

Paper for: The LEP Board

Title: Agenda Item 7 a - Annual Report and Accounts 2020-21

Date: 14 July 2020

Strategic Purpose: Ensuring Governance and providing Assurance

Resource Implications: None

LEP Board: On the recommendation of the Finance and Audit Committee, to approve the Annual Report and Accounts 2020-21 for signature by the Chair and Chair of F&A Committee.

Summary of the Annual Accounts

1. Attached to this paper are the annual report and accounts for the LEP, which have been scrutinised by the F&A Committee and discussed with the external auditors. Compared with previous years, the board's attention is drawn to three major changes which have transformed the LEP balance sheet (page 13):
 - Recognition of the LEP's investment in the Greater Manchester and Cheshire Life Sciences Fund
 - Draw down of project loans under the EZ Loan Facilities, and
 - Consolidation of Marketing Cheshire
2. The board will recall receiving a paper earlier in the year detailing the requirement to include the LEPs stake in the Life Sciences Fund. Recognition of the grant received to fund the investment has added £10M to the income and expenditure reserves. The corresponding entries are £8M of investments at current value (£8.4M has so far been invested), £1.6M owed by CEC shown in debtors, and the fair value loss of £0.4M. Each year the value of the investments is re-assessed and any change in value recorded through the fair value reserve.
3. The movements in fair value, "Gain/Loss on revaluation of investments" (page 10), have been substantial in the past two years. The board can, however, be assured that the fund follows established valuation techniques, is regulated by various authorities and independently audited. A significant loss (£1.6M) in the value of investments was reported in March 2020, following the general reduction in company values when the pandemic started, but valuations had largely recovered by March 2021, creating a fair value surplus of £1.15M in 2020-21. Apart from general market conditions, volatility cannot be ruled out given the investments are in early-stage life science technology, where success or failure at specific milestones can impact heavily on a company's value. The fund is invested in approximately 30 companies to provide, hopefully, sufficient opportunities of successes to mitigate against the risks of failure of some companies within the portfolio.
4. Turning to the EZ loan facility, the balance sheet (page 13) shows that £8M has been borrowed in respect of two projects, Glasshouse and Blocks 22-24. As part of the audit, the auditors had examined the loan agreements with reference to the provisions of the

accounting standards, FRS102, and concluded that the grants made to EZ projects and associated future flow of business rates could be recognised as intangible assets.

5. The corresponding entries to the £8M loan are intangible assets of £5M and £3M included within debtors. The debtor arises because the full value of the project loan has been drawn on Blocks 22-24 and held by CEC until each grant instalment is claimed by the developers. CEC will pay the instalments thus reducing the debtor and increasing the intangible asset value. Because the intangible asset and debtor carry values equal to the amount of the loan, the transactions have no direct impact on the LEP reserves, other than the cost of interest on the loan.
6. The board is reminded that the facilities are non-recourse and the local authorities' security for repayment is limited to the future flow of business rates.
7. During 2020-21, the LEP has reached two of the criteria (assets and number of employees) that now require it to consolidate Marketing Cheshire. In the accounts this means Marketing Cheshire has been added into the consolidated balance sheet and income statement. The company accounts for Marketing Cheshire will be independently scrutinised by the Finance and Audit committee of Marketing Cheshire before recommending them to the Marketing Cheshire board for approval in September.
8. Because the Income Statement (page 10) in the LEP consolidated accounts now includes Marketing Cheshire, the LEP company performance in 2020-21 is as follows:
 - Turnover increased from £3.3M to £4.4M. Additional funds for the Growth Hub (+£360k), the Pledge (+£40k including NHS Catalyst), the Getting Building Fund (GBF) management fee (+£75k) and funding from the Local Resilience Forum (LRF) (+£50k) contributed to the increase. In addition, grants towards training provided by the Accelerate Programme (+£150k) and towards other projects were funded from retained business rates. An amendment to income recognition, explained later, added £300k.
 - Costs of the Growth Hub, Pledge and Accelerate programmes increased in line with the increased funding, so the additional turnover for those programmes had little effect on operational outturn. However, the GBF management fee and LRF income have been fully recognised in 2020-21 but will be spent mostly in 2021-22. This had the effect of contributing towards an operational surplus in the year. In addition, control of the operational and administrative cost base contributed to a larger overall surplus.
 - On a like for like basis, before investing activities, the operating surplus was £284k compared to £26k in the prior year. The surplus, when added to what we had at the start of year, increased cumulative operational reserves to £580k.
 - A one-off adjustment has also been made to the accounts relating to a matter of income recognition and the LEP approach to core funds received for the development of strategy and plans. Historically, the LEP has deferred recognising the income provided for these activities until costs have been incurred. The auditors' opinion was the evidence for this approach was weak when examining the basis on which funds are provided by MHCLG/BEIS against the accounting standards for income recognition. After considering management's view and discussing several alternatives the F&A committee and deputy s151 officer concluded that the income should be recognised in 2020-21 accounts.
 - The impact of the decision has been to increase income by £312k with a corresponding increase in the operational surplus and reserves. The cumulative figure for operational reserves has therefore risen to £892k. However, this should not be misinterpreted as funds available for future projects because they are, in fact, already earmarked for specific activities. For management accounts, a proportion of

