

**Tertiary Education
Commission**
Te Amorangi Mātauranga Matua



Financial Monitoring Framework Guidelines for Tertiary Education Institutions

July 2016

The background features a repeating pattern of overlapping circles. Each circle contains a central four-pointed star and is surrounded by a ring of smaller chevrons pointing outwards. The circles are arranged in a staggered grid, creating a sense of depth and movement.

Financial Monitoring Framework Guidelines

How we assess your organisation's financial wellbeing

We group measures into two categories

We calculate a historical and future view of viability and sustainability using a graded scale. These are then collated into a single financial risk rating.

We combine individual scores to reach an overall score

To reach an overall risk rating, the individual scores are combined first into a historical and future risk rating, and then into an overall score using a six-step process (see Appendix One).



Viability focuses on the shorter-term financial performance

This enables judgements to be made about the ability, or otherwise, of the institution to meet its financial obligations as they fall due. The measures included within this dimension look at earnings, liquidity, cash flow and short-term debt servicing. Liquidity can, in some instances, include undrawn borrowing facilities. Details of the undrawn borrowing rules and declaration are outlined in Appendix Two.

Sustainability provides a longer-term view

This provides analysis of the financial performance and cost structures of the institution, and whether these are enduring. The measures within this dimension look at the balance sheet structure, return on assets, the longer-term picture presented by the viability measures, and a key revenue driver measure which looks at whether TEIs are achieving the Student Achievement Component funding delivery close to levels as agreed with the TEC.

Your overall risk rating

The lower of historical viability and historical sustainability becomes the historical risk rating. The lower of future viability and future sustainability becomes the future risk rating. These are then combined into an overall score. The weighting applied to the historical and future score is determined by the confidence assessment.

We will communicate the overall risk rating to you every year. The rating informs the level of financial reporting and monitoring required over the following year. We will discuss any additional monitoring requirements with you.

Make sure you provide complete and quality financial information

You submit all the information required of you

It is important that you provide all the financial information requested as this informs our confidence assessment and the framework measures. Incomplete templates are likely to be required to be resubmitted. We include key definitions in the financial monitoring template to help you provide quality information.

You use the reporting template to submit information

You need to use the reporting template to submit audited financial results, Council approved budgets, and two year forecasts to us. All information should be on a consolidated basis.

We assess your budgeting history and forecasting to establish a confidence assessment

We review the financial information provided by you and consider how confident we are that your forecasts are achievable. Our judgement is based on the assumptions provided, historical trends, and discussions with you. The confidence assessment is then used in the calculations of the overall risk rating.

When we undertake a confidence assessment we consider your history of providing accurate information and whether the forecasts:

- › rely on assumptions that contradict government policy;
- › create scenarios that are seen as unlikely to occur; or
- › do not align with other information supplied (such as business cases, investment plans, or funding letters).

Greater confidence in the forecast position increases the weighting on the future view, while lower confidence increases the weighting on historical performance. This reduces the likelihood that forecasts that appear unachievable will distort the overall risk ratings.

	Historical FMF risk rating	Future FMF risk rating	Best possible overall FMF risk rating
High confidence in forecast	25%	75%	As calculated
Moderate confidence in forecast	50%	50%	As calculated
Low confidence in forecast	75%	25%	Moderate risk
No confidence in forecast	100%	0%	High risk

We will discuss any concerns with you before finalising the overall risk rating

If we have low or no confidence in your forecasts, we will let you know, including our reasons for this.

You can then supply an updated forecast (such as lower growth scenarios) and/or provide additional background information around the assumptions. This helps us to understand your likely future position.

The Risk Assessment Report: A snapshot in time of your financial performance and risk profile

Your report outlines your results and risk rating

We will send your risk assessment report to you outlining your summary financial information, relevant measures, and risk rating once it has been finalised.

You will see a summary of the core financial information, and the score given to each risk category.

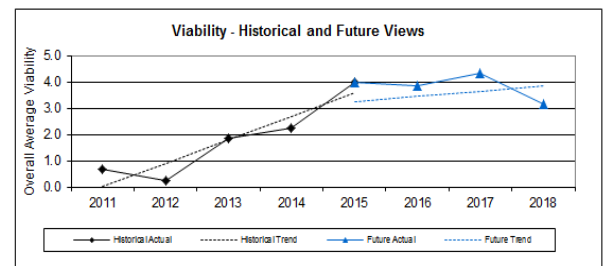
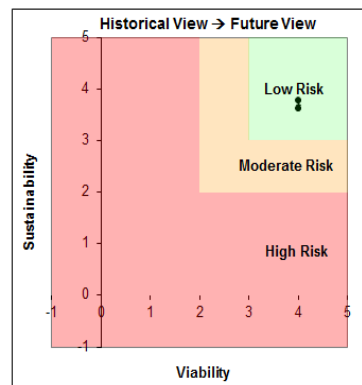
We include two graphs on the report:

- › The first show the direction of travel for between the historical and future views. This visually shows if you are travelling between risk zones over time, or operating in the same zone.
- › The second tracks the historical and future viability scores and tend over time.



