

**Seventeenth Meeting of the
IMF Committee on Balance of Payments Statistics
Pretoria, October 26–29, 2004**

Application of Accrual Principles to Debt Arrears

**Prepared by the Statistics Department
International Monetary Fund**

The views expressed in this paper are those of the author and should not be attributed to the International Monetary Fund, its Executive Board, or its management.

BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTEG)

OUTCOME PAPER (BOPTEG) # 3

JUNE 2004

(1) Topic: **Application of Accrual Principles to Debt Arrears**

(2) Issues – see BOPTEG Issues Paper #3

(3) Recommendations:

(i) The group agreed unanimously to harmonize the time of recording, and treatment of, arrears in various macroeconomic statistics.

(ii) The group unanimously recommended that 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.

(iii) If the terms and characteristics of financial instruments change when a liability goes into arrears, the majority of the group favored the treatment of this change as reclassification/other volume change but several supported its treatment as a transaction.

(iv) The group reinforced the view that data on arrears are important. There was a general consensus that data on arrears should be presented as memorandum or supplementary items rather than as subheadings under relevant instruments of the international investment position. Although it is useful to identify some commonly important arrears (such as arrears on public and publicly guaranteed debt), most members favored flexibility in determining which items of arrears are important to disseminate depending on each country's circumstances.

(v) The group noted that, in the accrual system, the accrual of interest is a separate event from payments and both are recorded. The arrears refer to payment arrears. The payments could be related to interest and/or principal. The group suggested that appropriate and consistent terminologies be used in drafting the manual.

(vi) The group raised questions on how the recommended treatment impacts on the analytic presentation of balance of payments, in which certain arrears are recorded presently as exceptional financing transactions. The group indicated that the new manual should address this issue.

(4) Rejected Alternatives:

The group rejected the imputation to account for the liability being repaid and its replacement by a new short-term debt (representing the arrears) when a liability goes into arrears.

(5) Questions for the Committee:

- (i) *Does the Committee agree that the time of recording and treatment of arrears be harmonized in various macroeconomic statistics? See 3(i) above.*
- (ii) *Does the Committee agree with the recommendation that no transactions should be imputed when a liability goes into arrears? See 3(ii) above.*
- (iii) *Which of the two alternative treatments -- transactions or reclassification/other changes -- is appropriate if the terms and characteristics of financial instruments change when a liability goes into arrears? See 3(iii) above.*
- (iv) *Is there a need for some guidelines for presenting data on arrears as supplementary items, where relevant, based on a country's circumstances? Or could it be left entirely to the compilers? See 3(iv) above.*
- (v) *Does the Committee have views on what constitute commonly important arrears (such as, arrears on public and publicly guaranteed debt) that could be presented as memorandum items? See 3(iv) above.*

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS
BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTTEG)

ISSUES PAPER (BOPTTEG) # 3

APPLICATION OF ACCRUAL PRINCIPLES TO DEBT ARREARS

Prepared by Manik Shrestha, IMF Statistics Department

April 2004

BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP

ISSUES PAPER (BOPTTEG) # 3

APPLICATION OF ACCRUAL PRINCIPLES TO DEBT ARREARS

Debt arrears occur when scheduled payments (repayment of principal or coupons) are not made by their due-for-payment date. The current statistical manuals seem to follow two separate bases for time of recording for repayments of debts.

I. Current international standards for the statistical treatment of the issue

In general, all macroeconomic statistics use the accrual basis for determining time of recording. However, the treatment differs for arrears. The *External Debt Statistics: Guide for Compilers and Users (External Debt Guide)* defines arrears as amounts that are past due-for-payment and unpaid (paras. 3.36, 3.37).

The time of recording basis followed in the *BPM5* (paras. 123, 528), *External Debt Guide* (paras. 2.29, 3.36), and *Government Finance Statistics Manual 2001 (GFSM 2001)*; para. 9.19) is that when a debt liability goes into arrears, transactions are imputed as if the repayment of debt liability had been made and a new short-term liability created. This time of recording basis conforms with the due-for-payment basis as repayments are recorded at the time they are due.

The treatment followed, in principle, in the *1993 SNA* (paras. 3.94 and 11.101) and *Monetary and Financial Statistics Manual (MFSM 2000)*; paras. 225, 238) is that repayments of debts are recorded when they are extinguished (such as when they are paid, or rescheduled, or forgiven by the creditor). This time of recording basis conforms with the accrual basis. Under this approach, arrears will continue to be shown in the same instrument until the liability is extinguished. When a liability goes into arrears, the terms and characteristics of the entire liability or only the portion in arrears may change. If the terms and conditions change with respect to any part of the liability, that part is to be treated as a separate instrument. However, the *1993 SNA* does not discuss this issue specifically (for example, whether to treat such events as transactions similar to debt reorganizations or as other changes due to reclassification of instruments).

Amounts rescheduled or forgiven by the creditors are treated the same way by both approaches.

The existing statistical manuals also emphasize the usefulness of data on arrears for various types of policy analysis and solvency assessments.

- The *External Debt Guide* (para. 4.4) explicitly distinguishes arrears under other debt liabilities and intercompany lending.

