



# Government Finance Statistics / IMF Statistics Department

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## The Balance Sheet

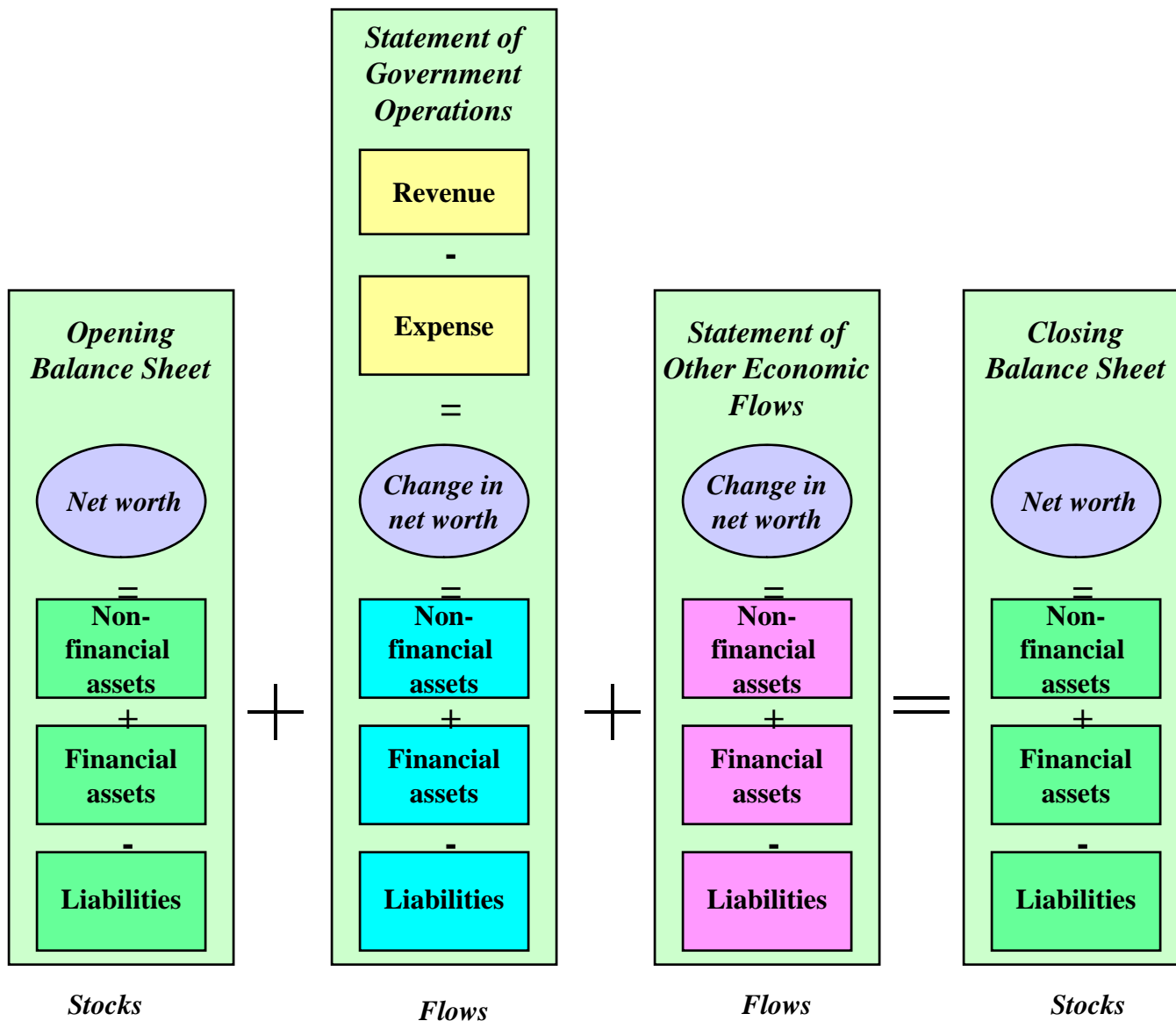
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# Contents of Lecture

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- **What is a balance sheet?**
- **Definition of assets and liabilities**
- **Valuation of assets and liabilities**
- **Main types of assets**
- **Definitions and classifications of nonfinancial assets, financial assets, and liabilities**
- **Memorandum items to balance sheet**
- **Supplementary cross-classification of financial claims by sector**

# GFSM 2001 Analytic Framework



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# What is a Balance Sheet?

