made between collective non-market services and individual non-market services provided by government: the six first functions correspond to collective services, as well as some limited parts of the others. This enables government final collective consumption expenditure to be calculated. The total expenditure aggregate and the expenditure transactions broken down by function are consistent with those in the ESA government finance statistics. Therefore, it does not include social transfers in kind — non-market production (D.631), already accounted for with production costs of government.

Table 20.1 — COFOG, the 10 functions of government

Code	Function	Type of service
01	General public services	Collective
02	Defence	Collective
03	Public order and safety	Collective
04	Economic affairs	Collective
05	Environmental protection	Collective
06	Housing and community amenities	Collective
07	Health	Mainly individual
08	Recreation, culture and religion	Mainly collective
09	Education	Mainly individual
10	Social protection	Mainly individual

Balancing items

The net lending/net borrowing (B.9)

20.112 The government net lending (+)/net borrowing (–) (B.9) is the difference between total revenue and total expenditure. It is equal to the balancing item of the capital account (B.9N) in the ESA accounts. It represents the amount the government has available to lend or must borrow to finance its non-financial operations.

20.113 Net lending (+)/net borrowing (–) is also the balancing item of the financial account (B.9F in the central framework). In concept, it is the same as the balancing item of the capital account, although in practice a statistical discrepancy can occur.

20.114 The term 'net lending/net borrowing' is a sort of terminological shortcut. When the variable is positive (meaning that it shows a financing capacity), it should be called net lending (+); when it is negative (meaning that it shows a borrowing need), it should be called net borrowing (–).

Changes in net worth due to saving and capital transfers (B.101)

20.115 The difference between all transactions that affect net worth during the accounting period is the balancing item: changes in net worth due to saving and capital transfers (B.101).

20.116 The changes in net worth due to saving and capital transfers provide a useful measure of government accounts and policies as they represent the resources acquired or consumed in the government's current operations.

20.117 The changes in net worth due to saving and capital transfers equal net lending/net borrowing plus net acquisition of non-financial assets (P.5 + NP) minus consumption of fixed capital (P.51c1).

	Net saving plus capital transfers (B.101)
less	acquisitions less disposals of non-financial assets (P.5+NP)
plus	consumption of fixed capital (P.51c1)
equals	net lending/net borrowing (B.9)
equals	transactions in financial assets less liabilities (financing)

Financing

20.118 The financial account of government in the GFS records the transactions in financial assets and liabilities as described in Chapter 5.

Transactions in assets

20.119 Currency and deposits (F.2) reflects mainly movements in government deposits at banks, notably at central banks, which can fluctuate substantially from one period to another, in particular due to Treasury operations. Other government units such as local government and social security funds also hold substantial deposits in bank accounts.

20.120 Debt securities (F.3) mainly reflect net purchases of bills, notes or bonds issued by banks, non-financial corporations, or non-residents including foreign governments, the purchases being carried out predominantly by asset-rich social security funds or other reserve funds. Government purchases of bonds issued by other resident government units are reported under this heading in a non-consolidated presentation, but are excluded from this heading in a consolidated presentation, being reported instead as debt redemption.

20.121 Loans (F.4) include, in addition to loans to other government units, lending to foreign governments, public corporations, and students. Loan cancellations are also reflected here with a counterpart entry under capital transfer expenditure. Loans granted by government not likely to be repaid are recorded in the ESA as capital transfers, and are not reported here.

20.122 Equity and investment fund shares (F.5) capture acquisitions less disposals of equity in corporations by government units. These may reflect equity injections in public corporations or portfolio investments, privatisation proceeds or super-dividends. They consist mainly of the following:

(a) equity injections (generally in the form of cash) to specific public corporations where government is acting as an investor with the expectation of a return on invested funds. Such injections are not considered as government expenditure in national accounts;

(b) portfolio investments, in the form of purchases of quoted shares on the market made by government units such as asset-rich social security funds, or other portfolio investment operations;

(c) net investment in mutual funds, which are alternative investment vehicles. In particular, placements in money market mutual funds are reported here, rather than under currency and deposits, despite being close substitutes for bank deposits;

(d) privatisations conducted by special privatisation agencies, as such entities are classified to general government;

(e) distributions by public corporations to their owners in excess of their operational profit excluding holding gains/losses, recorded as financial transactions as withdrawal of equity akin to a partial liquidation of the enterprise, rather than as government revenue.

20.123 Transactions in other accounts receivable (F.8) capture the impact of the accrual principle applicable in the ESA of recording transactions when the obligation to pay arises, not when the payment is actually made, even though public accounts or budget recordings have long been cash-based in most countries. The impact on the financing needs of government does not directly arise from the deficit, as government revenue can be cashed, or government expenditure can be settled, at accounting periods different from the economic transaction itself. Other receivables include receivables of taxes and social contributions as well as amounts concerning EU transactions (amounts paid by government on behalf of the EU but not yet reimbursed by the EU), trade credits or advances for expenditure, such as military equipment or rare occasions of wages or benefits paid one month in advance, etc. Whereas, in concept, such assets are temporary in nature, and they necessary individually disappear after a lapse of time, the flow reported for a sector, such as general government, do usually average above zero even over a period of time, because the stock of receivables tends to grow with rest of the economy.

20.124 In most countries, monetary gold and SDRs are managed by the central bank. When they are managed by government, they are recorded in the financial account of government.

20.125 Financial transactions are recorded at the transaction values, that is, the values in national currency at which the financial assets and/or liabilities involved are created, liquidated, exchanged or assumed between institutional units, on the basis of commercial considerations only.

20.126 The transaction value refers to a specific financial transaction and its counterpart transaction. In concept, the transaction value is to be distinguished from a value based on a price quoted in the market, a fair market price, or any price that is intended to express the generality of prices for a class of similar or even identical financial assets and/or liabilities. The value to report in the financial accounts for a loan sold on the secondary market is the value for which the loan was sold, and not the nominal value, and the reconciliation with the balance is entered in the other changes in assets accounts.

20.127 However, in cases where the counterpart transaction of a financial transaction is, for example, a transfer and therefore the financial transaction is undertaken other than for purely commercial considerations, the transaction value is identified with the current market value of the financial assets and/or liabilities involved. Thus, a loan purchased by a government at its nominal value, rather than at its fair or written-down value, is partitioned between an entry as a loan in the financial accounts at the fair value and a capital transfer, in recognition of a transfer of wealth by the government.

20.128 The transaction value does not include service charges, fees, commissions, and similar payments for services provided in carrying out the transactions; such items are to be recorded as payments for services. Taxes on financial transactions are also excluded and treated as taxes on services within taxes on products. When a financial transaction involves a new issue of liabilities, the transaction value is equal to the amount of the liability incurred exclusive of any prepaid interest. Similarly, when a liability is extinguished, the transaction value for both creditor and debtor must correspond to the reduction of the liability.

Transactions in liabilities

20.129 Transactions in liabilities are recorded at the value at which the liabilities are issued, or redeemed. This value may not be the nominal value. A transaction in liabilities includes the impact of interest accrued.

20.130 The repurchase by a unit of a liability is recorded as redemption in liabilities and not as an acquisition of assets. Likewise, at a subsector or sector level, the purchase by a government unit of a liability issued by another unit of the subsector in question will be presented in the consolidated presentation, as redemption of liability by that subsector.

20.131 Financial leasing and public-private partnerships (PPP) contracts when the asset is on government balance sheet imply recognising a debt of the lessee or grantor. Payments on such leases or PPP contracts are not expenditure for the full amounts, but debt servicing: redemption of a loan and interest expenditure.

20.132 Financing presented as long-term trade credits or accounts receivable/payable arrangements are to be classified as loans, because these involve the provision of long-term financing to the benefit of the borrowing party that is distinguished from a treasury facility that sellers commonly provide buyers with short-term trade-credit. In extending the maturity of the payment obligation considerably, the constructor assumes a financial role that is separate from its other activity of producer.

20.133 Lump sums exchanged at inception on off-market swaps are classified as loans (AF.4) when the lump sum is received by government. Off-market swaps are partitioned in the balance sheet into a loan component and a regular, 'at-the-money' swap component.

20.134 Similarly to receivables, transactions in other accounts payable reflect the time impact of the accrual principle, but on the liability side: when expenditure is incurred but not yet paid, or when payments are made in advance of the revenue recording. In addition to trade credit when they are short-term, payables include sums received from the EU but not yet paid out by government to the final beneficiary, prepayments in taxes or tax refunds not yet paid out.

Other economic flows

20.135 Both the other changes in volume of assets account and the revaluation account of the ESA GFS are identical to the accounts described in Chapter 6. All changes in assets and changes in liabilities arising from events other than economic transactions are recorded in one of these accounts.

Revaluation account

20.136 Revaluations are the same as described in Chapter 6. Additional relevant information as memoranda items, for example, revaluations in the equity of public corporations held by government units, are likely to be particularly important and, at the same time, difficult to measure because it is unlikely that there will be any market prices.

20.137 In the ESA, balance sheets entries are ideally at market value, apart from one or two specific instruments, and movements in interest rates reflected in stock market indices lead to noticeable changes in value of stock as well as in the net worth of institutional units. Such changes are not income in the ESA, and so they are not government revenue or expenditure, and do not affect government deficit/surplus. The changes are recorded in the revaluation account, which leads to changes in net worth due to nominal holding gains/losses (B.103). The changes in net financial worth of government during an accounting period are substantially affected by revaluations. The main sources of revaluations affecting net financial worth are, apart from the impact of foreign exchange denominated assets and liabilities, as follows:

(a) real estate assets of government;

(b) equity of government;

(c) security liabilities.

20.138 When a capital injection by government into a public corporation is considered a capital transfer, the equity valuation of the government stake in the beneficiary will generally increase, with entries in the revaluation account and not the financial account.

20.139 When an existing loan or trade credit is sold to another institutional unit the difference between the redemption price and the transaction price is recorded in the revaluation account of the seller and the purchaser at the time of transaction.

