



# Thirty-Fifth Meeting of the IMF Committee on Balance of Payments Statistics

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For discussion

## **C.8 Recording Penalties and Fines: Outcome of the Public Consultation**

Prepared by the Current Account Task Team (CATT)

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## C.8 Recording Penalties and Fines: Outcome of the Public Consultation

*Overall, the outcomes of the public consultation showed a strong agreement with the proposed clarification to distinguish payments for compensation to be recorded under current or capital transfers. Most participants welcomed the suggested time of recording and agreed that fines and penalties should impact earnings of direct investment enterprises, and that fines and penalties in mergers and acquisitions contracts should be recorded under direct or portfolio investment and not under current transfers. A more detailed summary of results is presented below.*

### DEFINITION OF FINES AND PENALTIES

- 1. Definition: Do you agree with the proposal to define fines and penalties transactions as “punitive in nature” to help distinguish these payments from payments of compensation, which are intended to compensate for injury or damages?**

The majority of respondents agreed with the proposed definition of fines and penalties as a way to separate these transactions from payments of compensation. From a practical perspective, some participants raised the issue of difficulties in distinguishing the punitive nature between fines and penalties, and compensations for damage. Others felt that even from a conceptual angle, the proposed demarcation is not clear enough and suggested better guidance and more transparent rules for compilers are needed in order to distinguish between fines and penalties and payments for compensation because of the interrelated nature of these two transactions. It was also suggested that examples be provided to compilers in the Compilation Guide.

### DEFINITION OF TRANSACTIONS RELEVANT FOR CAPITAL ACCOUNT

- 2. Do you agree with the proposed revision to clarify the economic meaning of “major compensation payments for extensive damages” and their recording as capital transfers?**

Almost all reviewers were in favor of the proposed revision to clarify the economic meaning of major compensation payments for extensive damages, which would help compilers identify which transactions should be recorded under capital transfers. Some respondents mentioned that it may also depend on the size of a country whether a compensation payment is considered as a major one and, bilateral discrepancies may still arise due to different interpretations. Alignment with System of National Accounts, Balance of Payments Statistics Manual, and Government Finance Statistics Manual were noted as important, as well more and clearer guidance is needed to avoid any misunderstandings.

### TIME OF RECORDING

- 3. Time of recording: Do you agree that (a) fines and penalties should not be recorded until the unit issuing the fine has an unconditional claim to the funds, and (b) an unconditional claim only exists once all likely appeals have been exhausted?**

There was unanimous agreement that fines and penalties should be recorded only when an unconditional claim on the funds is established by the issuing unit because if a fine or a penalty may still be appealed, the actual payment is unsure. Additionally, a clear majority of reviewers were also supporting the proposal that under an unconditional claim all possible appeals have been exhausted. However, some reviewers also noted that in practice, appeals can be lengthy and decisions by courts may be difficult to follow for

compilers and a correct recording could therefore be challenging. A close cooperation with government finance statistics (GFS) is needed to achieve a harmonized recording in balance of payments statistics and GFS. A participant of the public consultation that was against the proposal argued that the time of recording should actually be aligned with financial statements of the reporting of enterprises.

#### IMPACT OF FINES AND PENALTIES ON DIES AND RIES

##### **4. Do you agree that fines and penalties involving direct investment enterprises (DIE) should impact their reinvested earnings and therefore be recorded in the primary income account?**

Most respondents (82 percent) agreed with the proposal that fines and penalties should have an impact on earnings of DIE (a cost) whenever this amount has to be paid by the DIE. Therefore, it will be necessary to also update the direct investment sections of the *BPM6* to mention that fines and penalties can influence profits of DIEs. Reviewers that were against this suggested recording argued that fines and penalties are non-recurring expenses that should be excluded from the definition of Current Operating Performance Concept (COPC); these expenses should not be recorded in the primary income account as they may have large impacts on the Gross National Income (GNI).

#### TREATMENT OF FINES AND PENALTIES IN MERGERS AND ACQUISITIONS (M&A) CONTRACTS

##### **5. Do you agree to record fines and penalties in M&A contracts related to the value of the enterprise under direct or portfolio investment, and not as transfer payments?**

Almost all reviewers supported the proposal to record fines and penalties in M&A contracts under direct or portfolio investment and not as current transfers because the market value of the acquired enterprise can be affected. One reviewer suggested that Direct Investment Task Team (DITT) should be consulted. As a reminder, DITT largely agreed with the proposal as long as these sanctions were part of the M&A contract. Practical difficulties in distinguishing these transactions could exist. One participant mentioned that the pros and cons of the proposal are however not clearly stated in the Guidance Note and more extensive description is desirable, including attention for the conceptual link with conditional assets.

#### ADDITIONAL COMMENTS

##### **6. Do you have any other comments/suggestions on the Guidance Note (GN)?**

The following additional issues were raised by respondents:

- The GN should provide additional practical information and insight regarding the time of recording for fines and penalties in enterprises' financial statements.
- The authors of the GN should pay additional attention to paragraph 9.49 in the *GFSM 2014*. Under this paragraph, accumulated losses are defined as "payments by the government to non-governmental corporations for accumulated losses" and should be aware that there is no reference in *GFSM 2014* to government receipts for accumulated losses as major compensation payments. The authors may also consider mentioning "loss of life" in the GN explicitly because often loss of life is addressed in fine or penalty situations and is an integral part for defining the value of the payment. This additional guidance would eliminate confusion for compilers.

- The definition for major payments for compensation that have to be recorded under capital transfers is still not clear. The suggested expression in the GN, "the payment intended to recover losses incurred over a multi-year period or to the replacement of an asset" needs some further explanation. Some practical cases could be provided for example, to express in more detail what kind of transaction have to be included in the capital account. This would be helpful for compilers for putting this recommendation into practice.
- For the impact of paid fines and penalties on income of DIE and the recording of transactions between related enterprises, there is actually no need for additional clarifications in the updated *BPM6*. However, the non-availability of detailed information could be more challenging for a properly recording than lack of clarity in the manual.