(1/2)

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- **A balance sheet, or compilation of stocks, is a statement of the values of assets owned at a specific time and the financial claims (liabilities) held by other units against the owner of those assets**
- **Total assets minus total liabilities = net worth**
  - **Indicator of wealth**
  - **Net worth can also be viewed as the accumulation of transactions and other economic flows of all previous periods**

# What is a Balance Sheet?

(2/2)

<b>Assets</b>	<b>Opening balance sheet</b>	<b>Closing balance sheet</b>	<b>Liabilities and net worth</b>	<b>Opening balance sheet</b>	<b>Closing balance sheet</b>
<b>Non-financial assets</b>			<b>Liabilities</b>		
<b>Financial assets</b>			<b>Net worth</b>		
<b>Memorandum items</b>					

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# Definition of Assets and Liabilities

(1/4)

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- **An economic asset is an entity:**
  - Over which **ownership rights** are **enforced** by institutional units, individually or collectively;
  - From which **economic benefits** may be derived by its owner by holding it, or using it, over a period of time

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# Definition of Assets and Liabilities

(2/4)

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- **Ownership rights must be both **established** and **enforced**:**
  - **No/no => atmosphere and certain other naturally occurring assets**
  - **Yes/no => government-owned land that is so remote or inaccessible that the government cannot choose to enforce its ownership rights**
  - **Yes/yes => national parks**

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# Definition of Assets and Liabilities

(3/4)

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- **Economic assets must be able to provide economic benefits**
  - Benefits from **use of an asset**, such as land or machinery in production
  - **Property income**, e.g., interest, dividends, rents
  - Benefits by functioning as a **store of value** (holding gains and losses)

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# Definition of Assets and Liabilities

(4/4)

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- **Governments can create economic assets by:**
  - exercising their **sovereign power**, e.g., territorial sea, electromagnetic spectrum
- **Financial asset for one unit is liability for another unit (generally)**

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# Valuation of Assets and Liabilities

(1/4)

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- **Assets and liabilities on the balance sheet should be valued**
  - as if they were acquired / incurred on the date to which the balance sheet relates, taking into account age, condition, and other relevant factors
- **Thus: all assets and liabilities should be value at their **current market value****
  - For nonfinancial assets, the value **includes** all transport and installation charges, and all costs of ownership transfers
  - Values of financial assets **exclude** these costs

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# Valuation of Assets and Liabilities

(2/4)

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- **Different methods for valuation:**
  - **Market prices** (observable prices)
    - Investors, producers, consumers, creditor/debtor, etc.
    - Financial claims, real estate, transport equipment, crops, livestock, inventories, etc.
  - **Similar markets** (no observable prices – estimates)
    - Recent transactions (regularly, actively, and freely traded)
    - Similar assets (stock exchange, close substitutes)

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# Valuation of Assets and Liabilities

(3/4)

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- **Different methods for valuation (continued):**
  - **Perpetual inventory method** (written-down replacement cost)
    - Initial acquisition cost
    - Appropriate revaluation (price changes)
    - Allowance for consumption of fixed capital, amortization, or depletion
    - Many fixed assets, nonproduced intangible assets, such as patented entities

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# Valuation of Assets and Liabilities

