Changeover to the accruals principle of accounting for interest income

The IMF Balance of Payments Manual[1] and the ECB Guideline[2] stipulate that interest earned on debt securities (bonds and notes as well as money market instruments) and other debt instruments should not be recorded in the current account only at the time of payment, but should be distributed evenly across the interest period.[3] This is aimed at recording income in the current account as it accrues in terms of value to the owner of a security or other debt instrument during the reporting period. In addition to recording interest as income in the current account on an accruals basis, an offsetting entry is required under the relevant instrument in the financial account pursuant to the principle of double-entry accounting. This captures the income-driven increase in assets. When interest is finally paid, it is not recorded as income in the current account, instead a liquidation should be recorded under the interest-bearing financial instrument in the financial account, offsetting the payment stream.

As the German reporting system is not suitable for directly recording income on an accruals basis, this has to be estimated. Pursuant to the provisions of the IMF and the ECB, this is to be done by applying suitable reference rates to the relevant assets. Such a detailed computation necessitates a new database in which the securities holdings are shown on a security-by-security basis. A database of this kind is currently being developed. As well as a separate method for back-calculating interest income from the period between 1971 and 2003, another procedure therefore had to be applied for 2004 and 2005.

A simplified back-calculation method was used to convert interest payments statistics from the period between 1971 and 2003 to accruals-based statistics. The interest payments that were originally recorded were divided equally across theimmediately preceding interest period – usually a twelve-month period. Thus, a monthly figure calculated on an accruals basis comprises one-twelfth of the interest payments of the month concerned and one-twelfth of the interest payments of each of the following eleven months. This is based on the assumption that the majority of securities considered have annual coupon dates. Only in the case of money market instruments were three-monthly coupons assumed on the assets side and six-monthly coupons on the liabilities side.

Under the described back-accounting procedure, no figures can be calculated yet for 2004. Thus, the interest income series had to be estimated using aggregated stocks and reference rates. As an expedient, the monthly stock data were derived from the annual international investment position and the monthly balance of payments transactions. After a year, the interest flows calculated in this way for 2004 can be adjusted on the basis of the data from 2005. The same applies to the following years.

For technical reasons, it has not yet been possible to make the offsetting entries in the financial account necessitated by changes in the current account. Instead, the resulting discrepancies have been recorded under the position of statistically unclassifiable transactions (balancing item).

A comparison of the old time series and the new ones calculated in accordance with the accruals principle shows income discrepancies in single billion figures for some individual years. In most of the years, the interest recorded on an accruals basis is slightly higher than the interest actually paid (see chart on page 33). This is related to the fact that external assets and liabilities tend to rise, which, in connection with the timely accrued accounting entry, leads to higher interest income for the respective years.

1 IMF, Balance of Payments Manual, Fifth Edition, 1993. — **2** ECB, Guideline ECB/2004/15, 2004. — **3** A divergent rule applies to dividends. They are not subject to the accruals principle, instead they must be recorded at the time at which they are payable. This applies both to shares held in securities portfolios and to shareholdings in the form of direct investments. By contrast, reinvested earnings from direct investments are to be recorded in the period in which they are earned. In the German balance of payments reinvested earnings are calculated as a residual in that the dividends actually distributed in the respective reporting month are deducted from the – in part estimated – profits for the relevant financial year which are distributed across the relevant reporting year.

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