



Tertiary Education Commission
Te Amorangi Mātauranga Matua

Tertiary Education Institution Financial Monitoring Framework

Version 2.1

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Introduction

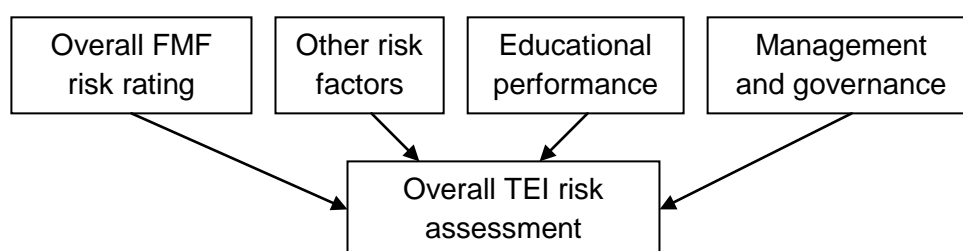
This document provides details of how the Tertiary Education Commission's (TEC) Financial Monitoring Framework (FMF) operates. The FMF was adopted by the TEC from 1 January 2010 to provide a structured approach to financial monitoring of tertiary education institutions (TEIs).

Following feedback from TEIs on version 1.0 of the FMF, the TEC sought the input of a number of chief financial officers across the sector on suggested changes to strengthen the FMF. Following endorsement for the changes, the FMF was updated as version 2.0, effective from 1 November 2010. The TEC has since had discussions with the sector on prudent liquidity (cash) management and has revised the definitions of two FMF ratios, with effect from 31 December 2011, to reflect current practice relating to the use of undrawn borrowing facilities in the tertiary sector.

The FMF is part of the TEC's overall approach to monitoring. The FMF is the primary method that the TEC uses to gain a snapshot of the financial wellbeing of TEIs. The TEC does this as part of its responsibility to monitor the financial performance of all TEIs in accordance with the Education Act 1989 (the Act) (S159KBA).

The FMF is intended to be an objective and transparent financial performance monitoring system for the TEI sector. The TEC has established a set of core objectives for the FMF and these are listed in Appendix 1 at the end of this paper.

The output from a series of financial calculations leads to an overall FMF risk rating. The risk rating calculated using the FMF is a major influence on the overall TEI risk assessment. As the diagram below shows, educational performance, management and governance along with other risk factors also contribute to the TEC's overall risk assessment of a TEI:



The overall FMF risk rating is a key component in determining the level of reporting and associated financial monitoring and contact between the TEC and a TEI over the following year.

An overview of the Financial Monitoring Framework

The FMF is an initial assessment of the financial wellbeing of a TEI. The FMF uses a basket of measures that, individually and collectively, have an ability to identify most key facets of TEIs financial performance and provides a score for each measure.

The data used in the FMF calculations are drawn from TEIs' historical group audited accounts, council budgets and forecast financials¹. Equivalent Full Time Student information is required by the FMF and is sourced from the agreed Investment Plans and the Single Data Return.

The FMF combines these measures into the two categories; Viability and Sustainability which are assessed over historical and future dimensions.

Viability focuses on the shorter-term financial performance, to enable 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.

Sustainability provides a longer-term view, to provide 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.

Lower scores within the FMF are associated with higher financial risk. The lower of the historical viability and historical sustainability score is taken as the historical view. This is repeated for the future view, with the lower of future viability and future sustainability score being used as the future view.

The historical and future views require merging into a single financial risk rating. Initially, the FMF did this by way of a matrix. Following the review² of the FMF (version 1.0) this is now done through a graded scale to provide an overall score, which then leads to an overall risk rating of low, moderate or high risk.

TEIs identified as higher risk (i.e. either a moderate or high risk assessment) will be required to supply more frequent financial information and the TEC will undertake greater scrutiny around the financial data supplied. This will enable identification of the key areas of risk within the institution, so that the Crown's monitoring and engagement can be appropriately focused.