Other changes in volume of assets account

20.140 The other changes in volume of assets accounts include flows that are neither economic transactions nor revaluations. For example, it captures the impact of a change in sector classification of units.

20.141 Loans write-off which do not reflect a debt cancellation with an explicit or implicit bilateral agreement are not transactions and are recorded in the other changes in the volume of assets account, with no impact on net lending/net borrowing.

Balance sheets

20.142 The same definition of an asset is used in the GFS general government accounts as in Chapter 7. The classification and value of assets and liabilities are identical in the ESA and the ESA-based GFS.

20.143 The sum of liabilities may be considered as a stock of debt. However, the definition of government debt in the context of fiscal surveillance departs from the total stock of liabilities in the ESA and in the GFS, both in terms of scope of liabilities accounted for and in terms of valuation.

20.144 Some assets are more specific to government: heritage assets, like historic monuments; infrastructure assets, such as roads and communications facilities; and equity stakes in public corporations that are without private equivalent.

20.145 On the liability side, equity liability (AF.5) will not normally be recorded for government units. However at a more aggregated level of government subsectors, equity liability can appear if entities have been classified inside the general government sector, as a result of the market/non-market test.

20.146 Net worth is the balancing item (B.90) of the balance sheet:

Net worth =		Total assets
	minus	Total liabilities

20.147 Own funds are the sum of net worth (B.90) and equity (AF.5) issued. Thus, in the ESA, own funds of units is defined as assets less liabilities excluding equity liabilities, while net worth is defined as assets less liabilities including equity liabilities. The ESA net worth is not the same as business accounting shareholders' equity or net worth. Business accounting net worth is closer in concept to the ESA own funds.

20.148 Where the net worth (B.90) of the general government sector cannot be calculated — due to the lack of information for measuring the stock of non-financial assets — the financial net worth (BF.90) is presented, showing the difference between the total financial assets and the total liabilities.

20.149 The ESA values balance sheet at market value, except for three specific instruments: currency and deposits (AF.2), loans (AF.4) and other accounts receivable/payable (AF.8). For those three instruments, the values recorded in the balance sheets of both creditors and debtors are the amounts of principal that the debtors are contractually obliged to repay to the creditors, even in cases where the loan was traded at a discount or premium, including interest accrued.

20.150 Security liabilities are valued at market value. Even though the debtor is only obligated for the value of the principal, the market value is significant because the debtor is obligated to pay a stream of future cash flows, for which the present value varies according to market yield, and the market value reflects the price that government would have to pay if it redeemed the instrument by purchasing it back on the market.

20.151 Quoted equity is valued using the most recent quotation price when drawing up the balance sheet. Unquoted equity can be valued by comparing ratios such as own funds at book value to the market value of equity, in similar classes of quoted companies. Other approaches can be used for valuing unquoted equity, such as using the own funds of the corporation, thus setting the net worth to zero. This approach can be used for public corporations that have unique types of activities such as when government has equity stakes in central banks. However, it is not recommended to use the own funds at book value, without adjustments, no more than using the nominal value of the issued equity.

Consolidation

20.152 Consolidation is a method of presenting the accounts for a set of units as if they constituted one single entity (unit, sector, or subsector). It involves eliminating transactions and reciprocal stock positions and associated other economic flows among the units being consolidated.

20.153 Consolidation is important for the general government sector and its subsectors. For example, assessing the overall impact of government operations on the total economy or the sustainability of government operations is more effective when the measure of government operations is a set of consolidated statistics. To relate government aggregates to the economy as a whole as in revenue or expenditure to GDP ratios, it is better to eliminate the internal churning of funds and include only those transactions that cross the boundaries with other domestic sectors and with the rest of the world sector. This is of particular relevance for the following transactions:

(a) property income such as interest;

(b) current and capital transfers;

(c) transactions in financial assets and liabilities.

20.154 Consolidation does not affect balancing items because the consolidated items appear symmetrically within each account. For example, a grant from a central government to a local government unit is consolidated by eliminating the expenditure from central government and the revenue from the local government, thus leaving unchanged the net lending/net borrowing of general government.

20.155 Conceptually, the nature of consolidation is to eliminate all flows among the consolidated units, but practicality should be kept in mind. In concept, transactions in the production account, such as sales and purchases of goods and services, may not or cannot be consolidated. The decision about the level of detail employed in consolidation should be based on the policy usefulness of the consolidated data and the relative importance of the various types of transactions or stocks.

20.156 When drawing up the consolidated accounts of government, the ESA prescribes consolidating the following major transactions (in order of importance):

(a) current and capital transfers, such as central governments grants to lower levels of government;

(b) interest arising on intergovernmental holdings of financial assets and liabilities;

(c) transactions, other economic flows and stocks in financial assets and liabilities, such as loans to other governments or acquisitions of government securities by social security units.

20.157 Purchases/sales of goods and services between government units are not consolidated in the ESA. This is because the accounts show sales on an output basis, and not on a disposal basis so that it is difficult to decide who is the counterpart transactor for this output. In addition, intermediate consumption and output follow two different valuation rules, basic prices and purchasers' prices, which creates additional difficulties.

20.158 Taxes or subsidies paid by one government unit or entity to another are not to be consolidated. However, taxes or subsidies on products cannot be consolidated in the system because there is no counterpart sector transactor in the ESA for such transactions; the relevant amounts are not separately recognised as expenditure and revenue (respectively) and are instead included in, or excluded from, the value of the intermediate consumption or of the sales.

20.159 Acquisitions/disposals of non-financial assets, including intergovernmental transactions in land, buildings, and equipment are not consolidated, because they already appear on a net basis in the account: acquisitions less disposals. Non-consolidated and consolidated accounts always show equal amounts for those items.

20.160 Some types of transactions that appear to take place between two government units are never consolidated because they are rerouted in the system to other units. For instance: employer social contributions, whether paid to social security or to government pension funds, are treated as being paid to the employee as part of compensation and then paid by the employee to the fund. Taxes withheld by government units from the compensation of their employees, such as pay-as-you-earn (PAYE) taxes, and paid to other government subsectors are treated as being paid directly by the employees. The government employer is simply the collecting agent in this case for the second government unit.

20.161 Practical difficulties arise with consolidation. For example, when a transaction to be consolidated is identified in the records of one unit, it is expected that the corresponding transaction will be found in the accounts of the counterparty; but it may not show there, as it may be recorded in a different period, it may have a different value, or it may be classified as a different type of transaction due to different accounting practices. These difficulties are inherent in the quadruple system of recording used in the ESA, but they may be more obvious with inter-governmental transactions.

ACCOUNTING ISSUES RELATING TO GENERAL GOVERNMENT

20.162 National accounts principles apply to the general government sector in the same way as to other sectors of the economy. However, due to the economic nature of the activities of government units or due to practical considerations, additional rules are given in this section.

20.163 Similarly, the national accounts principles apply in the same way to the measurement of government revenue and government expenditure. However, these principles, including notably the accrual principle, are applied given that the creditworthiness and liquidity constraints of government are fundamentally different from other measures. If expenditure is recorded in the government accounts when incurred by each government unit, irrespective of long lags of payment, revenue should be recorded in the accounts only when there is a high expectation and sufficient certainty that the respective cash flows will effectively take place.

20.164 When classifying a transaction, national accountants are not constrained by the designation of the transaction in the public accounts of government or in the bookkeeping of a corporation. As an example, a large payment to government made out of the corporation's reserves or from sales of assets and called 'dividend' in the public accounts is categorised as a super-dividend and recorded as a financial transaction in the national accounts — it is a withdrawal of equity. Reporting the economic reality where it is different from the legal form is a fundamental accounting principle to give consistency and to make sure that transactions of a similar type will produce similar effects on the macroeconomic accounts, irrespectively of the legal arrangements. This is of particular importance for transactions involving the general government.

Tax revenue

Character of tax revenue

20.165 Taxes are compulsory unrequited payments, in cash or in kind, made by institutional units to general government or supranational bodies exercising their sovereign or other powers. They usually constitute the major part of government revenue. Taxes are viewed in the system as transactions, as they are deemed to be interactions between units carried out by mutual agreement. Taxes are described as unrequited because the government provides nothing commensurate with the payment in exchange to the individual unit making the payment.

20.166 However, there are cases where the government provides something to the individual unit against the payment, in the form of the direct granting of a permit or authorisation. In this case, the payment is part of a mandatory process that ensures proper ownership recognition and performance of activities by law. The categorisation of such payments as a tax, or as the sale of a service, or the sale of an asset by the government, requires additional rules. Those rules are set out in Chapter 4.

Tax credits

20.167 Tax relief can take the form of a tax allowance, exemption, or deduction — which is subtracted from the tax base — or of a tax credit — which is subtracted directly from the tax liability otherwise due by the beneficiary household or corporation. Tax credits can be payable, in the sense that any amount of the credit that exceeds the tax liability will be paid to the beneficiary. In contrast, some tax credits are non-payable, and described as 'wastable'. They are limited to the size of the tax liability.

20.168 In national accounts, a tax relief that is embedded in the tax system is recorded as reducing the tax liability and therefore as reducing government tax revenue. This is the case of tax allowances, exemptions, and deductions, as they enter directly into the calculation of the tax liability. This will also be the case for non-payable tax credits as their value to the taxpayer is limited to the size of their tax liability. In contrast, this is not the case for payable tax credits, which by definition can affect non-taxpayers as well as taxpayers. As they are payable, payable tax credits are classified as expenditure and recorded as such for their total amount. The government tax revenue will, therefore, be that liable, with no reduction for payable tax credits awarded, and government expenditure will include all payable tax credits awarded. This has no impact on the net borrowing/net lending of the general government, but does have an impact on both the tax burden and the government expenditure, and on the corresponding ratios to GDP. The presentation of statistics shall permit the derivation of tax credits on a net basis.

Amounts to record

20.169 Appropriately recording tax revenue is essential for the measurement of government activities and performance. The amounts to record should correspond to amounts likely to be actually collected by government: this implies that amounts declared but deemed uncollectible should not be recorded as revenue.

