



**UK National Accounts sector and  
transaction classification**  
A summary of the classification process

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## **UK National Accounts sector and transaction classification: A summary of the classification process**

### **The National Accounts**

- 1) The National Accounts provide a framework for describing what is happening in national economies. All institutional units operating within an economy are classified to an institutional sector (for example as non-financial corporations, general government or households). All transactions between the sectors of the economy are also categorised as part of the National Accounts framework. Work on classification of sectors and transactions are a key input in the production of National Accounts.

### **Context**

- 2) Robust classifications are needed to produce good quality National Accounts, which are internally consistent and comparable across the world. In addition, because of the wide use of National Accounts statistics (and those based on them) as performance indicators, targets, and the basis for distributing large sums of money, classification issues can and do take on political significance.
- 3) This is particularly relevant in the area of public expenditure, revenues, borrowing and debt. This applies both domestically, and within the European Union. For example, in the European Union statistics based on the *European System of Accounts 1995* (ESA95) are used in:
  - the Maastricht Treaty measures, particularly of government debt and deficit, where they determine the convergence criteria for monetary union for non-members, and performance against the Growth and Stability Pact for eurozone members, and
  - the measurement of Gross National Income (GNI), one of the main determinants of member states' contributions to the European Union's budget
- 4) It is a legal requirement for European Union countries to compile statistical returns on the basis of ESA95. The *United Kingdom National Accounts* are produced by the Office for National Statistics (ONS) on this basis. Further guidance is contained in Eurostat's *Manual on Government Deficit and Debt*.
- 5) In the UK, the Government has also decided to base its fiscal policy framework on the National Accounts. Fiscal policy objectives are in terms of statistics based on National Accounts aggregates. This means that key public sector targets such as the current budget (the 'golden rule') and the debt to GDP ratio (the 'sustainable investment rule') are dependent on National Accounts definitions and classifications.

## **The classification process**

- 6) The international statistical manuals (mainly ESA95 and the *System of National Accounts 1993* (SNA93)) provide the broad framework and principles for deciding classifications. Statistical offices throughout the world have to interpret these manuals.
- 7) It is important to have a clear agreement on the boundary between the public and the private sectors and ONS, in conjunction with European partners, has developed a comprehensive set of guidelines. These guidelines focus largely on the boundaries of the general government sector (comprising central government, state government and local government) and the public corporations sectors, which together define the public sector.
- 8) Most of the financial information needed to produce the central government sector accounts is provided by government departments and agencies and routed through HM Treasury. ONS and HM Treasury have produced guidelines to help government departments classify their activities for National Accounts purposes. These have been circulated to departments with the expectation that most cases in departments will be settled by reference to the guidelines without the need for any consultation.
- 9) For cases not clearly covered by this guidance, policy departments – including HM Treasury – will refer issues to HM Treasury’s classification branch who act as technical experts and answer the straightforward queries on behalf of ONS. For those queries that are not straightforward, HM Treasury classification branch will ask ONS to interpret the guidance and to make a classification decision.
- 10) ONS is, however, final arbiter of National Accounts classification decisions in the UK and can examine cases on its own initiative at any time.
- 11) In some cases ONS will consult Eurostat, the statistical office of the European Union (see paragraph 18)). Examples include where a case has an international dimension or consistency with the *Manual on Government Deficit and Debt* requires clarification.

## **National Accounts Classification Committee**

- 12) The National Accounts Classification Committee (NACC) is the committee of expert staff within ONS that makes National Accounts classification decisions. The committee makes decisions on the sector classification of bodies/institutions and their transactions in line with the international statistical guidance.
- 13) NACC has a membership of around 15. Currently five of these are members of NACC by virtue of the posts they hold within ONS. These ‘ex-officio’ members include the chair of NACC who is appointed by the National Statistician.
- 14) More information on the NACC decisions and the decision-making process is provided below.

## **NACC classification decision process**

- 15) Classification cases can be initiated either by ONS or, following a departmental classification request, through HM Treasury's classification branch. Typically the cases initiated by ONS would relate to the classification of existing organisations or transactions or new developments in the economy. In many classification cases the answers will be straightforward and the NACC secretariat will deal with them. Others are referred to NACC.
- 16) HM Treasury may also submit policy proposals for classification by NACC, either on its own behalf if it has the policy lead, or on behalf of another department. Paragraphs 31 to 37 provide further information on the handling of these proposals.
- 17) The usual sequence of events for NACC classification cases would be:
  - a) A classification request comes to the NACC secretariat.

