EUROPEAN CENTRAL BANK

EUROSYSTEM

Comments on draft SNA chapter:

Chapter 3: Flows, stocks and accounting rules

Deadline for comments: 30 September 2007

Send comments to: sna@un.org

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This three-part template allows you to record your comments on draft chapter 3 easily and, at the same time, makes it easy for us to use your comments in considering revisions to the draft chapter. You may complete any one, any two, or all of the three parts of the template.

Especially when providing comments in Part III of the template, you are encouraged to focus on the new passages of the draft text. To facilitate this process, a file comparing the existing text and the draft text is available on the website under the following link: http://unstats.un.org/unsd/sna1993/projectmanagement/drafts/Chapter3dv2cdv0.pdf

Save this template and send it as an attachment to the following e-mail address: sna@un.org

Part I: General comments

In the space below, please provide any general comments, such as about the clarity with which the new recommendations were incorporated (30 words or less).

Comment:

Chapter 3 deals with some basics of national accounts: Stocks, flows and accounting rules. Not many comments are provided on the essentially unchanged section C (compared to the 1993 SNA) and on section E (which is in many parts identical to the corresponding text of the current draft BPM6). However, there are still open questions concerning the treatment of an economic asset, its borderlines as well as the concepts of benefits and of legal and economic ownership. Some comments refer to the asset/liability boundary.

Part II: Comments on specific draft paragraphs or passages

In your review of draft chapter 3, you may wish to devote particular attention to the passages listed below. For ease of reference, we have identified the relevant paragraphs. For each passage, a Word table is provided for you to use in making your comments. There is a row for general comments at the top of the table. Thereafter please use a separate row for each paragraph on which you wish to make detailed comments.

Definition of an asset

Questions about the adequacy of the *1993 SNA* definition of an economic asset led to the issue being among the forty-four considered during the Update. An AEG meeting concluded that the 1993 definition did not adequately cover risk, demonstrable value and constructive obligations.

1. Section B, about stocks, opens with a new and fuller definition of an asset than appeared in the *1993 SNA*. Paragraphs 3.18 – 3.28 describe the concepts of benefits and of legal and economic ownership, and then paragraphs 3.29 - 3.30 present the new definition. Are these paragraphs clear?

General comments	According to our understanding the treatment of constructive liabilities (obligations) was already solved in the context of the pension compromise not to include them into the asset boundary. The ECB would question whether it is necessary to introduce the concept of financial claims. If really needed, what is the link between claims and assets/liabilities? It would be worthwhile to discuss the relationship between liabilities, provisions and contingencies here. The introduction of the concept of benefits is important. As it overlaps with terms like social benefits its definition needs to be more elaborated. Currently, the definition is rather abstract and not very clear. Especially, the wording "*means of acquiring*" creates difficulties in understanding. Some clarifications may be included also in paragraph 3.19. Furthermore, the term "benefits" is used throughout the chapter with attributes like 'future', 'contingent', 'enhanced', 'assistance' or 'associated' which are not explained at all. This also applies to the combination of benefits and risks (it is more convenient to combine cost/benefit.). The treatment of risks seems to be rather short-cut as it refers only to two types of risk, related to production and to the process of transferring benefits between time periods. Finally, the concepts of aggregation, netting and consolidation should be better explained.

* Insert rows in this Word table for each paragraph on which you wish to comment.

Accounting rules: additions from *BPM6*

Section E presents the accounting rules of the System. Text from the draft *BPM6* has been added to the text from the *1993 SNA* in several places. These additions help implement the agreement to align the two manuals where appropriate. Of several additions (see file comparing the 1993 text with the present draft, where they are apparent), two in particular may be of interest.

2. Paragraphs 3.106 – 3.111 discuss quadruple entry accounting. Are these paragraphs clear and appropriate to the SNA?

General comment	These paragraphs are very useful. However, it seems to be more appropriate to start with the quadruple entry concept (as the standard in national accounts) and explain afterwards the vertical and the horizontal double-entry book-keeping (for balancing purposes).

* Insert rows in this Word table for each paragraph on which you wish to comment.

3. Paragraphs 3.113 – 3.128 are about valuation of transactions. In particular, paragraphs 3.113-3.114 explain how “market prices” should be interpreted. Are the paragraphs clear and appropriate for the SNA?

General comment	See other comments.

* Insert rows in this Word table for each paragraph on which you wish to comment.

