



**Good, Consistent Information,
Consistently Good Decisions**



GPEG

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Press Release

Good, Consistent Information, Consistently Good Decisions

The Guernsey think-tank, GPEG today publishes its third paper. The paper looks at the unusual accounting habits of the States and calls for the implementation of internationally recognised accounting standards. Funding to do this implementation was committed some 8 years ago and it has not happened yet. Quite why, remains to be discovered.

The States follow a financial reporting system that is really quite odd and provides ample opportunity for people to be confused and for misleading numbers to be generated or used.

There is considerable use of “off-balance sheet accounting” – with odd consequences. For example, any operating losses of the airport or the harbours (and quite a few other things) would not get deducted in arriving at the States “surplus” that was enthusiastically published by the last States. GPEG firmly believes that on any normal accounting basis the 2019 “surplus” would have been a substantial **deficit**.

Cash movements between two States owned bank accounts somehow were reported as a £3m part of that surplus!

GPEG has previously pointed out the very considerable issues with the failure to recognise the States’ employees very large pension deficit.

Indeed, the accounting is so odd that the auditors do not bless the accounts of the States’ activities. The more usual “true and fair” opinion is not given – merely compliance with the States’ home-grown accounting principles. The auditors do not provide the usual level of assurance that you should expect to see, which in itself gives a strong indication of their confidence in accounting process used by the States of Guernsey.

Further, the accounting for an identical transaction can vary depending on which set of States accounts it is reflected in. Quite odd.

One thing which is common in the accounts of the States’ activities is that past subsidies have been treated as fixed assets rather than the expense they really were, giving an unreasonably cheerful picture of the strength of the Island’s balance sheets. The extent of this is large – using more normal accounting would result in write-downs that would be in the hundreds of millions

Unclear, misleading and complex accounting figures can clearly lead to wrong decisions on spending and taxation as well as obfuscating measures of effective government.

Its not hard to move to normal accounting. Our single recommendation is to do so. Before any recovery plan can be agreed, we need to understand with confidence, our starting position. It is GPEG’s view that this should be priority number one.

This release is embargoed until 7am Wednesday 10th April 2021.

Jon Moulton and Lord Digby Jones will be available to discuss the paper.

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As GPEG has got to a more detailed grasp of the Islands' position it has become increasingly clear that the pre-election States were often engaged in actions where both pushing problems into the (often near) future and portraying things in an excessively cheerful light, were common. Whether it be dealing with the massive deferred essential capital expenditure at the port and elsewhere or the pension deficit, light often did not much shine on inconveniently difficult issues. The result was an increasingly debt funded growth in public spending and an unwarranted complacency as to our economy. It falls to the new States to sort out the resulting backlog of issues as a priority.

Clear good news came in this February when Mark Helyar's estimate of 2020 tax revenues, made in December, turned out to be happily pessimistic by £25m. It may well be that the Covid impact is less than feared but there still remains a daunting set of issues.

One of the reasons for this accumulation of unresolved issues was the bizarre and complicated accounting of the States. It is really hard to follow, so issues are not properly visible or appropriately considered.

You may well query the priority of getting the accounting of the States in better order when we are in the full blast of Brexit and Covid issues. We believe it is essential to getting things right to sort out the accounting.

This paper started off as a review of the Accounts for the States Trading Supervisory Board's Ports Accounts which cover the operation of the Harbours and the Airport.

It has transformed into a review of the financial reporting for the Bailiwick as the peculiarity of the accounting became apparent. Guernsey's

accounting seems to have evolved like one of Darwin's finches.

It is the view of GPEG that the current States methods of accounting are very overdue for being brought into the norms of accounting generally followed globally.

You may not think that this much matters – but it does. Accounts that don't show reality lead to bad decisions on allocating assets and to taking risks on a wrong basis. Accounts that cannot be understood are useless.

It is interesting that we have found very few people who actually follow the current States accounting. And those who did not follow them clearly include quite a few people who have taken important decisions without that understanding.

