Chapter 28: Non-financial corporations (revised title and revised content)

(OLD Chapter 21: Measuring corporate activity)

A. Introduction

28.1 Non-financial corporations have long held an important role in the economy, but their role has shifted over time. For a long time non-financial corporations were the main organizational form for heavy industry such as manufacturing, mining, transport and utilities. Over time, their importance in producing services has grown, and the growth of digitalization has led to large non-financial corporations investing in software assets, databases and digital platforms. These changes have led to more investment in intellectual property products relative to traditional plant and equipment. Non-financial corporations have also become increasingly global, with growing importance to multinational enterprises, foreign direct investment, and outsourcing of production. This chapter discusses how these and other developments are reflected in the national accounts.

Commented [ED1]: A new introductory paragraph to reflect the new title of the chapter and to make it parallel to the introductory paragraph in chapter 29.

~~28.1~~28.2 This chapter discusses aspects particular to corporations, many of which are common to both the financial and non-financial corporation sectors. Chapter 29 will focus on topics that are particular to financial corporations, but most of the issues discussed in this chapter are relevant to both financial and non-financial corporations, so reference will be made to corporations in general terms except for a few issues that are specific to non-financial corporations.

Commented [ED2]: Explains that this chapter mostly discusses topics that are relevant for all corporations, both financial and non-financial.

~~28.2~~28.3 This chapter begins in section B by discussing the demography of corporations; how they come about, how they disappear and how they merge with one another. The consequences of these actions in the SNA are almost all to do with recording the acquisition of the owner's equity in corporations and in some cases reclassification of assets and liabilities between sectors. Section C looks at some subsectoring of non-financial corporations and how this can be effectively deployed for analysis. Section D considers the relationships between corporations in the domestic economy and in the rest of the world. Much of this section is concerned with aspects of globalization and the derivation of relevant indicators, topics which are covered in more detail in chapter 23. Section E recalls some of the discussion in chapter 17 and looks further at the contribution of assets to production. Section F looks at the consequences of financial distress and the implications of remedial action for recording within the SNA. The last section, section G, covers a rather different subject and looks at the emergence of commercial accounting standards such as the International Financial Reporting Standards (IFRS) and at the relationship between IFRS and the SNA.

1. A note on terminology

~~28.3~~28.4 As explained in section B of chapter 5, the term corporation is used in the SNA to cover a wide variety of legal forms of institutional units. In addition, the expression enterprise is used in connection with production activities. While corporation is normally the term of preference in the SNA, other documents, notably the *OECD Benchmark Definition of Foreign Direct Investment,* fourth edition (Organisation for Economic Co-operation and Development, 2008) referred to as the *BD*, tend to use enterprise in preference to corporation. Further, the register of all enterprises or corporations is usually called a business register, even though "business" is not a term commonly used in national accounts. In this chapter, all three terms are used without implying a difference between them.

B. The demography of corporations

~~28.4~~28.5 Maintaining a list of corporations is similar to maintaining a list of all individuals present in the country in that it is necessary to record new corporations as they come into being and to record those that cease to be. A business register normally serves an administrative function in keeping track of the existing businesses in the economy but also serves as the basic sampling frame for surveys directed at businesses. Thus it is normal

for a business register to contain information on the activity, size, location, etc. of each business and to note when the main activity of a corporation changes from one type of activity to another. In addition a business register may also include information on the links one corporation may have to other resident and non-resident corporations. Best practices in the development and maintenance of business registers are presented in *Guidelines on Statistical Business Registers* (United Nations, 2024).

1. The creation of corporations

~~28.5~~28.6 Corporations can come into being in a number of ways. One is when what was previously an unincorporated enterprise within the household sector becomes incorporated. (The exact process of incorporation, such as when this may or must happen and how it is effected, will depend on the company law in effect in the country concerned.) When this happens, the assets and liabilities that were previously indistinguishably part of the household are separated off and become those of the corporation. In return for giving up control of these assets, and responsibility for the liabilities, the household acquires equity in the new corporation, initially exactly equal in value to the assets less liabilities transferred to the corporation. This transaction is recorded in the financial account. Once an enterprise is incorporated, the owning household no longer has a claim on the assets and has no responsibility for the liabilities but instead owns the equity in the corporation.

