

## **Report by the Comptroller and Auditor General to the Northern Ireland Assembly**

### **Agri-Food and Biosciences Institute 2018-19**

#### **Introduction**

1. This report highlights significant matters arising from my audit of the Agri-Food and Biosciences Institute's (AFBI) financial statements for 2018-19. I have qualified my opinion on the financial statements as I disagree with AFBI's recognition of £7 million income due under royalty agreements and related expenditure of £2.7 million. The royalty income AFBI is due to receive is currently subject to a dispute regarding the interpretation of the licence agreement.

#### **Background**

2. Under a 1998 research and licensing agreement between The Queen's University of Belfast (QUB) which acts as AFBI's agent, University of Saskatchewan (USK) and a vaccine company (the 1998 Agreement) patent royalties are paid to QUB and USK (together "the Universities") by the vaccine company. The vaccine company is due to pay a percentage royalty on the net sales of all vaccine products manufactured by making use of the results of joint research and/or protected by a patent for the duration of the patent protection. In addition, where no patent is granted in relation to a vaccine product or in a territory in which a vaccine product is sold, royalties are payable over a shorter term.
3. A separate 1999 memorandum of agreement between QUB and the Department of Agriculture for Northern Ireland (now DAERA) (the 1999 Agreement), requires QUB to pay to AFBI any royalties which it receives from the vaccine company less a QUB management fee. However, the Universities have received only one payment of £68,000 for patent royalties for this financial year from the vaccine company since June 2018 which was passed onto AFBI. AFBI recorded income of £7 million in its 2018-19 financial statements and £6.9 million as a receivable at the year-end arising from this agreement.

#### **Summary of findings**

4. International Financial Reporting Standard 15 (IFRS15) governs how income should be recorded within annual financial statements. The £7 million in income included in the financial statements is an estimate based on the validity of the patents during the 2018-19 financial year and a report from QUB which concluded on the income these patents might generate. As it is not probable that the amounts will be received the inclusion of this estimate is not in accordance with IFRS15. Consequently, the inclusion of £2.7 million of expenditure (associated fees, corporation tax and administration costs) is also incorrect. Comprehensive net expenditure is therefore understated by £4.3 million.
5. The 1998 Agreement specifies in Article 7.3.3 when patent royalties' payments should be made to the Universities; however the 1999 Agreement does not specify when QUB should pay AFBI following receipt of royalties from the vaccine company. In previous years payments have been made to AFBI by QUB in two parts in June and December each year in line with Article 7.3.3. These payments are usually based on sales reports from the vaccine company to the Universities detailing vaccine sales in various territories. AFBI has not received any sales reports and only one small payment from QUB since June 2018 and whilst attempts by the Universities to resolve the matter continue, with QUB acting as AFBI's agent, these have so far been unsuccessful. There is currently no documentation to suggest that the vaccine company agrees that £7 million or any other sum is due to AFBI.

6. The regularity opinion has been qualified as AFBI has not chosen to adjust the financial statements to remove the material misstatement. The additional net expenditure of £4.3 million would breach the amounts approved by the Department for the year in the final budget allocation letter if the accounts were adjusted.

#### **AFBI's response**

7. Based on the 1998 Agreement and the fact that sales of products from derived patents have occurred in the relevant periods combined with the patent expert advice, AFBI believes the amounts included in the financial statements to be due and payable and will ensure every effort will continue to be made to recover them. Therefore AFBI have recognised the £7 million income and £2.7 million of associated expenditure in these financial statements.
8. It is very concerning that payments due have not been received to date and AFBI will consider carefully all options open to obtaining these amounts including the legal enforcement of QUB and USK contractual rights. In addition, AFBI is reviewing the position to ensure that any lessons learned for any future commercial relationships that it may enter into are considered. Any such arrangements will be monitored and reviewed through the Oversight and Governance Committee.
9. It is AFBI's belief that this is a commercial dispute and the matter is included as a Contingent Liability in the notes to the accounts.

#### **Conclusions**

10. AFBI continues to work with QUB to obtain documented details from the vaccine company of vaccine sales and royalty income due during the 2018-19 financial year. This estimated £7 million of overdue royalty payments is a significant level of income due to the public purse. Its recovery should remain a priority for AFBI.
11. I recommend that AFBI reviews the management and contract arrangements for lessons learned before entering into future contracts for patents and royalty income.
12. In the short term, AFBI should also identify actions to ensure that such a situation as this does not re-occur in the future. I will keep this under review in the coming year.

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