<u>Discounted present value of expected future returns</u>

Section E.2 discusses valuation, beginning with the relatively straight-forward cases when actual exchange values represent market prices and then moving to the more difficult cases, including those where market-price equivalents must be used.

4. Paragraph 3.126 notes, as did the *1993 SNA*, that when none of several methods to represent market-price equivalents can be applied, flows and stocks can be recorded at the discounted present value of expected future returns. Does the description of this method strike an appropriate tone given the greater use and acceptance of this method since the *1993 SNA*?

General comment	We welcome the description of the various valuation concepts It would be useful to show the relationships between the different valuations rules. The net present value method (for instance used to estimate actuarials or to value unquoted shares and other equity) is seen as a valid method to value stocks (not flows).

Part III. Other specific comments

You are welcome to make other comments. Please do so by using Adobe Acrobat Version 6 or 7 to comment directly on the PDF of the draft chapter.

General comments	Various issues are not mentioned in the text: • Transactor principle versus debtor/creditor principle A financial asset held by one sector is clearly the liability of another sector without any conceptual ambiguity. But it is not as clear in the case of financial transactions, since there are two different notions of counterpart: the transactor and the debtor/creditor. Take the case of a government debt security sold by a depository corporation and bought by an insurance corporation. a) The "transactor principle" records a single transaction in debt securities between the insurance corporation sub-sector and the depository corporation sub-sector sector. b) The "debtor-creditor principle" records two financial links: an acquisition by the insurance corporation sub-sector of a debt security "issued" by government, and a redemption of an identical government debt security "repaid" to the depository corporation sub-sector. Because the financial account presents the net incurrence of liabilities (gross issues minus redemptions) and the net acquisition of financial assets (gross acquisitions minus sales), the financial account of government (without counterpart sector information) would not show anything, while in a from-whom-to-whom presentation two elements of information would be shown. The debtor-creditor principle is generally more useful because analysts are interested in the nature of the instruments bought rather than from whom they are bought, and because it is consistent with the method for balance sheets. In addition, the intervention of brokers and centralised clearing systems often makes it difficult to identify the actual transactors. • Two types of financial transactions Financial transactions consist of two types. The first involves only two units. Thus only two units are involved when the instrument exchanged is the liability of one of the two units: a transaction then involves either a creation or redemption of an instrument. This applies typically when there is no secondary market, and when an instrument is issued or redeemed. When there is a secondary market three units may be involved: the two units exchanging an asset, and the unit whose liability it is. • Ownership of own financial assets When an institutional unit purchases debt securities issued by itself the financial account does not generally record the transaction or the position in a consolidated or in a non-consolidated presentation. Such financial assets are not viewed as "consolidated" but as "non-registered". Not recording the ownership of financial assets issued by the same unit can also be thought of as "netting". This is similar to the treatment of non-financial transactions. Such transactions within units are not recorded, except in some exceptional cases such as the recording of output for own final use (*P.12*) and capital consumption (*K.1*) because the uses and resources appear in different accounts. Some financial accountants might prefer a "gross approach" and keep the instrument on both, the asset side and the liability side to follow the legal presentation (voting rights, actual payments of coupons, dividends, etc.) or to preserve the link with market statistics. In the "net approach" the purchase by a unit of its own debt is recorded as redemption of debt rather than an acquisition of consolidating assets. By contrast, the