~~28.6~~28.7 An individual may simply decide to set up a business, set up a legal entity and begin operations. Initially, there may be no assets of the entity and no liabilities but as these accrue they belong to the corporation and the owner's equity changes correspondingly. On a larger scale, there may be an agreement between a number of units, one or more of whom propose a business plan and one or more of whom agree to finance the operation. A formal agreement results in which the split of the rewards from the corporation's activity is determined and also the division of the responsibilities. The assets of the new corporation are recorded as being acquired by it and an amount of owner's equity in the corporation incurred as a liability towards the parties supplying the finance is also recorded.

~~28.7~~28.8 It is not necessary for the corporation to issue shares for the agreement on the share of the profit arising from the activities of the corporation to be binding. Cooperatives and limited liability partnerships are two examples of units the SNA treats as corporations where the way in which profits are shared between the owners is clear even though there are formally no shares.

~~28.8~~28.9 Corporations may also come into being at the initiative of government, an NPISH or a unit in another economy. In addition, a corporation may come into existence by the splitting of a previously existing corporation. This possibility is discussed below under mergers and acquisitions.

2. The dissolution of corporations

~~28.9~~28.10 Similarly there are several ways in which corporations may go out of existence. The first is when an entity is wound up after having been declared bankrupt. (The exact process varies from country to country. In some countries a declaration of bankruptcy means the corporation must stop trading immediately and the process of winding up its affairs begins. In other countries, there may be a time lag while the corporation has an opportunity to continue trading while it tries to recover its position and only if this fails is it wound up.) When a corporation is wound up, the receiver (the unit responsible for administering the liquidation of the corporation) sells all of its assets and distributes the proceeds amongst those having a claim on the corporation in a legally predetermined order. The shareholders are normally the last to be allocated any proceeds. In the case where the corporation is bankrupt it is quite common that the shareholders receive nothing. Only in very exceptional circumstances will the shareholders have any responsibility to provide funds towards settling other liabilities of the corporation.

~~28.10~~28.11 A corporation may be wound up voluntarily by its owners. When this happens the assets are sold and the proceeds are divided amongst the owners according to the shares each has in the corporation. If the corporation is one that had issued shares, it can only be wound up if a clear majority of shareholders agree or if a clear majority of the shares are first acquired by a sufficiently small number of units who can reach agreement to wind up the corporation.

~~28.11~~28.12 The acquisition of all shares of a corporation need not be a preliminary to the corporation ceasing

to exist; it may simply continue with a smaller number of shareholders or even as a private unlisted corporation. The advantage of remaining incorporated is that there is a limit to the liability of the owners to meet any shortfall on the corporation's balance sheet. Thus even when an individual or group of individuals wants to control the whole of a corporation they may choose simply to make it an unlisted corporation but still one with the limited liability that comes with incorporation.

~~28.12~~28.13 A third way in which a corporation may disappear is through it being merged with another corporation, though a merger does not automatically imply the merged corporation disappears. This too is discussed below under mergers and acquisitions.

3. Nationalization and privatization

~~28.13~~28.14 The government may decide to take ownership of a corporation for a number of reasons, either because it is felt it is in the public interest for government to control the corporation, in response to financial distress or for other reasons. When this happens the ownership of the corporation passes to the government, that is the government acquires the equity in the corporation, but the assets of the corporation remain on its balance sheet unless the government decides to nationalize the corporation and disband it at the same time. Often but not always, government may make a payment to the previous owners of the corporation but this may not necessarily correspond to their view of a fair price. Unless the corporation is dissolved, the process of nationalization leads to a change in the ownership of the corporation from private units to the government but the assets and other liabilities of the corporation continue to be owned by the corporation. The sale or purchase of equity in the corporation is recorded as a transaction in the financial account. There is also a reclassification of the assets and liabilities of a corporation being nationalized from the national private subsector to the public subsector recorded in the other change in the volume of assets account.

~~28.14~~28.15 The government may also decide to privatize a corporation it currently controls. When this happens the most usual mechanism is that its shares are offered to the public either for sale or, in some cases, without charge or perhaps at a price lower than the market would bear. When shares are offered free or at a reduced price, a capital transfer from government to the eventual shareholders needs to be recorded in the accounts as well as the acquisition of shares. As with nationalization, only the equity in the corporation changes hands, not its assets and other liabilities, and the change in ownership of the equity is recorded as a transaction in the financial account. The ownership of the assets and liabilities remains with the corporation but they are reclassified from the public to national private subsector in the other changes in the volume of assets and liabilities account.

