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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 21)

CHAPTER 21

LINKS BETWEEN BUSINESS ACCOUNTS AND NATIONAL ACCOUNTS AND THE MEASUREMENT OF CORPORATE ACTIVITY

21.01 Business accounts represent, alongside business surveys, a major source of information for corporate activity in national accounts. National accounting shares with business accounting a number of characteristics, the most noticeable of which are:

(a) the recording of transactions in accounts, i.e. in two-column tables;

(b) monetary valuation;

(c) use of balancing items;

(d) recording of transactions as they take place; and

(e) internal coherence of the system of accounts.

However, national accounting differs on a number of points, because it has a different objective: national accounting aims to describe within a coherent framework all the activities of a country and not just those of an enterprise or group of enterprises. This objective of a consistent picture across all entities in an economy and their relationship with the rest of the world-brings constraints which do not affect business accounting.

21.02 National accounting has international standards shared across every country in the world. The development and application of business accounting differ amongst countries. However, business accounting is moving to applying shared international standards. Harmonisation at world level began on 29 June 1973 with the creation of the International Accounting Standards Committee (IASC) whose mission was to develop basic accounting standards referred to as IAS (International Accounting Standards) and then later as IFRS (International Financial Reporting Standards), that could be applied across the world. In the European Union, the consolidated accounts of EU listed companies are prepared according to the IFRS frame of reference from 2005 onwards.

21.03 Detailed guidelines on the contents of business accounts and how to link business accounts to national accounts belong in specialised manuals. This Chapter answers the most common questions raised when compiling national accounts on the basis of business accounts, and addresses specific issues of the measurement of corporate activity.

SOME SPECIFIC RULES AND METHODS OF BUSINESS ACCOUNTING

21.04 In order to extract information from business accounts, national accountants should understand the international accounting standards for private corporations and for government bodies. The standards for private corporations are drawn up and maintained by the International Accounting Standards Board (IASB), and, for government bodies, by the International Public Sector Accounting Standards Board (IPSASB). The following paragraphs set out general principles of business accounting.

Time of recording

21.05 Business accounts record transactions when they take place, giving rise to claims and obligations, independently of the payment. This is recording on an accruals basis, as opposed to a cash basis. The national accounts are also drawn up on an accruals basis.

Double entry and quadruple entry accounting

21.06 In business accounts, each transaction of the enterprise is recorded in at least two different accounts, once on the debit side and once on the credit side for the same amount. This double entry system enables a check of the consistency of the accounts.

In national accounts, a quadruple entry system can also be used for most transactions. A transaction is reflected twice by each of the institutional units involved, for example once as a non-financial transaction in the production, income and capital accounts, and once as a financial transaction associated with the change in financial asset and liability.

Valuation

21.07 In business accounts and in national accounts, transactions are recorded at the price agreed upon by the transactors.

Assets and liabilities are generally valued at their original or historical cost in the financial statements of business entities, in possible combination with other prices, e.g. market prices for inventories. Financial instruments should be valued at fair value, which aim to reflect prices observed in markets by using specific valuation techniques if necessary.

In national accounts, assets and liabilities are recorded at current values at the time to which the balance sheet relates, not at their original valuation.

Income statement and balance sheet

21.08 For business accounts, two financial statements are prepared: the income statement and the balance sheet. The income statement groups together the transactions for income and costs, and the balance sheet stocks of assets and liabilities. These statements show the balances of the accounts, and transactions at an aggregate level. The statements are presented in the form of accounts. Both statements are closely linked to each other. The balance of the income statement is a profit or loss of the enterprise. This profit or loss is also included in the balance sheet.

21.09 The transaction accounts whose balance is included in the income statement are flow accounts. Their objective is to show the totals of income and expenditure during the financial year.

21.10 Balance sheets are stock accounts. They show the value of the assets and liabilities at the end of the financial year.

NATIONAL ACCOUNTS AND BUSINESS ACCOUNTS: PRACTICAL ISSUES

21.11 In order that national accountants may use business accounts on a large scale, and not just in isolated cases, a number of conditions must be met.