It is the view of GPEG that the current States methods of accounting are very overdue for being brought into the norms of accounting generally followed globally.

The subject is in parts really quite arcane, so the paper tries to put the issue in simple terms in the main text with more technical stuff being left to the appendices. We use the Ports accounts as an example. There are a number of other States related activities which have similar issues.

First of all, if you pick up the Ports' accounts you will see the normal features of an annual report – Boards of Directors, auditor's report, and 48 pages of accounts.



But the bit that is really odd is that **there is no company**. Ports, Guernsey Water, Guernsey Waste, States Works and Guernsey Dairy are all labelled “unincorporated trading entities”. Actually, this is a bit misleading as they are not entities at all! All that has happened is that relevant assets and liabilities for these activities are accounted for as if they were companies but legally and economically these assets and liabilities are simply owned by the States.

However, when the States put together their accounts, they do not show the profit or losses from these banished activities as part of the annual surplus or deficit nor do they add in the banished assets and liabilities. Nor are these costs or balance sheet items reflected in the 2021 States Budget (see page 77 thereof). A common accounting term for this is that these activities, of which the Ports is one, is “off-balance sheet”. Generally, such structures are disliked because of their lack of transparency, often tending to impenetrability, and their ready misuse to generate a misleading picture.

So, when the States announced a surplus of £106m for 2019 this excluded any deduction for the £4m plus loss at the airport. That is because the loss is “in” a non-existent entity. (Yes – it is bizarre).

The States have a strange (if cautious) approach of writing off capital expenditure as they pay for it. However, if this expenditure happens in the Ports it does not get written off. So, depending entirely on the arbitrary choice of where the amount is reported you can play games with the surplus. Build, say, a shopping arcade at the harbour for £10m; you could put it through the Ports and capitalise the spend or you could label it “States” and reduce “surplus”/increase the “deficit” by £10m. Economically and legally there is no difference.

The States pay for and directly own the shopping arcade in both cases, but the accounting is very different. The temptation is obvious.

The position gets even less clear when you look at the States Budget for 2021 which contains on page 106 the 2019 results for the Ports. The “operating surplus before depreciation/amortisation and loss on disposal of fixed assets” is as you would expect identical at £3,172k in both the Ports Accounts and the “Actual” 2019 numbers in the Budget. Good so far.

It then appears that the Budget 2019 “Actual” is arrived at on restating the Ports accounts to the States’ fixed asset write-off policy. A far from productive use of accounting resource. Having more than one version of the truth is, at best, confusing.

Then differences arise; there is “Investment Return and interest”, £329k in the Budget Paper and £485k (see Appendix D) in the Accounts – take off interest paid of £71k in the Accounts and you get to £414k, not £329k. There is a property down valuation of £125k but that does not make the figures align either.

But it then gets more opaque – the Budget then expenses £2,045k of capital expenditure to arrive at a “Surplus before depreciation” (How do you get depreciation if you have written off your capital expenditure??) Unfortunately, this does not easily track to the Ports Accounts which show capital spending of £1,986k with £1,579k being transferred to fixed assets in the Ports balance sheet in 2019.

These differences in figures are not a big deal but illustrate the issues of complexity, and perhaps error, introduced by not having consistent accounting principles and multiple sets of accounts. (Apologies for the boring detail.)



In 2019 some apparently odd things happened with the cash flows of the Ports. The accounts show that the States lent (to itself...) £2.5m to the Ports on 1st March. During the year, the Ports “repaid” part of a grant, £3m, to the States. One States bank account to another States bank account. The confusion of concepts now becomes quite startling as somehow this £3m became part of the 2019 States surplus. And the £2.5m was not deducted. (Appendix E deals with the strange “capitalisation of the Ports.”)

You may very well wish that you could generate a surplus for yourself by moving money from your right pocket to the left one. Sadly, the real world does not do this, but the States would have you believe that they can do so.

This kind of absurd accounting really should not be happening.