~~28.15~~28.16 There is more discussion on nationalization and privatization in chapter 30.

4. Mergers and acquisitions

~~28.16~~28.17 The process of corporations merging and de-merging is of interest within an economy but especially interesting when the merger (or de-merger) involves units in different economies. Foreign direct investment can hardly be discussed without considering the subject of mergers and acquisitions. Some of the expressions commonly used in this field are listed below. The descriptions come from the BD but similar concepts appear also in the BPM7.

~~28.17~~28.18 A merger refers to the combination of two or more corporations to share resources in order to achieve common objectives. A merger implies that, as a result of the operation, only one entity will survive and frequently occurs following an acquisition (described below). There are several types of merger possible.

a. A *statutory merger* relates to the business combination where the merged (or target) corporation will cease to exist. The acquiring corporation will assume the assets and liabilities of the merged corporations. In most cases, the owners of merged corporations remain joint owners of the combined corporation.

b. A *subsidiary merger* relates to an operation where the acquired corporation becomes a subsidiary of the parent corporation. In a reverse subsidiary merger, a subsidiary of the acquiring corporation will be merged into the target corporation.

c. *Consolidation* is a type of merger which refers to a business combination whereby two or more corporations join to form an entirely new corporation. All corporations involved in the merger cease to exist and their shareholders become shareholders of the new corporation. The terms consolidation and merger are frequently used interchangeably. However, the distinction between the two is usually in reference to the size of the combining corporations. Consolidation relates to an operation where the combining corporations have similar sizes while merger generally implies significant differences.

d. A *reverse merger* is a deal where the acquiring corporation ceases to exist and merges into the target corporation. If a corporation is eager to get public listing in a short period of time, it can buy a corporation with listed shares and merge into it in order to become a new corporation with tradeable shares.

e. A *merger of equals* is a type of merger where the corporations involved are of similar size.

~~28.18~~28.19 An acquisition is a transaction between two parties based on terms established by the market where each corporation acts in its own interest. The acquiring corporation achieves control of the target corporation. The target corporation becomes either an associate or a subsidiary or part of a subsidiary of the acquiring corporation.

a. A *takeover* is a form of acquisition where the acquiring corporation is much larger than the target corporation. The term is sometimes used to designate hostile transactions. However, mergers of equals (in size or belonging to the same sector of activity) may also result in a hostile takeover.

b. A *reverse takeover* refers to an operation where the target corporation is bigger than the acquiring corporation.

~~28.19~~28.20 A divestment (de-merger) refers to the selling of the parts of the corporation due to various reasons:

a. A subsidiary or part of the corporation may no longer be performing well in comparison to its competitors;

b. A subsidiary or a part may be performing well but may not be well positioned within the industry to remain competitive and meet long-term objectives;

c. Strategic priorities of the corporation to remain competitive may change over time and lead to divestments;

d. Loss of managerial control or ineffective management;

e. Too much diversification may create difficulties and thus lead the parent corporations to reduce the diversification of its activities;

f. The parent corporation may have financial difficulties and may need to raise cash;

g. Divestments may be realized as a defence against a hostile takeover.

~~28.20~~28.21 Corporate divestments can be conducted in different ways:

a. A *corporate sell-off* is the sale of a subsidiary to buyers that are other corporations in most cases.

b. A *corporate spin-off* occurs when the divested part of a corporation is floated on the stock exchange. The newly floated corporation is separately valued on the stock exchange and is an independent corporation. The shares in the newly listed corporation are distributed to the shareholders of the parent corporations who thereafter own shares in two corporations rather than one.

c. An *equity carve out* is similar to a corporate spin-off but the parent retains the majority control. This form has the advantage of raising cash for the divestor.

d. *Management buy-outs and buy-ins* occur when the buyer is the manager or a group of managers of

the corporation that is being sold off.

~~28.21~~28.22 In all these cases, transactions in the equity of the two corporations involved need to be recorded in the financial account and, possibly, a change of classification by sector in the other changes in the volume of assets and liabilities account.

