

**Tertiary Education
Commission**
Te Amorangi Mātauranga Matua



Financial Monitoring Framework Guidelines for Industry Training Organisations

March 2016

Understanding your financial performance through the Financial Monitoring Framework



We developed this framework to promote a shared understanding of ITO financial performance.


The framework provides clarity and transparency about the risk ratings we make

This guideline summarises what the Financial Monitoring Framework (the framework) is, how we use it to better understand industry training organisations' financial performance, and what information to submit to us. You will also see an example of what the final report will look like.

The framework:

- › assists us in monitoring financial performance
- › ensures we follow a consistent approach to monitoring
- › supports a 'no surprises' approach to monitoring and engagement, and
- › helps us calculate a financial risk rating.

Monitoring financial performance

We use the framework to monitor your organisation's financial performance. We developed this framework, together with the sector, to assist in our monitoring obligations.

Ensuring consistency of approach

The framework provides clarity and transparency around the financial monitoring assessments we make.

We do this by:

- › using readily available information
- › considering both historical and future performance
- › using evidenced-based financial theory relevant to the sector
- › avoiding unnecessary complexity in the design and construction of the framework
- › applying a formulaic approach and a judgement about forecast confidence
- › having stable measures and scoring, and
- › enabling self-assessment by your organisation.

Providing a shared understanding

We will share your results with you. We will use the information to better understand your performance and inform future engagement. We support a 'no surprises' approach to monitoring and engagement, which is evident in the framework.

Calculating a financial risk rating

The framework uses measures that identify key parts of financial performance, with emphasis on historical and forecast performance.

The framework applies a graded scale over a number of measures that are converted into an overall score and rating of low, moderate or increased risk. Lower scores are associated with higher financial risk.

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. Missing information will distort the ratios and scores, impacting on the overall risk rating. 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, board approved budgets, and two year forecasts to us.

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 accurate budgeting 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.

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.



The confidence assessment affects the weighting applied to the historical and future views

	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%	Increased 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.

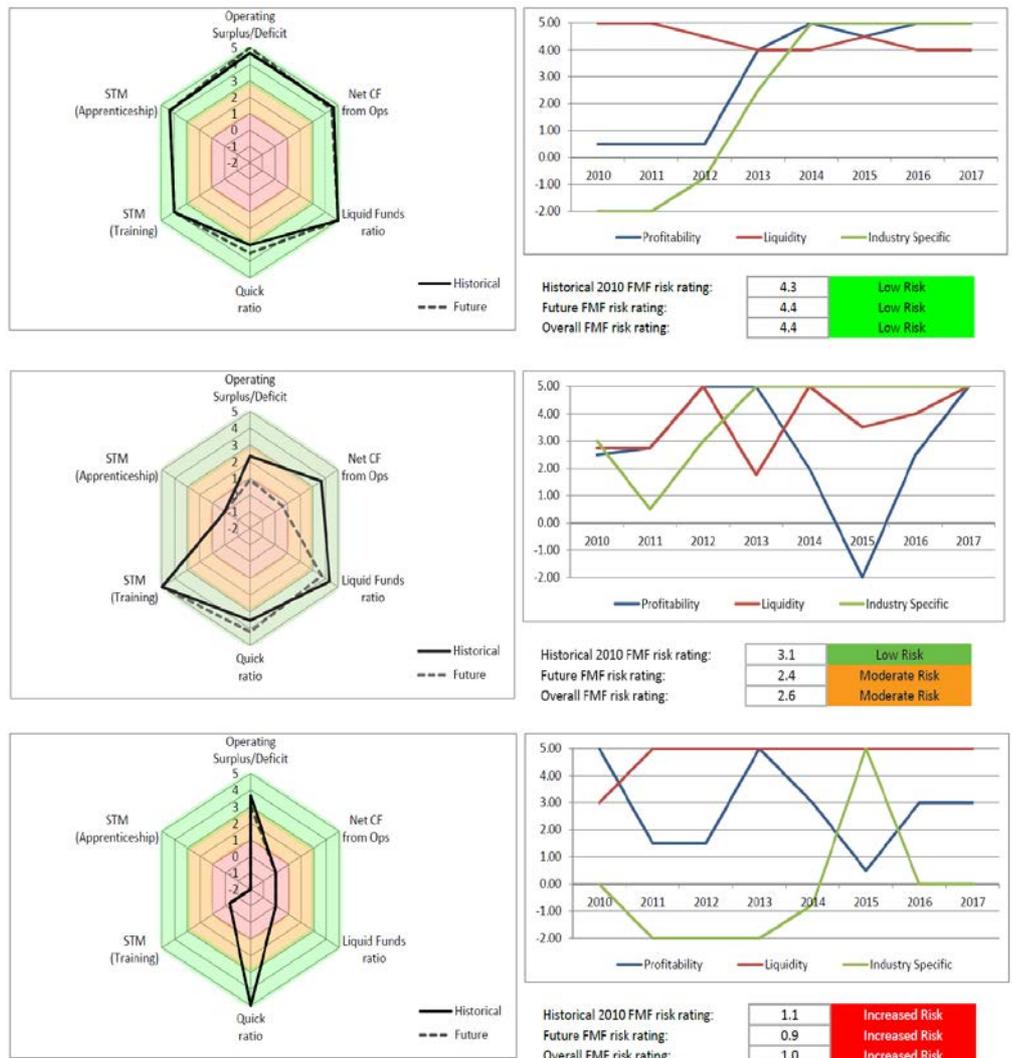
You will see a summary of the core financial information, and the score given to each risk category.

