How Big Should Be the United Kingdom's Exit Bill from the European Union? Insights from Modes of Accounting*

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1: INTRODUCTION

Commentators compete rhetorically about the portentous nature of the decision by the United Kingdom (UK) to leave the European Union (EU):[1] a familiar one is that this is the most important UK event since the end of the Second World War in 1945. This paper does not discuss the merits of what has become known as 'Brexit' but works on the assumption that it will happen, or at least that the key parties believe it will. Neither is it concerned with blow-by-blow accounts of negotiations which, though supposedly confidential, have been regularly leaked to newspapers.

The structure of the process had been designed by the UK diplomat Sir John Kerr to make exit from the EU28 so difficult that no country would activate Article 50 of the *Treaty on the Functioning of the European Union*.[2] Immediately after the delivery of the Article 50 letter on 29 March 2017, the United Kingdom was marginalised and certain UK citizens working in EU institutions were kept away from documentation and decisions on the basis of their allegedly conflicted loyalties. Control of the exit process is in the hands of the European Commission (EC), acting on behalf of the Council of Ministers (ie the governments of the Member States), now the EU27. Pre-conditions were set that the Commission would not discuss the UK's future trading relationship with the EU until there had been settlement of three issues: the treatment of non-UK EU citizens resident in the UK and of UK citizens resident in the EU27; the arrangements for the border between Northern Ireland and the Republic of

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[1] In a UK referendum called by the then Conservative Prime Minister David Cameron, the UK voted by 52% (Leave) to 48% (Remain) on 23 June 2016, the turnout being 72%. Having recommended a Remain vote, Cameron resigned immediately after the result, leading to Theresa May becoming Conservative Prime Minister and activating Article 50 on 29 March 2017.
[2] Page 45 of the 2012 consolidated version. Article 218(3) explains how the EU would organise itself, the UK having effectively made itself a third party.

Ireland;[3] and the financial settlement that the UK would pay. This exit bill quickly became known as the 'divorce bill' (Keep, 2017). Remarkably in retrospect, this eventuality had not featured in the Brexit referendum campaign. Because this paper concludes by disputing the applicability of the divorce analogy, we use the term 'exit charge' unless referring to documents or speeches where this term is used.

The motivation for this paper is to demonstrate how four modes of government accounting (as discussed in Section 3) cast light on the financial issues at stake in the exit charge calculations. This dramatic episode stimulates reflection on the way government accounting is conceptualised by 'experts' and how it is understood or misunderstood in public debate. Our expectation is that the exit charge will be a political fix, reflecting the relative bargaining power of the EU27 (strong) and the UK (weak) and that it will constitute one piece in a complex package (including treatment of citizens, trade relationships and judicial oversight). Notwithstanding frequent endorsements of fiscal transparency as a beneficial aspect of UK and EU public financial management, our expectation is that the financial settlement will be rendered opaque in order to neutralise criticism from the right-wing UK press of which UK governments are constantly fearful.

Paradoxically, the exit charge is economically irrelevant but politically toxic. The UK net contribution to the EU is currently of the order of £8-10 billion per annum which is roughly 1% of annual UK public expenditure. A much-cited figure for the so-called divorce bill is €60 billion, which if added to the UK public sector net debt would increase the net debt/GDP ratio from 87% to 90%. Before the global financial recession, the 2008 ratio was 48% (ONS, 2017). The exit charge is therefore small in relation to the potential effects of Brexit on GDP growth and on the public finances, for example due to sterling depreciation and trade disruption (Emmerson et al., 2016).

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[3] Violent civil conflict in Northern Ireland came to an end with the 1998 Good Friday Agreement, leading to the restoration in 1999 of devolved government in amended form. If Brexit means that the United Kingdom is outside both the EU single market and the EU customs union, some measure of border control is required. Although there are internal factors, Brexit and its consequences play a role in the non-functioning (though not yet formal suspension) of the Northern Ireland Assembly. The main parties of the two communities (Democratic Unionist Party and Sinn Fein) cannot reach agreement to restore the Assembly, a situation further complicated by the now minority UK Conservative Government having a 'confidence and supply' arrangement with the Democratic Unionist Party which only stands for election in Northern Ireland.

The short-term effects of Brexit will be disruptive to UK public finances, even if one believes that escape from the 'sclerotic' European economic and social model will bring long-term economic gains.

Despite numerical marginality, the UK has long obsessed about sending 'huge sums' to Brussels (May, 2017a). Current politicians are trapped by past rhetoric dating back to the Fontainebleau rebate secured by the then Prime Minister, Margaret Thatcher, in 1984, and vigorously defended since then by all UK governments. Implicit damage to the public finances through lower economic growth is less politically salient than handing over money. Moreover, the EU27 has taken advantage of UK political sensitivities by insisting on an early financial settlement before negotiations can move on to trade issues vital to the UK. The flavour of controversies about the 'divorce bill' are illustrated by the quotations in Table 1.

Our methodological approach has been the following. We have built on the academic literature on modes of accounting and our prior involvement in UK and EU public sector accounting developments. In relation to the exit charge, we have enjoyed no insider access to documentation, using only what is in the public domain. This has been less of a disadvantage than it might seem, because both the EU and UK sides have extensively leaked to the media their version of the rights and wrongs of the exit charge. We have therefore tracked events in the media, with the *Financial Times* being particularly useful. We have also participated in seminars held on the Chatham House Rule, which has facilitated contextualisation and interpretation, allowing us to seek clarifications where necessary.

The paper is structured in the following way. Section 2 discusses competing conceptualisations of the UK's relationship to the EU, noting that adherence to different conceptualisations is a major factor in the Brexit negotiations turmoil. Section 3 summarises four modes of government accounting: budgeting, financial reporting, statistical accounting, and fiscal sustainability analysis (Heald and Hodges, 2015). Each contributes to our understanding of why Brexit has become so conflictual over relatively small amounts of money. Section 4 provides an explanation of the financial structure of the EU sufficient to demonstrate how competing

conceptualisations promote conflict and misunderstanding about the exit charge. Section 5 suggests how the dispute might be resolved, while reminding the reader that international political fixes do not necessarily follow economic rationality or accounting principles. It highlights the risk that the financial settlement might be designed to be opaque, in order to confuse the public and media on both sides of the dispute. The fragility of fiscal transparency is demonstrated (Heald, 2012). Section 6 concludes by drawing out the implications of this unprecedented episode for public sector accounting research.