## (4/4)

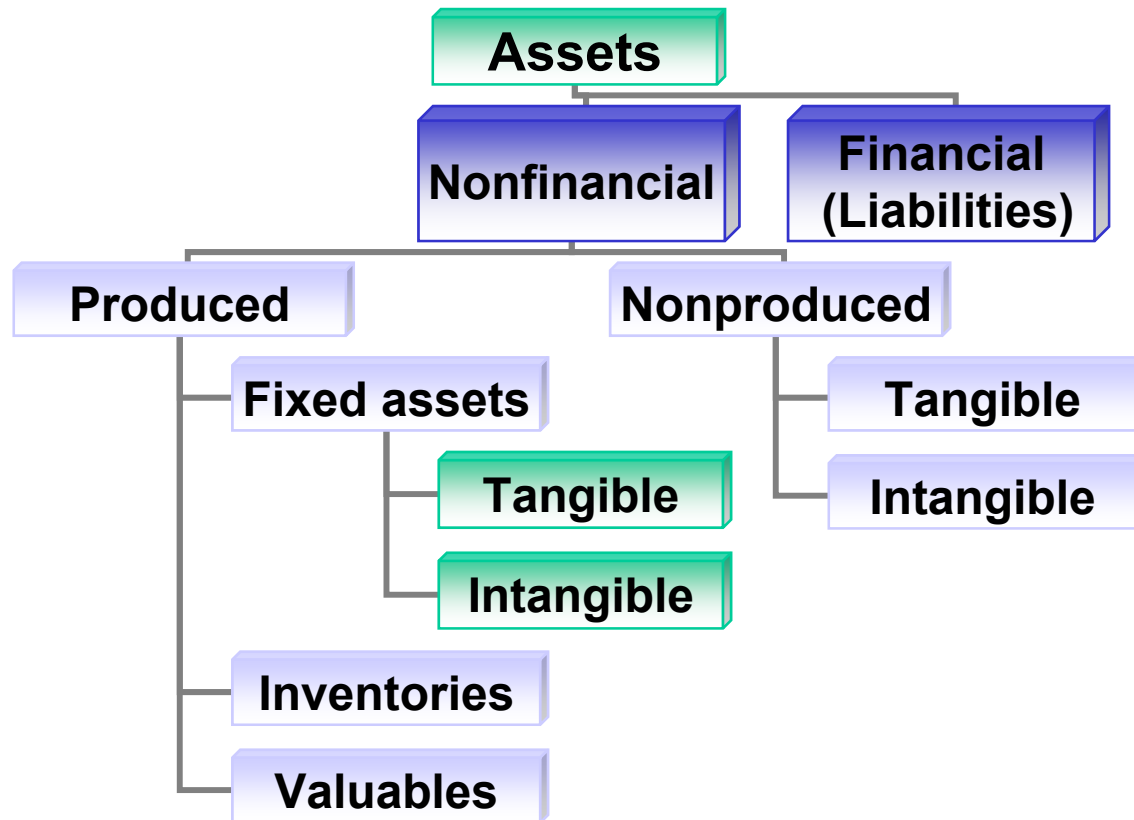
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- **Different methods for valuation (continued):**
  - **Present value method (PVM – discount rate)**
    - Present value of future economic benefits
    - Certain financial, natural (timber/subsoil) assets, and intangible assets
  - **Market exchange rate**
    - Convert into national currency at market exchange rate prevailing on date to which balance sheet relates
    - Mid-point between buying and selling spot rates

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# Main Types of Assets

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# Definition of Nonfinancial Assets

(1/2)

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- **Four main categories of NFAs**
  - **Fixed assets**
    - Produced assets that are used repeatedly or continuously in production processes for more than one year
  - **Inventories**
    - Goods and services held by producers for sale, use in production, other use at a later date

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# Definition of Nonfinancial Assets

(2/2)

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## – Valuables

- Produced goods of considerable value acquired and held primarily as **stores of value**
- Not used primarily for purposes of production or consumption
- Expected to appreciate (or not decline) in real value over time

## – Nonproduced assets

- Tangible naturally occurring assets **over which ownership rights can be enforced** (e.g., land, subsoil assets)
  - Intangible nonproduced assets (constructs of society by legal or accounting actions—patents, leases, etc.)
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# Classification of Nonfinancial Assets

## (2/2)

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### **61 Nonfinancial assets**

#### **611 Fixed assets**

6111 Buildings and structures

6112 Machinery and equipment

6113 Other fixed assets

#### **612 Inventories**

6121 Strategic stocks

6122 Other inventories

#### **613 Valuables**

#### **614 Nonproduced assets**

6141 Land

6142 Subsoil assets

6143 Other naturally occurring assets

6144 Intangible nonproduced assets

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# Definition of Financial Assets and Liabilities (1/3)

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- **Financial assets** consist of **financial claims**, monetary gold and SDRs allocated by IMF
- **Financial claims** are assets that entitle one unit, owner of asset, to receive one or more payments from a second unit (debtor) according to terms and conditions specified in the contract between the two units
  - **Financial claim** is an **asset** because it **provides economic benefit** to creditor by acting as **store of value** and earning **property income**

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# Definition of Financial Assets and Liabilities (2/3)

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- **Financial claims (continued):**
  - **Contractual relationship between two units**
  - **Creditor receives additional benefits in form of interest or other property income payments and/or holding gains**
- **Examples of financial instruments that are not assets**
  - **Contingencies**
  - **Conditional arrangements not binding on both parties (e.g., guarantees, lines of credit, etc.)**

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# Definition of Financial Assets and Liabilities (3/3)