Over time the level of differential treatment of TEIs may increase, providing more operational flexibility, or less reporting requirements, for lower risk TEIs. Assessing risk for such differential treatment may occur through either the FMF, components of the FMF, or the overall risk rating.

¹ This data is supplied by tertiary education institutions in a TEC-defined format.

² That review looked at all elements of the FMF and resulted in a number of changes.

Scoring and determining FMF views

Within the FMF each ratio is assigned a scoring table. The scoring table converts the financial ratios calculated for the measure into a score between -2 and +5. The conversion of ratios into scores is graded so that progressively poorer performance has a greater negative effect. Table 1 below provides an example of the scoring table for the operating surplus / deficit ratio. Appendix 2 contains details of all the measures (ratios) and their associated scoring tables:

Table 1: Score and risk level for operating surplus / deficit

Scoring table performance bands					
High Risk		Low Risk			Minimal Risk
-2	0.5	2	3	4	5
< -4%	-4% to 0%	0% to 3%	3% to 5%	5% to 7%	7% +

The ratios used in the FMF are calculated from historical audited results, the current council budget and forecasts for the two subsequent years. For the extended example following, if the year for the most recent audited results across the sector was for 2010, then current Council budgets would relate to 2011 and the forecast financials would be 2012 and 2013.

Following the review of the FMF (version 1.0) a number of ratios were amended or replaced. Appendix 3 provides a full listing of all the changes incorporated into versions 2.0 and 2.1 of the FMF. Three ratios within sustainability now use 3-year averages, rather than just a single year's financials. Those changes were considered consistent with looking at the longer term perspective which is the objective of the sustainability dimension. The 2010 ratio becomes the average of 2008, 2009 and 2010 financial information. Similarly, the 2013 ratio became the average of 2011, 2012 and 2013 forecasts. In this way multiple years of forecast data were combined into a single forecast view.

The revised FMF introduced a methodology in which multiple years of forecast data were combined into a single forecast view. This was done by applying weightings to the forecast years that collectively added to 100%. These changes to the initial version were considered necessary so that the forecast view incorporated the middle forecast year of data (using the above example of latest audited actuals being 2010 this middle year would be 2012 and would not have featured in the analysis).

The Viability forecast view had a 100% weighting on 2011. It will now have a 67% weighting on 2011 and 33% weighting on 2012.

The Sustainability forecast view had a 100% weighting on 2013. It will now have a 20% weighting on 2012 and an 80% weighting on 2013³.

Similarly, the historical view is calculated on the most recent year that has audited results (2010). Within the historical (2010) sustainability calculation, the 2008 and 2009 performance will have some impact due to the use of 3-year averages.

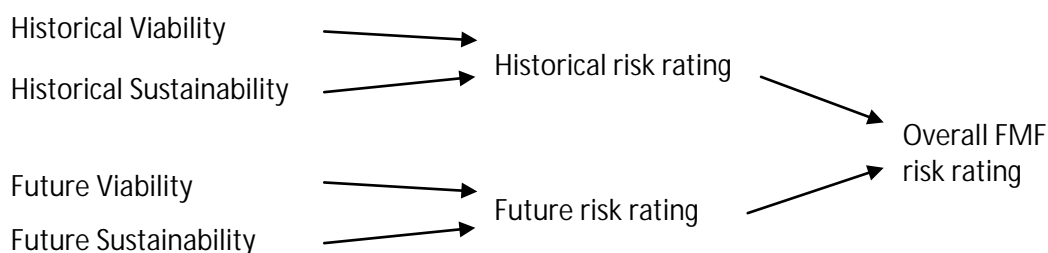
Explanation of debt repayment measure

The formula around debt repayment can be a little confusing as it introduces the concept of surplus liquidity. A number of TEIs have some form of borrowings but also have sufficient liquid assets to repay part, or all, of this borrowing and still meet expected minimum levels of liquidity. The debt repayment measure reduces the total debt balance in calculations by any liquidity in excess of 8% of cash outflow (payments) from operations⁴. An example of the calculation is provided below:

If a TEI had cash outflow from operations of \$100 million, \$6 million of total debt and \$13 million of liquid assets, maintaining 8% liquidity would require liquid assets of \$8 million. With \$13 million of liquid assets the TEI has \$5 million more than this minimum. The debt repayment measure considers that this excess or surplus liquidity essentially offsets the total debt balances. The debt repayment calculation therefore uses \$1 million not \$6 million in evaluating how many years' earnings would be required to repay the total debt balances.

