

Paper for: The LEP Board

Title: Agenda Item 8 – Accounting for the Life Sciences Fund

Date: 20 January 2021

Strategic Purpose: Governance

Resource Implications: None

Board: To note adjustments required in CWLEP Statutory Accounts.

Overview of the Life Sciences Fund

- On 1/10/2015, CWLEP entered into a partnership agreement with five other parties including the Greater Manchester Combined Authority and Cheshire East Borough Council to establish an investment fund that would provide capital to start up life sciences business.
- The CWLEP commitment to the partnership was to contribute £10M towards an overall fund of £30.7M. That commitment is drawn by the fund managers in instalments as required to fund investment deals. The fund is managed by Catapult Life Sciences Managers.
- The cash payments to the Life Sciences Fund have been processed on the CWLEPs behalf by CEC but, substantively, CWLEP has received the £10M from the Local Growth Fund to invest into the Life Sciences Fund.
- Over time the value of CWLEP's share in the fund has fluctuated as each new instalment of capital has been invested and with the estimated valuation of the investments in the companies thus funded. To avoid spurious estimates of value, the valuation of the investments follows procedures established to comply with Financial Reporting Standards (FRS102) and the International Private Equity and Venture Capital Guidelines issued by the British Venture Capital Association.
- Given that the fund is in its early (investment phase), the valuation of the investments is currently below the initial investment. However, as the business develop and grow, it is expected that the value will recover and generate a positive return for the fund and partners.
- In summary, CWLEP received a grant allocation of £10M in 2015. By 31st March 2020, the combined value of the contributions invested into the Life Sciences Fund amounted to £7.111M. The value of that investment as at 31st March 2020 was reported as £5.513M.
- In a separate agreement between CWLEP and CEC, the outstanding balance of £2.889M has also been invested in the fund by CWLEP on behalf of CEC to help finance the Council's contributions to the fund. Going forward, as calls are made by the fund on the partners, CEC pays the CWLEP contributions, such that CWLEP meets its contribution obligations.

Accounting for Partnerships

- Unlike a limited company, a partnership is not a corporate or legal body in its' own right.
- The partners, whether individuals or corporate entities, remain the legal "persons" and the operation of the partnership is governed by a partnership agreement made between them.

- Annual accounts (and tax returns) are prepared for the partnership and the respective proportions of the partnership profits or losses and assets and liabilities divided among the partners in accordance with their respective share of the partnership.
- It is then the responsibility of each partner to include their respective share of the partnership in their individual tax returns or, if the partner is a company, the company accounts and tax returns.

Omission by CWLEP

- On receipt of the partnership tax return for 2020, the Finance and Commercial Director realised that, since the inception in 2015, CWLEP has failed to include its share of the partnership within the CWLEPs statutory annual accounts.
- This omission was completely accidental. The cash flows relating to the investment were received and paid through CEC and a misunderstanding has arisen.

The Way Forward

- The issue has been discussed with CEC, as the accountable body, the external auditors and presented to the Finance and Audit committee. We are agreed that the LEP needs to make a correction when preparing its accounts for year ending 31st March 2021.
- Given that the grant receipt and investment amounted originally to £10M, the value of the CWLEP stake in the partnership will be shown on the accounts as a financial asset (investment).
- When preparing the annual accounts for the CWLEP for 31st March 2021, we will show the value of the partnership asset and, because the accounts also show the previous year, include the opening value of partnership asset as at 31st March 2020, **a Prior Year Adjustment**. A proforma balance sheet, before and after the adjustment, is attached in Appendix 1.
- The 2021 I&E account will show the change in market value in 2021 and the 2020 I&E account would show the change for that year. The changes in earlier years would be brought in through the prior year adjustment.
- The attached spreadsheet (Appendix 2) sets out the annual contributions made by the LEP to the fund, and the annual movements in the value of the investment assets.

Implications

- As a result of recognising the partnership investment, the CWLEP will carry higher asset values on its balance sheet. This is not something to be viewed as additional resources in the short term, but once the fund matures and investments within the fund are realised, any proceeds will return to CWLEP and be available for investment in other activities.
- To date CWLEP has had little exposure to Corporation Tax. CWLEP will be liable to tax on its share of taxable profits reported on the partnership tax return. The taxable profits will be based on the realised profits/(losses) following the disposal of individual investments. This means that there could be taxable profits even though some investments that are still held may have significantly decreased in value.

Ian Brooks

Finance and Commercial Director

Appendix 1 – Proforma Adjusted Balance Sheet at 31/3/2020

	As Reported 31/03/2020	Adjustments 31/03/2020	Revised 31/03/2020
FIXED ASSETS			
Intangible Assets	121,826	-	121,826
Tangible Assets	46,325	-	46,325
Investments	<u>1</u>	<u>5,513,187</u>	<u>5,513,188</u>
	168,152	5,513,187	5,681,339
CURRENT ASSETS			
Debtors	608,717	2,888,797	3,497,514
Cash at Bank	<u>946,632</u>	<u>-</u>	<u>946,632</u>
	1,555,349	2,888,797	4,444,146
CREDITORS			
Amounts falling due within one year	<u>1,427,348</u>	<u>-</u>	<u>1,427,348</u>
NET CURRENT ASSETS	<u>128,001</u>	<u>2,888,797</u>	<u>3,016,798</u>
TOTAL ASSETS LESS CURRENT LIABILITIES	296,153	8,401,984	8,698,137
NET ASSETS	<u>296,153</u>	<u>8,401,984</u>	<u>8,698,137</u>
RESERVES			
Income and Expenditure Account	296,153	-	296,153
Capital	<u> </u>	<u>8,401,984</u>	<u>8,401,984</u>
TOTAL RESERVES	<u>296,153</u>	<u>8,401,984</u>	<u>8,698,137</u>

Appendix 2

Cheshire and Warrington LEP Share of Life Sciences Fund

Year Ended	Initial Capital	Contributions	Cumulative Loan Account Balance	Reserve Unrealised		Revenue Reserve		Total share of Net Assets
				Movement in year	Cumulative	Movement in year	Cumulative	
31/03/2016	10	972,661	972,661	-	-	- 85,221	- 85,221	887,450
31/03/2017	10	1,513,134	2,485,795	-	-	- 170,376	- 255,597	2,230,208
31/03/2018	10	2,182,411	4,668,206	- 85,486	- 85,486	- 176,789	- 432,386	4,150,345
31/03/2019	10	1,628,665	6,296,871	- 709,668	- 624,183	- 153,904	- 586,289	6,334,775
31/03/2020	10	814,332	7,111,203	- 1,493,061	- 868,878	- 142,859	- 729,148	5,513,187