The secretariat prepares a document that summarises the facts of the classification case and puts forward the different interpretations that could be made. This will often involve additional research and requests for further detailed information.
  - b) The case is circulated to NACC members (a NACC consultation) with a deadline for responses. If the case is complex or high-profile, the chair may call a meeting of the committee to discuss the issue.
  - c) If the conclusion of the committee is unanimous, a reply will be prepared by the secretariat. If there are differences of view these are discussed.
  - d) Following NACC discussion, decisions will be taken based on majority voting.
  - e) In the event that there is a tied vote, the Chair will have a casting vote.
  - f) The decision will be authorised at the appropriate level and the reply sent to HM Treasury with full reasons for the decision. For any cases that require authorisation by the National Statistician (see paragraph 27)), there must be a quorum of at least half the ex-officio members voting.
  - g) The decision will be published as soon as cases are no longer commercial or policy in confidence and the appropriate explanatory material has been prepared.
- 18) In some cases ONS may consult Eurostat. Eurostat will only consider cases related to the Excessive Deficit Procedure (EDP) of the Maastricht Treaty. If it decides to give an opinion on a case, Eurostat will either take a straightforward decision, or go through a consultation process involving the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB). CMFB brings together statistical experts from all member states' national statistical institutes and central banks, Eurostat and the European Central Bank. A description of CMFB's procedures for consultation and provision of an opinion can be found on the Excessive Deficit Procedure page of their website at [www.cmfb.org](http://www.cmfb.org). The CMFB acts in an advisory capacity and Eurostat is responsible for the final decisions. In exceptional circumstances (such as the classification of 3G mobile phone spectrum

receipts), ONS may refer a case to the United Nations Statistical Commission.

### **Classification criteria: the basic approach to classification**

- 19) Each classification decision is taken on its own merits and in line with international statistical guidance. Cases of public interest tend to be one of two types:
  - I. whether an entity, an organisation or financing vehicle for example, is in the private or public sector
  - II. whether government receipts are a charge for a service or a tax

#### *i. Classification of an entity to the public or private sector*

- 20) The guidance is extensive but two main stages can be identified when classifying an entity to an institutional sector. The first involves a decision on whether the entity is within the public or private sectors, and the second a decision on whether it is a market or non-market producer.
- 21) In summary, the difference between the public and private sectors is determined by where control lies, rather than by ownership or whether or not the entity is publicly financed. International guidance defines control as the ability to determine general corporate policy. For example, this control can be exercised through the appointment of directors, control of over half of the shareholders voting power, through special legislation or decree, or through regulation.
- 22) As a result NACC will examine an entity to see whether there are any factors that enable any part of the public sector, either individually or collectively, to determine the general corporate policy of the entity. This includes recognition that government, or other sectors, may also control a unit through contractual arrangements. If this control is established, the entity is classified to the public sector.
- 23) Having decided whether an entity is part of the public or private sectors, the second important aspect for sector classification is to determine whether it is a market or non-market entity. Public sector market entities are classified as public corporations (for example, Royal Mail and Manchester Airport Group); public sector non-market entities are classified in the general government sector (for example, government departments and the BBC). General government is then subdivided into sub-sectors, including central government, state government and local government. Private sector market entities are classified as private corporations, and private sector non-market entities are generally classified to a sector known as Non-profit Institutions Serving Households.
- 24) The borderline between market and non-market classification is defined in the international guidance by whether more than 50 per cent of the production costs are covered by sales of goods and services.

## *ii. Classification of receipts as either a tax or service charge*

- 25) For entities within the public sector, classification as a market or non-market entity is dependent on how the entity is funded. Majority funding through grant-in-aid or taxation will result in classification as a non-market entity and allocation to the general government sector. Where an entity is majority funded by receipts, it is necessary to classify those receipts.
- 26) On the whole, government receipts are mainly divided into taxes or service charges. Taxes are compulsory unrequited payments, where unrequited means that the payer does not receive anything directly in return. Service payments are required in that they include the delivery of a service in exchange for a payment. In some instances the classification of these receipts can be difficult to interpret and the international statistical manuals recognise that 'the borderline between taxes and payments for services rendered is not always clear cut in practice'. As a result, NACC will consider the nature of the receipts carefully before reaching a decision.

### **Authorising the issuing of NACC decisions**

- 27) Depending on the degree of public interest or sensitivity of the classification case, the NACC decision will be authorised at an appropriate level:
- where the guidance is clear the NACC secretariat can notify an 'ex-officio' member of these decisions for authorisation
  - where the guidance requires interpretation a NACC consultation will take place. Most decisions will be authorised by the Chair, in whose absence the responsibility can be delegated to the vice-chair or to the head of Public Sector Accounts
  - politically sensitive cases or those likely to be of public interest will be authorised by the National Statistician

### **Status of decisions**

- 28) The status of classification decisions will be made clear in the replies sent to HM Treasury. In the majority of cases this will be that, based on the information provided, the decision represents the view of the ONS National Accounts Classification Committee. The reply will also note who has authorised the decision.
- 29) A decision will be referred to as 'provisional' if the arrangements on which the decision is based have yet to be implemented. Further NACC consultation may be required before a final decision is made.