The first is access to businesses' accounts. Usually, the publication of accounts is mandatory for large enterprises. Databases of such accounts are set up by private or public bodies, and it is important that national accountants are able to access these. For large enterprises, it is generally possible to obtain accounts directly from them.

The second condition is a minimum degree of standardisation of the accounting documents published by enterprises, since this is a necessary condition for computerised processing. A high level of standardisation is often associated with the existence of a body collecting accounts from enterprises in a standardised form. Collection may be organised on a voluntary basis, as in the case of the body running a financial statements centre which performs analyses for its members, or it may be made mandatory by law, as is the case where the collecting body is the tax authority. In both cases, national accountants are to request access to the databases, respecting the confidentiality policies that apply.

21.12 Business accounts can be used when the accounts are not compiled on a standardised basis. In many countries, sectors of the economy are dominated by a small number of large enterprises, and the accounts of those large enterprises can be used for the national accounts. Useful information can also be found in the notes to the accounts, such as more detail or guidance on how to interpret the entries in the accounts.

21.13 Business surveys are the other major source of data for the national accounts on corporate activities. Such surveys provide satisfactory results if the questions asked are compatible with entries and concepts of business accounts. An enterprise will not provide reliable information which is not based on its own internal information system. Business surveys are generally necessary, even in the best case where national accountants are able to access accounting databases, as the information contained in such databases is rarely detailed enough to meet all the needs of national accountants.

21.14 Globalisation complicates the use of business accounts in preparing national accounts. Business accounts must be drawn up on a national basis to be useful and this is not the case when enterprises have subsidiaries abroad. When the activity of the enterprise extends beyond the national territory, adjustments are necessary to create a national picture based on the enterprise's business accounts. Enterprises must provide to the business accounts database, either accounts on a national basis, or the adjustments to render the enterprise accounts on a national basis. When the accounts are collected from the enterprises by the tax authority, the tax authority generally requires that the data are provided on a national basis in order to be able to calculate the tax on profit, and this is the most favourable case for use in national accounts.

21.15 Another practical condition is that the financial year should correspond with the reference period of the national accounts. For annual accounts, this is generally the calendar year, and so it is desirable, in order to make best use of business accounts, that the majority of these enterprises start their financial year on 1 January. Enterprises can choose other financial year start dates. For operations corresponding to flows in the national accounts, it is often acceptable to recreate accounts on the basis of the calendar year by combining proportions of two successive financial years, but for balance sheets this method provides less satisfactory results, especially for items liable to rapid fluctuations during the year. Quarterly accounts are often compiled by large enterprises but they are rarely collected on a systematic basis.

THE TRANSITION FROM BUSINESS ACCOUNTS TO NATIONAL ACCOUNTS: THE EXAMPLE OF NON-FINANCIAL ENTERPRISES

21.16 The use of data from business accounts of non-financial enterprises for the preparation of national accounts requires several adjustments. These adjustments can be placed in three categories: conceptual adjustments, adjustments to enable consistency with the accounts of other sectors, and adjustments for exhaustiveness.

Conceptual adjustments

21.17 Conceptual adjustments are required because business accounts are not based on exactly the same concepts as national accounts and because where these concepts are close to each other, the valuation methods can be different. Examples of conceptual adjustments for the calculation of output are as follows:

(a) adjustment for the transition to the basic price. The turnover of enterprises is generally net of VAT but often includes taxes on products. Conversely, subsidies on products are rarely included in the turnover. It is therefore necessary to make an adjustment to the data from business accounts by deducting these taxes on products and adding these subsidies on products to arrive at an estimate of output at basic prices;

(b) insurance premiums. Insurance premiums paid by enterprises are part of their expenditure, but national accounts require that they be broken down into three elements: net premiums, the insurance service and premium supplements. Only the part corresponding to the service is intermediate consumption, and a correction is made by deducting net premiums and premium supplements from the gross payment.

Adjustments to achieve consistency with the accounts of other sectors

21.18 National accounts require that the accounts of enterprises are consistent with those of other enterprises and units in other institutional sectors. So, taxes and subsidies valued on the basis of accounts of enterprises must be consistent with those received by or paid by general government. In practice, this is not observed and a rule is needed in order to achieve consistency. Normally information from general government is more reliable than that from enterprises, and the data from business accounts is adjusted.

