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So 2005-06 was the year the NHS deficit for England finally went above half a billion. The reported deficit of £512m in the annual accounts may be rather less than initially feared, but it was still more than double the previous year's £251m deficit, and it was enough to see off chief executive Sir Nigel Crisp back in the spring. Right?

Not quite. July's Audit Commission report on NHS finances gives the lie to that received image of an NHS broadly in financial balance at the turn of the 21st century, then driven into deficit as accelerating cost pressures – pay in particular – overtook finance directors' ingenuity in devising short-term fixes. At the root of this revision is the internal government accounting system known as resource accounting and budgeting, or 'RAB' to the *cognoscenti*.

Until recently, few of us troubled to learn the intricacies of RAB. Its main purpose seemed to be obfuscation. A clever response to 'How big is your deficit?' might begin: 'Ah well, it depends which deficit you mean. Are you after our I and E deficit, or our underlying deficit, or our accumulated deficit; or do you mean our RAB deficit?' With luck, questioners at this point would check their watches and move discreetly on.

RAB is the system that has bizarrely required some trusts to repay a deficit twice over, as well as correcting its underlying cause. Under RAB, an overspending trust both has its deficit carried forward and has its income reduced in the following year. This double hit, combined with 'brave' efficiency savings targets, has sent a number of organisations into escalating levels of debt from which they now have minimal hope of recovery.

But not all trusts. Strategic health authorities have operated RAB in different ways. Some, reluctant to instigate a downward spiral, have not passed on RAB income reductions to trusts in deficit, or have used brokerage to protect trusts from deficit in the first place.

In the jargon of NHS finance, these have been termed 'RAB firebreaks'. One SHA finance director describes this as 'the ultimate teeming and lading' (a classic fraud where a member of staff borrows cash from the till on Saturday and pays it back on Monday, or next pay day). The Audit Commission, more generously, sees it merely as 'unfair', an attempt to tilt that level playing field just a little in one's favour.

RAB was first implemented across central government in 1998. Although the Department of Health accepted its introduction three years later, and presumably was given little choice in the matter, it soon became apparent that RAB makes little sense in the type of trading environment that was, at roughly the same time, being created within the NHS.

However, the way RAB has distorted overall NHS financial performance has only recently become apparent. Without the RAB effect, last year's NHS deficit would have been £395m rather than £512m. By any standards £117m is a material difference.

If the effect of RAB (and associated capital-to-revenue transfers) is unravelled back to implementation, the underlying deficit of the NHS has in fact been remarkably stable since 2001-02, in a range between £225m and £395m (see chart).

> **“The way RAB has distorted financial performance has only recently become apparent”**

The significance has not been lost on members of the Commons health select committee. 'The real position has been masked from the public eye,' said Dartford MP Howard Stoate to DoH director of finance and investment Richard Douglas in July.

'Your accounting system over the past five years has, very conveniently, made things look as if they were going quite smoothly. In fact the underlying deficit now is almost exactly the same as for the past five years.'

Three questions would seem to follow. The first might appear a little churlish but needs to be asked: why has it taken five years to address such a basic contradiction within the DoH financial regime, and why has it required the big commercial accounting firms to highlight the issue? The Audit Commission review was prompted by RAB's emergence as a regular theme in last year's flurry of NHS public interest reports, and by difficult questions to health secretary Patricia Hewitt during a *Panorama* programme in March.

Second, if the NHS's underlying annual deficit is consistently around 0.5 per cent of total funding, as the table appears to suggest, does this call for a different type of strategic response than the 'pile on the brakes' the NHS has experienced this year?

And third, what should happen next? The Audit Commission's call for the scrapping of RAB, and for reimbursement of the losses incurred by trusts, is understandable and offers a pragmatic route to preparing some struggling acute trust balance sheets for foundation trust status. The commission recommends a national buffer to compensate the DoH for the loss of the RAB system.

Yet it is hard to see where the necessary £500m or more will come from. Winning Gordon Brown's support will be no easy matter. After all the extra funding of recent years, the Treasury may not be especially sympathetic. ●

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Estimated underlying overspend 2001-05 (£m)

Financial year	Reported net surplus (deficit)	Est. underlying surplus (deficit)
2001-02	71	(291)
2002-03	96	(225)
2003-04	73	(341)
2004-05	(251)	(328)
2005-06	(512)	(395)

Estimated underlying surplus/deficit is after adjustment for the effect of RAB and for capital-revenue transfers. Source: *Public Finance*, 23 June 2006