the reserves will be reported as “earmarked” reserves and a list of commitments maintained.

9. Marketing Cheshire reported turnover of £0.8M (£1.2M, 2020) and an operating deficit of £51k (surplus £14k, 2020). Year-end reserves were £247k (£298k, 2020)

Current and Estimated Level of LEP Reserves 2021-22

10. The level of reserves held on the LEP Balance Sheet (page 13) has, by recognising the LEPs investing activities, undergone a transformation in 2020-21. As at 31st March 2021, the LEP audited accounts present reserves of £10.4M, which are a combination of operating reserves associated with general business and reserves associated with investing activity.
11. The table below separates the company reserves into component parts:

	Reserves from Operations	Reserves from Investment Activity	Total Reserves
As at 1/4/2020	296	8,402	8,698
Surplus for the year	284		284
One-off Income recognition	312		312
Interest payable on EZ Loans		(73)	(73)
Fair Value Surplus for the year		1,151	1,151
As at 31/3/2021	892	9,480	10,372
Of which “earmarked”	785	9,480	10,265

Of the £892k, it is fair to say that a high proportion (£785k) is already “earmarked” including £173k to cover the planned use of reserves, £312k set aside for strategy projects and a policy to maintain a minimum level of reserves of £300k. The investment reserve is ring-fenced in the short and medium term, linked as it is with the Life Sciences and EZ loan facilities.

12. In addition to reserves held within the LEP company, we also look to the balance of retained business rates, held by Cheshire East Council on behalf of the LEP, as reserves. The balance at 31st March 2021 was £4.13M. This is also, for the most part, already committed. The table below separates the balance of the retained business rates account:

Cash Balance at 31/3/21	4,133
Committed to EZ Grant	(3,077)
Committed to Accelerate	(600)
Net balance at 31/3/21	456

13. Looking ahead into the current financial year, the level of operating reserves is expected to reduce during the year, because we have a planned budget deficit and because retained business rates reduce until the receipt of annual payments normally received in October and November.

2021-22 Estimated Movement of Reserves

	LEP Company	Retained Rates	Total Reserves
01/04/2021	892	456	1348
01/05/2021	878	373	1251
01/06/2021	863	290	1154
01/07/2021	849	208	1056
01/08/2021	834	125	959
01/09/2021	820	42	862
01/10/2021	806	-41	765
01/11/2021	791	1176	1967
01/12/2021	777	1093	1870
01/01/2022	762	1011	1773
01/02/2022	748	928	1676
01/03/2022	733	845	1578
01/04/2022	719	762	1481

14. At 01/04/2022, £612k of LEP company reserves are “earmarked”, as are £521k of retained business rates.
15. In practice, the retained business rates reserve will not go below £0, cash flows will be managed accordingly.
16. One note of caution is that our plans for 2020-21 assumed receipt, as usual, of £500k annual core funding from MHCLG/BEIS. The payment has been delayed and we are working with MHCLG/BEIS colleagues and the LEP network to unblock the matter. In the unlikely event that core funds are not released, the reserves would, if nothing else were done, be £500k lower than shown in the table. Nevertheless, they remain positive and the LEP could manage in the medium term.
17. A movement in the reserves from investing activities should also be expected during the year. Interest payable will be accrued on the EZ loan facilities, estimated to be £400k for the year depending on the timing of project loan drawdowns.
18. There will also be a fair value movement on the investments in the Life Science Fund. In the past 2 years, due to significant volatility in valuations these movements have exceeded £1M. Given that the companies in the fund are early-stage life sciences businesses this also adds to the potential for large movements in the fair value reserve.

Recommendation

19. The Board is recommended to approve the Annual Accounts and authorise signature by the Chair and chair of the F&A Committee.