Table 1: The Tone of the Debate on the EU Exit Bill

Margaret Thatcher, UK Prime Minister	"I want my money back … I must be absolutely clear about this. Britain cannot accept the present situation about the budget. It is demonstrably unjust. It is politically indefensible; I cannot play "Sister Bountiful to the Community"	Dublin Summit, 1979
Vote Leave campaign	We send the EU £350 million a week. Let's fund our NHS instead. Vote Leave.	Vote Leave campaign bus
Boris Johnson MP	"On June 23rd you will face a historic choice … to take back control of huge sums a month - £350 million pounds a week - and spend it on our priorities such as the NHS."	ITV Referendum Debate, June 2016
George Osborne, UK Chancellor of the Exchequer	"If we take as a central assumption that the UK would seek a negotiated bilateral agreement, like Canada has, the costs to Britain are clear. Based on the Treasury's estimates, our GDP would be 6.2% lower, families would be £4,300 worse off and our tax receipts would face an annual £36 billion black hole. This is more than a third of the NHS budget and equivalent to 8p on the basic rate of income tax."	Foreword to HM Treasury analysis: the long-term economic impact of EU membership and the alternatives, April 2016
BBC report	George Osborne says he will have to slash public spending and increase taxes in an emergency Budget to tackle a £30bn "black hole" if the UK votes to leave the European Union	15 June 2016
Theresa May, UK Prime Minister	"The principle is clear: the days of Britain making vast contributions to the European Union every year will end."	Lancaster House speech, January 2017
Philip Hammond, UK Chancellor of the Exchequer	"We are all signed up to the Article 50 letter. We are all behind the speech [Theresa May] made in Florence. The enemy, the opponents, are out there on the other side of the table. Those are the people we have to negotiate with …"	Interview with Sky, 14 October 2017; the label 'enemy' was later retracted
Jean-Claude Juncker, President of the European Commission	"If you were sitting in a bar and if you are ordering 28 beers and then suddenly some of your colleagues is leaving and is not paying, that is not feasible. They have to pay - they have to pay. Not in an impossible way, I am not in a revenge mood. I am not hating British. The Europeans have to be grateful for so many things Britain has brought to Europe during war after war, before and everywhere and every time. But now they have to pay."	Lecture to students at the University of Luxembourg, 13 October 2017
Boris Johnson, UK Foreign Secretary	"The sums that I have seen that [the EU27] propose to demand from this country seem to me to be extortionate. I think that to "go whistle" is an entirely appropriate expression."	Parliament TV, 11 July 2017
Michel Barnier, EU Brexit Negotiator	"I am not hearing any whistling, just a clock ticking."	Speaking in Brussels on 12 July 2017

2: CONFLICTING CONCEPTUALISATIONS OF BREXIT

As in human divorces, both the UK and the EU have secured legal advice confirming their own position in the financial dispute. A report by the House of Lords European Union Committee (2017) concluded that, in the absence of a withdrawal agreement, the UK has no legal obligation to pay to exit, but that the "political and economic consequences … are likely to be profound". The disputed legal position provides context, but is outside the scope of this article.

Though evocative shorthand, the divorce analogy is unsatisfactory and generates as much confusion as it does insight. This Section considers conflicting conceptualisations of the broken UK relationship with the EU as analogous to:

A. divorce at the end of a human marriage
B. quitting a golf club
C. leaving a professional partnership
D. leaving a Treaty-based international organisation
E. terminating a contractual relationship under private law
F. secession from a state

Of central importance is the UK's transactional approach to EU membership, always assessing costs and benefits. This has applied across the UK political spectrum and has characterised all UK governments since entry into (what became) the EU in 1973. The late-arriving UK never embraced the existential 'peace and prosperity' vision of the EU and its predecessors that were shared by founder members. Rogers (2017) traced the origins of Brexit back to the 1992 Maastricht opt-outs on the single currency and Schengen, and particularly to the 2011 UK veto of Treaty changes desired by the eurozone countries at the height of the fiscal crisis. It is not that France and Germany do not themselves pursue self-interest in economic and fiscal matters, but that they share a European vision into which the UK has never bought. There is irony in that successive UK governments pressed early membership for the former communist states in Eastern Europe, with the purpose of diluting ambitions for political integration on the lines of the 'ever closer union' expressed as a political goal in EU Treaties (Miller, 2015). Although these countries can behave as transactionally as the UK and therefore should be natural allies, resentment at the

scale of Eastern European immigration into the UK was a powerful factor in the Leave campaign, in turn alienating Member States in Eastern Europe.

A. Analogous to Divorce as the End of Human Marriage

The analogy of divorce has attached to the UK's decision to activate Article 50 on 29 March 2017, thus setting the exit date at 29 March 2019.

Human divorces are complicated and how they are constructed has undergone significant legal change, particularly affecting financial settlements. Venue shopping has made London and the English courts the favoured location in high-worth divorces because of the courts' willingness to specify 50:50 splits of net assets, irrespective of wealth taken into a marriage (ie no entry charges), relative earnings during the marriage, and projected future earning power after the divorce. If Brexit were a human divorce then, on this basis, the UK would receive back its share of net assets or pay over its share of net liabilities at the settlement date. There would be an accounting calculation of the net assets (or net liabilities) of the EU, with the UK 'taking its share', whether positive or negative. There would be several subsidiary complications to argue about: would the UK share be determined with reference to its present GDP share, its population share, or its cumulative financial contribution over its membership years?

The notion that the exit charge should be calculated on net assets or net liabilities was rendered implausible by the sequencing imposed on the UK by the EU27, once Article 50 had been activated. Although Barker (2017) did some calculations based upon the EC's financial accounts, the EU27 has no intention of letting the UK take away a share of its net assets. Disruption having been caused by the UK's decision to leave, it must pay its share of financial liabilities but would have no claim on assets. Certainly this will not be a divorce of the kind obtainable from the UK courts at the dissolution of a marriage.

In a letter to which the *Financial Times* added the title 'UK has no obligation to finance future unaccrued spending commitments', Walker (2017) stated:

> Not all of the *reste à liquider* is legally committed by the EU, and, if it is unaffordable post-Brexit, the EU should cut its coat according to its cloth. That part to which the EU is legally committed but which it has not accrued for should be financed by the

> remaining member states. The UK will be getting no benefit from these programmes and has no moral or legal obligation to pay for them.