Amounts uncollectible

20.170 In all cases, only amounts that government realistically expects to collect should be recorded. Uncollectible taxes should not be accounted for in the net lending/net borrowing of the general government and generally not in the total revenue. Accordingly, the impact on general government net lending/borrowing of taxes and social contributions recorded in the system on an accrual basis shall be equivalent over a reasonable amount of time to the corresponding amounts actually received. The rules for the recording of taxes and social contributions are explained in Chapter 4.

Time of recording

Accrual recording

20.171 Accrual accounting records flows at the time economic value is created, transformed, exchanged, transferred or extinguished. It is different from cash recording and, in principle, from due-for-payment recording, defined as the latest time payments can be made without additional charges or penalties. Any period of time between the moment a payment accrues and the moment it is actually made is accounted for by recording a receivable or a payable in the financial accounts. The ESA recording is on an accrual basis. For some transactions such as payment of dividends or some specific transfers, the due for payment time is used.

Accrual recording of taxes

20.172 For government, recording revenue and claims at the time of the underlying event is particularly difficult, since often government records, for tax for example, are on a cash basis. When accrued taxes are calculated from assessments of taxes due, there is a risk of over-recording the tax revenue, a crucial government finance aggregate.

20.173 The period of time between the moment a transaction is recorded as accruing in the non-financial accounts, and the moment the payment is actually made, is bridged by recording an account receivable in the financial account in the accounts of one party and an account payable in the accounts of the other party. In cases where a prepayment, covering two or more accounting periods, is made to government, an account payable, which is a form of borrowing, is recorded in the financial account of government for the amounts due in future periods. This liability is extinguished when recording the due amounts of the transaction in the future periods. However, recording such a liability occurs only when the government has, legally or by means of a constructive obligation, the obligation to make a refund to the payer for the pre-paid amounts if the taxable event does not occur.

20.174 In accordance with accrual recording, taxes should be recorded when the activities, transactions or other events occur which create the liability to pay tax — in other words when the taxable events occur — and not when the payments are due to be made or are actually made. This time is usually when income is earned or when a transaction (such as the purchase of goods and services) generating the liability occurs, to the extent that the tax liability can reliably be measured. The different institutional arrangements for taxation (existence or not of assessments, like tax rolls) may lead in practice to using different recording methods, according to the characteristic of the tax. Thus, notably when there are no reliable assessments available or amounts unlikely to be collected cannot be reliably estimated, the time-adjusted cash method is considered an acceptable proxy for accruals.

20.175 In practice, when taxes are based on assessments, some flexibility is permitted concerning the time of recording where the measurement cannot be made in a reliable way before the time of assessment. In particular, for taxes on income, tax systems may require the development of a tax roll or another form of tax assessment before the amounts of tax due will be known in a reliable way, taking into account the changes in tax rates and final settlements. This moment, which might be the one where the economic behaviour of households is affected, is an acceptable time of recording. It is not necessarily the accounting period in which the payment is received.

Interest

20.176 Interest is an expenditure incurred by a debtor for the use of another unit's funds. Under the terms of the financial instrument agreed between them, interest (D.41) is the amount that the debtor becomes liable to pay to the creditor over a given period of time without reducing the amount of principal outstanding.

20.177 Interest is classified within property income (D.4). Differently to dividends (D.421), interest (D.41) entitles the holder/the lender to a fixed and predetermined income (or according to an agreed reference in the case of a floating interest rate). Interest is usually a major expense item of general government, since governments are often structural borrowers on the market.

20.178 In the system, interest is recorded on an accrual basis, i.e. interest is recorded as accruing continuously over time to the creditor on the amount of principal outstanding.

20.179 There are two ways in which the value of a discounted security can be determined during its life when the prevailing interest rate is different from the rate prevailing when the security was initiated. The debtor approach is from the perspective of the unit issuing the security and the creditor approach is from the perspective of the unit holding the security. From the debtor approach, the interest rate agreed on initiation is used throughout the life of the security. From the creditor approach, the current interest rate is used to value the interest between any two points in the life of the security.

20.180 Accrual interest is recorded according to the debtor approach, that is: based on the rate or yield prevailing at the time of creation of the financial instrument. Thus, interest expenditure to be recorded on fixed-rate debt securities does not vary over time in sympathy with market fluctuations, despite the fact that the market value of the securities fluctuates and that, accordingly, the opportunity costs of carrying this debt vary. In that way, interest expenditure avoids the volatility that the creditor approach entails. The repurchase of securities on the market, at a premium or at a discount to the principal outstanding, does not lead to any entry in revenue or expenditure at time of purchase or later on. Instead, any repurchase premium or discount reflects the settlement, recorded in the financial accounts, of a holding gain or loss that accrued in the past and was recorded in the revaluation accounts at that time.

20.181 Recording interest as accruing continuously has the consequence, on a security for instance, that the accrued interest charge is recorded starting from the time the security has been issued, not waiting for the time of the first coupon payment (often in the following year, in the classic case of a security with a yearly coupon payment). It means also that accrued interest on securities starts appearing as a liability as soon as issued interest is reinvested under the financial asset bearing it. As a result, the stock of accrued interest outstanding is always to be added to the value of the principal of the underlying instrument, and, subsequently, any interest payments reduce the debtor's liability. This basic principle covers all financial instruments bearing interest.

20.182 In many countries, government bonds or notes are issued in fungible tranches, over several years, with the same conditions concerning the nominal rate of interest. Because the market yield at time of further sale of tranches varies, each tranche is actually sold at a premium or at a discount. Thus, the rate of interest agreed on at time of issuing the bond is used for calculating interest, which will vary for each tranche, reflecting different amortisations of premium or discounts at issue, in a manner similar to amortisation of discounts on zero coupon bonds.

20.183 The issue price of bonds and notes issued in fungible tranches, and carrying coupons, includes an amount for coupons accrued to date, which are in effect 'sold' upon issuance. Such sold coupons are neither government revenue at time of sale nor treated as a premium. They are instead seen as a financial advance.

Discounted and zero-coupon bonds

20.184 Zero-coupon bonds are instruments where the debtor has no obligation to make any payments to the creditor until the redemption of the bond. The amount of the principal borrowed is lower than the value of the bond that will be repaid by the debtor. In effect, the debtor's liability is discharged by a single payment at maturity covering both the amounts of the principal and the interest accrued over the life of the instrument. The difference between the amount repaid at the end of the contract and the amount initially borrowed is interest and is allocated over the accounting periods between the beginning and the end of the contract. The interest accruing each period is treated as if paid by the debtor and then reinvested as an additional amount of the same liability. Interest expenditure and increases in the liability are then simultaneously recorded each period.

20.185 The gradual increase in the market value of a bond that is attributable to the accumulation of accrued and reinvested interest reflects a growth in the principal outstanding, that is, in the size of the asset.

20.186 The same principle applies to discounted bonds or bonds issued at a premium. In this case, the interest expenditure to be recorded is the amount of accrued coupon interest as specified in the contract, plus the amount accruing each period attributable to the difference between the redemption price and the issue price.

Index-linked securities

20.187 Index-linked securities are financial instruments, usually long-term bonds, for which the amounts of the periodic payments and/or the principal are linked to a price index or other index. Any additional payments to creditors due to changes in the index are considered as interest, including the uplift of the principal, to be recorded as accruing continuously. When the value of the principal is index linked, the difference between the eventual redemption price and the issue price is treated as interest accruing over the life of the asset, in addition to any interest due in that period.

Financial derivatives

20.188 Settlements on swap transactions are not considered as property income in the ESA. The settlements related to financial derivatives are financial transactions, to be recorded at the time of the effective exchange of financial instrument.

Court decisions

20.189 When a court of justice rules that compensation must be paid, or a transaction reversed, resulting from or related to past events, the time of recording of the expenditure or revenue is when the claimants have an automatic and incontrovertible right for a given amount that can be individually determined, and when it is unlikely that claimants will fail requesting their due. When a court of justice merely sets a principle of compensation, or when the claims must be reviewed for eligibility and in relation to determination of the amount by administrative services, expenditure or revenue is recorded as soon as the value of the obligation is reliably determined.

Military expenditure

20.190 Military weapon systems, comprising vehicles and other equipment such as warships, submarines, military aircrafts, tanks, missile carriers and launchers etc. are used continuously in the production of defence services. They are fixed assets, like those used continuously for more than one year in civilian production. Their acquisition is recorded as gross fixed capital formation, i.e. as capital expenditure. Single-use items, such as ammunition, missiles, rockets and bombs are treated as military inventories. However, some types of ballistic missiles are regarded as providing an on-going service of deterrence and therefore meet the general criteria for classification as fixed assets.

20.191 The time of recording of asset acquisition is the time of the transfer of the ownership of the asset. In case of long-term contracts involving complex systems, the time of recording of the transfer of assets should be upon actual delivery of the assets, not the time of cash payments. If some long-term contracts cover in addition the provision of services, government expenditure should be recorded at the time of the provision of services, recorded separately from the provision of assets.

20.192 If military equipment is leased, the transaction is invariably recorded as a finance lease and not as an operating lease. This implies that the recording of an acquisition of military asset is matched by the incurrence of an imputed loan by the government lessee. As a result, payments by government are recorded as debt servicing, a part as repayment of the loan, another part as interest.

Relations of general government with public corporations

Equity investment in public corporations and distribution of earnings

20.193 Government units have a close relationship with public corporations and quasi-corporations that they own. Despite this close relationship, flows between a government unit and its controlled corporation or quasi-corporation related to its equity investment are treated in the same way as flows between any corporation and its owners: equity investments from the investor into the unit invested in; distributions of earnings by the unit invested in, to the investor.

