**Table One: Prudential financial standards**

We use these indicators as a quick guide to assess the financial viability and solvency of a PTE. Most of the indicators are in common use by accountants and the wider finance sector. All the indicators should be calculated using an entity’s last set of financial accounts.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Indicator** | **Strong (5 points)** | **Adequate (3 points)** | **Poor (1 point)** | **High risk (-5 points)** | **Extreme risk (-10 points)** | **Calculation and comment** |
| 1 | Net tangible assets ratio | 10%+ of total revenue | 5% to 10% of total revenue | 2%-5% of total revenue | Less than $50,000 or less than 2% of total revenue | Zero or less | Total equity less intangible assets/Total revenue |
| 2 | Liquid assets ratio | 16%+ | 8%+ | 5% to 8% | Less than 5% | Zero or negative | Cash + bank + readily liquefiable investments-bank overdrafts/ Annual cash outflow from operations  Readily liquefiable investments include financial assets that can be liquidated within 90 days without materially affecting operations  The assessment may include TEC approved undrawn committed borrowing facilities with a term greater than one year and TEC approved investments with a Group central treasury |
| 3 | Working capital ratio | 120%+ | 100% to 120% | 75% to 100% | Less than 75% or where the working capital deficit exceeds annual net cashflow from operations | Less than 20% | Current assets/Current liabilities |
| 4 | Profitability ratio | 8%+ (i.e. generates a commercial return) | 0 to 8% | 0 to -8% | Loss>8% of total revenue or >30% of total equity | Size of loss precludes PTE from meeting its bills as they fall due | Net surplus after tax/Total revenue |
| 5 | Net cash flow from operations ratio | 111%+ | 108% to 111% | 100% to 108% | Ratio<100% | Signs the PTE is not generating enough cash to meet bills as they fall due | Annual cash inflow from operations/Annual cash outflow from operations |
| 6 | Debt equity ratio | Less than 20% | 20% to 33% | 33% to 50% | 50% to 80% | 80%+ or negative ratio | Debt/Debt plus net tangible assets  Debt excludes accounts payable, student fees in advance, and current liabilities unlikely to result in a cash outflow. Debt includes shareholder current accounts where these are a liability of the PTE |

**Table Two: Further financial indicators used**

Where there are concerns with the financial health of a PTE then we use this wider set of risk indicators; supplement these with additional financial and educational performance information, and follow up with a discussion with the PTE and its financial advisors to inform the assessment.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Indicator** | **Strong (5 points)** | **Adequate (3 points)** | **Poor (1 point)** | **High Risk (-5 points)** | **Extreme Risk (-10 points)** | **Calculation and comment** |
| 7 | Net surplus pre shareholder wages and directors fees | 8%+ | 0 to 8%+ | 0 to -8% | Loss>8% of total revenue or >30% of total equity | Size of loss precludes PTE from meeting its bills as they fall due | Total surplus + shareholder wages + directors fees + subvention payments/Total revenue |
| 8 | Variability in earnings year on year | Refer Variability in earnings table below | | | | | This indicator looks at both the variability in earnings and the direction of travel |
| 9 | Shareholders’ funds ratio | 75%+ | 60% to 75% | 40% to 60% | Less than 40% | Zero or less | Total equity minus intangibles/Total assets minus intangibles and pre-paid fees (liability)  Trust funds may need to be excluded from total tangible assets if the amounts are material  Equity excludes Shareholder current accounts |
| 10 | Going concern attestation by auditor or reviewing independent accountant | Confirmation of going concern status by auditor of Big 10 international accounting firms (include: Deloitte, PWC, E&Y, Grant Thornton, BDO) or OAG through an external audit opinion (must be for the latest accounts) | Confirmation of going concern status by auditor or reviewing independent accountant (must be for the latest accounts) | We have not been provided with an audit opinion/review report indicating a positive going concern assessment, or unconsolidated accounts have not been provided, or an attestation is positive but more than a year old | Auditor or reviewing independent accountant questions aspects of the “going concern” test; e.g. “fundamental uncertainty” or “emphasis of matter” or notes inability to assess – or the TEC considers there is evidence the PTE may not be a going concern currently or in future | Auditor or reviewing independent accountant considers the PTE not to be a going concern  Failure of one or more of the solvency tests in the Companies Act | Measures the outcome of the assessment |
| 11 | Other factors | None | Indications there may be factors with a negative bearing on the PTE’s financial viability. This includes possible future funding reductions | Concerns expressed by an external government agency, TEC IM, or TEC review of aspects of the PTE’s financial management capability or ability to generate a profit | Concerns expressed by a government agency, TEC IM, or TEC reviewer of “going concern” issues or other factors likely to have a material impact on the PTE’s solvency. Includes entities that receive a “zero allocation” letter | Evidence of insolvency (see Companies Act definition) | The factor considered must be verifiable, objective, evidence based and material. This does not exclude commercial judgements made by suitably qualified accountants |
| 12 | Meets funding commitments (prior year & current year) | 99% to 105% of contracted/ allocated provision at the start of the year | 97% to 99% | 90%-97% | Need for borrowing or TEC deferment of recovery to continue to operate or delivers less than 90% of allocated funding at start of year | Risk of failure to complete tuition to all students | Funding dollars delivered/funding dollars allocated. Across all TEC funds |
| 13 | Change in roll size (measured by EFTS) | EFTS increase year on year over the last three years | EFTS increase in current year over previous year | EFTS static (give or take 10 EFTS), or declining by less than 5% as a two year moving average when compared with prior two year period | EFTS decline year on year over the last three years | EFTS decline by over 30% on prior year and/or TEC considering discontinuing funding | EFTS figures are from your last December full year SDR.  The TEC may use prospective year information if there is a risk of EFTS enrolment underachievement |
| 14 | Total revenue | Increases year on year over the last three years | Increases in current year over previous year | Income static or declining/ increasing by less than 5% as a two year moving average compared with the previous two years (e.g. compares 2015 and 2014 with 2013 and 2012) | Total revenue declines year on year over the last three years | Total revenue declines by over 30% on prior year or TEC considering discontinuing funding | Total revenue from all sources. Based on the most recent annual financial accounts  The TEC reserves the right to use prospective information if there is a risk of total revenue materially declining |
| 15 | Interest coverage ratio | Greater than 12.0:1 or “Divide by zeros” or interest costs under $10,000 | Greater than 3.0:1 but less than 12.0:1 | Greater than 1.5:1 but less than 3.0:1 | Less than 1.5:1 but greater than 1.0:1 | Less than 1.0:1 | Earnings before interest expense and tax divided by interest expense |