Combining the different FMF views

The FMF consolidates the four separate views into a single view, as per the flow diagram below:



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.

³ As the sustainability calculations also use 3-year averages, the impact of the 2013 financials in the 2013 future sustainability score is effectively about 54%.

⁴ For many tertiary education organisations, their levels of liquidity will result in the terminology “No net debt” appearing within the FMF, even if some total debt is present on their balance sheet.

The historical and future views are then combined according to Table 2 below. The effect of this table is that the higher the confidence TEC has in forecasts (future view), the higher the weighting applied to the forecast financials in calculating the overall risk rating. If the TEC has low or no confidence in the forecasts, an upper limit is applied to the overall FMF risk rating that is able to be awarded:

Table 2: Calculation of the overall FMF risk rating

	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

* For example with high confidence, a historical rating of 2.5 and a future rating of 3.5 the overall FMF score is 3.25 ($2.5 \times 25\% + 3.5 \times 75\%$).

The effectiveness of the FMF is dependant on the information provided by TEIs. If the outcome of reviewing the forecasts is that the TEC determines that it has low or no confidence in the forecast outcome, the TEIs will be advised along with the reasons that have caused the TEC to reach this view. Concerns around forecasts may relate to explicitly stated assumptions; however, in the past many forecasts had a small number of stated assumptions. Areas of concern have typically been that the forecast:

- relies on events which have yet to occur;
- relies on assumptions which contradict government policy;
- creates scenarios that are seen as unlikely to occur; and/or
- fails to align with other information supplied.

Where problems exist, the TEI will be given the opportunity to supply an updated forecast and/or provide additional background information around why the assumptions chosen are sensible for that TEI. Hopefully, there will be minimal use of “low confidence” and no use of “no confidence” with the proviso that the TEC does not have control over the quality of forecasts and supporting information supplied by TEIs. Appendix 4 provides more details around TEC’s approach to forecasting by TEIs.

Unless restricted by low confidence, the overall FMF risk rating will depend on the score calculated:

- if the score is below 2.00 (High Risk); or

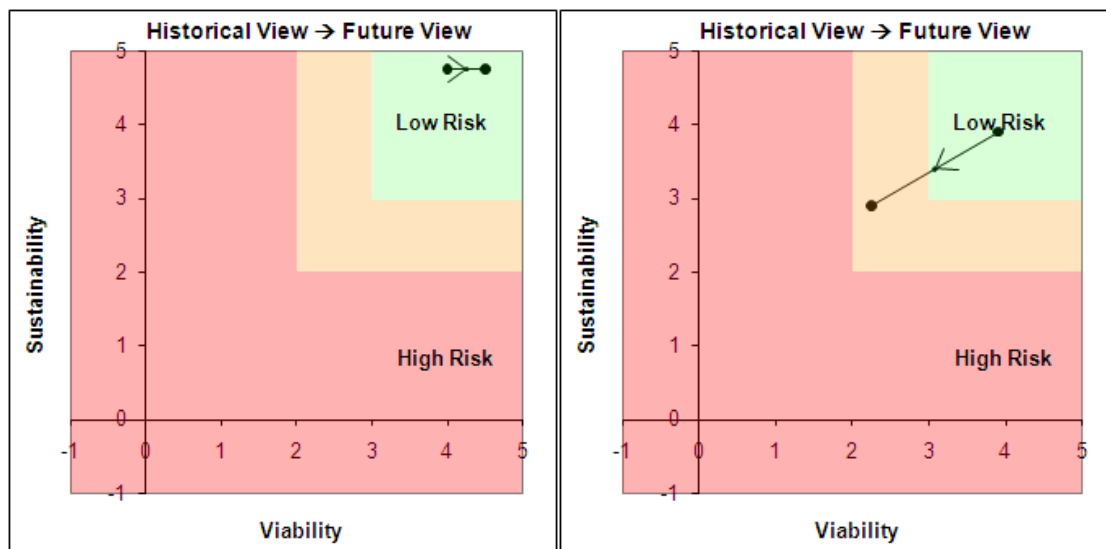
- if the score is between 2.00 and 2.99 (Moderate Risk); or
- if the score is 3.00 or above (Low Risk).

