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BRIEFING

A SERIES OF POST-REFERENDUM BRIEFINGS November 2017

This Briefing can also be viewed on this link to the Campaign for an Independent Britain website. It also has a link on Brexit Central: 'Brexit in Brief: Why the EU owes the UK money'

This is an update based on the Institute of Chartered Accountants' (ICAEW) report of June 2017.

That ICAEW report concluded that the net exit charge for the UK on leaving the EU would be a net payment to the EU of either £5 billion or £15 billion (plus the net cost of the two years' contribution to the EU budget for 2019 and 2020).

The update contains one major adjustment to the ICAEW report which is that the UK should not be responsible for any liability for the 'reste a liquider' amounts (called by the ICAEW, 'share of authorized expenditure not spent'.

Plainly the 'reste a liquider' amounts are not accounting liabilities but payments from future budgetary items, subject to the changes in all budgets. The EU auditors, as well as the European Parliament, have complained about the existence of the 'reste a liquider' amounts for some years and urged they should be stopped.

After adjustment to remove the 'reste a liquider', the exit charge in the ICAEW report turns into a payment from the EU to the UK. A more critical scrutiny of exactly how the EU pension system works – it is not a fund but an operational expense – could save a further £10 billion.

It should be clearly noted that the ICAEW report is, as can be expected, subject to many caveats, assumptions and uncertainties but, in the absence of any credible alternative, they are as robust as anything else on offer.

FUTURUS

Office 3, 89a London Road, East Grinstead RH19 1EJ

anthony.scholefield@ntlworld.com 07805 397424

http://www.futurus-thinktank.com

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THE FINANCIAL SETTLEMENT WITH THE EU

Calculations based on the ICAEW Report show there should actually be a payment from the EU to the UK

The EU proposals for negotiation

Key points from the European Council Guidelines for Brexit negotiations, 29 April 2017:

1.2 "In accordance with the principle that nothing is agreed until everything is agreed, individual items cannot be settled separately."

111.10 "A single financial settlement – including issues resulting from the MFF as well as those related to the European Investment Bank (EIB), the European Development Fund (EDF) and the European Central Bank (ECB) -= should ensure that the Union and the United Kingdom both respect the obligations resulting from the period of the UK membership in the Union. The settlement should cover all commitments as well as liabilities, including contingent liabilities."

Key points from the EU Commission Negotiating Directives, 3 May 2017:

111.12 "Hence the methodology for the financial settlement based on the principles laid down in Section 111.2 has to be established in the first phase of the negotiations."

111.30(a) "A calculation of the global amount that the United Kingdom has to honour in order to settle its financial obligations towards the Union budget, all institutions and bodies established by the Treaties, and other issues with a financial impact."

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Commentary

1. It should be noted that the *"withdrawal agreement"* should contain *"a calculation of the global amount",* etc.
2. It seems to be assumed that this calculation will be a positive figure, *"that the UK has to honour in order to settle its financial obligations"* when, in fact, there is a likelihood that it could be a negative figure with the EU honouring a payment to the UK.

   Of course these are the guidelines from the EU Council and the negotiating directives of the EU Commission and need not be accepted by the UK at all.

   What has been lacking is a presentation by the UK government.

   The Institute of Chartered Accountants (ICAEW) drew up a preliminary report in June 2017 and it would seem a basic necessity for any financial settlement to be at lest based on accounts scrutinized by properly qualified accountants even if there are bound to be some negotiations at the political level. Despite the ICAEW drawing up a preliminary report, the UK government has not shown any interest in taking up expert advice. This has been a great handicap with the EU negotiating team appearing far better briefed and the UK negotiators, lacking expertise, appearing amateurish and constantly giving concessions.

Introduction

Andrew Neil recently pointed out that neither the Remain nor Leave sides mentioned the exit charge in their campaigning. This may be because it is rather small as the ICAEW works out or 'is actually non-existent' after adjustments.

The Institute of Chartered Accountants (ICAEW) drew up a report in June 2017 entitled, '*Analysing the EU exit charge'.*

This seems to be a reasonable and professional report with all the figures for income, balance sheet and future budgeting dovetailing correctly. One should note, however, that they are estimates only and that many assumptions have had to be made.

One should also note that the ICAEW report is based on the 2015 EU accounts and will need updating in the final form.

There is one item omitted in my opinion from the asset division of the EU balance sheet because it is not capitalised in the balance sheet and, therefore, not shown in the ICAEW report. This is the 'intellectual property' of the EU, the cost of constructing databases, building up regulatory systems, etc. The UK contributed a great deal to these matters and will probably now have to build its own systems. It can claim to be recompensed for the asset which is not recognised in the EU accounts. (However, this is not taken into account in the following calculations.)

However, it is beneficial to have the ICAEW report as a yardstick against which any progress to a financial settlement can be judged.

The ICAEW Report

The ICAEW drew up three scenarios, a high scenario, a medium scenario and a low scenario. We can discard the high scenario since this was based on the UK leaving the EU in March 2019 without a transition and without paying into the EU budget for 2019 and 2020.

In Theresa May's Florence Speech, she accepted that there would be a transition and that, therefore, EU budget payments would continue in that period, *"honouring our obligations".* Therefore, for 2019 and 2020 one can assume for this purpose that the usual EU budget contributions will be made (£23 billion gross and £10 billion after UK receipts and rebates, as the ICAEW reports estimates).

The central scenario of the ICAEW showed a net exit charge of £15 billion and the low scenario, an exit charge of £5 billion.