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- When a financial claim (i.e., financial asset) is created, a **liability** of equal value is simultaneously incurred by the debtor
  - Liability (debtor) is counterpart of financial asset (creditor)
  - Exception is monetary gold and SDRs
- *Thus:* **Liabilities** are **obligations to provide economic benefits** to the units holding the corresponding financial claims

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# Classification of Financial Assets and Liabilities (1/2)

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- **Classification of financial assets and liabilities are based on**
  - **Liquidity and legal characteristics** of the instruments that describe underlying debtor-creditor relationship
    - No underlying debtor-creditor relationship for monetary gold and SDRs
    - Liquidity → negotiability, transferability, marketability
  - **Residence** of the other party to the instrument
    - Debtor residence for financial assets
    - Creditor residence for liabilities

# Classification of Financial Assets and Liabilities (2/2)

	FINANCIAL ASSETS (62)			LIABILITIES (63)	
	Domestic	Foreign	Monetary gold & SDRs	Domestic	Foreign
<b>Total</b>	<b>621</b>	<b>622</b>	<b>623</b>	<b>631</b>	<b>632</b>
• <b>Currency &amp; deposits</b>	<b>6212</b>	<b>6222</b>		<b>6312</b>	<b>6322</b>
• <b>Securities other than shares</b>	<b>6213</b>	<b>6223</b>		<b>6313</b>	<b>6232</b>
• <b>Loans</b>	<b>6214</b>	<b>6224</b>		<b>6314</b>	<b>6324</b>
• <b>Shares &amp; other equity</b>	<b>6215</b>	<b>6225</b>		<b>6315</b>	<b>6325</b>
• <b>Insurance technical reserves</b>	<b>6216</b>	<b>6226</b>		<b>6316</b>	<b>6326</b>
• <b>Financial derivatives</b>	<b>6217</b>	<b>6227</b>		<b>6317</b>	<b>6327</b>
• <b>Other accounts receivable/payable</b>	<b>6218</b>	<b>6228</b>		<b>6318</b>	<b>6328</b>

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# Memorandum Items to Balance Sheet

## (1/4)

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- **Provide supplemental information on items related to, but not in balance sheet**
  - **Debt**
    - Comprises all liabilities that require payment(s) of interest and/or principal by debtor to creditor at date(s) in the future
    - Nominal value (different from face value)
    - Market value
  - **Arrears**
    - Debt is in arrear when not liquidated by its due-for-payment date
    - Useful for policy analysis and solvency assessments

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# Memorandum Items to Balance Sheet

## (2/4)

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### – Obligations for social security benefits

- **GFS system does not recognize liability for government promises to pay social security benefits in future (e.g., retirement benefits, health care)**
- **Show as memorandum item:**
  - Present value of social security benefits that already have been earned according to existing laws/regulations, but are payable in the future
  - Calculated similar to liabilities for employer retirement scheme

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# Memorandum Items to Balance Sheet

## (3/4)

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### – **Contingent contracts**

- **Are contracts that create a conditional financial claim on a unit**
- **That is, claim only becomes effective if stipulated condition(s) arise**
- **Collectively, important for policy and analysis**
- **Can be potential assets or liabilities**
- **Examples:**
  - Government guarantees repayment of loan by another borrower (contingent liability)
  - Pending legal case in which government has claimed damages against another party (contingent asset)

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# Memorandum Items to Balance Sheet

## (4/4)

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### – Own-account capital formation

- Compensation of employees, use of goods & services, CFC, other taxes on production minus other subsidies on production

### – Uncapitalized military weapons and weapon-delivery systems

- Destructive weapons and vehicles, other equipment and structures that deliver such weapons are **not fixed assets**
- Useful to know their current market value for some analytic purposes
- Issue is under review

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# Supplemental Cross-classification of Financial Claims by Sector (1/2)

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- **To fully understand financial assets and liabilities of government sector**
  - Need to also look at sectors that have provided financing (not only type of instruments)
- **All financial claims are associated with two parties**
  - Can cross-classify instruments of financial claims with **sector of the second party**

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# Supplemental Cross-classification of Financial Claims by Sector (2/2)

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## SECTORS

### Domestic

- Other general govt units
- Central bank
- Other depository corporations
- Financial corporations n.e.c.
- Nonfinancial corporations
- Households and NPIs serving households

### Foreign

- International organizations
- General government
- Financial corporations other than international organizations
- Other nonresidents