The headline States’ “surplus” is really quite an arbitrary amalgam of figures with only a passing resemblance to a profit and loss account. Confusingly the terms “surplus” and “deficit” do not consistently mean the same things in the various reports and announcements.

The solution to the “off balance sheet” issue is really quite simple. The States accounts should contain all the activities they own in a single set of numbers – accountants call this consolidation. This adding together of all the activities involves eliminating all the transactions between the component parts of the States so that you don’t have a profit arising from say, Guernsey Electric supplying power to the States being reported in Guernsey’s main States accounts as an expense of the States. Whilst the reported profit in Guernsey Electricity does not make it to those States accounts. Clearly the net position is really, no profit and

no loss, and adding the two sets of accounts together gets to that position.

Consolidation is not hard or novel. UK corporate groups have been legally obliged to do this since 1948. If you want numbers to assess a particular activity, then there is little difficulty in preparing accounts for that purpose.

We are encouraged to hear that there is some renewed action being taken to introduce consolidation by the States.

Accounts are virtually universally prepared under (fairly massive) sets of accounting standards that are published by accounting bodies. Except the Guernsey States Accounts where the accounting policies are our own home-grown product.

3 possibilities exist for accounting principles to be adopted by the States. They are:

FRS 102 – UK GAAP (Generally Accepted Accounting Principles) – the Isle of Man follows these;

IAS – International Accounting Standards – also called IFRS (International Financial Reporting Standards) – Jersey follows these; and

IPSAS - International Public Sector Accounting Standards. Malta – and Guernsey - are adopting these.

These standards are mostly pretty similar, and are much more comprehensive, than The States of Guernsey’s assorted policies.

Since 2012 when funds of £1.3m were allocated in Guernsey (see Appendix A) to fund moving reporting to IPSAS; progress has been slight. Reasons are far from clear. Inadequate emphasis has clearly been put upon getting to the much more transparent and useful financial statements that IPSAS would provide.



Cynically it may have been politically expedient to continue with impenetrable accounting. Or it may have been inadequate resource or management. Whatever – 8 years is about 7 years too long to implement a good set of accounting principles and to see much more useful reports.

World War 2 lasted 6 years.

The confusion that can arise is well illustrated in the Ports’ auditors report. (See Appendix B).

FRS102 (see Appendix C) simply does not apply to the Ports’ Accounts. The auditors’ own report is only that the financial statements are prepared in accordance with stated accounting policies (regardless of their utility or logic) which do not comply with any set of accounting standards. In addition, FRS 102 only applies to accounts which are intended to give a “true and fair view” – the normal blessing that is sought from an audit. The Ports’ accounts are not intended to give such a view.

Nonetheless, and remarkably, the expert auditors point out one substantial divergence with FRS 102 as an issue. This is that there has been no full impairment review has been undertaken on the Ports’ Fixed Assets “in light of the accounting losses”.

This effectively says that if the harbour or airport does not make profits then the value of its fixed assets is not a lot. These fixed assets are in the books for £228m (£136m for the harbour and £92m for the airport). If such a review were undertaken, under FRS 102, the £228m

would presumably be written down very considerably.

A way of getting to grips with the real commercial value of the assets is to consider what someone might pay for the opportunity to own a business with £23m in revenues, a large pension deficit, no current profits and very substantial capital expenditure requirement (apparently £35m needed for the harbour just to stay fully open). A very much smaller value than £228m seems to be implied.

The Ports Accounts cover the harbours and the airport. It could have been made more obvious to show what the results were for the two separate activities but with a little analysis you can derive the following from the 2019 Accounts.

The first thing you might notice is that a 2019 surplus is reported – somewhat at variance with the Auditors’ report of “accounting losses”. However, it is very clear that the Airport is very lossmaking. Some form of impairment review would be required under virtually all accounting standards. The recoverable amount of an asset or cash generating unit is generally defined as the higher of its fair value less costs to sell and its value in use; and that higher value is the value that accountants require to be put on the balance sheet.