### **Review of classification decisions**

- 30) There is no systematic review of classification decisions. However, ONS will review earlier decisions if new information has come to light, circumstances have changed or interpretation of international guidelines has evolved. Such reviews are conducted following the same process as for other classification decisions. If a review results in a different decision, that is a reclassification,

time series for the National Accounts and public sector finances will be revised accordingly.

### **Policy proposals**

- 31) Policy proposals differ from other cases in that they are forward-looking rather than concerned with existing organisations or transactions which have already taken place. Such proposals might involve the creation of a new organisation, the re-structuring of an existing organisation, or the creation of a new type of transaction or financing vehicle.
- 32) As noted above, ONS is occasionally asked to provide classification decisions on policy proposals so that the Government can understand how these proposals would be treated in the National Accounts and so take account of the potential consequences for public spending, public revenues or debt measures.
- 33) It is essential that ONS is not drawn into policy discussion and does not participate directly in the policy formulation process. It is not the role of ONS to provide policy advice on how bodies and transactions should be structured. ONS does not perform this kind of service as this would have the potential to compromise the classification process as detailed here. ONS's only involvement with these policy proposals is to determine the National Accounts classification of the proposed body or transaction. As a result, it is necessary to ensure that the integrity of the classification process and the resulting National Statistics are protected.
- 34) ONS will, therefore, remain at arms length from the policy officials and work through HM Treasury's classification branch following the same classification process as outlined in paragraphs 6 through 18. Consistent with this, if it proves necessary for ONS to request a briefing from the department, such briefings will be confined to the provision of the factual information required to inform the classification decision.
- 35) Most policy proposals will be in a near final form when presented to ONS and will include all the relevant details to enable ONS to make a judgement. Any classification decisions based on a near final policy proposal will be deemed as 'provisional' and dependent on the proposal being implemented as described. If the circumstances change it is the responsibility of the department to inform HM Treasury. HM Treasury will then inform ONS.
- 36) However, on rare occasions, departments might seek a view on a major proposal at an early stage of its development. In such cases, ONS will provide a provisional classification decision in the expectation that it may be asked to examine a more final proposal at a later stage. Exceptionally, in the interim ONS will only consider alternative versions of the same proposal if substantial and significant changes have been made. The explanatory article published on the final policy proposal will note how many versions of the proposal ONS considered.
- 37) Final classification decisions will be published when the policy is announced by the Government. At this point ONS would expect to include in the explanatory article any relevant declassified material relating to the final proposal which had previously been supplied on a restricted basis.

## Publication and reporting of decisions

- 38) The *ONS Sector Classification Guide* provides a comprehensive list of public sector bodies and an indicative list of other sector classifications within the UK economy. Routine sector classification decisions will be published in the monthly update of the *Sector Classification Guide* at [www.statistics.gov.uk/nacc](http://www.statistics.gov.uk/nacc). For decisions likely to be of public interest, ONS will issue a news release and article explaining the decision. ONS may show relevant sections of the draft article to HM Treasury and the responsible policy department for fact checking.
- 39) ONS's annual report to Parliament will record major decisions announced in the year in question. Where a provisional decision about a policy proposal has been made, but the final policy decision has not been announced, the fact that such a decision has been made will simply be noted. Further information will be provided if and when a final policy decision is announced.

## Different accounting systems

- 40) ESA95 is designed as an integrated system of economic accounts for the whole economy. It is not used to produce financial reporting statements for individual entities. As a result, the treatment of organisations and transactions may differ between financial reporting systems and the National Accounts system.
- 41) In its response to the Treasury Committee report on the classification of Network Rail, the Government agreed that where the National Accounts and financial statements of central government departments 'produce apparently contradictory results as regards sector classification, it is appropriate that the parties concerned should explain to the public the rationale for their views'. To this end, when preparing articles on a National Accounts classification, ONS will invite the appropriate accountants and auditors to provide material on the treatment in financial statement accounts and Whole of Government Accounts.

## Classification documentation

- 42) The *Sector Classification Guide* and full documentation detailing major NACC decisions is available on the ONS website, at [www.statistics.gov.uk/nacc](http://www.statistics.gov.uk/nacc).

## References

- 'System of National Accounts 1993', UN, OECD, IMF, EU, 1993.
- 'European System of Accounts 1995', EU, 1996.
- 'Manual on Government Deficit and Debt', EU, 2006.
- 'Government Response to the Committee's First Report: National Statistics: The Classification of Network Rail, Session 2002-03', Treasury Committee.