This letter writer considers that it is the financial reporting treatment, not the legal commitment, that determines whether there is a moral or legal obligation to pay.

B. Analogous to Quitting a Golf Club

Joining a golf club usually involves paying a joining fee (which might loosely be interpreted as relating to existing assets such as valuable land) and then an annual membership fee. Eventually the member exits the golf club, perhaps because they become too infirm to play. That would involve giving a period of notice, paying the final year's fees, and settling any outstanding bar bills and green fees. Golf clubs have large memberships and each member will eventually leave. The departing member does not receive a share of net assets at the date of departure nor have to fund a share of net liabilities, which might relate to employee pension liabilities and negligence claims.

An extreme scenario would be when all members exit and leave behind either net assets or net liabilities, for which membership of an unincorporated golf club had previously made them jointly and severally liable. The UK was perhaps never serious in claiming a share of net assets, but it would like the clean break of the golf club scenario. The major figures of the EU27 do not see the EU as analogous to a golf club; institutional design did not envisage exit. As for a golf club, the departing Member State does not receive a share of assets, but, unlike a golf club, it is held responsible for its share of liabilities and contingent liabilities.

C. Analogous to Leaving a Professional Partnership

In the days when the large auditing firms were partnerships, one bought into the partnership at entry and was bought out at exit. Because of unlimited liability one was jointly and severally liable during the partnership but free from liability after departure. Accession countries to the EU do not pay an entrance fee, though substantial economic and political costs may be implicit in conforming to the European *acquis*.

D. Analogous to Terminating a Commercial Contract

In a contractual relationship between two private entities, the relationship will only survive long-term if both see future gain to themselves. Market logic legitimately applies to such terminations, both sides calculating what they can get. This sense of continuous calculation to assess position is alien to the European vision, but closer to the transactional approach of the UK. As an approach to EU membership, it is well represented by the UK Foreign Secretary's 'go whistle for the money' taunt to the EU27 (see Table 1).

E. Analogous to Leaving a Treaty-based International Organisation

The United Nations is an international organisation which does not dissolve states. Countries can walk out of international organisations because of policy disagreements: the latest example is the United States' decision to leave UNESCO in 2018, having suspended its subscriptions since 2011 (UNESCO, 2017). The degree of enforcement of financial obligations is likely to depend on the financial firepower and political weight of the particular state. In contrast, the EU is a supranational organisation on a track towards political and economic integration, which assumed that accessions would be irreversible.

F: Analogous to Secession from a State

The EU is not yet a state, so the analogy is stretched. However, two EU Member States face threats of secession: Catalonia from Spain and Scotland from the UK. At the time of the Scottish independence referendum in 2014, the UK Government position was that a departing Scotland would have no claim on UK assets but would have to assume its share of UK liabilities, such as the national debt (HM Government, 2014).

The EC's 'chief spokesman' captured the EU27 view of the UK Brexit financial liability in a letter to the *Financial Times* (Schinas, 2017):

> … all commitments undertaken by the 28 member states should be honoured by the 28 member states. No member should pay more and no member should receive less because of the UK's decision to leave the EU.

This characterises the UK as the disrupter of EU finances and contends that no other Member State should be worse off because of Brexit. This reflects the fears that either

the receiving Eastern European Member States will receive less subsidy and/or that Germany and others will have to pay more. Another example of disruption is the costs of moving the European Banking Authority and the European Medicines Agency from the UK: this is 'the disrupter should pay' principle.

Taken literally, this would mean that the UK should pay the present value of all future net contributions: Brexit would not then damage EU fiscal sustainability. The Schinas letter indicates that the 'no worse off' condition would apply to the liabilities and contingent liabilities of the EU on Brexit day, and to the working through of the 2014-20 Multiannual Financial Framework (MFF), to be considered in Section 4. Although Brexit is not secession, it feels like that to key players in the EU27.

Two conclusions deserve emphasis. First, much argument is opportunistic, with actors calling on principles to support their desired outcome. This is no surprise but it makes satisfactory resolution more difficult when public positions harden and the negotiators expect allegations of betrayal and sabotage from behind them. Second, conflicting understandings of the UK-EU relationship coalesce with deliberate misinterpretations of accounting and statistical data.

3: Four Modes of Government Accounting

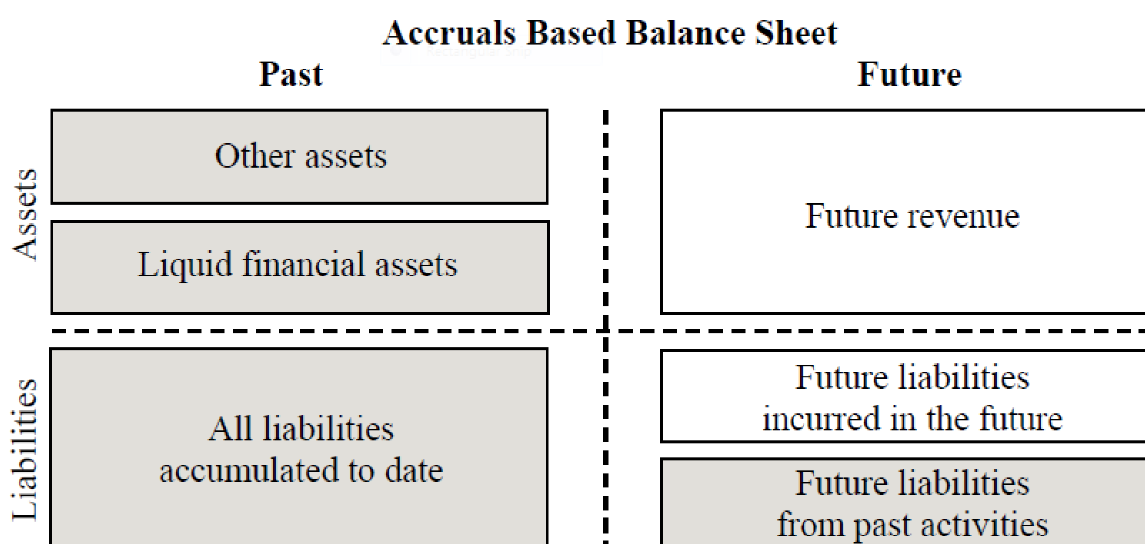
Power politics dominate the fraught exit charge negotiations between the UK and the EU. On 12 June 2017, the EU27 published a statement of principles governing the calculation (European Commission, 2017) whereas the UK has consistently refused to state publicly its position, other than a conditional offer of circa €20 billion in the UK Prime Minister's specially arranged Florence speech on 22 September 2017 (May, 2017b). This overture was intended to row back from the ministerial aggressiveness evidenced in Table 1.