	gross approach records it as an acquisition of consolidating assets.
3.2	Drop “and related tables” in the second sentence and “and tables” in the third sentence. “current account” and “accumulation account” in the fourth sentence.
3.4	First sentence: “at the beginning and <u>the</u> end …”
3.5 and 3.6	First sentence: “a store of <u>economic</u> value …” and “Economic values …”
3.6	First sentence: drop ‘and liabilities.” A second sentence should be included as follows: “Only financial assets have liabilities as counterparts – with the exception of gold bullion.
3.7	Last sentence: Instead of ‘capital flows’ ‘capital transfers.’
3.8	Third sentence: “The value of an asset <u>or of a liability</u> may be …”
3.10	First sentence: “Economic flows <u>as outflows or inflows</u> are …” Second sentence: “A balancing item is an accounting <u>item</u> …” Last sentence: “is <u>defined</u> as net worth.”
3.11	First sentence: “Balancing items are <u>compiled</u> because …”
3.13	Last sentence: “The classification <u>of accumulation entries and</u> of stocks …”
3.15	The term ‘money’ might be misleading. National currency?
3.16	Last word: Drop “table.”
3.17	First sentence: Reference should be made to Section E.1. c) “… in the classifications of transactions, other flows and <u>stocks</u> and …” d) “… a distinction <u>is</u> made between resources and uses, or between <u>changes in assets and in liabilities for flows and between assets and liabilities for stocks</u>.” Last sentence: Why here? This short sentence creates misunderstandings. Should be dropped.
3.19	Last sentence: Instead of ‘financial liabilities’, ‘liabilities.’ Also in following paragraphs.
3.20/3.25	The concepts of “legal ownership” and “economic ownership” should be elaborated in more for better understanding. We suggest providing some examples. Additionally, it is not clear why the definition of the economic owner included in paragraph 3.25 refers to “(…) benefits associated with the *use* of entity in the course of economic activity (…)” while in the definition of an asset in paragraphs 3.5 (and 3.29) we read “An asset is a store of value representing a benefit or a series of benefits accruing to the *economic owner* by *holding* or *using* the entity (...)”. We would like also to point out that it is not clearly expressed what should be understood under the term “ownership” used in other paragraphs - legal or economic - as these two concepts have been introduced. According to the AEG decision the concept of economic ownership should be used in the new SNA. It seems to us that this approach is reflected in the definition of an asset, where an economic owner is referred to, and this definition could be treated as an indication that the economic ownership should be applied, but, on the other hand, it is said for non-financial assets (in paragraph 3.157) that “the accrual principle usually comes down to recording at the moment when the *legal* ownership of those assets changes hands”.

3.24	What does the last sentence mean?
3.29	Second sentence: This definition is in contradiction to paragraph 3.19 in which only financial assets and liabilities are seen as means to transfer values. Include: "store of <u>economic</u> value."
3.30	Do we need the first sentence? One would argue that (in the System) an asset is always an economic asset because it is a store of economic value.
3.31ff	We have some doubts whether the concept of a 'financial claim' is useful to introduce (as it is not use anymore).
3.33	As described above constructive liabilities should not be treated as liabilities in the System.
3.35	Why shares are separately treated and not equity as a whole? Would it not make more sense to introduce own funds as discussed during the recent AEG meeting and distinguish between debt and equity?
3.38	Supplement the second sentence: "The first level of classification of assets – produced non-financial assets, non-produced non-financial assets and financial assets - …"
3.39 and 3.40	The sentence: "Similar arguments apply to artefacts treated as valuables" is difficult to understand. The same applies to the third sentence of 3.40. The last world in 3.40. "sale" should be substituted by "transaction."
3.42	Last sentence: Drop "into the totals of the table" and substitute it by "as produced non-financial assets."
3.44	Which "some environmental assets" are meant? Could example be included?
3.45	As explained above, the concepts of constructive liabilities, contingent liabilities and provisions have to be defined and explained here.
3.46	One-off guarantees are seen as assets under specific conditions as described in the section on guarantees.
3.48	Because of the importance of revaluations it might be considered to distinguish three types of economic flows – transactions, revaluations and other changes in the volume of assets. Drop: "tables" in the third sentence.
3.49	This paragraph is a repetition of 3.8. The same applies to 3.93 and to 3.101 (the latter a repetition of 3.10). References would be sufficient.
3.50	The terms 'monetary transactions' and 'non-monetary transactions' were already be used in the 1993 SNA. However, it should be considered to use another terminology because the 'monetary transactions' is misleading and has a different meaning in the context of monetary analysis (may be, transactions in monetary terms).
3.55	The subtitle 'Transactions with and without counterparts' is misleading. All transactions described in this sub-section are with counterparts.
3.59	In the second sentence, are the terms 'actual transactions' and 'observed transactions' really used in national accounts?
3.63	First sentence: 'insurance corporations' instead of 'insurance funds' or 'insurance

