

## **AGENDA ITEM 7**

### **PAPER FOR THE FINANCE AND AUDIT COMMITTEE 15/12/2020**

#### **ACCOUNTING FOR THE LIFE SCIENCES FUND**

**Purpose:** To discuss and agree how the CWLEP's partnership stake of the Life Sciences Fund should be accounted for in the CWLEP management and annual 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 stake in the partnership was to contribute £10M, by way of a loan, towards an overall fund of £30.7M. The loan is drawn 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 LGF 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 loan 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 31<sup>st</sup> March 2020, the combined value of the loan contributions invested into the Life Sciences Fund amounted to £7.111M. The value of that investment as at 31<sup>st</sup> 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. The value of each partners proportion of the partnership is reflected in the partners' accounts.

- 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.
- Given the scale of the grant receipt and investment of £10M, this represents a material misstatement of the prior year's accounts.
- Having identified the omission, the situation has been discussed with the CEC, as the accountable body, and the external auditors.
- We are agreed that the LEP needs to make a correction when preparing its accounts for year ending 31<sup>st</sup> March 2021.

### The Way Forward

- The value of the CWLEP stake in the partnership will be shown on the accounts as a financial asset.
- When preparing the annual accounts for the CWLEP for 31<sup>st</sup> March 2021, we will need to 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 31<sup>st</sup> March 2020, **a Prior Year Adjustment**.
- 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 1) sets out the annual contributions made by the LEP to the fund, and the annual movements in the value of the investment assets.
- Appendix 2 shows the proposed accounting entries.

### Exposure to Corporation Tax

- CWLEP would 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.
- Funding a significant corporation tax liability may require CWLEP to withdraw some, or all, of the realised profit from the fund.

**Ian Brooks**

**Finance and Commercial Director**

Appendix 1

Cheshire and Warrington LEP Share of Life Sciences Fund

Year Ended	Initial Capital	Loan 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
31/03/2021	10		7,111,203		- 868,878		- 729,148	5,513,187

Appendix 2

**Proposed Accounting Entries**

<u>Event</u>	<u>Value</u>	<u>DR</u>	<u>CR</u>
Receipt of Grant	£10M	Cash	Capital Grant Received (part of reserves)
Capital Contribution to the Partnership	£10	Investment	Cash
Loan Instalment to Life Science Fund	Various	Non-Current Financial Asset	Cash
Loan to CEC	Various	Non-Current Debtor	Cash
Repayment of CEC Loan	Various	Cash	Non-Current Debtor
Combined Annual Losses to 31/3/2020 arising from unrealised losses on Life Science Assets and revenue losses <sup>(a)</sup>	Various	Unrealised Profits/(Losses) on Financial Assets	Non-Current Financial Asset
Annual movement in value of Life Science Fund Assets	Various	Unrealised Profits/(Losses) on Financial Assets	Non-Current Financial Asset
Repayment of Loan by the Life Sciences Fund (until repaid)	Various	Cash	Non-Current Debtor
Payment of Fund Profits to LEP	Various	Cash	Unrealised Profits/(Losses) on Financial Assets

**Note:**

(a) This may need to be split for revenue losses and unrealised investment profits or losses.