Skills Funding Agency

Financial Health Assessment of Non-college Organisations

May 2015

Of interest to training organisations

Financial Health Assessment of Non-college Organisations

Purpose

1. This document sets out the Skills Funding Agency's (SFA's) approach to the financial health assessment of non-college organisations. We assess the financial health of:

    - All non–college education providers that hold a direct contract with us.
    - Subcontractors;
    - Anyone applying to the Register of Training Organisations (Register) or other SFA procurement rounds.

    This is to understand the degree of risk to the SFA in contracting with them, either directly or indirectly. It also establishes the maximum recommended value of contracts appropriate to the financial resources of organisations that have a direct contract.

Definition

2. We use financial health as 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
    - gearing

Data Sources

4. We use the information from the latest available financial statements (or accounts) to calculate these three elements. Every non-college organisation must submit this information to us under the terms of their contract(s) and/or in line with the requirements of our Register.

5. Organisations applying to our Register or procurement round need to complete and submit a self-assessment toolkit, along with their financial statements. For further details, please refer to the Self-assessment Toolkit and Supporting Guidance notes.

6. Financial statements submitted must be **full accounts** (not abbreviated), and audited, if appropriate. If only abbreviated accounts are required for Companies House filing, organisations must still submit their full statutory accounts to us, which must include the following:

   - profit and loss account
   - balance sheet and relevant notes
   - commentary and breakdowns

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

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

8. If an organisation is unable to supply statutory financial statements because it has not traded for a sufficient period, it must supply its first 12 months' forecast figures and management accounts to date, showing actual activity. As a minimum, these should consist of:

   - forecast profit and loss account
   - end of period forecast balance sheet
   - cash flow forecast
   - narrative of key assumptions made

9. Organisations that do not already hold a direct SFA contract and 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 must include:

   - 12-month forecast profit and loss account

- end of period forecast balance sheet
- 12-month rolling cash flow forecast
- narrative supporting the assumptions made in preparing the business plan

10. Any financial health assessment grade awarded from the submission of a business plan or financial forecast will only remain valid until the first set of financial statements become available.

11. We will assess business plans and financial forecasts on an individual basis. We will take into consideration their achievability, potential for delivery against the information submitted and any autoscore recorded.

12. If any of the required information is missing, we will grade financial health as 'Inadequate', due to insufficient information available for assessment.

13. Training organisations with a current funding agreement must submit new financial statements each year. They should do this as soon as the statements 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.

14. Organisations that hold an existing SFA contract may be subject to further periodic financial reviews.

Exemptions

15. The following organisations are exempt from financial health assessment, and do not need to submit annual financial statements to the SFA:

- central government departments, including Executive Agencies or non-departmental public bodies.
- local authorities, including Local Education Authority (LEA) schools
- Academy schools, free schools or sixth-form colleges
- NHS trusts, fire authorities or universities monitored and supported by the Higher Education Funding Council for England (HEFCE)

- major national charities or voluntary organisations with an annual turnover in excess of £100 million, where SFA-funding is less than 5% of the organisation’s annual incoming resources.
- established public limited companies (plcs) or other registered companies with an annual turnover in excess of £100 million, where SFA-funding is less than 5% of the organisation’s annual turnover.

16. If an organisation is applying to the Register for the first time and considers that it should be exempt from financial health assessment then it must supply a copy of its most recent accounts along with a completed exemption form.

17. Further education (FE) colleges are subject to a separate monitoring regime and are not required to submit accounts for Register application purposes.

Large Employers

18. The SFA directly contracts with some employers to fund training they deliver to their own employees. Established plcs and other registered companies that the SFA directly contracts with as large employers are out of scope and do not require a formal annual financial health assessment. This is on the basis that:

    a. When first contracting, financial statements assessed by the SFA indicated the organisation to be financially stable; and

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

19. Once we confirm status and financial stability no further formal assessment would normally be required other than an annual review. The SFA’s Provider Financial Management and Assurance (PFMA) team will access the latest financial statements. They will confirm organisational status and that no change has occurred which could affect the employer’s ‘out of scope’ status.

20. An employer may come ‘within scope’ if:

    a. total SFA-funding becomes material, that is, it exceeds 5% of turnover; or

b. we become 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.

Parent Companies

21. If an organisation is part of a wider group of companies or classed as a subsidiary, it must submit full financial statements for the ultimate UK parent company. It must also submit those of the contracting or applying organisation.

22. If an organisation fails to submit parent company accounts this may result in the award of an ‘Inadequate’ grade.

Financial health descriptions

Grade	**Definition**	**Indicators**
Outstanding	An organisation that appears to have **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 this is a negative figure, 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

23. 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

24. We will make an initial grade assessment by comparing the aggregated points score with the assessment criteria shown below:

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

Moderation criteria

25. We may moderate the initial grade; moderation criteria include, but are not limited to the following.

    a. We cannot grade higher than ‘Satisfactory’ if an organisation scores 0 points for one of the three ratios.

    b. Where auditors have given the financial statements a qualified or adverse opinion.

c. We will give an ‘Inadequate’ grade if financial statements are overdue for filing at Companies House.

d. We will grade financial health as ‘Inadequate’ if organisations do not submit the most recently filed full financial statements to us (or other information sufficient to assess financial health).

e. If there is a group/parent company whose financial position could significantly impact the financial health of the organisation with whom the SFA is contracting, we may moderate the grade accordingly.

f. 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 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

g. Where an organisation’s financial health is calculated as ‘Inadequate’, solely because of a deficit on the pension scheme (as measured under FRS17) which reduces the level of reserves, the grade may be moderated to ‘Satisfactory’.

h. 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 repayments we may moderate a calculated grade of ‘Inadequate’ to ‘Satisfactory’.

i. 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, we may moderate the financial health score to 'Satisfactory', if we consider the underlying business profitable.

j. We may moderate organisations graded 'Inadequate' to 'Satisfactory' upon receipt of a fully completed parent or director's guarantee.

Recommended funding limits

26. A key aspect of the financial health assessment process is the setting of a maximum Recommended Funding Limit (RFL) for organisations that contract directly with the SFA. It is a measure of an organisation's financial capacity to deliver. The funding limit will also vary depending upon whether the organisation is new or has existing contracts. There are other constraints that may impact an organisation's capacity to deliver, such as its infrastructure. Other SFA teams monitor and consider these when awarding contracts.

27. The concept of a RFL is not applicable to FE colleges or organisations considered exempt or out of scope for financial health assessments.

The SFA's RFL methodology

28. We calculate the RFL as a percentage of the organisation's turnover from their latest annual financial statements. The relevant percentage is determined as follows:

Grade	**Organisations that hold an existing SFA contract**	**Organisations that do not hold an existing SFA contract but have a financial history**	**Organisations that do not hold an existing SFA contract and are assessed 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

29. We consider organisations that do not hold a contract with us at the time of assessment a greater risk. We will calculate the RFL on reduced percentages; the maximum RFL is £2 million.

30. We will assess business plans individually on their own merits. We will allocate a financial health category of ‘Satisfactory’ to business plans we consider viable. We will set the RFL at the turnover in the plan to a maximum of £1 million.

Implications of the RFL within the SFA

31. 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.

32. The funding limit is a recommended maximum. If we propose to award a contract that takes the aggregate values over this limit, we may prepare a Financial Risk Management Plan (FRMP). We will approve this 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).

33. Organisations that hold an existing SFA contract may be subject to further periodic review.

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