Representing the Views Graphically

The FMF report issued for each TEI (see Appendix 5 for an example) will contain a graph representing the direction of travel for a TEI between the historical and future views. This visually shows if a TEI is travelling between risk zones over time, or operating in the same zone. For many TEIs, both points will be in the low risk zone. Figure 1 below contains the following:

- the historical view (historical viability and historical sustainability);
- the future view (future viability and future sustainability); and
- a directional line connecting these two points.

Figure 1: Examples of Historical to Future view graphs



In the first example, the TEI has very high sustainability scores which are maintained, while Viability scores also increase slightly.

In the second example, the TEI currently has low risk financials but there is something contained within the forecast which significantly lowers Viability and, to a lesser extent, Sustainability.

Declaration process for incorporation of undrawn borrowing facilities

The FMF has been revised to allow for the incorporation of undrawn borrowing facilities when assessing the liquidity of TEIs. This revision uses a declaration-based approach that relies on certain eligibility criteria to determine whether the proposed undrawn borrowing facilities should be included in the calculation of the liquid funds ratio and quick ratio of the FMF.

TEIs seeking to have undrawn borrowing facilities included in their liquidity assessments will be asked to provide confirmation that their facilities are structured in such a way as to meet all the criteria. If a TEI does not fully meet the criteria, it may still seek to have the facility incorporated by supplying additional information to the TEC to support this request. The key criteria are:

- 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 criteria⁵ 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%.

The TEI will also be asked to confirm that the borrowing facilities to be incorporated in the FMF cover the years proposed, or that the TEI is already in discussions with the TEC about a revised consent.

TEIs will need to specify the amount of undrawn borrowing facilities they seek to have included each year. This may be less than the TEIs total committed facilities because only part of the facility may meet the eligibility criteria.

Where the TEC has gained assurance that the eligibility criteria have been met the undrawn borrowing facilities will be included in the FMF ratio calculations for each applicable financial year.

⁵ The thresholds in relation to each of these elements are aligned to the FMF low risk thresholds.

Determining the overall risk assessment

As previously outlined, the overall TEI risk assessment has contributions from the FMF risk rating, educational performance, management and governance, and “other risk factors”. These different components of educational and financial performance, along with management and governance, all contribute to the overall TEI risk assessment. While some components of the overall TEI risk assessment are formulaic, the overall assessment is a judgement formed by the TEC.

The term “other risk factors” has been intentionally broadly defined. The intention of this category is to allow the TEC to explicitly recognise all the unique features that exist in relation to a TEI.

These may influence, either positively or negatively, the overall risk levels applicable to a TEI but can be difficult or impossible to identify or quantify through financial ratio analysis. Examples of factors that may be considered include:

- the long-term historical financial performance of the TEI;
- a history of exceeding, meeting or failing to meet council budgets;
- the degree of deferred asset maintenance existing in relation to the campus;
- how the history of the TEI may impact on the financials (size of the TEI, nature of interventions (if any), senior management changes, changes in council, key initiatives etc);
- staffing / personnel efficiency and any known industrial relations issues;
- any rapid changes in performance yet to be reflected in submitted financials;
- any recent or likely impact from external shocks, such as fires, floods, and earthquakes.

The TEC intends to augment the FMF risk rating with an outlook view where the TEI achieves a rating other than low risk. This view would be positive, neutral or negative. A positive outlook view would indicate that, although the FMF risk rating is moderate (or high), the TEC has confidence in the actions that management and the council are taking to address the situation. Most of the time a low risk TEI will not have the more detailed analysis undertaken and, therefore, will not have an outlook augmentation to its risk rating.