£'000	Airport	Harbour	Ports	
"Surplus/(loss)"	-395	3567	3172	
Depreciation	-3968	-1494	-5462	
	-4363	2073	-2290	
Revaluation of investment property	-125		-125	
	-4488	2073	-2415	
Investment return			485	See Appendix D
Interest/loss on assets sales			-74	
Asset specific contributions release			3332	See Appendix E
Surplus (alleged) for 2019			1328	



There is considerable scope for debate about the level of impairment that given circumstances require. As a first cut though, the airport is just a lossmaker – run as it is then the business is worthless. Its assets could be sold but either that would be on an alternative use basis (which would be bonkers) or to someone prepared to milk the monopoly (landing and parking fees up, opening hours down etc) without much regard to the general interests of the island – sadly I do not think that the £92m is remotely supportable and that something nearer £10m would be the right accounting number.

Does it really matter if the accounts show £10m or £92m for the airport Fixed Assets? The big point is that the write-off from £92m to £10m actually reflects past expenditure which was in reality a subsidy. The current accounting conceals this basic fact. Subsidies may be entirely appropriate, but they are money spent, and not valuable assets created, and decisions should be taken against that background.

Similar arguments apply to the harbour – the £136m in the balance sheet should perhaps be nearer £25m. A write down of £111m. (No precision claimed!)

These “impairments” (write-offs) would actually be even more if the heavy losses of the Ports for 2020 and forecast for 2021 are taken into account. According to the 2021 States Budget paper the forecast deficits (on some unspecified definition) for the Ports for 2020 and 2021 exceed £19m. The latest lockdown will have increased that. (See Appendix F),

The Accounts justify the failure to perform an impairment review “as the primary objective is to facilitate travel to and from the island and not generate an economic return.” Whilst there is some reason to be sympathetic to that line of

argument, it would also justify writing off all of the Fixed Assets. Or indeed to report nothing.

The ports’ pension accounting is at least 20 years out of date. The general idea of accounting for pension costs is that you try to match the cost of providing a pension against the work done. There are considerable complications in doing so but the idea is easy enough. The relevant accounting standard is one of 3 choices of standards – the IAS 19 (IFRS), IPSAS 39 (international government standard) or FRS 102 (UK GAAP) – none of which are followed by the States Trading Supervisory Board, or stated to be used, in preparing the Accounts.

Things are messy on the pension front as the employees of the Ports are members of the (very underfunded) States of Guernsey Public Servant’s Pension Scheme. We quote from the Ports Accounts “Although the scheme is a multi-employer plan, it is not possible to identify the Ports’ share of the underlying assets and liabilities on a reasonable and consistent basis.” Obviously, this should not be the case. Realistically there is only one employer too. Certainly, it must be possible to compute the pension liabilities for the staff, past and present.

As the employees of the ports are around 200 (in the Ports accounts for 2019 but apparently 66 in the 2019 main States accounts??) of the total States’ employees of around 4,700 a reasonable guess is that Ports has an unbooked pension deficit of around £45m though this could easily be wrong by £20m in either direction. This is a large number in the stated net assets of £230m. (*Our previous GPEG Paper “Beware of the Hole” bears on this pension issue.*)



The annual pension expense of £1.2m is probably less than accounting should show but data is lacking to estimate this. The reported pension expense is simply the contributions made each year which if you don't know what the related assets and liabilities are could be a long way from the actual realistic expense. It might simply be that you pay a contribution on 1st January rather than on 31st December or the other way round. Either which way the payment date should not affect the operating results – but it does. This really means that there is significant uncertainty of the true profit or loss of the Ports.

Just to illustrate how far Guernsey has drifted from general accounting standards the following illustrates roughly (very) the effects of using more usual accounting on the Ports' accounts:

	£m
Net Assets as Accounts	230
Less pension deficit	-45
Less impairment	-213
Accounting Net Asset Deficit	-28

Now this needs taking in proportion. Clearly the island has to maintain air and sea links. What the revised accounting shows is that the States have pumped money into subsidising these links over a very long term and that that reality has been that the recognition of those very substantial subsidies has been obscured by the accounting. It seems the harbour needs very shortly another £35m or so for non-improvement works. More subsidy comes! Operating losses in 2020 and 2021 will also be a painful drain on States' cash.