Examples of adjustments for exhaustiveness

21.19 Examples of adjustments to enterprise accounting data for exhaustiveness are absence from statistical files, exemption from tax and social declarations, and evasion.

Examples of specific adjustments are as follows:

(a) evasion regarding output sold and sale of goods for resale. Enterprises may underestimate the value of sales to evade paying tax, and an adjustment is made for this under-declaration based on information provided by the tax offices;

(b) income in kind is employee recompense in the form of goods and services supplied free of charge. When this output and income are not recorded in the business accounts, an adjustment is made to the recorded values, for use in the national accounts. Where employees are housed free of charge, an estimate of the corresponding property rentals is included in output and income of employees where they are not already included in the business accounts;

(c) tips. When employees receive tips from customers of the enterprise, these must be considered as part of the turnover and thus of output. Tips not recorded as output and employee income in the business accounts are estimated and the output and income adjusted for the national accounts.

SPECIFIC ISSUES

Holding gains/losses

21.20 Holding gains and losses are one of the main difficulties in the transition from business accounts to national accounts, mainly due to the nature of the information available in business accounts. For example, intermediate consumption of raw materials may not be a direct purchase, but a withdrawal from stock. In national accounts, the withdrawal from stock is valued at the current market price, while in business accounts the withdrawal from stock is valued at its historical cost, i.e. at the price of the goods when purchased. The difference between the two prices is a holding gain/loss in national accounts.

21.21 Eliminating holding gains/losses on stocks is not easy as it requires the collection of numerous pieces of supplementary accounting information and the use of many assumptions. The information collected must relate both to the nature of the products stocked and the change in prices in the course of the year. Since the information available on the nature of products more often than not relates to sales and purchases rather than to the stocks themselves, it is necessary to base the estimates on models the relevance of which is difficult to verify. But, despite its imprecision, this exercise is the price that has to be paid for being able to use the data from business accounting.

21.22 The valuations of assets at fair value provide a better picture of the balance sheet than valuations at historic cost but they also generate more data on holding gains/losses.

Globalisation

21.23 Globalisation makes the use of business accounts more difficult when businesses have foreign establishments. The activity carried out beyond national borders must be excluded from the accounts in order to use them for national accounts. This exclusion is difficult except in the best case where tax regulations require enterprises to publish accounts for their activity exclusively on national territory. The existence of multi-national groups poses valuation problems, as exchanges between subsidiaries can be made on the basis of prices not observed in the open market, but set to minimise global tax burden. National accountants make adjustments to bring the prices of intra-group transactions into line with market prices. In practice this is extremely difficult, due to the lack of information and the lack of a comparable free market for highly specialised products. Adjustments can only be made in exceptional cases, based on an analysis that is accepted by experts in the area concerned.

21.24 Globalisation has supported the reintroduction of recording imports and exports on the basis of change of ownership of goods, rather than change of physical location. This renders business accounts more appropriate for national accounts, as business accounts are also based on a change of ownership of goods rather than physical change of location. When an enterprise places processing with an enterprise based outside the national economic territory, business accounts are on the appropriate basis to act as a data source for the national accounts. Whilst this helps, there remain many measurement issues in the estimation of multinational businesses in the national accounts.

Mergers and acquisitions

21.25 Corporate restructuring causes the appearance and disappearance of financial assets and liabilities. Where a corporation disappears as an independent legal entity because it has been absorbed by one or more corporations, all financial assets/liabilities including shares and other equity that existed between that corporation and those that absorbed it disappear from the system of national accounts. That disappearance is recorded as changes in sector classification, and structure in the other changes in the volume of assets accounts.

21.26 However, the purchase of shares and other equity of a corporation as part of a merger is recorded as financial transaction between the purchasing corporation and the previous owner. Replacement of existing shares by shares in the takeover or new corporation are recorded as redemptions of shares accompanied by the issue of new shares. Financial assets/liabilities that existed between the absorbed corporation and third parties remain unchanged and pass to the absorbing corporation(s).

21.27 Where a corporation is legally split up into two or more institutional units, new financial assets and liabilities (appearance of financial assets) are recorded as changes in sector classification and structure.