Equity investment

20.194 An equity investment occurs when economic agents place funds at the disposal of corporations, in exchange for a promise of future dividends or other types of return. The amount invested is known as equity capital, and is part of the own funds of the corporation and the corporation has a large degree of freedom in the way of using them. In exchange, the owners receive shares or some other form of equity. These represent property rights on corporations and quasi-corporations and entitle the holders to:

(a) a share of any dividends (or withdrawals of income from quasi-corporations) paid at the choice of the corporation but not to a fixed and predetermined income; and

(b) a share in the net assets of the corporation in the event of its liquidation

and, as such, the shares are financial assets.

20.195 It is important to distinguish between the withdrawal of equity by the corporation to its owner and the return on equity investment, notably the income earned in the form of dividends. Only regular distributions from the entrepreneurial income are recorded as dividends by corporations or withdrawals of income from quasi-corporations. Large and irregular payments to the owner are recorded as a withdrawal of equity.

20.196 It is necessary to determine when payments of government into public corporations are government expenditure or acquisition of an asset and so a financial transaction, and conversely when distributions to government by public corporations are government revenue or a financial transaction.

Capital injections

Subsidies and capital injections

20.197 Subsidies are current transfers, usually made on a regular basis, from government, or occasionally from the rest of the world, to producers designed to influence their levels of production, the prices at which their outputs are sold or the remuneration of factors of production.

20.198 Payments to public corporations on a large and irregular basis, often called 'capital injections', are not subsidies. They are events that aim at capitalising or re-capitalising the beneficiary corporation, being put at the disposal of the latter in a long term perspective. According to the 'capital injection test', such capital injections are either capital transfers or acquisitions of equity, or a combination of both. The two cases are as follows.

(a) A payment to cover accumulated, exceptional or future losses, or provided for public policy purposes, is recorded as a capital transfer. Exceptional losses are large losses recorded in one accounting period in the business accounts of a corporation, which usually arise from downward revaluations of balance sheet assets, in such a way that the corporation is under threat of financial distress (negative own funds, breach of solvency, etc.).

(b) A payment where the government is acting as a shareholder in that it has a valid expectation of earning a sufficient rate of return, in the form of dividends or holding gains is an acquisition of equity. The corporation must enjoy a large degree of freedom in how it uses the funds provided. When private investors are part of the capital injection, and the conditions for private and government investors are similar, this is evidence that the payment is likely to be acquisition of equity.

20.199 In many cases, payments made by government units to public corporations are intended to compensate for losses in the past or in future. Government payments are treated as an acquisition of equity only if there is sufficient evidence of the corporation's future profitability and its ability to pay dividends.

20.200 Given that capital injections increase the own funds of the unit invested in, it is likely to also lead to an increase of the investor's equity stake in the invested unit. This is automatically the case of those 100 % owned public corporations whose equity is the value of their own funds. Such an increase in equity is not used as a criterion to judge the nature of the capital injection; instead, it leads to an entry in the revaluation account when the injection is recorded as capital transfer, and to an entry in the financial accounts when the injection is recorded as addition to equity.

Rules applicable to particular circumstances

20.201 Capital injections carried out in the context of privatisation, when privatisation is expected to occur in less than one year, are recorded as a transaction in equity for the amount not in excess of privatisation proceeds, the remainder being subject to the capital injection test. The proceeds of privatisation are then deemed to repay the capital injection.

20.202 Capital injections can be carried out by way of debt cancellation or debt assumption. Accounting rules applicable to those events result in the payment being a capital transfer, except for a privatisation when they are an acquisition of equity, the value of which is within the amount of privatisation proceeds.

20.203 Capital injections in kind, by way of the provision of non-financial assets, are without impact on net lending/net borrowing. When the injection is expected to earn a sufficient rate of return, it is treated as a change in structure (K.61), the asset provided entering the balance sheet of the corporation via the other change in volume of assets accounts. When the injection is not expected to earn a sufficient rate of return, a capital transfer (investment grant, D.92) is recorded together with a matching entry in disposal of non-financial assets (P.5 or NP).

Fiscal operations

20.204 Fiscal operations are carried out by government and financed through the budget under the usual budgetary procedures. However, some operations originated by government units may involve the intervention of entities not ruled by the legal government framework, including public corporations. Though they will not be reported in the budget, and might escape the usual control procedures, it is appropriate to record them within government revenue and expenditure. This is because the ESA recognises when government is the principal party to an operation and the public corporation is acting as an agent.

Public corporations distributions

Dividends versus withdrawal of equity

20.205 The earnings from equity investment in public corporations may be recorded as a distributive transaction which are usually dividends, or as a financial transaction. Dividends are property income. The resource available for distribution of dividends is the entrepreneurial income of the corporation. Thus, the resources from which dividends are paid would include neither the proceeds of sales of assets nor the distribution of revaluation gains. Dividends funded from, or based on, such sources are recorded as withdrawal of equity. The same basic principles apply to withdrawals from income of quasi-corporations.

20.206 Large and irregular payments or payments that exceed the entrepreneurial income of the year are called super-dividends. They are funded from accumulated reserves or sale of assets, and are recorded as withdrawal of equity equal to the difference between the payment and the entrepreneurial income of the relevant accounting period. In the absence of a measure of entrepreneurial income, the operating profit in business accounts is used as a proxy.

20.207 Interim dividends are recorded as property income (D.42) to the extent that they can be related to the accrued income of the corporation. In practice, two conditions must be fulfilled:

(a) the corporation making this payment makes short-period accounts available to the public and the payment is based on at least two quarters;

(b) the interim payment should be in the same proportion as the dividends paid in the previous years, consistent with the usual rate of return to the shareholder and with the trend in growth of the corporation.

If these conditions are not met, the interim payment is recorded as a financial advance, classified under other account receivable/payable (F.8), until the annual result is determined, given the need to conduct the super-dividend test of comparing the interim dividends with the entrepreneurial income of the year.

Taxes versus withdrawal of equity

20.208 Taxes have a legal basis and are under the control of legislative procedure. These transactions, which are by mutual agreement, constitute the main revenue of general government.

20.209 However, it may occasionally happen that a transaction described as a tax in legal documents is not recorded as such in the ESA. One example is the case of an indirect privatisation. If a public holding corporation sells its equity ownership in another public corporation and remits some of the proceeds to the government under the heading of tax, or is liable to a tax generated by the privatisation event and subsequent realised gains, under the heading of a capital gains tax, the payment is recorded as a financial transaction.

Privatisation and nationalisation

Privatisation

20.210 Privatisation commonly involves the sale by government of shares or other equity in a public corporation. Privatisation proceeds are not government revenue but a financial transaction recorded in the financial account, with no impact on the government deficit/surplus, as this event is net worth neutral and is a reclassification of assets (AF.5 against AF.2) in the balance sheet of government. A direct sale of non-financial assets, such as buildings and land rather than an entire corporation, is recorded in the capital account as disposals of fixed assets or non-produced non-financial assets, unless carried out in the context of corporate restructuring.

20.211 Any purchase of services to achieve this process should, however, be recorded as government intermediate consumption and should not be netted out of the privatisation proceeds. Thus, privatisation proceeds are to be recorded gross in the financial accounts.

Indirect privatisations

20.212 Privatisation can occur under more complicated institutional arrangements. For instance, assets of a public corporation may be sold by a public holding company, or another public corporation, controlled by government, and all or part of the proceeds are passed to government. In all cases, the payment to government of the proceeds on the sale of assets in this manner is to be recorded as a financial transaction, irrespective of the way it is presented in the books of the government or of its subsidiary, with a simultaneous decrease in shares and other equities corresponding to the partial liquidation of assets of the holding company. Any privatisation proceeds retained by the holding are privatisation receipts of government ploughed back by way of a capital injection, which is then subject to the capital injection test to determine the nature of the payment.

20.213 It may also happen that the public holding company, or other public corporation, acts as a 'restructuring agency.' In such a context, the proceeds of the sale may not be paid to government but kept by the restructuring agency to inject capital into other enterprises. When the restructuring unit, whatever its legal status, acts as a direct agent of government, its main function is to restructure and change the ownership status of public corporations and to channel funds from one unit to the other. The classification of the unit will normally be to the general government sector. However, when the restructuring unit is a holding company controlling a group of subsidiaries, and only a minor part of its activity is dedicated to channelling funds in the way described above, on behalf of government and for public policy purposes, the public holding company is classified in one of the corporations sectors according to its main activity, and the transactions made on behalf of government are to be rerouted through government.

Nationalisation

20.214 Nationalisation means government taking control of specific assets or an entire corporation, usually by acquiring the majority or the whole stake in the corporation.

20.215 Nationalisation usually takes the form of a purchase of shares: government buys all or part of the shares in the corporation at market price — or at a price sufficiently close, considering usual market practices with regard to valuation of corporations in the same activity. The transaction is by mutual agreement, even though the former owner may have little choice with regard to refusing the offer, or negotiating the price. The purchase of shares is a financial transaction to be recorded in the financial account.

20.216 Exceptionally, government may acquire ownership over a corporation through an appropriation or confiscation: the change in ownership of assets is not the result of a transaction made by mutual agreement. There is no payment to the owners, or such payment which is made does not reflect the fair value of assets. The difference between the market value of the assets acquired and any compensation provided is recorded as an uncompensated seizure in the other changes in the volume of assets account.

Transactions with the central bank

20.217 Two types of payments by the central bank to the government are observed in practice:

(a) payments made on a regular basis, usually in the form of dividends, based on the current activity of the central bank (like managing foreign exchange reserves). These payments are recorded as dividends as long as they are not higher than a measure of net operating income, consisting of net property income, net of costs and of any transfers. Amounts in excess of this sum are to be recorded as a decrease in equity;

(b) exceptional payments following the sale or the revaluation of reserve assets. These payments are recorded as a withdrawal of equity. The rationale is that the value of such assets affects the value of the equity liability of the central bank and the equity assets of government. Thus, holding gains on the reserve assets of the central bank have a counterpart in the equity assets of government via the equity liability of the central bank.

Payments from central government to the central bank are to be recorded in a similar way as for other public corporations. In particular, large payments are subject to the 'capital injection test' to determine the character of the payments.