C. Subsectors

~~28.22~~28.23 The subsectoring of the non-financial corporations sector~~s~~ is discussed in section D of chapter 5. There is a three-way split of corporations between those that are national private corporations, those that are controlled by the government (public corporations) and those that are foreign controlled. Within national private corporations and public corporations, "of which" items are included for domestically controlled public and private corporations that are part of a domestic multinational enterprise group (or "MNE" group, see paragraph 5.38). Furthermore, for countries where this is important, it is recommended to include within foreign-controlled corporations "of which" items for SPEs. In addition to these breakdowns according to ultimate control, it is also desirable to distinguish between market non-profit institutions (NPIs) and for-profit institutions (FPIs). The subsectors are shown in table 5.2 in chapter 5.

~~28.23~~28.24 The reason for identifying NPIs is twofold. In the first place, in order to have a comprehensive picture of NPIs, as described in chapter 31, it is necessary to be able to identify those market NPIs that are assigned to the corporations sector. Identifying them separately may be unexpected to some users, since there is often a misconception that all NPIs are non-market and fall in the NPISH sector. The other reason for identifying NPIs separately is that for some analyses it may be desirable to analyse corporations excluding the NPIs if it is felt that their economic behaviour is significantly different.

~~28.24~~28.25 In identifying publicly controlled corporations, there is a question about how to provide long time series if there has been a significant change in the number and type of corporations subject to public control during the period. It is usual to provide a time series that includes only those corporations that were subject to public control at each period in question. Because interest usually focuses on how much of the corporate sector was controlled by the government, and how this has changed over time, this gives an appropriate picture. However, if the intent is to explore the behaviour of the same group of corporations over time a supplementary table may be prepared that takes the current definition of publicly controlled corporations and uses this set of corporations over the time period considered regardless of whether or not they were publicly controlled for the whole of that period.

~~28.25~~28.26 Identifying foreign controlled corporations and domestically controlled corporations that are part of an MNE group is key to looking at the interaction between the domestic economy and the rest of the world. Chapter 23 discusses the role of MNEs and members of MNE groups in the economy and describes supplementary data that can be used for monitoring the activities of foreign controlled corporations and domestic MNEs. Exploring this in greater detail is the subject of the following section.

D. Relations between corporations in different economies

~~28.26~~28.27 Deregulation of markets, technological innovations and cheaper communication tools have allowed investors to diversify their participation in competitive markets abroad. In consequence, a significant increase in cross- border financial movements including direct investment has become a key factor in international economic integration, more generally referred to as globalization.

~~28.27~~28.28 Regular analysis of direct investment trends and developments is an integral part of most macroeconomic and cross-border financial analysis. It is of prime importance to policy analysts to identify the source and destination of these investments. Several indicators based on direct investment statistics facilitate the measurement of the extent and impact of globalization.

1. Foreign direct investment

~~28.28~~28.29 Foreign direct investment (FDI) is a key feature of the external accounts and it is useful to review some of the basic concepts associated with this. Further details can be found in both BPM7 and the BD. In the context of FDI, the term enterprise tends to be used rather than corporation, but as noted in the introduction, no difference of meaning is intended.

~~28.29~~28.30 Direct investment statistics embody four distinct statistical accounts:

a. Investment positions,

b. Financial transactions,

c. Associated income flows between enterprises that are related through a direct investment relationship, and

d. Other changes in the value of assets and liabilities, especially revaluation terms.

~~28.30~~28.31 Direct investment is a category of cross-border investment associated with a resident in one economy (the direct investor) having control or a significant degree of influence on the management of an enterprise (the direct investment enterprise) that is resident in another economy. Ownership of 10 percent or more of the voting power is evidence of a direct investment relationship.

~~28.31~~28.32 Direct investment may also allow the direct investor to gain access to the economy of the direct investment enterprise which it might otherwise be unable to do. The objectives of direct investors are different from those of portfolio investors who do not have significant influence on the management of the enterprise.

~~28.32~~28.33 Direct investment enterprises are corporations which may either be subsidiaries in which over 50 per cent of the voting power is held, or associates in which between 10 per cent and 50 per cent of the voting power is held or they may be quasi-corporations, such as branches, which are effectively 100 per cent owned by their respective parents. Enterprises that have no direct investment influence upon one another (that is the 10 per cent voting power criterion is not met) but are directly or indirectly influenced in the ownership hierarchy by the same enterprise (which must be a direct investor in at least one of them) are described as fellow enterprises.

