This document is circulated for consideration under item 6 of the Agenda.
THE UNITED KINGDOM FINANCIAL ACCOUNTS

The accounting framework

1. The United Kingdom (UK) financial accounts are compiled by the Office for National Statistics (ONS) as an integral part of its full national accounts matrix. The national accounts are compiled on the basis of the UN System of National Accounts (SNA 93) and more specifically the European System of Accounts (ESA 1995). The accounts are compiled and published quarterly about 12 weeks after the end of the latest calendar (for example, accounts for the fourth quarter and year 1997 were published in full on 13 March 1998).

2. The UK National accounts matrix integrates the UK statistics for gross domestic product (GDP), gross national product (GNP), balance of payments, public sector borrowing requirement, money supply and sector accounts. The sector accounts comprise distribution and use of income accounts (current transactions), capital accounts (capital transactions), financial accounts (financial transactions and financial balance sheets).

3. Table A shows the summary national accounts for the year 1997. The bottom sixth of the matrix headed net financial transactions is a summary presentation of the financial account for that year.

4. The sectors used in the UK’s financial accounts are Households and Non-Profit Institutions Serving Households, Private Non-Financial Corporations, Financial Corporations (banks, building societies, insurance and pension funds, other financial institutions), Public Corporations, Central Government, Local Government and Rest Of The World. In table A the Public Corporations have been combined with the Private Non-Financial Corporations, Central and Local Government have been combined as General Government. The Rest of the World account is simply a different presentation of the statistics in the UK balance of payments.

5. Financial balance sheet accounts are also compiled each quarter, to the same timetable as the national accounts, but are not shown in the Table A matrix which concentrates on flows.

6. All the accounts are published quarterly about 12 weeks after the end of the latest calendar quarter. Some components of the accounts (including GDP, public sector borrowing requirement, money supply and its counterparts, UK official reserves) are published sooner, in some cases, monthly.

Data sources

7. The UK financial accounts draw on many sources of data, some statistical and some administrative. Where possible the same data source is being used for the distribution and use of income, the capital and the financial balance sheet accounts. This facilitates coherence between the four accounts.
8. Most financial accounts data are collected via sample surveys conducted by the ONS, the Bank of England and the Building Societies Commission. The statistics are collected especially for the national accounts and therefore potentially differ from the figures in supervisory returns.

9. The ONS financial surveys cover financial companies and institutions (life assurance funds, pension funds, non-life insurance companies, finance leasing companies, consumer credit grantors, securities dealers, unit trusts and investment trusts), (large) private non-financial corporations and public corporations. Financial transactions data are collected quarterly from financial companies and institutions, as are key components of the balance sheets of private non-financial corporations from which their financial transactions are derived (after allowance for revaluation, capital gains etc.). Balance sheet data are collected annually from financial companies and institutions.

10. The ONS also collects overseas direct investment statistics from companies and conducts periodic sample surveys of the ownership of shares listed on the London stock exchange using companies’ share registers.

11. The Bank of England collects survey data from banks. A monthly balance sheet survey provides the basis of the balance sheet and financial transactions for the banking sector and of the monthly broad money supply (M4) statistics. This return also supplies data on banks’ custody holding of UK government securities and other paper for the Rest Of The World sector. Quarterly returns provide detailed analyses of certain components of the banks’ balance sheets, including detailed counterpart sector details on UK residents’ bank deposits and borrowing. Similar statistics are collected from building societies by the Building Societies Commission (a supervisory body).

12. The Bank of England also provides data on companies’ capital issues and redemptions.

13. Data taken directly from the government’s own administrative records are supplied by HM Treasury and the Bank of England and used to compile statistics on central government finance.

14. Direct measurement of the household sector’s financial accounts is very difficult. Counterpart data is provided by banks, building societies and most financial institutions for deposits by and lending to the household sector. Financial accounts statistics for the household sector have to be calculated by residual for many categories in the financial transactions accounts.

15. Reliability gradings for each cell in the UK financial accounts are given in Table B. This table shows all the separate transaction rows for which UK financial accounts are published, whereas Table aggregates this into summary form.

Compilation

16. The UK National accounts are compiled and stored on the ONS’s central computer system using or ‘Central Shared Data Base’ (CSDB). Data are fed into the central system using the CSDB and a relational data base that provides the structure for aggregating to transaction and sector totals.

17. The financial accounts are compiled at a very detailed level. The published accounts show about 50 transaction rows. Underlying this, the accounts are compiled for over 350 sub-instruments.
Quality controls

18. Each transaction row in the financial accounts is constrained to sum to zero. This is achieved
allocating any unidentified financial transactions to one or more ‘residual’ sectors. The residual sector is
often the household sector since this is the sector which frequently has the poorest sources for data. For
example, the total of new issues (net redemption) of British government securities in any one quarter is
known and survey data provides estimates of purchases and sales by all sectors other than the household
sector. Thus it is logical to allocate the difference between central government’s net new issues and net
purchases by the other sectors of the UK economy to the (residual) household sector. However, this
process does sometimes raise problems of coherence in the household sector, in which case the other
sectoral estimates could be subject to amendment (see later section on Balancing the Accounts).