This paper does not seek to put forward proposals for the financing policy for the Ports. We do believe that realistic numbers will likely lead

to better decisions in resolving this issue.

You may remember the triumphant announcement in June 2020 by the then Chief Minister of a surplus (of £106m) that was 100 times that predicted. GPEG's work clearly shows that in fact the outcome was very materially affected by some "non-standard" accounting practices and policies and that on a more usual accounting basis there was actually a **deficit**. Given the accounting complexity the majority of the States members and the population had no realistic chance of disentangling the reality from the propaganda. The result was that many people felt good about the state of the economy and they became unconcerned about both the level of government expenditure and the fast growing debt.

With this came the publication of "Revive and Thrive", a States publication with something nice in the future for pretty well everyone in the Bailiwick. Some 24 pages rendered most remarkable by the total absence of any financial cost numbers whatsoever.

The warm glow from the misleading "surplus" potentially could have helped cause an unaffordable wave of spending and borrowing.

Accounting does matter. The politics would have been very different if people were concerned about a **deficit**.

Moreover, poor accounting can reduce the visibility of things. Given the "off-balance sheet" nature of the reporting of losses in operations such as the Ports where losses do not directly affect the "surplus" of the States it is much easier and less visible for inefficient operation to be missed or for non-economic cash "injections" to be made.



In addition, the lack of consolidation means that the full effect of some actions may be hard to spot.

It is generally true that any degree of accounting complexity will obscure the reality of a situation as most people cannot follow that accounting. When the accounting does not follow usual accounting conventions the proportion of people who will properly understand what is going on will be even less.

Even the normal comfort of a full audit is missed here. The auditors of the States and its offshoots do not state if the accounts are accurate or even if they are prepared on an appropriate basis. They merely state they are prepared in accordance with the stated accounting policies – which could be absurd as far as the auditors are concerned. The usual “true and fair opinion” cannot be got from an auditor when there are very significant differences from normal accounting processes and accounting standards. This inevitably means that there is more than the usual risk of error in both the reporting and the communication of reality.

8 years ago, it was thought that £1.3m was needed to sort the accounting out. (see Appendix A.) Some progress has been made, we are told. So perhaps a further £700k remains to be spent. At the most basic level, we wager that a significant multiple of that £700k has been wasted in explaining and disentangling the current accounting in the last 8 years. A much larger number will probably have been wasted because of decisions made against an inappropriate or misunderstood financial picture.

Spending a relatively small amount on getting the accounting right will have a very strong return.

Another example is the failure to show the normal accounting-based deficit on the States Superannuation Fund. If made more visible this large and volatile number might make more people concerned about the potentially nasty effects of prospective high inflation (see for example, <https://www.bankofengland.co.uk/speech/2021/february/andy-haldane-recorded-mini-speech-on-inflation-outlook>) on such an underfunded fund. As it is very few people understand the very considerable risks with its impacts potentially lasting a generation ahead.

Clarity is particularly necessary when including or excluding investment gains or losses in “surplus”. This number is likely to be very variable and is mostly not realised in cash. The States’ Budget does not forecast or report these whereas the States Accounts happily include the outcome as “surplus”.

A good example of what can happen is what has more recently happened is the most recent financial numbers released by the States. In November, the 2021 Budget was published. At that time the information was that 2020 would have an “*overall general revenue Budget deficit*” of £59m. We honestly are not sure what this concept is. Does it exclude capital expenditure, losses on the unconsolidated activities (we have been told it does), investment returns, Aurigny/Cabernet losses or what?

If we had one set of accounts prepared to a normal standard, things would be easier.

It is perhaps ironic that given the dominance of financial services in the Island we would not have an outstandingly good basis for accounting for ourselves.

This paper should have been written earlier but GPEG simply was not around to write it.