~~28.33~~28.34 Direct investment relationships are identified according to the criteria of the Framework for Direct Investment Relationships (FDIR, described in the BD), including both direct and indirect relationships, through a chain of ownership. Suppose that corporation A controls corporation B and B controls C then A in effect has control over C also.

2. FDI and globalization

~~28.34~~28.35 Direct investment positions show an important class of investment made abroad and received from abroad, divided between equity and debt, at a given reference point in time. FDI positions as a percentage of GDP give one indication of the extent of globalization at that time. These structural indicators demonstrate the interdependence of economies.

~~28.35~~28.36 Financial transactions show the net inward and outward investments with assets (acquisitions less disposals or redemptions) and liabilities (incurrence less discharges) presented separately by instrument in any given period. FDI financial transactions expressed as a percentage of GDP provide one indicator of the changes over that period in the degree of globalization of an economy. This indicator provides early information on the relative attractiveness of economies (both domestic and foreign) for new investments after allowing for the withdrawal of investments or disinvestment during the same time period.

~~28.36~~28.37 Direct investment income provides information on the earnings of direct investors and of the direct investment enterprises. Direct investment earnings arise (i) from distributed earnings as well as undistributed earnings which are treated as reinvestment of earnings in that enterprise and (ii) from interest on inter-company loans, trade credit and other forms of debt. FDI income flows as a percentage of GDP provide information on the relative importance of the earnings of direct investment in both the reporting economy

and abroad.

3. The role of "pass through funds"

~~28.37~~28.38 "Pass through funds" or "funds in transit" are funds that pass through a direct investment enterprise resident in one economy to an affiliate in another economy, so that the funds do not stay in the economy of the affiliate. Such flows have little impact on the economy they pass through. While special purpose entities, holding companies and financial institutions that serve other non-financial affiliates are particularly associated with funds in transit, other enterprises may also have pass through funds in direct investment flows.

~~28.38~~28.39 Pass through funds are included in direct investment in standard presentations because they are an integral part of a direct investor's financial transactions and positions with affiliated enterprises. (An exception is made for positions in debt instruments between related financial institutions.) Excluding these funds from direct investment would distort and substantially understate direct investment financial flows and positions at aggregate levels. Further, inclusion of these data in direct investment promotes symmetry and consistency among economies. However, for the economies through which the funds pass, it is useful to identify inflows and outflows not intended for use locally by the entity concerned.

~~28.39~~28.40 FDI has a key role to play in development, especially in emerging countries. In order to explore how much of global FDI reaches these countries, and where it originates, a supplementary analysis is useful. Such an analysis identifies the country where the pass through funds originate by identifying the first unit other than a pass through fund in the host or investing economy (in the outward or inward chain) as appropriate.

4. Ultimate investing country

~~28.40~~28.41 Presentations of FDI according to the *BD* show the country of the immediate counterparty and the industry of the immediate counterparty for outward FDI. For inward FDI, it is possible to determine not only the immediate counterparty but also the ultimate investor. The ultimate investor for this purpose is the enterprise that has control over the investment decision to have an FDI position in the direct investment enterprise. As such the ultimate investor controls the immediate direct investor. It is identified by proceeding up the immediate direct investors ownership chain through the controlling links (ownership of more than 50 per cent of the voting power) until an enterprise is reached that is not controlled by another enterprise. If there is no enterprise that controls the immediate direct investor, then the direct investor is effectively the ultimate investor in the direct investment enterprise.

~~28.41~~28.42 The country in which the ultimate investor is resident is the ultimate investing country in the direct investment enterprise. It is possible that the ultimate investor is a resident of the same economy as the direct investment enterprise. (A controls B controls C. A and C are resident in the same economy but B is resident in another.) This phenomenon is known as round tripping.

~~28.42~~28.43 In order to transform the usual presentation by country to the supplementary ultimate investing country presentation, the entire FDI position that is attributed to the country of residence of the immediate direct investor(s) is allocated to the country of residence of the ultimate controlling parent.

