Skills Funding Agency

Financial Health Assessment of Non-college Organisations

September 2013

Of interest to training organisations

Financial Health Assessment of Non-college Organisations

Purpose

1. The Skills Funding Agency (the Agency) assesses the financial health of all contracted organisations, subcontractors and anyone applying to the Register of Training Organisations. This is to understand the degree of risk to the Agency in contracting with them, either directly or indirectly, and to establish the maximum recommended value of contracts appropriate to the financial resources of those organisations which have a direct contract. This document sets out the Agency's approach to the Financial Health Assessment of non-college organisations.

Definition

2. Financial Health is a measure of an organisation's financial status in terms of financial performance and ability to meet ongoing financial commitments.

3. Financial Health is graded, based on the following three elements:

    - solvency
    - profitability, and
    - gearing.

Data Sources

4. The information we need to calculate these three elements is taken from the latest available financial statements (or accounts) which every non-college organisation has to submit to the Agency under the terms of their contract(s) and/or in line with the requirements of the Agency's Register of Training Organisations.

5. Financial statements submitted should be full accounts (not abbreviated) and audited, if appropriate. If only abbreviated accounts are required for Companies House filing, organisations must still submit to the Agency a fuller version, including, as a minimum:

    - profit and loss account

- balance sheet and relevant notes
- commentary and breakdowns.

Organisations must supply the full accounts, not just an extract or selected pages.

6. If an organisation, due to its legal form, is not required to produce statutory financial statements, it should submit accounts in the format used for producing annual accounts, and include the same minimum elements noted above.

7. If an organisation is unable to supply statutory financial statements because it has not traded for a sufficient period, it should supply its first 12 months forecast figures including management accounts to date. As a minimum this should consist of a:

- profit and loss account
- balance sheet
- cashflow forecast, and
- a narrative of key assumptions made.

8. Prospective training organisations who do not have a financial history, may submit a fully costed business plan for assessment. There is no set format for a business plan, but as a minimum it should include:

    - a 12-month forecast profit and loss account
    - a balance sheet
    - a 12-month rolling cash flow forecast, and
    - a narrative supporting the assumptions made in preparing the business plan.

9. If available, you should submit management accounts showing the current year's trading position to date to support a business plan or financial statements.

10. If any of the required information is missing, Financial Health **will be graded as 'Inadequate'**, due to insufficient information available for assessment.

11. Training organisations with a current funding agreement must submit new financial statements each year, through their Agency contact. This should be done as soon as they become available, but no later than nine months after the year end. Failure to submit accounts on a timely basis will result in the award of a Financial Health grade of ‘Inadequate’ until accounts are submitted.

Exemptions

12. The following organisations are exempt from Financial Health assessment, so they are not required to submit annual financial statements.

- Government departments, executive agencies or non-departmental public bodies
- Local authorities, including Local Education Authority (LEA) schools
- Academy schools and Free schools
- NHS trusts, fire authorities, universities
- Major national charities such as OXFAM, Red Cross, RNIB, RNLI; and
- Large Employers (see 25 below).

13. Established Public Limited Companies (plcs) and other registered companies for whom Agency funding is incidental to their business are also exempt if they are training their own staff only. For these purposes, Agency funding will be ’incidental’ if Agency contract values are no more than 5% of annual turnover. However, if applying to the Register of Training Organisations, they should still supply a copy of their most recent accounts to demonstrate this.

Financial Health descriptions

Grade	Definition	Indicators
Outstanding	An organisation that appears to have very robust finances to fulfil its contractual obligations and to respond successfully to opportunities or **adverse** circumstances.	Normally an organisation with Outstanding/Good indicators for solvency, profitability and gearing.
Good	An organisation that appears to have sufficiently robust finances to fulfil its contractual obligations, and to respond successfully to most opportunities or adverse circumstances.	Normally an organisation with at least two Good indicators for solvency, profitability and gearing.
Satisfactory	An organisation that appears to have sufficient resources to fulfil its contractual obligations, but also appears likely to have limited capacity to respond successfully to opportunities or adverse circumstances.	Normally an organisation with at least two Satisfactory indicators for solvency, profitability and gearing.
Inadequate	An organisation that is in financial difficulty and very likely to be dependent on the goodwill and/or the financial support of others. There is a significant risk of organisations in this group not being able to fulfil contractual obligations because of weak financial health.	Normally an organisation with at least two Inadequate indicators for solvency, profitability and gearing.

Financial Health elements

Element	Definition
Solvency	Current ratio defined as: $\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Profitability	Operating position after tax as a percentage of income, defined as: $\frac{\text{Profit after Tax}}{\text{Turnover}} \times 100$ For this purpose, depreciation and amortisation are added back to profit after tax and dividends are subtracted.
Gearing	Total debt as a percentage of reserves and debt. Reserves are defined for this purpose as shareholders funds less intangible assets. If negative, an automatic score of 0 is given. Debt is defined as all long-term and short-term borrowing, including bank overdrafts, finance leases, directors' and group and other loans.