Restructures, mergers, and reclassifications

20.218 When a public corporation is restructured, financial assets and liabilities may appear or disappear reflecting new financial relationships. These changes are recorded as changes in sector classification and structure in the other changes in the volume of assets account. An example of such a restructuring is when a corporation is split into two or more institutional units and new financial assets and liabilities are created.

20.219 The purchase of shares and other equity of a corporation as part of a merger, on the other hand, is to be recorded as a financial transaction between the purchasing corporation and the previous owner.

20.220 Any change in the classification of assets and liabilities not related to restructuring or changes in sector classification, such as the monetisation or demonetisation of gold, is recorded as a change in the classification of assets or liabilities in the other changes in the volume of assets account.

Debt operations

20.221 Debt operations can be particularly important for the general government sector, as they often serve as a means for government to provide economic aid to other units. The recording of these operations is covered in Chapter 5. The general principle for any cancellation or assumption of debt of a unit by another unit, by mutual agreement, is to recognise that there is a voluntary transfer of wealth between the two units. This means that the counterpart transaction of the liability assumed or of the claim cancelled is a capital transfer. No flow of money is usually observed, this may be characterised as a capital transfer in kind.

Debt assumptions, debt cancellation and debt write-offs

Debt assumption and cancellation

20.222 Debt assumption occurs when a unit assumes responsibility for another unit's outstanding liability towards a creditor. This happens frequently when a government guarantees a debt of another unit and the guarantee is called or activated.

20.223 When a government assumes a debt, the counterpart transaction of the new government liability is a capital transfer in favour of the defaulting debtor. The case where a financial asset is recorded as a counterpart is to be examined carefully. There are two different contexts.

(a) An actual pre-existing financial asset is acquired against a third party, as in the case of guaranteed export insurance. Thus, government records, as the counterpart transaction of its new liability, the acquisition of a financial asset equal to the present value of the amount expected to be received. If this amount is equal to the liability assumed, no further entries are required. If the amount expected to be recovered is less than the liability assumed, the government records a capital transfer for the difference between the liability incurred and the value of the asset acquired.

(b) Government simply records a claim against the benefiting corporation, which is in most cases a public corporation in difficulty. In general, because of the very hypothetical value of this claim, no such claim is recorded. Possible future repayments by the beneficiary will be recorded as revenue by the government.

20.224 Debt payments on behalf of others are similar to debt assumptions, but the unit making the payments does not assume the entire debt. The transactions recorded are similar.

20.225 Debt cancellation (or debt forgiveness) is the extinction or reduction of a claim by agreement between the creditor and the debtor. The creditor records a capital transfer payable for the amount cancelled and the other unit records a capital transfer receivable. Mutual agreement is often presumed though not formally established in case of government forfeiting claims, such as in the case of student loans and lending to farmers.

20.226 Debt assumptions and debt cancellations which benefit a controlled entity result in an increase in the value of the equity in the unit being invested in, that is reflected in the revaluation accounts. If a government has its debt assumed by another government, then it records a capital transfer revenue, a new debt to the assuming government unit, or both.

20.227 Debt assumptions and debt cancellations carried out in the context of privatisation are recorded as transactions in equity, for the amount not in excess of privatisation proceeds, the remainder being a capital transfer, in order to ensure the accounting neutrality of the way in which privatisation is conducted. Privatisation must be carried out within one year.

20.228 When debtor governments offer to repay the debt in anticipation, at a value below the principal value which includes interest in arrears, the event leads to an entry in the capital account with an impact on the government net lending/net borrowing, as a grant by the creditor is presumed. When early redemption leads to the payment of a penalty or fee to the lender as foreseen in the contract, the amount shall be recorded as income of the lender. In the case of securities, a buyback on the market leads to an entry in the revaluation accounts, unless the early redemption is imposed on the securities holder.

20.229 The difference in value in case of sale to a third party of government claims against other governments leads to a capital transfer entry in the capital accounts, with an impact on the government deficit, because the nature of the claim implies an original intention to convey a benefit, and the sale is a way to conduct debt restructuring.

20.230 As a result, the capital transfer expenditure of government is revenue of the debtor, in recognition of the fact that it is the genuine beneficiary of the transaction, with an entry in the rest of the world account matching the creditor government expenditure. For the seller, the transaction value of the claim disposed off is the principal value. The value of the claim enters both the new creditor's and debtor's accounts, i.e. respectively, the bank balance sheet and the ROW accounts — for the international investment position, at its reduced value.

20.231 In rarer cases, when the discount negotiated with the third party or with a debtor offering the repurchase of its debt only reflects changes in market interest rates, and not a change in credit worthiness, the government creditor can be presumed to be acting as a normal investor. The difference, net of any penalty or fee, is entered in the revaluation accounts. One test is whether the amount repaid could have exceeded the principal value.

Debt assumption involving a transfer of non-financial assets

20.232 If a government wants to ease the debt burden of a public corporation, it may also, in addition to the debt assumed by a government unit, take over non-financial assets such as public transport infrastructure. This debt assumption involving a transfer of non-financial assets to the government unit is deemed to be made by mutual agreement, and has exactly the same impact as a debt assumption on the government net lending/net borrowing: the amount of the capital transfer to be recorded in favour of the corporation is equal to the amount of the debt assumed. An acquisition of non-financial assets has a negative effect on net lending (+)/net borrowing (–).

Debt write-offs or write-downs

20.233 Debt write-offs are the reduction by a creditor in the balance sheet of the amount owed to it, usually when a creditor concludes that a debt obligation has little or no value, because the debt is not going to be paid; the debtor is bankrupt, has disappeared or cannot be realistically pursued for recoveries that would justify the various costs incurred. Debt write-downs refer to the reduction by a creditor in the carrying value of an asset in its balance sheet.

20.234 Write-downs and write-offs are internal accounting actions by the creditor and are often not recognised as transactions, because they are not carried out by mutual agreement. However, it happens that write-downs and write-off do not amount to the annulment of the claim over the debtor and consequently there may commonly be reversals of write-downs, and less frequently write-offs.

20.235 Debt write-downs do not lead as such to entries in the balance sheet of the creditor because the carrying value of the debt already reflects the market value of the instrument or is at nominal value in the case of loans, unless the market value is proxied by the written down book value (in the case where the write down enters the revaluation accounts). In contrast, debt write-offs lead to the removal of the asset from the creditor balance sheet by way of an other change in the volume for the amount exiting — the principal value for loan, a market value for securities, unless the write-off reflects a debt cancellation event. Thus, differently from debt assumption or debt cancellation, debt write-offs and write-downs have no effect on net lending/borrowing of government.

Other debt restructuring

20.236 Debt restructuring is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor. The debt instrument that is being restructured is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. If there is a difference in value between the extinguished debt instrument and the new debt instrument, it is a type of debt cancellation and a capital transfer is necessary to account for the difference.

20.237 A debt-for-equity swap occurs when a creditor agrees to replace a debt owed to it by an equity security. For example, government may agree with a public enterprise owned by it to accept an increase in the government's equity stake in the public enterprises in place of an existing loan. In such circumstance, the event should be subject to the capital injection test. Any difference in the value of the debt instrument being extinguished and the equity recognised is a capital transfer with an entry recorded in the revaluation accounts.

20.238 Debt arrears occur when a debtor misses an interest or principal payment. The debt instrument will not normally change, but knowing the amount of debts in arrears can provide important information.

Purchase of debt above the market value

20.239 The acquisition of debt for a value above the market value, at inception is called concessional loans, and later on debt defeasance. Both intend to convey a benefit and so the recording of expenditure such as a capital transfer is required.

20.240 Debt defeasance occurs when a debtor matches debt instruments with financial assets having the same or greater debt service inflows. Even when the defeased instruments have been transferred to a separate entity, the gross position should still be recorded by treating the new entity as an ancillary unit and consolidating it with the defeasing unit. If the ancillary unit is non-resident, it is treated as a special purpose entity and the transactions of government with this unit should be treated as described in section 'The government finance presentation of statistics'.

20.241 Debt issued on concessional terms. There is no precise definition of concessional loans, but it is generally accepted that they occur when units of the general government sector lend to other units in such a way that the contractual interest rate is intentionally set below the market interest rate that otherwise would apply. The degree of concessionality can be enhanced with grace periods, frequencies of payments, and a maturity period favourable to the debtor. Since the terms of a concessional loan are more favourable to the debtor than market conditions would otherwise permit, concessional loans effectively include a transfer from the creditor to the debtor.

20.242 Concessional loans are recorded at their nominal value just as other loans, but a capital transfer is recorded as a memorandum item at the point of loan origination equal to the difference between the contract value of the debt and its present value using a relevant market discount rate. There is no single market interest rate that should be used to measure the capital transfer. The commercial interest reference rate published by the OECD may be applicable when the loan is issued by one of its member countries.

Defeasances and bailouts

20.243 A bailout is a term meaning a rescue from financial distress. It is often used when a government unit provides short-term financial assistance to a corporation to help it survive a period of financial difficulty or a more permanent injection of financial resources to help recapitalise the corporation. Bailouts of financial institutions are often referred to as financial defeasance. Bailouts are likely to involve highly publicised one-time transactions with large values and, therefore, to be easy to identify.

20.244 Intervention of general government can take various forms. Examples are the following:

(a) a government may guarantee certain liabilities of the enterprise to be assisted;

(b) a government may provide equity financing on exceptionally favourable terms;

(c) a government may purchase assets from the enterprise to be assisted for prices greater than their true market value;

(d) a government may create a special purpose entity or other type of public body to finance and/or to manage the sales of assets or liabilities of the enterprise to be assisted.

20.245 Government guarantees during a bailout are treated as one-off guarantees to entities in financial distress. An example is where the entity is not able or has substantial difficulties to meet its obligations since its cash generating abilities are limited or the tradability of its assets is severely limited due to exceptional events. This will normally lead to recording a capital transfer at inception, as if the guarantee were called, for the entirety of the granted guarantee or, in case a reliable estimation is available, for the amount of the expected call, which is the expected loss of government. See also paragraph 20.256.