5. Multinational enterprises

28.44 As well as information relating to (foreign) direct investment where only a 10 per cent voting power is required to identify a (foreign) direct investor, there is interest in analysing the activities of members of MNEs~~)~~ groups, where control is determined to exist through (i) an immediate (foreign) direct investment relationship where the direct investor owns more than 50 per cent of the voting power in the (foreign) direct investment corporation; or (ii) an indirect (foreign) direct investment relationship arising from the ownership of voting power in one direct investment corporation that owns voting power in another corporation(s) – indirectly through a chain of control (see paragraphs 5.126 to 5.127). Thus the members of MNE groups correspond to foreign controlled enterprises in the sense of subsectors in the SNA.

~~28.43~~28.45 If a domestically controlled public or private corporation is an MNE or is a member of an MNE group, i.e., it is either the ultimate controlling parent of one or more foreign corporations or it is controlled by a domestic MNE that is the ultimate controlling parent of one or more foreign corporations, then it should be classified as part of an "of which" subsector of corporations that are part of a domestic MNE (see paragraph 5.38). Section E of chapter 23 describes a template for institutional sector accounts and external accounts with additional granularity and SPEs (figure 23.6) which is designed to present details on foreign controlled corporations and domestically controlled public and private corporations that are part of domestic MNE groups.

28.46 In addition to statistics on the activities of MNEs, statistics are also available for the wider group of corporations with links in other economies, not just those where there is majority ownership, called foreign affiliates. These statistics are known as Foreign AffiliaTes Statistics (FATS), and are described in European Business Statistics Compilers' Manual for Foreign Affiliate Statistics (FATS) (Eurostat, 2024) and elaborated in Measuring Globalisation: Handbook on Economic Globalisation Statistics (Organisation for Economic Co-operation and Development, 2005). Work is continuing to ensure the consistency of the various sets of statistics cited in these and other publications on globalization.

~~28.44~~28.47 Another template for supplementary data presented in chapter 23 (table 23.2) identifies the role of enterprise characteristics in the current account. The template breaks down domestic versus foreign ultimate control and also calls for the identification of small and medium-sized enterprises. The chapter also suggests providing statistics on the Activities of Multinational Enterprises (AMNE statistics) and the closely related FATS. These statistics provide an additional perspective on the impact of foreign direct investment that is complementary to data on international flows and positions.

6. Outsourcing

~~28.45~~28.48 There are two ways in which a non-financial corporation A in economy X may have another non-financial corporation B in economy Y assemble parts for it. Although the effect appears similar, the consequences for recording in the accounts are quite different. Suppose that A and B are unrelated enterprises, and B contracts to do work for A in return for a fee. (This case is described elsewhere, for example in chapter 36.) In this case there is no recorded transfer of the items from A to B (or X to Y). Only the agreed fee is recorded as a transaction between the two economies.

~~28.46~~28.49 However, if A and B both belong to the same group of corporations, then it may be the case that there is a transfer of the risks and rewards of the items on their dispatch from A to B. The question is whether a realistic price is entered for the items in the trade figures for both A (and X) and B (and Y) as the items move internationally. When A and B are related, transfer pricing is used to value the transactions between affiliated enterprises. In some cases the transfer prices may be distorted. Suppose the tax regime in Y is more liberal than that in X. It may then be the case that A artificially lowers the price of the items dispatched to B in order to minimize profits in X while B records a higher profit subject to the lower tax regime in Y. In principle, international accounting standards and the balance of payments recommendations indicate that items transferring across borders should be valued at "arm's length" prices, that is to say prices that would prevail if there were no relationship between the two corporations involved. Making such an adjustment is not easy but it is in the interests of tax authorities, customs officials and the statistician to see whether appropriate adjustments can be made if the sums involved are significant and adjustments can be made with sufficient reliability. Other aspects of global production are discussed in section B of chapter 23.

E. The contribution of assets to production

~~28.47~~28.50 Chapter 17 discusses the role of capital services in production and the calculation of multifactor productivity (MFP). The assets to be considered in calculating productivity are those fixed assets that are both owned and used by the enterprise plus any natural resources and other non-produced assets including contracts, leases and licences and possibly marketing assets they both own and use in production. Assets that are not legally owned by the enterprise but are subject to a financial lease are included in the calculations in the same way that they are recorded on the balance sheet of the enterprise. However, assets that are leased under an operating lease agreement are excluded. This may mean two enterprises undertaking similar

activities using similar assets may show different productivity figures because one uses assets it owns and the other assets that it leases. An area for supplementary analysis is to consider compiling information on assets according to the using rather than the owning industry and to look at the implications for operating surplus and productivity of the use of leased rather than owned assets.