A cynic might argue that a headline number will eventually be agreed, and then a spurious official calculation produced to justify that number. Nevertheless, developments in public sector accounting research can cast light on the underlying issues that must be confronted.

Pioneering work in the 2000s by Frank Eich, who was then responsible for the UK Treasury's long-term fiscal projections, is conveniently summarised in Eich (2008). Figure 1 reproduces his conceptualisation of the public sector balance sheet. This facilitates an exposition of the four modes of government accounting (Heald and Hodges, 2015): budgeting; financial reporting; statistical accounting; and fiscal sustainability analysis.

Starting with government financial reporting, in which there has been extensive innovation in the 2000s, Eich's (2008) schematic Figure 1 is illuminating.

Figure 1: Conceptualisation of the Public Sector Balance Sheet



Source: Eich (2008, Chart 3.3).

In countries that have led public sector accounting reform, accrual accounting has replaced variants of cash accounting and modified accruals. Figure 1 has four quadrants, the vertical dimension distinguishing between assets and liabilities and the horizontal dimension between events in the past and in the future. It illuminates the gains from having a public sector balance sheet, but also the gaps that affect – to varying degrees – both financial reporting and statistical accounting.

Whereas financial reporting provides comprehensive coverage of liabilities accumulated to date (the bottom left quadrant), statistical accounting generally does not include provisions that arise from past events. Both modes of accounting attach central importance to recognition criteria. For example, certain items are not

recognised in balance sheets because they are executory contracts: no accounting recognition until delivery. Therefore, though organisations have contractual obligations to employees, future employment costs are not put in the balance sheet as liabilities. Until relatively recently, public sector organisations did not report accrued employee pensions liabilities.

Public sector balance sheets do not include future taxation revenue (top right quadrant). Of most relevant in the present context is what lies in the bottom right quadrant:

a) future liabilities from past activities (which financial reporting seeks to cover comprehensively, unlike statistical accounting)
b) future liabilities incurred in the future

The main innovation of fiscal sustainability projections is to place attention on (b), which fail accounting recognition criteria but which hang over future public finances. An example is the to-be-accrued pension liabilities arising from the future employment of existing and new public employees. Unlike (a), these fail accounting recognition criteria, being treated as executory contracts.

With regard to the top left quadrant, financial reports are prepared on the going-concern convention: the default assumption is that the organisation will continue in broadly the same shape and condition. Statements of financial position are understood by users to be prepared on this basis. Financial reports are not prepared on the basis that the entity will terminate or be broken up, irrespective of whether the measurement basis is historic cost or some form of current cost or fair value accounting. Herein lies one difficulty for exit charge calculations that seek a basis in annual financial reports. For example, the reported net assets of the European Investment Bank (EIB) are irrelevant to a calculation that includes an offset for assets. The relevant calculation would be the UK's share of the hypothetical flotation value of the EIB.[7]

Fiscal sustainability analysis, taken over from the Treasury on the establishment of the Office of Budgetary Responsibility in 2010, is highly relevant to the exit charge.

[7] The assets offsets in Barker (2017) are based on the valuations in EU accounts: see Table 2 of this paper.

This involves forecasting cash flows over 50-year and infinite time horizons, on the basis of 'existing policies'. The calculation of fiscal gaps indicates the extent of fiscal unsustainability that has to be resolved by increases in taxation or reductions in expenditure. Even at the national level, there are serious difficulties in establishing in operational terms what constitutes existing government policies. The economic and demographic uncertainties are profound. What happens over time in terms of the crystallisation of the contingent liabilities relating to the increasingly complex EU financial architecture is of profound importance to the exit charge calculation. If assumptions are made now, a lump-sum exit bill can be calculated, whether that is handed over as a single payment or in stages. Alternatively, the final amount of the exit bill will be heavily influenced by future economic conditions and EU decision-making on how to handle such contingent liabilities (eg generosity to EU pensioners and willingness to write-off loans to outside organisations and countries).

There is plenty of evidence that it is budgeting that decision makers care about, much less the later financial reports (Procedure Committee, 2017; Public Administration and Constitutional Affairs Committee, 2017). Unlike statistical accounting (on Eurostat (2013) standards) and financial reporting (more harmonisation broadly on IFRS/IPSAS standards), budgeting processes remain the sole responsibility of nation states. There are wide differences, especially on the breadth of coverage of public institutions and in the accounting basis (cash, accruals, or variants) (Blöndal, 2015). The common features are that Executive decision-making (Diamond, 2013) and the acquisition of legitimacy through legislative endorsement (Lienert, 2013) use the budgeting numbers, however these are constructed.

Of critical importance to the exit charge is the way in which the EU conducts its budgeting through the Multiannual Financial Framework (MFF). The European Commission website (undated) states that the MFF is 'not the budget of the EU for seven years' but 'a framework for financial programming and budgetary discipline'. Exposition of the MFF system will be provided in Section 4.

The point to be stressed is the different ways in which the UK and EU undertake their budgeting. The UK has Spending Reviews, their periodicity, years covered and

content being entirely under Treasury control. Spending Reviews are conducted on an accruals basis and tend to cover three years ahead; they are never voted by Parliament. Formal authorisation, again on an accruals basis, takes place after the financial year has started, through what is known as the Supply procedure (Jack, 2011). Unspent amounts in voted Estimates expire at financial year end, and have to be voted again, even if the Treasury operated a carry-over system, variously known as 'End-Year Flexibility' (EYF) or 'budget exchange'. In 2010, the incoming Coalition Government cancelled all accumulated EYF that had built up during the 1997-2010 Labour Government.