Graphs show historical and future views across the measures

Figure 1: Example of graphs in the report



Historical 2015 FMF risk rating:	3.6	Low Risk
Future FMF risk rating:	3.8	Low Risk
Overall FMF risk rating:	3.7	Low Risk

Appendix 1: Financial Monitoring Framework assessment calculations

A six-step approach is used to calculate the overall risk rating. This is an automated and formulaic calculation. The risk assessment report includes summary financial performance information, the confidence assessment, and each measure. An example of the report is attached at Appendix Two.

Step 1: Calculate a percentage or ratio for each measure

There are twelve performance measures. The measures are grouped, into six viability measures and six sustainability measures.

A percentage is calculated for each of the performance measures over five financial years: two historical years, the current year, and two forecast years. These are presented in the report.

Step 2: Convert each measure's percentage, for each year, to a score between -2 and +5

Each percentage is converted into a score between -2 and +5. This conversion is graded. Progressively lower scores have a greater negative effect, reflecting the higher level of associated risk. A score of 3 or above is considered low risk. A score of -2 is considered high risk.

The individual percentage, not the score, is presented in the report.

The tables below provide a definition and the scoring bands for each measure.

Viability focuses on the shorter-term financial performance

Table 1: viability scoring table

Measures	Definition / calculation	Scoring table performance bands (a score of 3 and above is considered low risk)					
		-2.0	0.5	2.0	3.0	4.0	5.0
Profitability							
Operating surplus/deficit	Operating surplus/deficit before unusual and non-recurring items to total income	< -4%	-4% to 0%	0% to 3%	3 to 5%	5 to 7%	7% +
Core Earnings	EBITDA to total income	< 3%	3% to 7%	7% to 9%	9% to 11%	11% to 13%	13% +
Net cash flow from operations	Cash inflow (receipts) from operations to cash outflow (payments) from operations	< 104%	104% to 108%	108% to 111%	111% to 113%	113% to 115%	115% +
Liquid funds ratio (liquidity)	Liquid resources less short term overdrafts to cash outflow (payments) from operations	< 2%	2% to 5%	5% to 8%	8% to 12%	12% to 15%	15% +
Ability to service debt (interest coverage ratio)	Earnings before interest paid and abnormal to Interest paid.	< 1.0:1 x	1.0 to 1.5:1 x	1.5 to 3:1 x	3 to 6:1 x Or no interest and core earnings ratio less than zero	6 to 12:1 x Or no interest and core earnings ratio 0% - 10%	>12:1 x Or no interest and core earnings ratio greater than 10%
Quick ratio	Readily liquefiable resources divided by current liabilities likely to result in cash outflows.	0 to 0.5 x	0.5 to 1.0 x	1.0 to 1.5 x	1.5 to 2.0 x	2.0 to 2.5 x	2.5 + x

Sustainability provides a longer-term view

Table 2: Sustainability scoring table

Measures	Definition / calculation	Scoring table performance bands (a score of 3 and above is considered low risk)					
		-2.0	0.5	2.0	3.0	4.0	5.0
Debt equity ratio	Total debt to total debt plus equity.	25% +	15 to 25%	7.5 to 15%	0 to 7.5%	0%	0% and 10%+ Core Earning
Achievement of SAC domestic funded allocation (\$)	Actual delivered domestic SAC funding as a percentage of original SAC domestic funded allocation as agreed with TEC at beginning of year.	0 to 85%	85 to 94%	94 to 97%	97 to 98% or 103%+	98 to 99% or 101 to 103%	99 to 101%
3-year average viability	Viability is calculated for 3 years and the average of these is taken as the score value.	As the scores are already calculated on a scale of -2 to +5 no further adjustments are required. This score is taken from the overall average viability score on the FMF output report.					
3-year average return on property, plant & equipment employed	The ratio EBITDA to end of year property plant & equipment is calculated for 3 years and the average of these is taken as the ratio value.	< 0%	0 to 2.5%	2.5 to 4.5%	4.5 to 6.5%	6.5 to 8.5%	8.5%+
Debt repayment	Total debt less any surplus liquidity to 3-year average surplus/deficit before abnormals.	average deficits and net debt or a ratio of >1,000%	500 to 1,000%	200 to 500%	100 to 200%	<100%	No net debt
Trend and variability in financial viability indicators	Comparison of long term trend in financial viability over a five year period.	Very high variability and downward trend	High variability and downward trend	Some variability and upward trend or Previously high score, some variability and negative trend	Low variability and upward trend	Very low variability and upward trend	Previously high score, low variability and upward trend