	enterprises'.
3.99	Holding gains are also defined for liabilities as explained later in the chapter.
3.76 to 3.78	On transfers in kind, the text distinguishes between transactions in kind and transfers in kind. Transactions in kind are recorded 'as if they are transfers in cash followed by the expenditure by the recipient on the product concerned'. It is not clear from the text - certainly not from the examples given - in what respect transfers in kind are different. Or, are only social transfers in kind different, because they are recorded as an implicit transfer of income? More clarity should be provided.
3.100	It would be useful to refer here to the option to derive asset price 'indices' (for financial asset and liability categories and also by institutional sector) by accumulating nominal holding gains or losses.
3.106	The quadruple-entry accounting principle as one of the basic principles of national accounts should be introduced first. Afterwards, the vertical and horizontal double-entry principles should be explained.
3.109	Another example could be included, e.g. the identity of the net issuance and net acquisition of debt securities.
3.112	It is unclear what 'the provision of capital' means.
3.126	Last sentence: 'non-financial assets' should be substituted by 'non-financial assets and also some types of financial assets.'
3.127	On the conversion into national currency, the second part of the paragraph repeats - in more or less the same wording - what is stated in the first part. From the fourth sentence: 'The exchange value should then be converted to national currency at the midpoint rate (the same is stated in the second sentence) prevailing at the time the transaction takes place (the same is stated in the first sentence)'. What is the additional meaning of the fourth sentence?
3.139	Last sentence: 'financial corporations' instead of 'financial enterprises.'
3.142	As the 'value' of other changes in the volume of assets is derived from the value of stocks the paragraph deals with a tautology.
3.145ff	The first sentence should read: '… that holding gains in <u>a financial asset</u> are matched by holding losses in the <u>corresponding liability</u> …'
3.150	Various types of valuation rules are described here. Reference could be made to the External Debt Guide in which the various valuation concepts are defined and explained.
3.160	First sentence: "government expenditure" instead of "public spending." Second sentence: The second sentence is difficult to understand as financial transactions are often the 'result' of non-financial transactions. "Financial assets" instead of "financial claims."
3.161	The discussion of the 'float' should go into a Handbook.
3.163	We would recommend using the term 'financial asset' or 'financial asset category' instead of 'financial instrument.' Last sentence: It is not always obvious to treat such events as transactions. This issue needs more elaboration.

3.168	The abbreviation FISIM should be used. Last sentence: By definition there are no timing issues to be tackled concerning balancing items.
3.169	The issues described in this paragraph refer mainly to mismatches to due the statistical sources used for compiling national accounts. Therefore, it might be more appropriate to discuss this in a Handbook.
3.171	We would like to express our reservation whether wording "it *effectively* holds" should be maintained in the new SNA.
3.172	The last sentence is rather unclear. It should be dropped or modified.
3.176	Use 'generally', instead of 'fundamentally.'
3.180ff	At least to types of netting should be distinguished: (i) netting by taking the difference between (gross) acquisition and sale or between issuance and redemption (net acquisition of financial assets and net incurrence of liabilities) and (ii) netting by taking the difference between corresponding financial assets and liabilities. The text in the corresponding paragraphs (3.180 to 3.183) is not very clear on this. Furthermore, the exceptions mentioned in 3.182 should be listed. Finally, the introduction of the credit and debit notion seems to be not necessary as it is not used anymore in the System. Netting has various meanings. • Financial transactions are recorded net in the sense that, for example, transactions in liabilities show gross issues minus gross redemptions. (Information on gross issues are often available, for instance if data are collected by a security-by-security database). Otherwise, non-financial transactions are recorded gross, except for transactions related to the acquisition of capital assets. • Financial accounts are presented net across instruments with different characteristics and with different debtors/creditors, provided they are within the same asset category. For example, when recording transactions in financial assets, the sale of a long-term debt security is netted off the purchase of long-term debt securities even though the debt securities sold might have slightly different characteristics and different debtors from the debt securities purchased. However, from-whom-to-whom financial accounts re-establish gross recording when the sector of the debtor is different. • "Net recording" versus "gross recording" relates also to the treatment of ownership of own instruments. • Entries in non-financial accounts such as the balancing items are also referred to as being recorded "gross" or "net" (e.g. *B.1g* and *B.1n*, which are GDP and NDP), but this generally refers to the adjustment for consumption of fixed capital. An exception to this is net lending/ net borrowing where the netting refers to the net impact of transactions in financial assets and liabilities or of the transactions recorded in the capital account.
3.184ff	The section on consolidation is rather short and should be extended. By consolidating flows or stocks there is a loss of information. Consolidation involves consolidation of two types: where transactors are both in the same sector or sub-sector; and where the units holding the asset and the liability are both in the same sector or sub-sector.

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