The TEC will determine the outlook view through review of the other risk factors and undertaking a more detailed (second tier) analysis of the financial statement information supplied. This will occur when a TEI has historical or future views scoring as moderate or high risk. This analysis will look to understand why the TEI is receiving the risk rating and decide what further action (if any) should be taken. This will incorporate looking at a wider number of areas and is beyond the mechanics of the FMF calculation.

Implications of overall TEI risk assessment

The FMF risk rating and other risk factors (which may be financial) influence the overall TEI risk assessment assigned. Increased monitoring of financial results is appropriate if the TEI in general, or the financial statements specifically, show evidence of increasing risk. Table 3 below identifies the groupings:

Table 3: Reporting from combinations of Overall FMF risk and Overall TEI Risk Assessment

Outcome of the overall FMF risk rating And the overall TEI risk assessment	Financial reporting level of risk
Low FMF risk and low overall risk assessment; or Moderate FMF risk and positive outlook combined with a Low overall risk assessment.	Low risk
Low FMF risk and moderate overall risk assessment; Moderate FMF risk (neutral or negative outlook) and Low overall risk assessment; Moderate FMF risk and Moderate overall risk assessment; or A High FMF risk with a positive outlook and Low overall risk assessment.	Moderate risk
High FMF risk with a neutral or negative outlook; A High FMF risk with a positive outlook and Moderate overall risk assessment; or High overall risk assessment.	High risk

If, as a result of revised FMF assessments or changes in educational, governance and other risk factors, the associated financial reporting level of risk changes, a TEI will be notified of this change.

Table 4 below sets out the risk assessments levels and related financial reporting and monitoring to be undertaken:

Table 4: Level of reporting and monitoring according to TEIs' risk classification

Financial Reporting level of risk	Financial reporting and monitoring for the TEC
Low risk	Two standard financial information collections per year (actual and forecasts).
Moderate risk	Three standard financial information collections per year (Provisional, actual and forecasts) More intensive analysis against second tier of assessment areas to determine key areas of risk Low level interventions considered.
High risk	Three standards data collections per year (Provisional, actual and forecasts) Collection of specified information, such as monthly financial management accounts and council papers More intensive analysis against second tier of assessment areas to determine key areas of risk Full range of interventions considered.

Reporting due dates for each year are on the TEC website and take into account the standard TEI reporting cycles. From past years these are likely to be around:

- 28 February; if provisional accounts and council budgets are required;
- 15 May for audited accounts and approved council budgets for the current year; and
- early December for 3-year forecasts and current year projection.

Financial statement templates to be completed will be available on the TEC website six weeks prior to the reporting due dates.

The TEI half-year return which provides financial information to the Ministry of Education to enable government to prepare fiscal period accounts is still required. Full details of this requirement are on the TEC website.

Any additional information requirements in place for a TEI continue to apply. These include any separately agreed arrangements with either the TEC, or as specified by the Secretary for Education in relation to section 192(4) of the Act consents, such as borrowing conditions, regardless of whether the monitoring is by the TEC or the Ministry of Education.

Advice of risk level assessment to TEIs

The first risk rating (or baseline) from the FMF was undertaken in December 2009 and used the 2008 financial information for the historical view. The TEC will communicate annually to each TEI, outlining:

- the financial assessment completed;
- the assigned overall FMF risk level together with the overall TEI risk assessment;
- the level of monitoring and engagement; and
- any additional monitoring or reporting required, including the consideration of any interventions.

If subsequent reporting or other events indicate a change in risk level, resulting in a need to revise monitoring and engagement levels, the TEC will advise the TEIs together with the completed risk assessment.

Copies and worked example

A generic template of the framework, including the spreadsheet and formula together with a worked example, are posted on the [TEC website](#) and are also available from: Teifm.info@tec.govt.nz.

This allows each TEI to self-assess and to model future assessments using financial information compiled by the institution.