20.246 If the government buys assets from the enterprise to be assisted, the amount paid will normally be more than the true market price of the assets. The purchase is recorded at the actual market price and a capital transfer recorded for the difference between the market price and the total amount paid.

20.247 During a bailout, governments often buy loans from financial institutions for their nominal value rather than their market value. Even though loans are recorded at nominal prices, the transaction is partitioned by recording a capital transfer and an entry in the revaluation accounts. If there is reliable information that some loans are irrecoverable, fully or for nearly their total amount, or if there is no reliable information on the expected loss, these loans are accounted for at zero value and a capital transfer is recorded for their former nominal value.

20.248 If a public institutional unit is created by government with its only task being to assume management of the bailout, the unit should be classified in the general government sector. If the new unit is intended to be an on-going concern with the bailout a temporary task, its classification as a government unit or a public corporation is made following the general rules as described in the section on restructuring agencies above. Units that purchase financial assets from distressed financial corporations with the objective of selling them in an orderly manner cannot be considered financial intermediaries because they do not place themselves at risk. They are classified in the general government sector.

Debt guarantees

20.249 A debt guarantee is an arrangement in which a guarantor agrees to pay a creditor if a debtor defaults. For general government, giving a guarantee is a way to support economic activities without a need for an immediate cash outlay. Guarantees have a significant impact on the behaviour of economic agents by modifying the lending and borrowing conditions on financial markets.

20.250 For each guarantee, there are three parties involved: the lender, the borrower, and the guarantor. Originally, stocks and flows of the credit relationship are recorded between the lender and the borrower, while after the call stocks and flows related to the guarantee relationship are recorded between the lender and the guarantor. Thus, the activation of guarantees involves the recording of flows and changes in the balance sheets of the debtor, the creditor, and the guarantor.

20.251 There are three main types of guarantee:

(i) guarantees that meet the definition of a financial derivative;

(ii) standardised guarantees; and

(iii) one-off guarantees.

Derivatives-type guarantees

20.252 Guarantees that meet the definition of financial derivatives are those that are actively traded on financial markets, such as credit default swaps. The derivative is based on the risk of default of a reference instrument and generally not actually linked to an individual loan or bond.

20.253 When such a guarantee is initiated, the purchaser makes a payment to the financial institution creating the derivative. This is recorded as a transaction in financial derivatives. Changes to the value of the derivative are recorded as revaluations. If the reference instrument defaults, the guarantor pays the purchaser for its theoretical loss on the reference bond. This is also recorded as a transaction in financial derivatives.

Standardised guarantees

20.254 Standardised guarantees cover similar types of credit risk for a large number of cases. It is not possible to estimate precisely the risk of any one loan being in default, but it is possible to estimate how many, out of a large number of such loans, will default. The treatment of standardised guarantees is explained in Chapter 5.

One-off guarantees

20.255 One-off guarantees exist where the conditions of the loan or the security are so particular that it is not possible for the degree of risk associated with the loan to be calculated with any degree of accuracy. In general, the granting of a one-off guarantee is considered a contingency and is not recorded as a financial asset/liability in the balance sheet of the guarantor.

20.256 In exceptional cases, one-off guarantees granted by governments to corporations in certain well-defined financially distressed situations (for example where the corporation has negative own funds), implying a very high likelihood to be called, are treated as if such guarantees were called at inception (see also paragraph 20.245).

20.257 The activation of a one-off guarantee is treated in the same way as a debt assumption. The original debt is liquidated and a new debt is created between the guarantor and the creditor. The debt assumption implies the recording of a capital transfer in favour of the defaulting debtor. The capital transfer is offset by a financial transaction, the financial liability transferred from the corporation to government.

20.258 The activation of a guarantee may or may not require repayment of debt at once. The accrual principle for time of recording suggests that the total amount of debt assumed should be recorded at the time the guarantee is activated and the debt assumed. The guarantor is the new debtor, and principal repayments by the guarantor and interest accruals on the assumed debt should be recorded when these flows occur. Thus, when calls on guarantees solely involve the settlement of the debt service due on the debt during the accounting period, as in the case of cash calls, a capital transfer is recorded for the amounts settled. However when a pattern of partial calls are observed such as three times in succession, and is expected to continue, a debt assumption is recorded.

20.259 When the original debtor refunds the guarantor while an expenditure has been recorded on past guarantee calls, revenue is recorded by the guarantor. However this revenue should be tested for the super-dividend test when the debtor is controlled by the guarantor; any excess of the refund over the entrepreneurial income is recorded as withdrawal of equity.

Securitisation

Definition

20.260 Securitisation consists of issuing securities on the basis of cash flows that are expected to be generated by assets, or other income streams. Securities depending on cash flows from assets are called 'asset backed securities' (ABS).

20.261 In securitisation, the originator conveys ownership rights over assets, or the right to receive specific future flows, to a securitisation unit, which in return pays an amount to the originator from its own source of financing. Such a securitisation unit is often known as a special purpose entity. The securitisation unit obtains its own financing by issuing securities using the assets or rights to future flows transferred by the originator, as collateral. The key question in recording the payment by the securitisation unit to the originator is whether the transfer of the asset is a sale of an existing asset to the securitisation unit, or a means of borrowing using future flows of revenues as collateral.

Criteria for sale recognition

20.262 In order for the securitisation to be treated as a sale, a marketable asset must exist in the balance sheet of government and there must be a full change of ownership to the securitisation unit as evidenced by the transfer of the risks and rewards linked to the asset.

20.263 Thus, securitisation of future revenue flows not recognised as a return on economic assets, such as future oil royalties, is borrowing by the originator.

20.264 When a securitisation involves flows associated to a financial or a non-financial asset, the risks and rewards associated with owning the assets must be transferred for a sale to be recorded.

20.265 If government retains a beneficial interest in the securitisation, by way of retaining a deferred purchase price, which is the right to excess flows above the original securitisation value, or the right to own the last tranche issued by the securitisation unit, or by other means, no sale has occurred, and the event is originator's borrowing.

20.266 If government, as originator, guarantees repayment of any debt incurred by the securitisation unit related to the asset, risks associated with the asset have not been transferred. No sale has occurred and the event is originator's borrowing. Guarantees can take various forms such as insurance contracts, derivatives, or clauses of substitution of assets.

20.267 If it is determined that the securitisation contract involves the true sale of a marketable asset, the sector classification of the securitisation unit must be examined. Criteria are set in the section 'Defining the general government sector' for establishing if the securitisation unit is an institutional unit and if it has a financial intermediation function. If the securitisation unit is classified to the government sector, the securitisation is government borrowing. If the securitisation unit is classified as other financial intermediary (S.125), then the securitisation will be reported as a sale of assets, with no direct impact on government debt, and with an impact on government deficit if the flows are securitised on a non-financial asset.

20.268 If government provides compensation, in the form of cash after the event, or other means such as guarantees, thus removing the transfer of risks, a securitisation originally viewed as a sale is from that moment classed as borrowing, with the following transactions: incurrence of a liability and acquisition of assets with a capital transfer expenditure in the event that the value of the liability exceeds that of the asset.

Recording of flows

20.269 When a securitisation operation is recorded as borrowing, the cash flows passed on to the securitisation unit are first recorded in the accounts of government and simultaneously as repayment of debt, both interest and principal.

20.270 When cash flows extinguish prior amortisation of the debt incurred, the remainder liability is removed from the government balance sheet by another change in volume.

20.271 After complete extinction of a debt incurred, any remaining cash flows passed over to the securitisation unit in accordance with the securitisation contract are recorded as originator's expenditure.

Other issues

Pension obligations

20.272 The treatment of pension schemes is described in Chapter 17, including a supplementary table to the core national accounts of the ESA, where all obligations of pension schemes are to be accounted for, including pension obligations arising from social security schemes. The pension entitlements of government sponsored unfunded employment-related defined benefit schemes are to be recorded only in those supplementary accounts.

Lump sum payments

20.273 On occasion, units may pay a lump sum to government in exchange for taking over some of their pension obligations. Such large one-off transactions occur between a government and another unit, usually a public corporation, often linked to the change of status of the corporation, or to its privatisation. The government usually assumes the obligations in question in exchange for a cash payment covering the expected deficit resulting from the transfer.

20.274 In concept, being an equal exchange of cash for the incurrence of an obligation that is a liability, the transaction should not affect measures of net worth and financial net worth, and should not alter government net lending/net borrowing. However, the pension obligation may not appear as a liability on the balance sheet of either of the units transferring and assuming the obligations. For example, when transferred to the government, the pension obligations may be merged with a social security scheme for which no liability is recognised.

20.275 In this context, such a lump sum payment should be viewed as a prepayment of social contributions. In consideration of the various arrangements observed in practice and in order to avoid any distortion in the calculation of some aggregates such as labour costs and compulsory levies, the lump sum is recorded as a financial advance (F.8), a prepayment of miscellaneous current transfers (D.75) which will be recorded in the future in proportion to the related payments of pensions. As a result, the lump sum payment has no impact on the net lending/net borrowing of the general government in the year of transfer of obligations.

Public-private partnerships

Scope of PPP

20.276 Public-private partnerships (PPPs) are complex, long-term contracts between two units, one of which is normally a corporation (or a group of corporations, private or public) called the operator or partner, and the other normally a government unit called the grantor. PPPs involve a significant capital expenditure to create or renovate fixed assets by the corporation, which then operates and manages the assets to produce and deliver services either to the government unit or to the general public on behalf of the public unit.

20.277 At the end of the contract, the grantor usually acquires legal ownership of the fixed assets. The fixed assets are in most cases characteristic of some core public service such as schools or universities, hospitals, and prisons. They also may be infrastructure assets because many of the large projects undertaken by means of PPPs involve the provision of transportation, communications, utilities, or other services typically described as infrastructure services.