We include two graphs that represent the historical and future views across all measures. An example of the report is set out in Appendix Two.

A **spider graph** shows the historical and future view for each category. A **time series graph** shows your scores over time for each of the three categories.

Figure 1: Examples of graphs in the report

Graphs show historical and future views across all measures



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 the percentage and score for each measure. An example of the report is attached at Appendix Two.

Step 1: Calculate a percentage for each measure

There are six performance measures. The measures are grouped, two per category, under three categories: Profitability, Liquidity, and Industry Specific.

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.

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

Profitability considers operating surplus/deficit and net cashflows from operations

Table 1: Profitability scoring table

Measures	Definition / calculation	Scoring table performance bands (a score of 3 and above is considered low risk)						
		-2.0	0.5	1.0	2.0	3.0	4.0	5.0
Profitability								
Operating surplus/deficit	Operating surplus/deficit before unusual and non-recurring items to total income	< -10%	-10% to -5%	-3% to -5%	-3% to -1%	-1% to 1%	1% to 3%	> 3%
Net cash flow from operations	Cash inflow (receipts) from operations to cash outflow (payments) from operations	< 94%	94% to 99%	99% to 101%	101% to 103%	103% to 105%	105% to 107%	> 107%

Liquidity considers the level of liquid (i.e. cash) assets and the ability to service current liabilities

Table 2: Liquidity scoring table

Measures	Definition / calculation	Scoring table performance bands (a score of 3 and above is considered low risk)						
		-2.0	0.5	1.0	2.0	3.0	4.0	5.0
Liquidity								
Liquid funds ratio (in months)	Liquid assets less short term overdrafts to cash outflow (payments) from operations x 12 (score in months)	< 0	0 to 0.25	0.25 to 0.5	0.5 to 1.25	1.25 to 2.5	2.5 to 3.5	> 3.5
Quick ratio	Readily liquefiable assets divided by current liabilities likely to result in cash outflows	< 1.0	1.0 to 2.0	2.0 to 3.0	3.0 to 4.0	4.0 to 5.0	5.0 to 6.0	> 6.0

Industry specific ratios consider the achievement of Standard Training Measures (STM) against the agreed Investment Plan allocations

Table 3: Industry specific scoring table

Measures	Definition / calculation	Scoring table performance bands (a score of 3 and above is considered low risk)						
		-2.0	0.5	1.0	2.0	3.0	4.0	5.0
Industry specific								
Achievement of STM (trainee)	Number of achieved trainee STM as a percentage of original agreed trainee STM at beginning of year	0% to 85%	85% to 90%	90% to 94%	94% to 97%	97% to 98% > 103%	98% to 99% 101% to 103%	99% to 101%
Achievement of STM (apprentices)	Number of achieved apprentice STM as a percentage of original agreed apprentice STM at beginning of year	0% to 85%	85% to 90%	90% to 94%	94% to 97%	97% to 98%	98% to 99%	> 99%

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.

Table 4: Historical view

	One year prior	Two years prior
Historical view	67%	33%

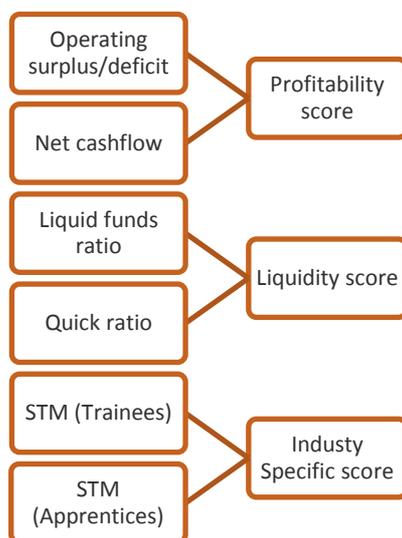
Table 5: Future view

	Current year – budget	1 st year forecast	2 nd year forecast
Future view	50%	30%	20%

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 two measures in each category. No weighting is applied to any of the measures.