Financial Health scoring

14. For each of the three elements a score will be awarded as shown below:

Score	Solvency	Profitability	Gearing
0	< 0.5	< 0	>= 90 or negative
10	>= 0.5	>= 0	< 90
20	>= 0.6	>= 1	< 80
30	>= 0.7	>= 2	< 70
40	>= 0.8	>= 3	< 60
50	>= 1.0	>= 4	< 50
60	>= 1.2	>= 5	< 40
70	>= 1.4	>= 6	< 30
80	>= 1.6	>= 7	< 20
90	>= 1.8	>= 8	< 10
100	>= 2.0	>= 9	= 0

Grading the Financial Health score

15. An initial grade assessment will be made by comparing the aggregated points score with the assessment criteria shown below:

Outstanding	240 - 300 points
Good	180 - 230 points
Satisfactory	120 - 170 points
Inadequate	<=110 points

Moderation criteria

16. The Agency may moderate the initial grade. Moderation criteria include, but are not limited to, the following.

- Where an organisation scores 0 points for one of the three ratios then it can be graded no better than Satisfactory.
- Where the financial statements have been given a qualified or adverse opinion by the auditors.

- If financial statements are overdue for filing at Companies House, an Inadequate grade may be given.
- Where the most recently filed full financial statements are not submitted to the Agency (or other information sufficient to assess Financial Health) then the Financial Health will be graded as Inadequate.
- If there is a group/parent company whose financial position could impact significantly on the Financial Health of the organisation with whom the Agency is contracting, the grade may be moderated accordingly.
- Where information other than the latest available financial statements, supported by factual evidence, indicates that the Financial Health is significantly different from the autoscore. 'Significantly' is here defined as sufficiently different to generate an autoscore at least one grade lower. Examples might include (but would not be limited to):
    - a court ruling which has financial consequences
    - the loss of a material contract or area of provision
    - a contingent liability crystallising
    - recall of debt by the bank
    - loss of key personnel
    - cessation of trading.
- Where an organisation's Financial Health is calculated as Inadequate solely as a result of a deficit on the pension scheme (as measured under FRS17) which reduces the level of reserves.
- If long-term borrowings are high, but are predominantly and demonstrably secured on long-term fixed assets, for example a mortgage on property; if this significantly affects the Financial Health (by at least one grade) and finances suggest that sufficient cash is being generated to cover associated interest charges.
- Where an organisation's Financial Health in an isolated year is calculated as Inadequate solely due to making a distribution of a number of years'

accumulated profits through a dividend, resulting in a zero score for Profitability. In such circumstances the Agency may moderate the Financial Health score to Satisfactory if the underlying business is considered profitable.

- Organisations graded Inadequate may be moderated to Satisfactory upon receipt of a parent company or director's guarantee.

Recommended funding limits

17. A key aspect of the Financial Health assessment process is the setting of a maximum Recommended Funding Limit (RFL) for organisations who contract directly with the Agency. This is a measure of an organisation's financial capacity to deliver but is not required where the organisation is a further education college, is exempt or is out of scope for a Financial Health assessment. The funding limit will also vary depending upon whether the organisation is new or has existing contracts. There are other constraints that may impact on the capacity of an organisation to deliver, for example its infrastructure, that are monitored by other Agency teams and need to be taken into account when awarding contracts.

The Agency's methodology

18. The recommended funding limit is calculated as a percentage of the organisation's turnover as per their latest annual financial statements. The relevant percentage is determined as follows:

FH Grade	**Organisations holding an existing Agency contract**	**Prospective training organisations with a financial history**	**Assessments based on business plans or forecasts**
Outstanding	150%	100%	n/a
Good	125%	75%	n/a
Satisfactory	115%	50%	See below
Inadequate	0%	0%	No contract

19. Organisations within scope that hold an existing Agency contract will not normally be allocated a recommended funding limit of more than £30m.

20. Prospective training organisations that do not hold a contract with the Agency at the time of assessment are considered a greater risk and as such will have a RFL calculated on reduced percentages. The maximum RFL is set at £2m.

21. Business plans will be assessed on an individual basis on their own merits. Business plans that are considered by the Agency to be viable will be allocated a Financial Health category of Satisfactory. The RFL will be set at the turnover per the plan up to a maximum of £1m.

Implications of the RFL within the Agency

22. Before contracting, the Financial Health score and RFL are used to inform contract negotiations. The majority of training organisations are awarded contracts whose aggregate values are within the RFL.

23. The funding limit is a recommended maximum. Where the Agency proposes to award a contract which takes the aggregate values beyond this limit, this would be subject to a Financial Risk Management Plan (FRMP) being prepared and approved internally within the Agency in accordance with the latest operational guidance and appropriate risk mitigation measures (which may include, for example, enhanced performance management, greater audit scrutiny and regular submission of management accounts).

24. Organisations that hold an existing Agency contract may be subject to periodic further review.

Large Employers

25. The Agency directly contracts with some employers to fund training which they deliver to their own employees. Established plcs and other registered companies that the Agency directly contracts with in this way as Large Employers are out of scope and do not require a formal annual Financial Health assessment provided that:

    - when first contracting, financial statements assessed by the Agency indicated the organisation to be financially stable, and

- Agency funding is incidental to their business (that is, Agency contract values are no more than 5% of annual turnover).

26. The Agency's Provider Finance Team will access the latest financial statements prior to contracting to confirm that proposed funding is incidental (that is, within the 5% limit) and identify any concerns around financial stability.

27. Once status and financial stability have been confirmed, no further formal assessment would normally be required other than an annual review – the Agency's Provider Finance team will access the latest financial statements to confirm organisational status and that no change has occurred which could affect the employer's 'out-of-scope' status. Results of these reviews will be fed back to the relevant account managers within the Agency and National Apprenticeship Service for action.

28. The reasons why an employer may come 'within scope' are:

    - total Agency funding becomes material, that is, it exceeds 5% of turnover; or
    - the Agency becomes aware of concerns over the Financial Health of the organisation including, for example, a qualified auditor's report and/or doubt over the going concern basis.

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