Future developments

There are no scheduled changes planned for the FMF, however, the TEC will continue to monitor the performance of the framework. If there are any areas identified for improvement, or a change(s) to accounting reporting standards causes a material restatement of items used in the framework, the TEC will consult with the tertiary sector on possible changes to the FMF.

Appendix 1: Objectives of the Financial Monitoring Framework

The core objectives of the FMF are to:

- assist in the monitoring of the financial performance of all TEIs in accordance with the Education Act 1989 (s159KBA);
- have sector acceptance of the TEC's approach to financial monitoring generally and the FMF specifically;
- have a framework that ensures consistency of assessment across the TEI sector;
- provide an objective assessment system, which will enable clarity and transparency for the TEI sector about the financial monitoring assessments of the TEIs made by the TEC and where judgement is necessary transparency will still exist in how the assessment occurred;
- use readily available information;
- aim for simplicity / avoid unnecessary complexity in the design and construction of the framework, and where possible use a formulaic approach;
- have stability in the measures and scoring, with any amendments needing to pass a test of improving the framework's overall performance;
- allow a differentiated treatment of focus and resources where higher level monitoring would apply to TEIs deemed a higher financial risk, with correspondingly less monitoring and reporting for lower risk TEIs;
- be based on sound financial theory and also relevant to the TEI sector;
- be forward looking rather than purely focused on past historical performance;
- allow for alternative methods of exhibiting financial strength, for example a good ability to pay bills as they fall due may be exhibited through either strong operational cash flows and smaller cash reserves or weaker operational cash flows but larger cash reserves; and
- assist in identifying causes of weakness in financial performance and assist with implementing appropriate solutions for a TEI given the balance of risks they are exposed to.

Financial performance is only one element of a TEI's overall performance. The TEC expects TEIs to maintain a low financial risk but within this low risk zone strive for strong educational performance. The FMF is not resetting TEI sector expectations around TEIs' performance to the scoring bands associated with 5's.

Appendix 2: Financial Monitoring Framework Measures (Version 2.1)

Scoring tables for each financial measure

Measures	Definition / calculation	Scoring table performance bands					
		-2 (high risk)	0.5	2	3 (low risk)	4	5 (minimal risk)
Viability							
Operating surplus/deficit ⁶	Operating surplus/deficit before abnormals 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 cashflow ⁷ 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) ⁸	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% +

⁶ The performance band scores for this measure were altered in November 2010 so that 3% is aligned to the low risk boundary.

⁷ The performance band scores for this measure were altered in November 2010 so that 111% is aligned to the low risk boundary.

⁸ The definition for this measure was altered in December 2011 and replaces liquid assets with liquid resources.

Measures	Definition / calculation	Scoring table performance bands					
		-2 (high risk)	0.5	2	3 (low risk)	4	5 (minimal risk)
Ability to service debt (interest coverage ratio)	Earnings before interest paid and abnormals to Interest paid.	< 1.0:1 x	1.0 to 1.5:1x	1.5 to 3:1x	3 to 6:1x Or no interest payments and core earnings ratio less than zero	6 to 12:1x Or no interest payments and core earnings ratio 0% - 10%	>12:1x Or no interest payments and core earnings ratio greater than 10%
Quick ratio ⁹	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							
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 good debt service ability (10%+ Core Earnings)
Achievement of SAC domestic funded allocation (\$) ¹⁰	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%

⁹ The definition for this measure was altered in December 2011 and replaces readily liquefiable assets with readily liquefiable resources.

¹⁰ This measure was altered effective November 2010 and replaces EFTS with SAC domestic funded allocation.

Measures	Definition / calculation	Scoring table performance bands					
		-2 (high risk)	0.5	2	3 (low risk)	4	5 (minimal risk)
3-year average viability ¹¹	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 ¹²	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 ¹³	Total debt less any surplus liquidity to 3-year average surplus/deficit before abnormals.	A TEI has average deficits before abnormals and net debt or a TEI with surpluses has a ratio of >1,000%	500 to 1,000%	200 to 500%	100 to 200%	<100%	No net debt

¹¹ This measure was added to the framework in November 2010 and replaces the earlier return on net assets employed measure.