In contrast, the EU operates on a dual commitments (seven-year MFF) and payments (annual budget) basis, in which unspent commitments carry forward and do not expire. Hawkish Member State attitudes to authorising payments in the annual budget, often with the UK in the forefront, have prevented commitments in the MFF being fully funded for individual years, leading to a build-up of unexpired commitments: for the figures, see Section 4. This squeezing pushes spending forwards to later years, beyond the end of the current MFF period, adding to the lags in spending that have characterised the MFF system. Working from its own practices, the UK thinks of unspent commitments on 29 March 2019, or at least at the end of the MFF on 31 December 2020, as not being its responsibility. In contrast, net recipient EU27 countries are programming that expenditure into the 2020s, considering the MFF amounts to be a binding obligation on all the EU28.

4: The Substance of the Dispute

In terms of headline numbers, the EC is asking for circa €60 billion and the UK, after initially denying that it had anything to pay, made what was interpreted as an offer of €20 billion in the Prime Minister's Florence speech (May, 2017b). It does not seem coincidental that €20 billion is about two years' UK net contribution, thereby filling the budgetary hole in the final two years of the 2014-20 MFF. Sterling depreciation of 14% against the euro since the Brexit referendum increased the sterling cost of the exit settlement which will be payable in euros (European Commission, 2017a).

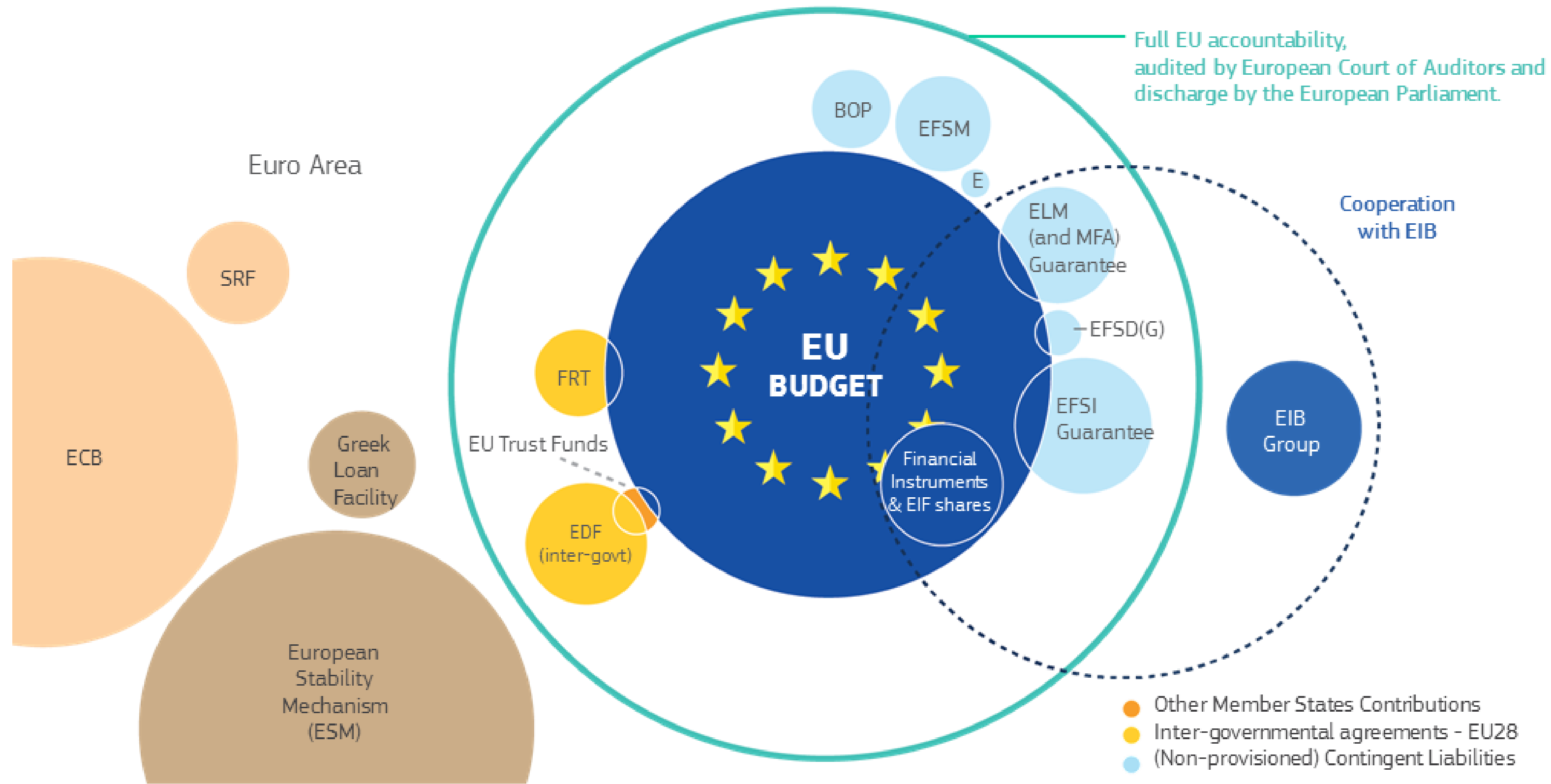
Much discussion about the exit charge has centred around the EU budget and the EC consolidated financial report. However, there is a much broader context, as is shown in Figure 2. This complex architecture reflects not only the growing complexity arising from the co-existence of the eurozone 19 and the non-eurozone 9, but also off-balance sheet activity on behalf of the EU28. Sinn (2015) has criticised these developments as constituting a 'shadow budget' which – if not checked – will grow non-transparently alongside tight control of the EU budget.

Figure 2 demonstrates this complexity. The blue circle represents the EU budget, which might be thought of as the planet. There are many moons, some intersecting with the EU budget, all of which fall within what is known as 'full EU accountability'. This term means that they are audited by the European Court of Auditors and subject to discharge by the European Parliament. The key to Figure 2 provides full titles relating to the acronyms of organisations and funds falling within the green circle.

On the right of Figure 2 and intersecting with the EU budget is the dotted circle representing the European Investment Bank (EIB) Group. The EIB is an EU institution not consolidated in the accounts of the EC. The area of intersection contains, for example: financial instruments and EIB shares (within the EU budget); European Fund for Strategic Investments Guarantees (partly inside the EU budget and wholly within the green circle of full EU accountability); and the European Financial Stability Mechanism and Euratom loans (outside the EU budget but inside the green circle).