There will always be more pressing issues than fixing an accounting system, but the current situation is costly and risky. The costs and time to fix are not very significant. It just needs getting on with.

You cannot do a good job with the wrong tools.

Recommendation:

Just one – **follow internationally recognised accounting standards as soon as possible.** It is way overdue. Apart from possible delays on property valuations (which can be parked) a few months should suffice. Whilst waiting it is really important that our politicians make sure that they understand the quirks of the current system before acting.

You cannot do a good job with the wrong tools.



Appendix A

<https://www.gov.gg/CHttpHandler.ashx?id=111107&p=0>

Appendix B

“Emphasis of Matter — Basis of Accounting and Restriction on Distribution and Use

We draw attention to note 2 to the financial statements, which describes the basis of accounting. Specifically, no full impairment review has been undertaken on the Ports' Fixed Assets. This is not in compliance with FRS 102, which would require a full impairment review in light of the accounting losses. The financial statements are prepared to assist Ports to comply with its financial reporting requirements. As a result, the financial statements may not be suitable for another purpose (*whatever that may be!*). Our report is intended solely for Ports and should not be distributed to (*freely available on the web*) or used by parties other than Ports (*e.g. the owners! And the Ports is not an entity*). Our opinion is not modified in respect of this matter.”

Apparently the auditors are criticising the Board for not complying with a rule book that does not apply to the accounts and that the auditors are not reporting on. Confusing, is it not?

(Our thoughts italicised.)

Appendix C

“FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland Scope of this Financial Reporting Standard 1.1 This FRS applies to financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period.”

Extract from FRC publication of FRS 102 in March 2018.

Appendix D

It is a bit of a mystery as where this comes from. There is no note explaining it and apart from an investment property valued at £375,000 there are no investments visible on the balance sheet. The most likely explanation of the £485,000 is that it represents the investment returns on the States investments which realised around 11.8% (largely unrealised), in 2019 and is therefore the return on the “Balances with States Treasury” which started the year at £4.0m and ended at £6.3m in the States own accounts. But psychic powers would be useful to know this.

Appendix E

This is a novelty area of accounting. The States put money into the company to fund the last Guernsey runway project and the Harbour Cranes project. Oddly, this number is not split in the Accounts between the airport and harbour. The accounting then treats the amount received as a grant and releases the gift in annual doses in line with the depreciation of those assets. However, the amount of unamortised gift is treated -inappropriately we think - as a distributable reserve. The picture becomes even less clear as £3m was "repaid" in 2019. Normal accounting language is that loans are repaid and reserves are dividend or redeemed.

The method of accounting does not comply with any relevant accounting standard – grants are normally booked as creditors and released to profit and loss in the same annual proportions as the depreciation of the related fixed asset is charged for. If the grant is potentially repayable (as this clearly is) then the justification for releasing an annual credit becomes problematic.



The States use the term “Reserve” very much in their own way. Sometimes it is just an allocation of expenditure in budgeting. Sometimes it represents “earmarked” funds. But in the Ports’ accounts the (rough) equivalent of shareholder’s funds is just a heading “Reserves”. It appears that there are several reserves as “all reserves are distributable” (given the absence of an entity this is rather philosophical) but there is no split of the number into its various components. Then as you will see this reserve is treated like a creditor. Even those of an accounting background will not follow this easily. We doubt if many people could follow the byzantine language on accounting around Cabernet (Aurigny’s holding company) or the Bond Reserve contained in the main States Accounts. Some language simplification would remove some of the obfuscation.

Appendix F

The 2019 Ports surplus on page 6 of the 2021 Budget is £1243k. Page 106 shows £1453k for what is apparently the same number. Trying to agree with the Ports Accounts (page 16) is not readily done. The 2020 forecast deficit on page 6 of the Budget is different from the probable outturn on page 106.

Verification:

A late draft was shared with the States. Deputy Helyar helpfully provided a limited response which is reflected herein. No other feedback as to the factual basis of the paper was received.