

## Explanatory Note on Accounts in accordance with discussion at the Economy, Infrastructure and Skills Committee on 25<sup>th</sup> October 2017

As was previously explained, the Finance Wales Group comprises three distinct business activities:

- a) a corporate and administrative activity, which provides support to the rest of the Finance Wales Group. This function is operated with the aim of being cost neutral and/or breaks even.
- b) a fund management activity which operates primarily in Wales, but with a small operation in England and generates a modest surplus.
- c) a fund holding activity, which is much more variable from an accounting perspective and is influenced by a number of inputs including, inter alia, European Grant Income, provisions for bad and doubtful debts and the sale of equity assets.  
N.B. Any capital returned and profit on a fund is used to repay the initial capital invested from WG and third parties, and any remaining surplus can be used by the WG to invest in the next fund, creating a sustainable source of funding for Welsh businesses.

Our results are a consolidation of all these activities.

You may recall that at March 2016, the Finance Wales Group was showing a deficit on the year of £1,336,000. This has now transformed to a surplus of £16,175,000. The table below attempts to explain how this has come about:

		£000s
	Mar-16	(1,336)
Increase in income		85
Provisions for Bad Debts		(9,862)
Increase in administration expenses		(189)
		<u>(11,302)</u>
Recognition of ERDF Income		16,212
Reduction in WG core funding		(468)
Profit on Sale of Equity investments		3,740
		8,182
Reduction in interest received		(231)
Reduction in interest paid		286
Other gains		8,488
	Mar-17	16,725

Highlighted below are the four most significant changes.

### **Provisions for Bad Debts**

Finance Wales is required to maintain a realistic valuation of both its debt and equity portfolios. Inevitably this means that in addition to revaluing equity holdings where there is evidence of growth, we have to down value both debt and equity investments based on the likelihood of repayment. In this case the level of provisions increased by £9,862,000 on the previous year. The 2016 provisions were unusually low and the 2017 increase brings provisions more in line with the longer term norm.

### **Recognition of European Regional Development Fund Income**

Under accounting rules we are required to recognise this grant money as income, at the time we make investments from any fund backed by these resources. The Wales Business Fund began to make investments during the year in question and thus triggered the release of significant additional funding.

### **Profit on Sale of Equity Assets**

During the Financial Year, eight equity investments were disposed of, generating a surplus of £3.30m [on the invested amount?].

In the previous Year, five such disposals were made generating a deficit of £0.44m

### **Other gains**

As you will be aware Finance Wales administers the Help to Buy (Wales) fund on behalf of the Welsh Ministers. This fund lends up to 20% of the purchase price of a new property to a purchaser and recovers 20% of the proceeds of the property upon sale, or when the owner wishes to take 100% ownership.

The overall value of the Help to Buy (Wales) loans are indexed annually and any variation in value of the property, in this case an increase, is required to be recognised through Finance Wales accounts and this "profit" contributes to the group surplus. At this stage this is not a cash profit as the cash will not be received, until the property is sold or the owner takes 100% ownership, which may not take place for many years.

This surplus is however, wholly repayable to the Welsh Government in order to repay the Financial Transactions Capital cash advanced to make the original loan and any surpluses would be repatriated to the Welsh Government.

This has created a taxable gain which has been offset against other loan losses and thus no tax was payable. As all surpluses to the Help to Buy (Wales) fund belong to the Welsh Government, from 2018 the Welsh Government will recognise the gain directly, removing the item from the Finance Wales income statement. The accounts for 2018 will not include any income related to house price growth and will also have a reversal of the 2017 income.

Of these four major variances, only the Profit on the Sales of Equity Assets and possibly the level of provisioning can be seen as descriptors of Finance Wales' performance, rather than the consequence of accounting conventions.

We trust this note is of help but of course we will be pleased to take your questions and observations on 25<sup>th</sup> October 2017.