These are a good deal less than the figures floating about in the media.

In fact, using the ICAEW report and making one necessary and one reasonable adjustment, it is perfectly logical to state that there will not be an exit charge at all but a payment from the EU to the UK.

Adjustments to the ICAEW Report

The adjustments to the report are as follows:

		£ billion	
		Low Scenario	Central Scenario
ICAEW net exit charge from EU to UK		5	15
Less:			
Share of authorised expenditure not spent (Reste a liquider)		28	28
Minus:	proportion of rebate	(8)	(8)
	spending in UK	(10)	(10)
Share of 'committed spending not yet authorised'		-	16
Minus:	rebate	-	(3)
	Spending in UK	-	(3)
Total after adjustment due from EU to UK		+5	+5

Note: The Low Scenario already eliminated any UK liability for "committed spending not yet authorised", which is discussed below.

So, both scenarios are now the same with the overall result being a projected exit refund from the EU amounting to £5 billion.

This should be the target for the financial settlement subject, of course, to updated figures and more precision in all the amounts as well as sorting out the question of 'intellectual property'.

Why should *"committed funding not yet authorized"* not be included as it is not in the ICAEW 'Low Scenario' but is included in the central scenario? The reason is explained in the ICAEW report but it should be noted that, if the UK remains in a transitional arrangement for 2019 and 2020 and continues to pay into the EU budget, much of these 'committed but not authorised' amounts will move forward to become authorised spending commitments and then into actual spending or accounting liabilities and, to avoid double accounting, should be eliminated altogether as shown in my adjustments. Eventually at the 31st December 2020, the ICAEW estimates that the *"committed spending not yet authorised"* will total Nil. It will either have moved forward to become *"authorized spending not yet incurred" or* 'reste a liquider' or will have become an accounting liability in 2019 and 2020.

Reste a liquider

That leaves the question of' *"authorised spending not yet incurred",* the 'reste a liquider' which the ICAEW estimates as a gross UK amount of £28 billion dropping to £10 billion after rebates and spending in the UK.

I have discussed this with the ICAEW and opinion is as follows:

Q Are these liabilities?

A *"No, they would not show up in the accounts – they are a budget and don't meet IFRS recognition criteria as there is not necessarily any legal or constructive obligations to pay them at this stage – they are just what is budgeted – and what there was arguably an intent to pay when the budget was drawn up."*

"I don't think anyone is saying there is a legal or constructive obligation that would mean these amounts had to be accounted for."

Difference between accounts and budget

At this stage we should recall that Michel Barnier has repeatedly called for *"a settling of the accounts"* not *"a settling of budgets*".

All organisations make budgets and usually change them quite a few times before they become a spending matter. Certainly the UK government and the EU do this. Such organisations usually intend to pay for their budgets but budgets change and adjust to changed circumstances. In particular, in the UK changes of governments cause changes in budgets and no parliament can bind its successors (except overseas and until this mandatory legal payment is repealed). The EU budgets also differ from ordinary budgeting in that they are one-sided, the budgets being calculated without reference to the money being on hand to pay for them. This introduces instability into the budgets of the member states.

The EU auditors, as well as the European Parliament, have complained about the existence of the 'reste a liquider' for some years.

In their report on the 2016 EU accounts, the auditors stated, *"This year, the total amounts of payments the EU committed itself to making from future budgets (the 'reste a liquider' was higher than ever before. The amount is projected to continue to rise through to 2022. Clearing this backlog and preventing a new one from forming should be priorities when planning the Multi Annual Financial Framework (MAFF) for the period starting in 2020."*

The short analysis is that the EU is committing money it has not got but is committing the money from future years' budgeting. Clearly the auditors are unhappy and want it cleared up and stopped. It is indeed appalling accounting and unilaterally destabilizes the budgets of the member states.

When the UK leaves it should not pay anything for amounts budgeted but not yet authorised to be spent and in many cases not projected to be spent for some future date especially as these amounts have been authorised above the current year's contributions from member states and have been offset against future budgets. If the EU auditors recognise this practice *"should be prevented from forming"* from the point of view of the EU member states it is prejudicial to proper accounting and control.

With the rejection of liability for the 'reste a liquider' practice, itself criticised by the EU auditors, this leaves a potential payment of £5 billion from the EU to the UK as the 'financial settlement'.

(Note: This analysis and these adjustments assume that the UK pays its EU budget contributions in 2019 and 2020, the transitional period, subject to dovetailing different financial year ends which, after allowing for rebates and spending in the UK, amounts to £10 billion [ICAEW figures])

A note on EU pensions

The ICAEW estimate was that EU total pensions accrued liability by March 2019 was about £63 billion with UK contribution of 12-14% - it is, say, £10 billion.

These pensions are not paid out of a set-aside fund. They are simply an expense each year in the EU accounts, in itself an undesirable accounting practice.

It has been pointed out that, when the UK joined the EU it immediately started paying contributions **for those who had retired before the UK even joined**. There was no rebate for this. The UK then continued to pay for pensions as part of its EU budget contribution for 44 years.

As the pay-as-you-go method of paying pensioners still carries on in the EU into the future, it is difficult to see why the UK should pay for future pensions, applying the same logic as in what happened when the UK joined the EU, which is that the pensions paid are a yearly expense of operation (exactly as UK government pensions are accounted for) not a contribution to a pension fund.

This termination of a budget contribution for past pensions would save £10 billion, although the UK would then likely set up a pension scheme for UK citizens serving, or retired, from Brussels.