19. A similar procedure is used in the balance sheet accounts to ensure that total assets are equal to
total liabilities in each financial transaction row.

20. Each sector’s balance in the income and capital account between the changes in liabilities and net
worth, and the changes in assets is called the net lending or net borrowing. In theory the net lending/net
borrowing for each sector should equal the net lending/net borrowing of all its financial transactions.
However, problems with accurate and comprehensive measurement mean that this is not the case in
practice, and each sector account includes a statistical discrepancy, which is the difference between the
section net lending/net borrowing from the income and capital account and the net lending/net borrowing
from the financial account. This statistical discrepancy is located in the financial account but is a measure
of all the errors, commissions and inconsistencies in any or all of the income and capital account and the
financial account. These sector statistical discrepancies are generally less than 2 per cent of GDP and, for
the central government sector, for which virtually all data comes from a single source (HM Treasury), the
statistical discrepancy is very small. Recent statistical discrepancies are given in the following table.

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Households</td>
<td>6 882</td>
<td>-1 375</td>
<td>-5 389</td>
<td>-8 894</td>
<td>-8 269</td>
</tr>
<tr>
<td>Private Non-Financial</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporations</td>
<td>260</td>
<td>-369</td>
<td>3 662</td>
<td>4 751</td>
<td>-1 914</td>
</tr>
<tr>
<td>Financial Corporations</td>
<td>-7 569</td>
<td>-7 388</td>
<td>-372</td>
<td>5 432</td>
<td>9 385</td>
</tr>
<tr>
<td>Public Corporations</td>
<td>294</td>
<td>350</td>
<td>109</td>
<td>463</td>
<td>-567</td>
</tr>
<tr>
<td>Central Government</td>
<td>-328</td>
<td>-272</td>
<td>-241</td>
<td>-147</td>
<td>-429</td>
</tr>
<tr>
<td>Local Government</td>
<td>-577</td>
<td>511</td>
<td>-43</td>
<td>312</td>
<td>463</td>
</tr>
<tr>
<td>Rest of the World</td>
<td>1 038</td>
<td>8 543</td>
<td>2 274</td>
<td>-1 917</td>
<td>-156</td>
</tr>
<tr>
<td>Total*</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-1 487</td>
</tr>
<tr>
<td>GDP at market prices</td>
<td>637 817</td>
<td>676 036</td>
<td>712 548</td>
<td>754 601</td>
<td>801 972</td>
</tr>
</tbody>
</table>

*equals, but opposite in sign to, the residual error observed between GDP measured by the factor income
approach and by the expenditure approach.

Balancing the national accounts matrix

21. In the ONS one statistician and his/her team is responsible for each sector for which statistics are
compiled, and for minimising that sector’s statistical discrepancy. Most of these statisticians are also
responsible for the quality and coherence of one or more of the component financial transactions rows of
the national accounts matrix. Each source series that feeds into the central computer system is also the
responsibility of one of these sector statisticians.
22. Each quarter these statisticians meet two or three times to review their source data and make adjustments, where necessary, to ensure the resultant national accounts figures are both plausible and internally consistent. This process resolves any implausible residual estimates by adjusting the least reliable among the remaining components of the relevant financial transactions row. It makes use of all information available to the ONS whatever the source. It also helps to identify anomalies at an early stage, which may require the examination of alternative evidence for some parts of the accounts, if sector balancing items are unacceptably large. Such evidence may take the form of figures from an alternative data source for a particular cell of the matrix. More usually it is an estimate of change or knowledge of trends, from other sources which cannot be directly quantified within the ‘hard’ data series used for the accounts. The collective judgement of all the statisticians involved in the compilation of national accounts (including, where appropriate, those from the Bank of England) is required to improve the coherence of the accounts. A similar more intensive process of achieving coherence also takes place as part of the annual cycle - in this case also extending to input-output analysis. The processes also ensure that the resultant sector balancing items are minimised.

23. Because ONS produces quarterly balance sheet data at the same time as the financial transactions data, the resultant statistics can be used to help ensure consistency (after allowing for revaluation and reclassification) between changes in the balance sheet levels and the financial transactions estimates.

24. The balance sheet data is also used to allocate dividend and interest receipts (in the income and capital account) among the various sectors of the economy. For example, tax records tell us that the total amount of dividends paid by the private non-financial corporations each quarter. This total is split among the receiving sectors in proportion to those sectors’ balance sheet holdings of these shares. The resultant dividends and interest matrix contains much of the data which is required to calculate the Financial Intermediation Services Indirectly Measured (FISIM) figures.

25. The ONS prepares the accounts showing full reconciliation between the changes in balance sheet levels and the financial transactions data. Most of the UK balance sheet statistics are at market value on the reporting date. The main exception is overseas direct investment, which is at book value.