Step 3: Calculate an overall historical and an overall future score for each category

The scores for each measure (which are based on the percentages) are combined into an overall historical and an overall future score, using a weighted average.

The *historical view* is based on the audited results for the last two years; the *future view* is based on the current budget and forecasts for the next two years.

The overall historical and future scores are presented in the report.

Historical view weighting

	Historical year one	Historical year two
Viability	67%	33%
Sustainability	80%	20%

Future view weighting

	Current year	Forecast year one	Forecast year two
Viability	67%	33%	
Sustainability		20%	80%

Step 4: Combine the scores in each category to get future and historical scores

The weighted average scores for each percentage, calculated in step 3, are then combined to give a category score by taking the average score of the six measures in each category. No weighting is applied to any of the measures.

Step 5: Combine the two historical and two future scores are combined

The two historical scores are combined and the two future scores are combined for each category to get overall historical and future scores.

The lower of historical viability and historical sustainability becomes the historical risk rating. The lower of future viability and future sustainability becomes the future risk rating. These overall scores are presented in the report.

The overall historical and future ratings are shown on the risk assessment report, along with a “traffic light” visual representation

Table 7: Risk scores and levels

	Risk level	Colour
Below 1.00	High risk	Red
Between 1.00 and 2.99	Moderate risk	Orange
3.00 or above	Low risk	Green

Step 6: Combine the historical and future scores into a single risk rating, weighted depending on the confidence assessment

In finalising the overall risk rating, a weighting is applied based on the confidence assessment. Greater confidence in the forecast position increases the weighting on the future view, while lower confidence increases the weighting on historical performance. This reduces the likelihood that forecasts, which appear unachievable, will distort overall risk ratings.

If we have low or no confidence in your forecasts, an upper limit will apply to the overall risk rating. This score is represented visually using the “traffic light” system shown in table 7.

Table 8: Calculation of the overall risk rating

	Historical risk rating	Future risk rating	Best possible overall risk rating
High confidence in forecast	25%	75%	As calculated
Moderate confidence in forecast	50%	50%	As calculated
Low confidence in forecast	75%	25%	Moderate risk
No confidence in forecast	100%	0%	High risk

Appendix 2: Declaration process for incorporation of undrawn borrowing facilities


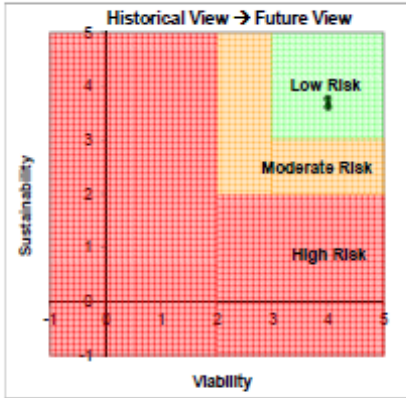
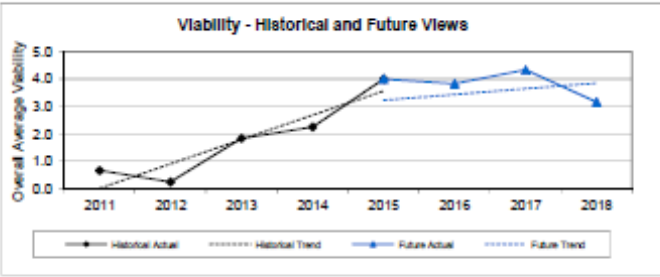
The FMF allows for the incorporation of undrawn borrowing facilities when assessing the liquidity of TEIs, where the following criteria are met:

- › a consent issued by the Secretary for Education under Section 192 (4)(d) exists that allows the TEI to borrow for general operational purposes;
- › the borrowing facility has not required a Crown guarantee and is on standard commercial terms appropriate for the tertiary sector;
- › the facility is long-term and unable to be readily cancelled by the issuing bank;
- › the facility is through a registered trading bank with a significant market share;
- › the TEI has an agreed treasury policy that covers liquidity; and
- › the TEI meets the agreed financial performance criteria¹ for the two years prior to, and the year it seeks to have the undrawn borrowing facilities recognised for:
 - good profitability – an operating surplus/deficit ratio before abnormals of 3% or more;
 - strong operational cash flows as shown by having a net cash flow from operations above 111%; and
 - the TEI has maintained a liquid funds ratio (including undrawn borrowing facilities) of at least 8%.