20.278 A general description that includes the most common accounting problems is as follows: a corporation agrees to acquire a complex of fixed assets and then to use those assets together with other production inputs to produce services. Those services may be delivered to government, either for use as an input to its own production such as in motor vehicle maintenance services, or for distribution to the public without payment such as education services, in which case government makes periodic payments during the contract period and the corporation expects to recover its costs and earn an adequate rate of return on its investment from those payments.

20.279 PPP contracts under this definition involve the grantor paying the operator 'availability' or 'demand' fees, and as such constitute a procurement arrangement. In contrast to other long-term service contracts, a dedicated asset is created. Thus, a PPP contract implies the government purchase of a service produced by a partner through the creation of an asset. There can be many variations in PPP contracts regarding the disposition of the assets at the end of the contract, the required operation and maintenance of the assets during the contract, the price, quality, and volume of services produced, and so forth.

20.280 When the corporation sells the services directly to the public through for example a toll road, the contract is seen as a concession rather than a PPP. The price is routinely regulated by the government and set at a level that the corporation expects will permit it to recover its costs and earn an adequate rate of return on its investment. At the end of the contract period, the government may gain legal ownership and operational control of the assets, possibly without payment.

20.281 In PPP contract, the corporation acquires the fixed assets and is the legal owner of the assets during the contract period, in some cases with the backing of the government. The contract often requires that the assets meet the design, quality, and capacity specified by government, be used in the manner specified by government to produce the services required by the contract, and be maintained in accordance with standards defined by government.

20.282 Furthermore, the assets typically have service lives much longer than the contract period so that government may control the assets, bear the risks and receive the rewards, for a major portion of the assets' service lives. Thus, it is frequently difficult to determine whether it is the corporation or the government that bears the majority of the risks and reaps the majority of the rewards.

Economic ownership and allocation of the asset

20.283 As with leases, the economic owner of the assets in a PPP is determined by assessing which unit bears the majority of the risks and which unit is expected to receive a majority of the rewards of the assets. The asset will be allocated to this unit, and consequently the gross fixed capital formation. The main risk and reward elements to be assessed are:

(a) construction risk, which includes costs overruns, the possibility of additional costs resulting from late delivery, not meeting specifications or building codes, and environmental and other risks requiring payments to third parties;

(b) availability risk, which includes the possibility of additional costs such as maintenance and financing, and the incurrence of penalties because the volume or quality of the services do not meet the standards specified in the contract;

(c) demand risk, which includes the possibility that demand for the services is higher or lower than expected;

(d) residual value and obsolescence risk, which include the risk that the asset will be less than its expected value at the end of the contract and the degree to which the government has an option to acquire the assets;

(e) the existence of grantor financing or granting guarantees, or of advantageous termination clauses notably on termination events at the initiative of the operator.

20.284 The risks and rewards are with the operator if the construction risk and either the demand or the availability risks have been effectively transferred. Majority financing, guarantees covering a majority of financed levied, or termination clauses providing for a majority reimbursement of finance provider on termination events at the initiative of the operator lead to the absence of effective transfer of either of these risks.

20.285 In addition, owing to the specificity of PPP contracts, which involve complex assets, and when the assessment of risks and rewards is not conclusive, a relevant question is which unit has a decisive influence on the nature of the asset and how the terms and conditions of the services produced with the asset are determined, notably:

(a) the degree to which the government determines the design, quality, size, and maintenance of the assets;

(b) the degree to which the government is able to determine the services produced, the units to which the services are provided, and the prices of the services produced.

20.286 The provisions of each PPP contract shall be evaluated in order to decide which unit is the economic owner. Due to the complexity and variety of PPPs, all of the facts and circumstances of each contract should be considered, and then the accounting treatment, that best reflects the underlying economic relationships, selected.

Accounting issues

20.287 If the corporation is assessed as being the economic owner and if — as is commonly the case — the government obtains legal and economic ownership at the end of the contract without an explicit payment, a transaction is recorded for the government's acquisition of the assets. One general approach is for the government gradually to build up a financial claim and the corporation gradually to accrue a corresponding liability such that the value of both will equal the expected residual value of the assets at the end of the contract period. Implementing this approach requires existing monetary transactions to be rearranged or new transactions to be constructed using assumptions about expected asset values and interest rates. This implies partitioning the PPP payments, when the PPP asset is off government balance sheet, in a component representing the acquisition of a financial asset.

20.288 An alternative approach is to record the change of legal and economic ownership at the end as a capital transfer in kind. The capital transfer approach does not reflect the underlying economic reality as well, but data limitations, uncertainty about the expected residual value of the assets, and contract provisions allowing various options to be exercised by either party make using a capital transfer approach the most prudent.

20.289 Another significant problem arises when government is assessed as being the economic owner of the assets but does not make any explicit payment at the beginning of the contract. A transaction must be constructed to accomplish the acquisition. The most common suggestion is that the acquisition be made with an imputed financial lease because of the similarity with actual financial leases. The implementation of that choice, however, depends on the specific contract provisions, how they are interpreted, and possibly other factors. For example, a loan could be imputed and actual government payments to the corporation, if they exist, could be rearranged so that a portion of each payment represents repayment of the loan. If there are no actual government payments, then non-monetary transactions could be constructed for the loan payments. Other means of payment by government for the asset could be an operating lease prepayment if an operating lease is imputed or an intangible asset for the right of the corporation to access the assets for the production of services.

20.290 Another important problem concerns the measurement of production. Whatever decisions are made about which unit is the economic owner of the assets during the contract period and how the government eventually acquires them, care should be taken that production is correctly measured. Again, there are options and their desirability varies with the exact situation and the availability of data. The difficulty arises when the government is assessed as being the economic owner of the assets but the assets are used by the corporation to produce services. It is desirable to show the value of the capital services as a cost of production of the corporation, but that may require the imputation of an operating lease, which in turn may require a rearrangement of actual transactions or a construction of non-monetary transactions to identify the lease payments. An alternative is to show the cost of capital services in the production account of the general government sector but to classify the output of the government in the same way as the classification of the output of the corporation so that the total output in the economy is correctly classified.

Transactions with international and supranational organisations

20.291 Transactions that occur between resident units and international or supranational organisations are classified to the rest of the world sector.

20.292 An example of such transactions is between non-government residents and institutions of the European Union, where these are considered as the principal parties to the transaction even though government units play a role as an intermediary agent in channelling the funds. The recording of the main transactions is directly between the two parties and does not impact on the government sector. The government's role is recorded as a financial transaction (F.89).

20.293 The recording of specific transactions between national residents and institutions of the European Union are set out below for various categories:

(a) taxes: some taxes on products, such as import duties and excises, are payable to institutions of the European Union or other supranational organisations. These form three categories:

(1) those payable directly, such as, in the past, the European Coal and Steel Community levy on mining and iron and steel producing entities, which are recorded directly;

(2) those collectible by national governments as agents on behalf of the institutions of the European Union or other supranational organisations, but where the tax is judged as payable directly by the resident producers. Examples are levies on imported agricultural products, monetary compensatory amounts levied on imports and exports, sugar production levies and the tax on isoglucose, co-responsibility taxes on milk and cereals, and custom duties levied on the basis of the integrated tariff of the European Communities. Such items are recorded directly from the producers to the supranational organisation, with government's role as an intermediary recorded as a financial transaction;

(3) receivables of value added tax in each Member State. They are recorded as receivable by national governments, with the amounts that Member States provide to the European Union recorded as a current transfer (D.76). The time of recording of the transfer from government is when it is to be paid;

(b) subsidies: any subsidies directly payable by supranational organisations to resident producers are recorded as directly payable by the supranational organisation rather than a resident government unit. Subsidies payable to resident producers and channelled through government units as intermediaries are similarly recorded directly between the principal parties, but also create entries in other accounts receivable/payable (F.89) in the government financial accounts;

(c) miscellaneous current transfers: contributions to the European Union budget from Member States for the third and fourth types of payment designed to give the European Union its own resources. The third resource is calculated by applying a flat rate to the Value Added Tax base of each Member State. The fourth resource is based on the gross national income of each Member State. Such payments are considered to be compulsory transfers from governments to the European Union. They are classified as miscellaneous current transfers and recorded when they are to be paid;

(d) current international cooperation: most other current transfers, in cash or in kind, between government and non-resident units, including international organisations, are classified as current international cooperation. This includes current aid to developing countries, wages payable to teachers, advisers and other government agents in activity abroad etc. One characteristic of current international cooperation is that it consists of transfers made on a voluntary basis;

(e) capital transfers: investment grants, in cash or in kind, and other capital transfers, especially as the counterpart transaction of debt cancellation or debt assumption, can be payable to or receivable from an international or supranational organisation;

(f) financial transactions: some financial transactions, usually loans, may be recorded when granted by international organisations such as the World Bank and International Monetary Fund. Government investments in the capital of international and supranational organisations apart from the International Monetary Fund are classified as other equity (F.519), unless there is no possibility of repayment in which case they are classified as current international cooperation.

20.294 The institutions of the European Union make significant current and capital transfers through structural funds such as the European Social Fund, the European Regional Development Fund and the Cohesion Fund. The final beneficiaries of such transfers can be government or non-government units.

20.295 Grants paid from structural funds often involve co-financing, whereby the European-Union jointly funds an investment made by government. There can be a mixture of pre-payments, interim and final payments, which may be channelled through at least one government unit. Resident government units may also make advances payments of the receipts expected from the European Union.

20.296 When non-government units are the beneficiaries, any payments made by government in advance of European Union cash receipts are recorded as financial transactions in other accounts receivable/payable. The counterpart of the financial transaction is the European Union if the accrual point of the non-financial transaction has occurred, otherwise it is the beneficiary. The accounts receivable/payable positions unwind when the cash is paid.

20.297 The recording time of co-financed government expenditure transfers is the time when European Union authorisation is given.

20.298 There may be circumstances where government advances exceed the amount allowable once this is determined by the authorisation process. If the beneficiary is in a position to repay the excess this unwinds the other accounts payable it has with government. If the beneficiary cannot repay, then a capital transfer from government is recorded cancelling the other accounts payable.