On the left of Figure 2, outside both the EU budget and full EU accountability, are the institutions connected to the eurozone, notably the European Central Bank and the European Stability Mechanism. The UK's multiple opt-outs mean that it has no involvement in this area of Figure 2. Moreover, the difficulty of making Treaty revisions, to which the UK has contributed, has increased the use of intergovernmental agreements between subsets of EU Member States. This is also a mechanism by which Member States bypass the European Commission.

Figure 2: The Whole Picture of EU Finances



Borrowing and lending:
BOP: Balance of Payments loans
EFSM: European Financial Stabilisation Mechanism
E: Euratom loans
ECB: European Central Bank
ECA: European Court of Auditors
EDF: European Development Fund
EFSD(G): European Fund for Sustainable Development Guarantee

EFSI: European Fund for Strategic Investment
EIB: European Investment Bank
EIF: European Investment Fund
ELM: External Lending Mandate
ESIF: European Structural and Investement Funds
FRT : Facility for Refugees in Turkey
MFA : Macro-Financial Assistance loans
SRF : Single Resolution Fund

Financial Instruments :
Equity and debt for small and medium enterprises and loan guarantees for innovation projects

Note: The size of the circles does not correspond to actual values.

Source: European Commission (2017b)

If Brexit were analogous to a divorce on the basis of a *pro rata* split of net assets, there would be a valuation on Brexit day of everything within the green circle. Although it is unclear what is included, Barker (2017) attached a total valuation of €22.5 billion, providing the UK with an offset of €2.7 billion (12% share) or €3.4 billion (15% share).[8] With 16.1%, the UK is the largest shareholder in the EIB, but ceasing to be an EU Member State on 29 March 2019 would render it legally unable to continue as a shareholder. In principle, the EU27 might 'buy out' the UK's (largely unpaid) share capital, or these shares might be disqualified. The EU27 have no intention of the UK taking assets with it; Brexit is seen as analogous to secession, not to divorce, and discouraging imitation is a high priority.

Several complications for the financial settlement have arisen since the activation of Article 50.

First, the EU view of the likely UK exit liability was first promulgated by well-briefed articles in the *Financial Times* (Barker, 2017), providing indicative numbers for total EU liabilities and alternative methodologies for calculating the UK share. This is summarised in Table 2.

[8] The 12% share relates to the average of UK net contributions after the rebate, 15% to before the rebate (Barker, 2017, p. 9).

Table 2: Alex Barker's Brexit Bill Calculations

	EU end 2018 € billions	UK share 12% € billions	UK share 15% € billions
Pensions	63.80	7.70	9.60
Reste à Liquider (RAL at end 2018)	241.00	29.20	36.20
Other	172.40	22.60	27.60
TOTAL LIABILITIES	**477.20**	59.60	**73.30**
Guarantees/provisions	23.10	2.80	3.50
EU Loans	56.10	6.80	8.40
TOTAL CONTINGENT LIABILITIES	**79.20**	9.60	**11.90**
TOTAL OF LIABILITIES AND CONTINGENT LIABILITIES	**559.70**	**69.10**	**85.20**
Assets	22.50	2.70	3.40
UK rebate for 2018 (approx)	-	6.00	6.00
Receipts for UK projects (approx)	9.00	9.00	9.00
POSSIBLE OFFSETS	**31.50**	**17.70**	**18.40**

Note: There are some rounding errors in the original source.
Source: Barker (2017, p. 10).

In June 2017 came the official publication of the EU's principles for calculating the exit charge, though without numbers (European Commission, 2017a). The numbers reported by Barker (2017) were interpreted in the UK as an opening gambit: however, Jean-Claude Juncker, President of the European Commission, noted that the financial calculations were more complex than expected, but that the British would have to pay (Boffey, 2017). In contrast, the UK Government has never published its own analysis of the UK liability, though ministers have rubbished the EU figures as extortion, punishment and ransom (see Table 1). It has also become clear that Prime Minister Cameron's pre-Referendum instruction that the UK civil service would make no preparations for Brexit was obeyed. The specious UK argument that it would accept pension liability only for those EU pensioners who are UK nationals was

clumsy (if it were a tactical ploy to have something to concede later on) or inflammatory (if serious).

Second, the UK's liability is potentially affected by the appearance on the UK agenda of a 'transition period' after 29 March 2019, possibly of two years. During this period, the UK would be in the departure lounge: not a Member State, so having no representation, but subject to: the usual budgetary contributions; all EU law (presumably included that newly coming into force); and subject to the jurisdiction of the European Court of Justice (ECJ). Such an arrangement would partly 'solve' the budgetary gap which worries both net recipient and net contributing Member States, as two more years of the 2014-20 MFF would expire. However, the issue of unspent commitments would remain: on past experience, significant amounts of Reste à liquider would continue until at least 2023, and some for much longer (European Commission, 2015).[9] Further involvement of the ECJ and the European Court of Auditors would cross 'red lines' set by the UK Government for internal party management purposes. Another issue is that impending Brexit may reduce the amount of EU receipts (eg from competitively tendered programmes such as Horizon 2020) and thus increase the net contribution.

Third, threats to fiscal transparency have become evident. Having elevated the exit charge to such prominence, the pressures to conceal the amounts payable have mounted. Rather than a clean break at 29 March 2019 (pay the agreed financial liability as a lump sum as total discharge, then pay for participation in particular programmes), there might well be staged payments.

This possibility of staged payments raises an important issue in relation to the *EU (Withdrawal) Bill.* Payments that arise from Treaty obligations generally fall within the accepted areas where payments can be classified as Consolidated Fund Standing Service, which leads to an automatic charge on the Consolidated Fund without requiring Parliamentary approval, as is the case, for example, with the salaries of

[9] There was a large build-up of unspent MFF allocations during the 2007-13 period, due to the global financial recession leading to austerity measures in most countries which inhibited co-financing.

judges and the salary of the Comptroller & Auditor General. Normally such an arrangement requires a specific piece of primary legislation to provide the authority, as instanced by Section 2(3) of the *European Communities Act 1972 Act* in relation to UK payments to the EU.[10]

In contrast, the relevant provision in the *EU (Withdrawal) Bill* is Clause 9:

9 Implementing the withdrawal agreement

(1) A Minister of the Crown may by regulations make such provision as the Minister considers appropriate for the purposes of implementing the withdrawal agreement if the Minister considers that such provision should be in force on or before exit day.