If you are wish to have undrawn borrowing facilities included in your liquidity assessments you will need to provide confirmation that their facilities meet all the criteria, via a declaration. If you do not fully meet the criteria, you may still seek to have the facility incorporated by supplying additional information to us to support this request. You will need to specify the amount of undrawn borrowing facilities they seek to have included each year.

¹ The thresholds in relation to each of these elements are aligned to the FMF low risk thresholds.

Appendix 3: Financial Monitoring Framework risk assessment report example

Financial Performance Assessment - Financial Monitoring Framework (FMF)									
Tertiary Education Institution:		Institute of Hypothetical Results					Date of Report:		Jun 18
Viability - Historical View	2015	Actual		Version		Received			
Sustainability - Historical View	2015	Actual		Final		01/05/16			
Viability - Future View	2016 (1st of 2 yrs)	Budget		Updated		01/05/16			
Sustainability - Future View	2018 (2nd of 2 yrs)	Forecast							
Key Information ¹	2013 A	2014 A	2015 A	2016 B	2017 P	2018 P	TEC confidence in forecasts		
Total revenue (\$m)	98.2	107.4	109.4	112.0	106.9	108.7	Moderate		
Total expenses (\$m)	99.1	107.1	107.0	107.3	103.1	104.5			
Surplus (deficit) (\$m)	-0.9	0.4	2.4	4.7	3.8	4.2			
SAC category EFTS	7,568	7,688	7,609	7,790	7,454	7,424			
International EFTS	492	579	594	630	690	775			
Total EFTS	9,314	9,657	9,494	9,709	9,297	9,352			
¹ The key information is as supplied in the TEI Financial Monitoring templates to the TEC									
Viability ²	2015 A	2016 B	2017 P	2018 P	FMF Score (3 +) ³	Historical	Future		
Operating surplus/deficit	2.2%	4.2%	3.5%	3.9%	3% or more	2.0	3.0		
Core earnings	10.8%	12.7%	11.5%	11.5%	9% or more	3.0	4.0		
Net cashflow from operations	116.6%	114.6%	113.8%	114.3%	111% or more	5.0	4.0		
Liquid funds ratio	18.3%	13.6%	17.4%	24.1%	8% or more	5.0	4.3		
Ability to service debt	6.8	9.1	32.5	Operating Deficit	3.0x or more (or no interest costs)	4.0	4.3		
Quick ratio	2.5	2.3	2.7	3.7	1.5x or more	5.0	4.3		
Overall Average Viability	4.0	3.8	4.3	3.2		4.0	4.0		
Sustainability ²	2015 A	2016 B	2017 P	2018 P	FMF Score (3 +) ³	Historical	Future		
Debt equity ratio	3.0%	3.8%	0.8%	0.8%	7.5% or less	3.0	3.0		
Achievement of EFTS	101.7%	N/A	N/A	N/A	97% or more	4.0	NA		
3-Year average viability	2.7	3.4	4.1	3.8	3 or more	2.7	3.8		
3-Year ave return on property, plant and equipment	7.3%	8.1%	8.4%	8.4%	4.5% or more	4.0	4.0		
Debt repayment	No net debt	26.6%	No net debt	No net debt	200% or less	5.0	5.0		
Trend and variability in average viability	3.0	3.0	3.0	3.0		3.0	3.0		
Overall Average Sustainability	3.6	3.5	3.8	3.8		3.6	3.8		
² Refer to the Financial Monitoring Framework table of measures for definitions of the measures used and the related risk assessment scores.									
³ The ratio value that is required to score 3 or more. An average of 3 or more is necessary for an overall rating of low risk									
									
<p>Historical 2015 FMF risk rating: 3.6</p> <p>Future FMF risk rating: 3.8</p> <p>Overall FMF risk rating: 3.7</p>			<p>Low Risk</p> <p>Low Risk</p> <p>Low Risk</p>						
Comments									