- The *GFSM 2001* (para. 7.144) suggests that each classification be divided into the amount not in arrears and the amount in arrears as well as that total amounts in arrears be shown as a memorandum item.
- The *BPM5* table on Selected Supplementary Information (Table 8) includes various categories of arrears on exceptional financing that are needed to derive an analytic presentation, as published in the IMF's *International Financial Statistics (IFS)*. It does not discuss arrears in cases other than exceptional financing.
- The *MFSM 2000* (para. 239) requires that data on interest arrears be presented as a memorandum items in sectoral balance sheets.
- The *1993 SNA* (para. 11.101) also notes that it may be useful to group all arrears of interest and repayment under a memorandum item.

II. Concerns/shortcomings of the current treatment

The existing international statistical manuals seem to follow different treatment of arrears. While *BPM5*, *GFSM 2001*, and the *External Debt Guide* record transactions when arrears arise, the *1993 SNA* and *MFSM 2000* record transactions only when the liability is extinguished. The time of recording for debt arrears could be harmonized in various macroeconomic statistics.

Under the *BPM5* approach, all arrears are classified under short-term liabilities. This has the consequence that arrears are no more linked to associated instruments, rather they are treated as separate financial instruments. This requires separate recording of arrears in statistical systems. However, the *GFSM 2001* (para. 3.49) notes that arrears arising from failure to repay debt obligations as scheduled will not be apparent without supplemental information in the due-for-payment recording basis. Further, to derive an analytic presentation, as published in the IMF's *IFS*, separate identification is needed of various categories of arrears on exceptional financing (as in the *BPM5* Table 8). The imputation of transactions also gives the impression that the debtor has made the repayment and obtained a new source of financing.

The *1993 SNA* approach does not record arrears as transactions. It distinguishes arrears between those where terms and conditions change and those that do not. For the latter, to identify amounts of arrears included in the stock of each instrument, either a separate sub-heading would be needed for each instrument having arrears or arrears would need to be shown as memorandum items. Presentation of arrears as a separate subheading under each instrument, when terms and conditions do not change, has the advantage that arrears are linked to associated instruments. For countries that do not compile international investment position statistics, separate information on various categories of arrears on exceptional financing would be needed if an analytic presentation of balance of payments is to be derived.

Under the *1993 SNA* approach, the existing guidelines are not clear as to the treatment of arrears if the terms and characteristics of financial instruments change when a liability goes into arrears (as transactions or changes in classification).

A related issue is the treatment of non-performing loans. Generally, loans are defined as non-performing when payments are overdue by more than a specified time period. In that sense, all non-performing loans include arrears (unless they are written off). Under the *BPM5* approach, non-performing loans would not include arrears because a new liability is created when arrears arise. Valuation and other issues related to non-performing loans will be dealt with in a separate issues paper.

III. Possible alternative treatments

Two possible alternative treatments are presented in the *Annotated Outline* (para. 3.11) for recording of arrears that do not change the terms and conditions of the instrument. They are:

- (1) imputation of transactions that the liability had been repaid and then replaced by a new short-term debt (representing the arrears), or
- (2) no imputation of transactions but continuing to show arrears in the same instrument until the liability is extinguished, but either requiring arrears to be shown in the balance sheets as a sub-group under relevant instrument or to be shown as memorandum or supplementary items¹.

If the terms and characteristics of financial instruments change when a liability goes into arrears, the *1993 SNA* approach could be clarified as to whether the change in characteristics of financial instruments should be treated

- (1) as transactions (extinction of the old liability and creation of a new), or
- (2) as other changes in financial assets and liabilities due to reclassification of instruments.

IV. Points for discussion

- (1) *Do the BOPTEG members consider it essential that the time of recording for arrears be harmonized in various macroeconomic statistics?*
- (2) *Which of the two possible time of recording principles is appropriate for recording arrears and repayments of debts?*

¹ In the new Balance of Payments Manual, a distinction will be made between memorandum and supplementary items. Memorandum items are considered as a part of the standard components whereas supplementary items are raised as options that may be considered when a particular issue is of interest to analysts and policy makers.

- (3) *If the 1993 SNA approach is followed,*
- (a) *Should the data on arrears be presented as subheadings or memorandum items?*
 - (b) *Are data needed on all arrears or on selected arrears?*
 - (c) *If data are needed only for selected items, which arrears are needed (for example, arrears on public and publicly guaranteed debt, technical arrears (External Debt Guide para. 3.37), etc.)?*
 - (d) *Which of the two alternative treatments -- transactions or reclassification/other changes -- is appropriate if the terms and characteristics of financial instruments change when a liability goes into arrears?*

References

Annotated Outline for the Revision of BPM5, IMF, April 2004 (Chapter 3).

1993 SNA (paras. 3.94, 11.101).

BPM5 (paras. 123, 528, Table 8).

Government Finance Statistics Manual 2001 (paras. 3.49, 7.144, 9.19).

Monetary and Financial Statistics Manual 2000 (paras. 225, 238, 2239).

External Debt Statistics: Guide for Compilers and Users (paras. 2.29, 3.36, 3.37, 4.4).