F. The consequences of financial distress

~~28.48~~28.51 Signs that a non-financial corporation is suffering financial distress include the level of profits that it has been generating recently and possibly the level of dividends it is able to offer. It is also probable that it suffers a cash flow problem and is unable to meet its liabilities on a timely basis. Competitors may take the opportunity to launch a takeover bid. However, if no takeover bid is offered the question here is how the corporation may survive at all.

~~28.49~~28.52 In a similar way, a financial corporation may suffer financial distress because it has difficulty in raising finance and is unable to service its liabilities. Again this is a circumstance in which a competitor may launch a takeover bid but this may not always be forthcoming.

~~28.50~~28.53 If the corporation, whether financial or non-financial, is deemed to be of national importance this may be an instance where government steps in and offers either to take over the corporation, in effect nationalizing it, or may offer a major capital injection in return for a degree of control, possibly full control, of the corporation. The recording of nationalization and capital injections by government as well as of the steps that may be taken under a bailout are discussed in chapter 30.

~~28.51~~28.54 Another possibility is that the government offers a guarantee to the creditors of the corporation in distress. 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. In most instances, the guarantor is deemed to make a capital transfer to the original debtor, unless the guarantor acquires an effective claim on the creditor, in which case it leads to the recognition of a financial asset (a liability of the debtor). The recording of guarantees including those offered by government is discussed in part B of chapter 25.

1. Bad debts

~~28.52~~28.55 All corporations, but especially financial corporations, may suffer from bad debts and this phenomenon may be particularly acute when other aspects of the economy also exert financial pressure on the corporation. Within the SNA, loans are always recorded as the amount that is due to be repaid to the creditor. In cases where the debtor has a bad credit rating this may overstate the market value of the loan. This is seldom done on a loan by loan basis but is regularly done for classes of loans.

~~28.53~~28.56 The SNA identifies a subset of bad debts as non- performing loans. As explained in paragraph 14.76, these are loans whose payments of interest or principal are past due by 90 days or more or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons (such as a debtor filing for bankruptcy) to doubt that payments will be made in full. The SNA recommends that memorandum items be compiled for the accounts showing the nominal and market value of bad loans and the implications for interest flows, the amount of interest accruing on the nominal value, the amount of interest outstanding from previous periods and the amount relating to the current period that is unpaid. The proposed memorandum items are discussed in paragraphs 14.77 to 14.78.

~~Elaborating the accounting for assets where the market value suddenly diverges from past trend values and the whole question of when it might be appropriate to define and use “fair values” is one item on the research agenda as explained in annex 4. In addition, circumstances emerging from the credit crisis that emerged in 2008 will continue to be monitored to see if other memorandum items or other steps should be recommended.~~

2. Debt rescheduling

~~28.54~~28.57 According to the accrual basis, repayments of debts are recorded when they are extinguished (such as when they are paid, or rescheduled, or forgiven by the creditor). When arrears occur, no transactions should be imputed, but the arrears should continue to be shown in the same instrument until the liability is extinguished. See paragraph 4.223 for more information.

G. Links to International Financial Reporting Standards (IFRS)

Commented [ED3]: This section has been redrafted in response to Recommendation 7 of Guidance Note AI.1: "When it comes to valuation of transactions and positions in the SNA and BPM, it is also recommended to provide more details on the relationship between the SNA and BPM on the one hand, and business and public sector accounting standards on the other."

~~28.55~~28.58 The *International Financial Reporting Standards* (IFRS are a comprehensive set of accounting standards designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities.

~~28.56~~28.59 There is a close relationship between the SNA and IFRS. They are both accrual-based accounting standards and have similar measures of revenues, expenditures, assets and liabilities and similar accounting concepts of control, economic substance, recognition, and valuation. Compilation of macroeconomic statistics in accordance with the guidelines of the SNA is facilitated by the adoption of IFRS by profit-oriented entities.