(2) *Regulations under this section may make any provision that could be made by an Act of Parliament (including modifying this Act).*

(3) But regulations under this section may not—

(a) impose or increase taxation,

(b) make retrospective provision,

(c) create a relevant criminal offence, or

(d) amend, repeal or revoke the Human Rights Act 1998 or any subordinate legislation made under it.

(4) No regulations may be made under this section after exit day.

Subsection 9(2) is italicised in the text of the Bill because it can create a charge on the public purse, including a standing charge. A provision directly equivalent to Section 2(3) of the 1972 Act could be inserted by secondary legislation. If that happened, neither House of Parliament (Commons and Lords) could amend the regulations nor vote on the amount. Because of Reste à liquider from successive MFFs and the gradual crystallisation of contingent liabilities, this situation could exist for a very long time.

The European Commission website (undated) explains the MFF in the following terms:

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[10] The 1972 Act reads as follows:

(3) There shall be charged on and issued out of the Consolidated Fund or, if so determined by the Treasury, the National Loans Fund the amounts required to meet any [EU obligation] to make payments to [the EU or a member State], or any [EU obligation] in respect of contributions to the capital or reserves of the European Investment Bank or in respect of loans to the Bank, or to redeem any notes or obligations issued or created in respect of any such [EU obligation]; and, except as otherwise provided by or under any enactment,—

(a) any other expenses incurred under or by virtue of the Treaties or this Act by any Minister of the Crown or government department may be paid out of moneys provided by Parliament; and

(b) any sums received under or by virtue of the Treaties or this Act by any Minister of the Crown or government department, save for such sums as may be required for disbursements permitted by any other enactment, shall be paid into the Consolidated Fund or, if so determined by the Treasury, the National Loans Fund.

> The multiannual financial framework (MFF) lays down the maximum annual amounts ('ceilings') which the EU may spend in different political fields ('headings') over a period of at least 5 years. The upcoming MFF covers seven years: from 2014 to 2020. The MFF is not the budget of the EU for seven years. It provides a framework for financial programming and budgetary discipline by ensuring that EU spending is predictable and stays within the agreed limits. It also allows the EU to carry out common policies over a period that is long enough to make them effective. This long term vision is important for potential beneficiaries of EU funds, co-financing authorities as well as national treasuries (European Commission, undated website).

The MFF follows a special acceptance procedure: proposed by the European Commission, voted on by the European Parliament on a Yes/No non-amendable basis, after which the European Council can make changes without going back to the Parliament. The MFF has been regarded as binding by recipient and contributing countries, though actual payments can be frustrated by restricting the annual budget.

Less attention has been paid to the build-up of contingent liabilities, an unsurprising development after long periods of tight control over EU expenditure. Contingent liabilities are liabilities which fail the recognition criteria to be included in financial reports. If there is not a single figure that is agreed to fully discharge the financial obligations deriving from the UK's membership, there could be EU27 demands for further payments for several decades as contingent liabilities crystallise. This crystallisation process will be managed by the EU27, with the UK having no role in decisions that influence those amounts, for example, debt write-offs from the EU budget to EU institutions and third parties. Figure 2 serves as a reminder of the increasingly complex financial architecture of EU institutions, and the likely problems that would arise from being outside the European Council, the Commission, and exclusion from inter-governmental agreements.

The 2010-15 UK Coalition Government undertook a comprehensive evaluation of its relationship with the EU, in what was known as the 'Balance of Competencies Review', set up to consider what changes the UK should seek. The study component on the EU Budget, which was co-ordinated by the Treasury, summarised its findings:

> Responses from stakeholders, across the academic community, think tanks, representative groups and Devolved Administrations, suggested that *while the balance of competences in the area of the EU Budget is largely appropriate*, the application of competences could be improved by reform of budget structures, through improving the financial management of the EU Budget in Member States and EU Institutions

> alike and particularly through reform of budget expenditure, focussing on areas of genuine added value' (HM Government, 2014, p. 5, italics added).

In the run-up to Brexit, such a favourable conclusion might come as a surprise. In part, it reflects UK influence after the financial scandals that led to the resignation in 1999 of the Santer Commission and to the conversion of EU financial reporting to accruals, largely based on IPSAS (Grossi and Soverchia, 2011).

Section 5: Resolving the Dispute

Writing critically about a high-profile public policy dispute always invites the comeback of 'what would you do?' Although this is not the purpose of this paper, as set out in Section 1, some outline suggestions can be made.

Compared with issues such as the Irish border and future trade relationships, the UK financial settlement is technically resolvable and much less economically important than its profile. Toxicity started on the UK side with claims for rebates and general obstructiveness, but has become contagious.

Analysis of the modes of government accounting leads to the following observations relevant to resolution:

(1) The financial reports of European institutions are a useful source of pulled-together information, but whether something has been accrued or not is not a decisive consideration

(2) As shown in Section 4, it is budgeting that really matters in the EU, when that is understood to include the MFF (D'Alfonso and Sapala, 2015). Much negotiating conflict could have been avoided by an early UK offer to meet its net contribution for the last two years (2019 and 2020) of the present MFF, and its share of Reste à liquider from 2021-onwards. Theresa May's Florence speech (May, 2017b), which effectively covered net contributions for 2019 and 2020, came much too late, being couched in terms of a two-year transition starting on 30 March 2019. The impending budgetary gap unnecessarily alienated Member States on both the net contributing and net receiver sides of the EU budget

(3) The departure of a large net-contributing Member State has long-term implications for the fiscal sustainability of the EU budget and EU institutions

more generally, and removes one of the most aggressive hawks on EU spending. Willingness on the part of the UK to honour obligations under MFF 2014-20 would smooth the adjustment process, but would not resolve the long-term fiscal issue. Moreover, the departure of the UK will shift the balance of power away from Northern Europe, perhaps in the direction of higher EU spending. This would affect the total size of the UK exit charge if some of it were to be dependent on the future discharge of obligations, rather than a lump sum at exit constituting total discharge.