20.299 When government units are the beneficiaries, the government revenue is moved forward to match the time of expenditure in a departure from the general rules on time of recording for such transfers. If there is a considerable time lag between the government expenditure taking place and cash being received, then the revenue can be recorded when the claim to the European Union is submitted; this is applicable only when: reliable information on the time of the expenditure is not available; or amounts are big; or the time lag between the expenditure and submission of claim is small.

20.300 All advance payments from the European Union to government units as final beneficiaries at the inception of multi-year programmes are recorded as financial advances.

Development assistance

20.301 Governments provide assistance to other countries by lending funds at an interest rate that is intentionally less than the market interest rate for a loan with comparable risk (concessional loans as described in the section 'Accounting issues relating to general government', 'Dept operations'), or grants in cash and in kind.

20.302 Recording the international assistance through grants in kind, such as deliveries of food stocks, often creates difficulty. The prices of the goods or services being delivered in kind, such as the food stocks, in the receiving country might be quite different from the prices in the donor country. As a general principle, the value of the donation to the recipient should be regarded as equal to the cost of providing the assistance to the recipient. It follows that the prices of the donor country should be used as a basis for the calculation of the value of the donation. In addition to the goods or services themselves, all supplemental costs identifiable with the delivery of the goods or services should be included, such as transportation to the foreign country, delivery within that country, the compensation of government employees of the donating country to prepare the shipments or oversee their delivery, insurance, and so forth.

THE PUBLIC SECTOR

20.303 The public sector consists of general government and public corporations. The elements composing the public sector are already present in the main sector structure of the system and can be rearranged to compile the public sector accounts. This is undertaken by putting together the subsectors of the general government sector and the public subsectors of non-financial and financial corporations.

<table>
<tr><th>Non-financial corporations</th><th>Financial corporations</th><th>General government</th><th>NPISHs</th><th>Households</th></tr>
<tr><td>Public</td><td>Public</td><td rowspan="2">Public</td><td rowspan="2">Private</td><td>Private</td></tr>
<tr><td>Private</td><td>Private</td><td></td></tr>
</table>

20.304 Public financial corporations can be further divided into the central bank, and other public financial corporations, which can be further subdivided into subsectors of financial corporations as appropriate.

Table 20.2 — The public sector and its subsectors

<table>
<tr><td colspan="4">General government</td><td colspan="3">Public corporations</td></tr>
<tr><td rowspan="2">Central government</td><td rowspan="2">State government</td><td rowspan="2">Local government</td><td rowspan="2">Social security</td><td rowspan="2">Public non-financial corporations</td><td colspan="2">Public financial corporations</td></tr>
<tr><td>Central bank</td><td>Other public financial corporations</td></tr>
</table>

20.305 Public sector accounts may be constructed according to the ESA framework and sequence of accounts, and in principle both consolidated and unconsolidated versions are analytically useful. Alternative presentations, such as the consolidated and unconsolidated equivalents of the Government Finance Statistics presentation described earlier in this Chapter, are also useful.

20.306 All institutional units included in the public sector are resident units controlled by government, either directly or indirectly by public sector units in aggregate. The control over an entity is defined as the ability to determine the general policy of that entity. This is described in more detail below.

20.307 The distinction between a public sector unit being part of general government or a public corporation is determined by the market/non-market test, as described in Chapter 3 and above. Non-market public sector units are classified in general government and market public sector units are classified as public corporations. The only exception to this general rule is for certain financial institutions that either supervise or serve the financial sector, which are classified as public financial corporations irrespective of whether they are market or non-market.

20.308 The legal form of a body is not a guide to its sector classification. For example, some legally constituted public sector corporations may be non-market units and hence classified to general government rather than as public corporations.

Public sector control

20.309 Control of a resident public sector unit is defined as the ability to determine the general policy of the unit. This can be through the direct rights of a single public sector unit or the collective rights of many. The following indicators of control are to be considered:

(a) rights to appoint, veto or remove a majority of officers, board of directors etc. The rights to appoint, remove, approve or veto a majority of the governing board of an entity are sufficient to determine control. Such rights may be directly held by one public sector unit, or indirectly by public sector units in aggregate. If the first set of appointments are controlled by the public sector but subsequent replacements are not subject to these controls, then the entity remains in the public sector until the time when the majority of the directors are not controlled appointments;

(b) rights to appoint, veto or remove key personnel. If the control of general policy is effectively determined by influential members of the board, such as the chief executive, chairperson and finance director, then the powers to appoint, veto or remove those personnel are given greater prominence;

(c) rights to appoint, veto or remove a majority of appointments for key committees of the entity. If key factors of the general policy, such as remuneration of senior staff, pay and business strategy, are delegated to subcommittees, then the rights to appoint, remove or veto of directors on these subcommittees is a determinant of control;

(d) ownership of the majority of the voting interest. This will normally determine control when decisions are made on a one-share, one-vote basis. The shares may be held directly or indirectly, with shares owned by all public sector units aggregated. If decisions are not made on a one-share, one-vote basis the situation should be analysed to see if the public sector has a majority vote;

(e) rights under special shares and options. These golden or special shares were once common in privatised corporations and also feature in some special purpose entities. In some cases they give public sector entities some residual rights to protect interests; such rights may be permanent or time-limited. The existence of such shares is not by itself an indicator of control, but needs to be carefully analysed, in particular the circumstances where the powers may be invoked. If the powers influence the current general policy of the entity they will be important to the classification decisions. In other cases they will be reserve powers that may confer rights to control general policy in times of emergency etc, these are judged as irrelevant if they do not influence existing policy, although in the event that they are utilised they will usually trigger immediate reclassification. The existence of a share purchase option to public sector entities in certain circumstances is a similar situation, and a judgement is necessary on whether the powers to implement the option influence the general policy of the entity;

(f) rights to control via contractual agreements. If all the sales of an entity are to a single public sector entity, or a collection of public sector entities, there is scope for dominant influence that can be judged as control. The presence of other customers, or the potential to have other customers, is an indicator that the entity is not controlled by public sector units. If the entity is restricted from dealing with non-public sector customers due to public sector influence, then this is an indicator of public sector control;

(g) rights to control from agreements/permission to borrow. Lenders often impose controls as conditions of making loans. If the public sector imposes controls through lending, or to protect its risk exposure from a guarantee, which are tougher than a private sector entity would typically face from a bank, this is an indicator of control. If an entity requires permission from the public sector to borrow, then this is an indicator of control;

(h) control via excessive regulation. When regulation is so tight that it effectively dictates the general policy of the business, it is a form of control. Public authorities can in some cases have powerful regulatory involvement, particularly in areas such as monopolies and privatised utilities where there is a public service element. It is possible for regulatory involvement to exist in important areas, such as price setting, without an entity ceding control of general policy. Choosing to enter into or operate in a highly regulated environment is similarly an indicator the entity is not subject to control;

(i) others. Control may also be obtained from statutory powers or rights contained in an entity's constitution, for example to limit the activities, objectives and operating aspects, approve budgets or prevent the entity changing its constitution, dissolving itself, approving dividends, or terminating its relationship with the public sector. An entity that is fully, or close to fully, financed by the public sector is considered to be controlled if the controls on that funding stream are restrictive enough to dictate the general policy in that area.

20.310 Each classification case needs to be judged on its own merits and some of these indicators may not be relevant to the individual case. Some indicators, such as (a), (c) and (d) in paragraph 20.309, are sufficient by themselves to establish control. For others a number of separate indicators may collectively indicate control.

Central banks

20.311 Central banks are generally assumed to be public financial corporations, even in the case where other than government are their sole or majority legal owner. They are considered as public corporations through governments having economic ownership or exerting control by other means.

20.312 A central bank is a financial intermediary, whose activity is subject to specific legal provisions, and which is placed under general control of government, representing the national interest, even though the central bank enjoys a large degree of autonomy or independence with respect to exercising its main activity (notably the monetary policy). The key issue here is the recognition of the central bank's main function and activity — to manage the nation's reserve assets, to issue the national currency and to conduct the monetary policy — rather than its legal status. Government often has a formal right to liquidation proceeds.

20.313 Because of the existence of such beneficial interest or because of the government role, ownership of government over the central bank equity — or, at least, over the reserve assets managed by the central bank — is recognised in national accounts, as an economic ownership even in circumstances where it has no legal ownership.

Public quasi-corporations

20.314 Public quasi-corporations do not possess the legal characteristics of independent corporations but behave sufficiently differently from their owners, and more like entities in the non-financial or financial corporations sectors, to be recognised as institutional units.

20.315 The activities of the quasi-corporation must be ring-fenced, with sufficient information to allow a complete set of accounts to be compiled (see point (f) of paragraph 2.13), and be market units.

Special purpose entities and non-residents

20.316 Public sector entities may set up or use special purpose entities (SPEs) or special purpose vehicles. Such units often have no employees or non-financial assets and little physical presence beyond a 'brass plate' confirming their place of registration. They may be resident in a different territory.

20.317 SPE units set up by the public sector must be investigated to see if they have the power to act independently, are restricted in their activities, and carry the risks and rewards associated with the assets and liabilities they hold. If they do not meet such criteria they are not recognised as separate institutional units and, if resident, are consolidated into the public sector unit that created them. If non-resident they are recognised as part of the rest of the world and any transactions they undertake are re-routed via the public sector unit that created them.

20.318 Non-resident international joint ventures between governments, where neither party has control of the entity, are apportioned to governments as notional resident units.

Joint ventures

20.319 Public and private sector units can enter into a joint venture whereby an institutional unit is established. That unit may enter into contracts in its own name and raise finance for its own purposes. The unit is allocated to the public or private sectors depending on which party controls it.

20.320 In practice, in most joint ventures there is joint control. If the unit is classified as non-market it is by convention classified to general government since its behaviour is that of a government unit. If the unit is classified as a market producer and control is evenly divided, then the unit is partitioned into halves, one half allocated to the public sector and the other allocated to the private sector.