The treatment of guarantees in UK public accounts 
and in the System of National Accounts

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Summary
This paper explains the treatment of guarantees in international accounting standards and in UK public accounts which follow those standards. It describes a proposal for updating the treatment of certain types of guarantees in the SNA. The Advisory Expert Group (AEG) has approved the proposal in principle and is now considering some of the details. The key points of the SNA update proposal are that a financial liability would be recorded in the balance sheet of the guarantor equal to the expected cost of calls on guarantees, as in the accounting standards, and government expenditure (subsidies, grants) would be recorded for guarantees given away for free, or sold at prices below cost.

Background
Guarantees for the purpose of this paper are guarantees given by a guarantor to a lender to protect the lender from the risks of a borrower defaulting on its repayments to the lender. The guarantors can be public or private units. The guarantor gives funds to the lender when the borrower defaults, and might obtain a claim on the borrower depending on the type of guarantee contract.

Guarantees given by private units usually take the form of financial derivatives traded on a market: credit default swaps (CDS) for example. It is not proposed to change how these are recorded in an updated SNA. The market value of the instruments would be recorded in the balance sheets of the counter-parties; changes in value would be recorded as holding gains/losses (K.11); and settlement payments would be financial transactions in derivatives.

Guarantees given by Governments usually have a different form and have different motives. Governments are observed giving guarantees to public corporations, private corporations and households. The usual motive for giving a guarantee to a public corporation is to help it to reduce its borrowing costs and hence increase the dividends it pays to government, or to reduce the subsidies it needs, or to keep down the prices charged to customers. The motive for giving a guarantee to a private sector organisation would normally be to encourage a particular type of economic activity through lowering borrowing costs. For example, such guarantees exist to promote exports and to encourage capital expenditure by small firms. Guarantees for the borrowing of households are usually for house purchase or education.

Giving a guarantee is therefore a way for government to facilitate, and/or subsidise, economic activity without a need for an immediate cash outlay. They are a way of shifting possible cash costs into the future. It could be argued that a system of economic accounts should record guarantees when they are given, not just when actual cash payments are made under the guarantee, because that is when they influence economic behaviour and create potential costs for government.