(4) The financial settlement number will look big in absolute terms, but the numerical significance of the net budgetary contribution and of the exit charge has been so exaggerated in UK politics that any number is politically toxic. Insiders know the fiscal irrelevance of the annual net contribution and of the exit charge compared to other likely effects of Brexit, yet are willing to accept far larger damage to UK public finances by risking a cliff-edge exit.[11]

(5) There might be an attempt to conceal the size of the financial settlement,[12] in breach of the UK Government's professed commitments to fiscal transparency and its strong performance[13] on the IMF's (2016) 'Fiscal Transparency Evaluation of the United Kingdom'. In contrast, there is a case for a single lump-sum payment that constitutes a 'clean break', before – if this is agreed – the UK 'buys in' to certain EU programmes on a quasi-contractual basis. This would make the future relationship fiscally transparent. Although insiders may react with horror at this suggestion, they might recollect how widespread ignorance about the UK's financial relationship with the EU played a prominent and perhaps decisive role in the Brexit referendum. The horse may already have bolted, but a lack of transparency about future payments to the EU might contaminate future UK-EU co-operation on substantive policy.

[11] The cliff edge refers to the UK leaving the EU on 29 March 2019 without an agreement on its future relationship to the EU. The prospect of such an outcome is likely to prompt activation by companies of contingent plans to relocate activities to elsewhere in the EU27.

[12] The *EU Withdrawal Bill 2017* would allow Ministers to classify exit payments as Consolidated Fund Standing Services, which by-passes the Supply Estimates procedure where these could feasibly be voted down, especially if there were staged payments. This long-standing device is used to protect payment of salaries of judges and the salary of the Comptroller & Auditor from a vote in the House of Commons.

[13] One of the areas of weak performance was the assessment and management of fiscal risks.

Section 6: Conclusion

Analysis of the specific case of the UK's Brexit financial settlement casts light on theoretical and practical issues in public sector accounting. In particular, it emphasises the primacy of budgeting, understood to include the setting of spending envelopes as well as legislative approval of annual expenditure. Given Laswell's (1936) characterisation of politics as 'Who Gets What, When, How', it should have come as no surprise that the first reaction of the EU27 to impending Brexit was to focus on the budgetary gap left in the 2014-20 MFF. After that would come dividing the spoils, particularly in terms of relocated private sector jobs and of European agencies. This reaction was interpreted in the UK as a desire to inflict punishment.

However feeble legislative scrutiny of government budgets may be, the legitimacy of public spending is enhanced by the necessity for governments to gain legislative approval. Refusal of such approval would in parliamentary systems threaten the future of a government (Wehner, 2010). The symbolic importance is rarely matched by the accessibility of budget information or by actual use, not least because governments and would-be governments welcome legislative weakness. There is an influential tradition in the public finance literature promoting Executive dominance over the legislative as beneficial for fiscal discipline and fiscal sustainability (von Hagen and Harden, 1995).

Bergmann et al. (2016) attribute the growing attention in OECD countries to consolidated government financial reporting to the increasing fragmentation of government, in part due to the influence of New Public Management. Consolidated information can provide an overview of the financial performance and position of government which the accounts of individual entities cannot do. This is one of the reasons for closer relationships between the standard setters for statistical accounting and for public sector financial reporting (IPSASB, 2014). Although there are excellent reasons for wanting prompt and reliable government financial reports, these attract limited parliamentary scrutiny and minimal public attention. Reviewing past performance does not have the same appeal as making claims to future resources through the budgeting process.

As accruals-based government financial reporting takes hold, consolidation brings useful information about the 'whole picture' (Bergman, 2014; Heald and Georgiou, 2011), bringing to the fore activities of government with financial implications that would not have been visible under cash accounting or without consolidation of accruals accounts. Faced by such constraints, governments often seek off-balance sheet mechanisms to achieve policy objectives without the transactions being recorded as public expenditure or as public debt.

The EU illustrates one of the ironies of these developments: it uses the 2012 Fiscal Compact[14] to tighten its fiscal control over Member State public finances, including surveillance of contingent liabilities. Yet, as Figure 2 demonstrates, the EU itself has developed off-balance sheet devices. The EIB is not consolidated in the accounts of the EC, and the European Fund for Strategic Investments (EFSI) is a joint venture between the EC and the EIB. Infrastructure projects can then be delivered in Member States through EFSI projects, including Public-Private Partnerships that are designed to meet the criteria established by Eurostat (2016) to allowing off-balance sheet treatment in statistical accounts, whatever the financial reporting treatment under IPSAS32.

As a result of the necessary conventions upon which they rest, neither financial reporting nor statistical accounting provide all the financial information necessary to assess the fiscal sustainability of governments. Sustainability analysis is only an analytical tool because of the unavoidable stylised assumptions, for example about demographic and productivity trends and about what constitutes 'present policy'. However, it provides valuable clues that could enable fiscal adjustments to be undertaken earlier and at lower cost: public authorities and private actors have longer in which to adjust.

Attempts by governments to conceal fiscal reality, whether or not intended to do 'good by stealth', undermines claims of fiscal transparency and damages public confidence in financial numbers. Within the EU, fiscal sustainability analysis has

[14] Because the UK exercised its veto, the Fiscal Compact was implemented through a 2012 intergovernmental treaty. It represents a stricter version of the EU Stability and Growth Pact, accompanied by tighter enforcement by the European Commission.

focused on the position of Member States, rather than on the EC or the EU system as a whole (see Figure 2). Brexit is one of a number of big shocks: the 2008 global financial crisis; the 2011 eurozone fiscal crisis; technological developments; and the fragmentation of party systems. Brexit reduces the size of the EU and the departure of a net budget contributor means that, after the completion of the 2014-20 MFF, either net contributors will pay more and/or net recipients will receive less.

A warning to accounting standard setters and to public sector accounting researchers is that, in particular political circumstances, expert opinion can be trumped by lack of understanding and/or wilful misinterpretation of data. The IFS (Emmerson et al., 2016, p. 2) disputed the extra £350 million a week claimed by the Brexit Leave campaign to be available for spending on the NHS after Brexit. This figure was before the UK's receipts from the EU and before the Fontainebleau rebate: the correct figure was £150 million a week, calculated on the assumption that Brexit would have no other effect on UK public finances. Yet the fictitious number was widely believed and has since been repeated by Boris Johnson, the UK Foreign Secretary, leading to a rebuke from the Chairman of the Statistics Authority (Norgrove, 2017). The technical accomplishment of the UK's financial reporting changes since the 1995 White Paper (Treasury, 1995) has not been matched by success at communicating financial performance. The questions of accessibility, intelligibility and actual use should be high on the agenda of standard setters, governments and public sector accounting researchers.

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