This is presented in the report as a category total.



Step 5: Combine the three overall historical and the three overall future scores into a single score for each

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

A weighting is applied to reflect the differing risk impacts of the three categories, with the Liquidity score having the greatest level of impact on the historical and future risk rating. The higher weighting on liquidity and profitability reflects the importance of these measures on overall risk.

These overall scores are presented in the report.

Table 6: Calculation of the historical and future risk ratings

	Profitability	Liquidity	Industry specific
Historical FMF risk rating	30%	50%	20%
Future FMF risk rating	30%	50%	20%

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	Increased 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%	Increased risk

Appendix 2: Financial Monitoring Framework risk assessment report example

Financial Performance Assessment - Financial Monitoring Framework (FMF)

Industry Training Organisation

Example ITO

Year of Report: 2015

Historical View (Current year -2)
Historical View (Current year -1)
Future View (Current year)
Future View (Current year +1)
Future View (Current year +2)

2013
2014
2015
2016
2017

Actual
Actual
Budget
Forecast
Forecast

Version
Final
Updated

Received
14/01/15
14/01/15

Key Information ¹	2012	2013	2014	2015	2016	2017
Total revenue (\$000)	94,169	176,335	215,933	232,841	246,732	254,400
Total expenses (\$000)	97,859	171,888	208,458	235,081	218,115	222,318
Surplus (deficit) (\$000)	(3,690)	4,447	7,474	(2,440)	29,539	32,082
Industry Training Fund STMs	18,807	30,219	27,825	27,447	22,917	30,032
Modern Apprenticeship Fund STMs	3,136	6,005	14,102	15,524	12,630	15,332
Total STMs	19,743	36,224	34,988	42,971	35,547	45,365

TEC confidence in forecasts High

¹ The key information is as supplied to the TEC in the ITO Financial Monitoring templates

Profitability Measurements	2013	2014	2015	2016	2017	FMF Score (3+) ²	Historical	Future
Operating surplus/deficit	2.5%	3.5%	(1.0%)	12.0%	12.6%	-1% or more	4.7	3.5
Net cashflow from operations	90.1%	96.2%	92.3%	112.3%	112.3%	104% or more	-0.3	1.5
Overall Profitability Score	1.0	2.8	0.0	5.0	5.0		2.2	2.5

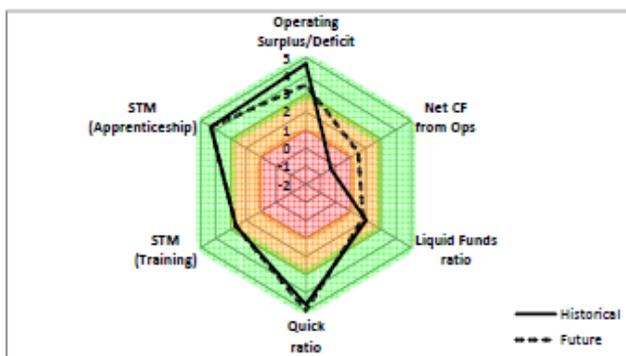
Liquidity Measurements	2013	2014	2015	2016	2017	FMF Score (3+) ²	Historical	Future
Liquid funds ratio	0.50	0.60	0.51	0.52	0.45	1.25 or more	2.0	1.8
Quick ratio	5.06	6.29	6.42	6.53	6.44	2.0x or more	4.7	5.0
Overall Liquidity Score	3.0	3.5	3.5	3.5	3.0		3.3	3.4

Industry Specific Measurements	2013	2014	2015	2016	2017	FMF Score (3+) ²	Historical	Future ³
Achievement of STM (Trainee)	98.7%	95.8%	99.8%	101.9%	101.4%	97% or more	2.7	2.7
Achievement of STM (Apprentices)	100.3%	98.5%	101.8%	115.7%	111.7%	97% or more	4.3	4.3
Overall Industry Specific Score	4.5	3.0	4.5	3.5	3.5		3.5	3.5

Overall Scores 3.0 3.1

² 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

³ The future view for Industry Specific Measures duplicates the historical delivery pattern, regardless of forecast delivery percentages



Historical FMF risk rating: 3.0
Future FMF risk rating: 3.1
Overall FMF risk rating: 3.1

Low Risk
Low Risk
Low Risk

Comments