*Earnings variability*

The following table looks at how the Net surplus to Total revenue financial indicator has changed over time. The risk category and score assigned in column 1 depends upon the observable characteristics in the further columns.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Net Surplus** | **Financial results** | **Ratio Variability** | **Direction of travel** | **Comment** |
| **Strong (score 5)** | Positive net surplus | Previous two years of surplus and outlook is a surplus | Less than 300 percentage points | Improving ratio | Must have all characteristics |
|  | Latest net surplus above 20% | Previous year in surplus | Less than 500 percentage points | Positive or negative | Must have all characteristics |
| **Adequate (score 3)** | Positive net surplus | Previous year in surplus | Less than 500 percentage points | Improving ratio | Must have all characteristics |
|  | Latest net surplus above 20% | Previous year in surplus | Less than 700 percentage points | Positive or negative | Must have all characteristics |
|  | Positive net surplus | Previous two years in surplus | Less than 500 basis points | Positive or negative | Must have all characteristics |
| **Poor (score 1)** | Positive net surplus | Previous year in surplus or loss | Less than 700 percentage points | Positive or negative | Choose best description of characteristics here or below |
|  | Net loss | Previous year in surplus or loss | Less than 300 basis points | Positive or negative | Choose best fit |
|  | Latest net surplus above 20% | Previous year in surplus or loss | Less than 1000 percentage points | Positive or negative | Choose best fit |
|  | Positive net surplus | Previous two years of surplus | Above 500 percentage points | Positive or negative | Choose best fit |
| **High risk (score -5)** | Positive net surplus | Previous year in surplus or loss | Above 700 percentage points | Positive or negative | Choose best fit |
|  | Net loss | Previous year in surplus or loss | Above 300 percentage points | Positive or negative | Choose best fit |
|  | Net loss greater than 50% of previous year’s total equity | Previous year is a loss | Not a factor | Not a factor | Choose best fit |
|  | Net loss | Previous two years of losses | Not a factor | Not a factor | Choose best fit |
| **Extreme risk (score -10)** | Net loss greater than the previous year’s or the existing year’s net tangible assets | Not a factor | Not a factor | Not a factor | Must have characteristic. If met then use this category |
|  | Two years of losses and forecast loss for current budget year | Not a factor | Not a factor | Not a factor | Must have characteristic. If met then use this category |

**Table Three: Calculating the overall financial viability risk score**

For each financial indicator used, including the prudential financial standards, a score is assigned. By summing the scores and dividing by the number of indicators it is possible to assign a PTE an overall score (ranging from -10 to 5). The higher the score the stronger the financial viability is.

A PTE’s overall risk classification is then determined two ways:

1. PTEs that fail the minimum prudential financial standards for their last set of accounts or current budget automatically receive either a High (D) or Extreme (E) risk grade. If a PTE does not meet the minimum prudential financial standards, but its overall risk indicator score is calculated as a (C) or better then the PTE will be assigned a High risk (D) category, otherwise the PTE is categorised as Extreme risk (E).
2. In all other cases a PTE’s classification is determined as follows:-

|  |  |
| --- | --- |
| **Overall average (mean) score** | **Overall assessment** |
| Greater than 4.5 | Strong (A); |
| Between 3 and 4.5 | Adequate (B) |
| Between 2.5 and 3 | Poor (C) |
| Between 1.0 and 2.5 | High risk (D) |
| Less than 1.0 | Extreme risk (E) |

If information is not available to calculate some indicators the inability to assess will be noted for future follow-up and the average will be calculated as the average of the available scores.