~~28.57~~28.60 The SNA and IFRS have different objectives. The objective of general purpose financial statements is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. The SNA is an integrated system of accounts covering the total economy and its five institutional sectors, two of which are the financial corporations and the non-financial corporations.

~~28.58~~28.61 This difference in objectives causes some differences in the information presented and in how accounting concepts are implemented. The main differences between IFRS and the SNA involve reporting entity, scope, consolidation, recognition of assets, recognition of liabilities, valuation, and the treatment of revaluations and other changes in volume. Table 28.1 summarizes the differences between SNA and IFRS.

Table 28.1. Comparison of SNA and IFRS

System of National Accounts	IFRS
Objective	
Allow users of macro-economic statistics to monitor and analyze the performance of the economy.	To provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.
Reporting entity	
Institutional units and sectors: The statistical reporting unit is an institutional unit, defined as an entity that is capable, in its own right, of owning assets, incurring liabilities, and engaging in economic activities in its own name. However, the primary focus is on groups of institutional units (sectors or subsectors).	An entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity.
Scope	
Total economy and the resident units comprised by its five institutional sectors. The general government sector includes government units at all levels of government, social security funds, and non-market producers controlled by government units.	Profit-oriented entities engaged in commercial, industrial, financial and similar activities, whether organized in corporate or in other forms.
Consolidation	
Flows between the units within a sector or subsector are generally not consolidated. Consolidated accounts are compiled for complementary or analytical presentations, including for the general	IFRS requires presentation of consolidated financial statements for the controlling entity. In this case, the reporting unit is the group, defined as the parent and its subsidiaries. Control is the main criterion that determines

System of National Accounts	IFRS
government sector.	consolidation.
Recognition of assets	
Based on economic ownership. The economic owner of a non-financial asset or financial asset is the institutional unit entitled to claim the benefits associated with the use of the asset by virtue of accepting the associated risks.	Based on control. Control of the resource entails the ability to use the economic resource and obtain the economic benefits that may flow from it.
Recognition of liabilities	
To maintain symmetric recording in the integrated framework of economic accounts, liabilities are only recognized when there is a recognizable corresponding claim of a counterparty. For example, provisions for one-off guarantees and bad debts are recognized in IPSAS but not in the main framework of economic accounts.	A liability is recognized whenever there is a present obligation of the entity to transfer economic resources as a result of past events. In IFRS, there is no need for a counterparty to recognize an asset for the reporting entity to recognize the liability.
Valuation	
Current market prices are used to value flows and stocks. Production cost, the market price of a similar item, the written-down current replacement cost or present value of future benefits may be used as alternative valuation methods if a market price is unavailable.	On initial recognition, IFRS requires measurement at transaction price. On subsequent measurement, historical cost, fair value, value in use, fulfilment value, or current cost can be used.
Revaluations and other volume changes	
Holding gains or losses are reported in the revaluation account, and changes in volume are reported and in the other changes in volume of assets and liabilities account.	Some gains or losses due to changes in prices or changes in volume of assets and liabilities are recognized in the Statement of Profit of Loss and some are recognized in the Statement Presenting Comprehensive Income.

28.5928.62 For multinational enterprises, the standard accounts may be available only for the group as a whole where relationships between enterprises in different countries have been consolidated. In this case, national accountants would need to consult other sources for the required non-consolidated data.

28.6028.63 Three particular areas where the IFRS adopts approaches somewhat different from the SNA are in the area of the recognition of holding gains and losses as income, in the recording of provisions and contingent liabilities, and in recording operating leases for lessees (where the IFRS has a treatment that is inconsistent between lessors and lessees). As discussed in paragraph 14.114, certain types of provisions should be recorded as supplementary items in SNA balance sheets. For operating leases with a term of more than 12 months, the IFRS requires the lessee to recognize an asset and associated liabilities, even though those assets and liabilities are also recognized by the lessor. The SNA treatment of operating leases is based on the concept of economic ownership and treats operating leases, regardless of duration, as not involving a change of economic ownership (see section B of chapter 27).

28.6128.64 In addition to the IFRS for private corporations, the International Public Sector Accounting Standards (IPSAS) perform a similar function for government bodies. There is a discussion of the IPSAS in chapter 30.

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