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States of Guernsey – 2022 Accounts – GPEG's Quick Commentary

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Deputy Helyar said: "*What is positive is that we continue to move forward in our transition to International Public Sector Accounting Standards.*

"As we get nearer to completing the transition, I hope it puts to bed the myth that the Accounts, which are independently audited, aren't accurate or cannot be relied upon.

***"This has never been the case, but it's become a way of distracting from the genuine problem of our deficit which we must deal with urgently*."**

According to the BBC this quote was given on 27th June 2023 on the release of the States Accounts.

Factually:

The States voted funds to cover the cost of moving to International Public Sector Accounting Standards in 2012. We still have a miscellany of non-standard and confusing accounting. No rush…all is to be fixed in another two years apparently. Quite pathetic.

There is a very limited audit report – "the financial statements for the year ended 31 December 2022 are prepared, in all material respects, in accordance with the accounting policies stated in note 1 to the financial statements". This is a lot different from the usual "true and fair" opinion. Note 1 adopts "principles" not generally accepted in financial accounting. (Note the audit fee has risen from £221k in 2021 to £443k!)

We don't doubt the numerical accuracy of the figures presented. Its just that they are, in part, using the wrong ammunition and firing at obscure targets.

The statement "This has never been the case" is obviously Nelsonian. Has he noticed the £1.7 billion of fixed assets that have now been recognised in the year?

The accounts are a very poor, and often extremely confusing, basis for making decisions. The language used is itself confusing. The auditors warn the Accounts may not be suitable for purposes other than "financial accounting".

We agree that the large and growing deficit (whatever it is numerically) is a huge concern. Massive capital projects are being put forward that would have to be funded from selling investments, increased borrowings, cutting public expenditure and/or increasing taxes. There is no easy choice.

There are a number of points that we could make about the Accounts but we will first focus on trying to get near to what is the annual run rate of cash need in the future. We start with a £3m "deficit".

Last year we seem to have repaid £45m in borrowings – good news! However, £115m has been withdrawn from the investment portfolio "to cover in-year operational and capital expenditure commitments."

Then there is capital expenditure of £46m last year. It is extremely unclear what will be spent over the next few years – the electricity strategy alone will be towards a billion pounds spent over the next decade. Ports and education will also have their hands out.

The Government Work Plan published at the same time as the Accounts points out, with anguish, the endless new desires of the States to increase spending whilst not agreeing to any tax rises to fund all this spending. Efforts at cost cutting are so far very marginal and deferred into the next election.

Back to trying to find a future run rate deficit!

There is the bizarre Core Investment Reserve position – verbatim from the Accounts: "The Core Investment Reserve is a long-term reserve, the capital value of which is only available to be used in the exceptional and specific circumstances of severe and structural decline or major emergencies. The States have a policy for the target balance of the Core Investment Reserve being 100% of General Revenue income. The balance of the Core Investment Reserve represents 29% of the 2022 General Revenue income budget. An amount of approximately £384m would need to be added to this Reserve to attain the target balance of 100% of General Revenue income."

Clearly the chances of this being achieved are pretty slight. It clearly demonstrates how the Island has moved from a conservatively run, "small state" government to a reckless disregard for eating up the wealth the Island had not so long ago. And clearly no option exists but to renege on this Core Investment Reserve promise.

Then there are the assorted States entities that are not added into the numbers – Guernsey Electricity, Guernsey Post, Cabernet (Aurigny), Alderney Electricity, Ports (includes the airport), Guernsey Waste, States Works and the Dairy. These do not follow "Note 1" accounting, or even the same accounting as each other. Their annual cash consumption has been very high in recent years due in part to Covid. A guess might be £10m pa future cash needs for these entities - before infrastructure spends which could be very considerable.

Adding it all up, it would seem that a cash deficit might be very crudely estimated as £200mish per year over the next 5 or 6 years. The biggest variables will be capital expenditure and pensions which are in the hands of the States. (The performance of the investment portfolio will lose significance as the assets are sold.)

Absent major tax and spending policy changes by the States, liquidating the investments (and perhaps, the £78m of investment properties) would probably cover the deficits until towards the end of that 5-6 year period. Additional borrowings would then be the only remaining route. This would not be easy.

Something has to give on tax and/or spending.

A 20% GST or nearly doubling income tax or something equally nasty would be needed to maintain the Island's financial balance longer term if we just keep spending. Beyond doubt such tax rises would result in some significant level of economic decline and depopulation.

Things to Note in The Accounts:

- **Besides (finally) putting the fixed assets onto the books the Social Security Contributory Fund has also been "amalgamated" into the accounts. Both really overdue moves in the right direction.**
- **The States investments had a horrible year. Performance was down with a 29% miss of its target in the year – resulting in an £89m recorded loss of 11.6%. In fairness this is not much worse than average for comparable investment funds in 2022.**
- **The balance sheet still shows the investments that belong to the pension fund but not the related liability. Quite misleading and apparently being fixed this year.**
- **The States employee pension fund was a big beneficiary in its accounting from higher gilt yields which (in simple terms) increases the assumed future investment returns to 4.8% pa. At the same time inflation is assumed to drop to a long-term 3% pa. When you compound the two for 30 years or so the result is a cheerful decrease in the deficit of £1.0bn! Given current rates of inflation you might think this 3% inflation number pretty optimistic – this pension is simply a very large risk to the island. If (most unlikely but not impossible) we had last year's interest and inflation rates persisting, then the deficit would increase by a couple of billion pounds rather quickly.**
- **In more easily understood terms the employee pension fund received £49m in contributions and paid out £76m in pensions whilst losing £200m on its investments. This is not a healthy trend if it continues. The civil service pension benefits remain massively better than private sector equivalents.**
- **Weird part of the Auditors Report: "Our report is intended solely for the Policy & Resources Committee (the "Committee") and should not be distributed to or used by parties other than the Committee." DO NOT READ THE ACCOUNTS IT SEEMS!**
- **Having fixed the fixed asset accounting, it does not apply to leased assets – why?**
- **The restatement of the prior year accounts is quite complex. We suggest you do not try to follow it.**
- **The States directly employ some 4,900 "Full Time Equivalents" – given part-timers the actual workforce will be considerably more. A stated 181 members of staff cost >£100k pa to employ. There are more employed in agencies such as the Guernsey Financial Services Commission.**
- **In 2022 £66m was spent on "Contracted out work" as opposed to £36m in 2021. This is in addition to £12m of consultancy costs. We do not know what these are.**
- **The "(Non-Pay) Expenditure shows "Services" increasing from £35m to £46m. Again we do not know what this is.**
- **In 2002 £50m was spent by the States on grants and subsidies.**
    - **£2.5m on Overseas Aid. (Note that the proposed huge spending on carbon emission reduction will nearly entirely be spent on improving the air in other jurisdictions who will on the whole not reciprocate. Effectively the hundreds of millions needed for this is more Overseas Aid).**
    - **The Lieutenant Governor cost £712k.**
    - **See page 88 of the Accounts if you want to see the full list.**

- ***This is not intended to be a complete review and we have not covered points which are not substantial or are unduly complicated (complexity is mostly to do with the trading “entities”).***