¹² This measure has been altered effective November 2010 so that it now calculates as a 3-year average.

¹³ This measure has been altered effective November 2010 and assesses debt levels against 3-year average earnings.

Measures	Definition / calculation	Scoring table performance bands					
		-2 (high risk)	0.5	2	3 (low risk)	4	5 (minimal risk)
Trend and variability in financial viability indicators	Comparison of long term trend in financial viability over a five year period.	Last trend point below 2, high variability in trend points and negative trend in trend points	Last trend point between 2 and 3, high variability in trend points and negative trend in trend points	Either last trend point below 3 and either low variability in trend points or a positive trend in trend points or Last trend point above 3, high variability in trend points and negative trend in trend points	Either last trend point below 3, low variability in trend points and positive trend in trend points or Last trend point above 3 and either low variability in trend points or favourable trend in trend points	Last trend point between 3 and 4, low variability in trend points and favourable trend in trend points	Last trend point of 4 or more, low variability in trend points and favourable trend in trend points

Defined Terms within the Financial Monitoring Framework measures (Version 2.1)

“**Abnormals**” means unusual enough to influence the economic decisions using the reported results. Abnormal item adjustments include any unusual and non-recurring gains and/or losses (in each case as reflected in the relevant statement of comprehensive income). An item does not qualify as non-recurring simply because it is unplanned or unexpected. Examples of abnormals include: gains or losses on asset disposals or revaluations; discontinued operations; and major restructuring costs. Reclassification of abnormals may occur if an organisation’s application of abnormal differs materially from the rest of the sector.

“**Actual domestic delivered SAC funding**” means the costed value of the actual EFTS delivered by TEIs. The calculations for this will be sourced directly from the Single Data Return (SDR) reporting and will correspond to the same funding categories used in the calculation of the Domestic SAC funding allocation.

“**Cash inflow (receipts) from operations**” means the amount recorded as cash received from operating activities in the cash flow section of the financial statements of an institution.

“**Cash outflow (payments) from operations**” means the amount recorded as cash paid from operating activities in the cash flow section of the financial statements of an institution.

“**Current liabilities likely to result in cash outflows**” means current liabilities that are likely to result in a cash payment rather than a delivery of services. Examples include accounts payable, trade creditors, short-term overdraft and current debt. Items excluded from the definition include employee entitlements, student fees in advance and trust liabilities.

“**Domestic SAC funding allocation**” means the domestic SAC funding allocation (\$) for the institution agreed with TEC for the current year. SAC funded domestic EFTS may or may not actually be being funded depending on the total number of EFTS at the institution and the agreed investment plan domestic SAC funding allocation and corresponding EFTS.

“**EBITDA**” means earnings (Operating surplus/deficit) before interest (expense and revenue), tax, depreciation, amortisation and one-off abnormals within the financial statements of an institution.

“**EFTS**” means Equivalent Full Time Students.

“**End of year property, plant and equipment**” means the closing balance of property, plant and equipment (fixed assets) from the statement of financial position of the institution and includes software (intangible assets) as this is in the nature of property, plant and equipment.

“**Equity**” means the total equity reported in the financial statements of an institution.

“Financial statements” means the audited annual accounts, budgeted financial statements, reforecast financial statements or projected statement of financial performance (as the case may be) of an institution. Financial statements cover a period of one calendar year unless stated otherwise.

“Interest expense” is the amount recorded as interest expense in the financial statements of an institution.

“Interest revenue” is the amount recorded as interest revenue in the financial statements of an institution.

“Liquid resources” is cash, securities or other investments which can be readily converted into cash. Upon application agreed qualifying undrawn borrowing facilities will be included in this category. For the avoidance of doubt receivables are not considered a liquid asset and trust cash and short-term investments are not included.

“Net interest paid” means interest expense less any interest revenue in the financial statements of an institution.

“Operating surplus/deficit before abnormals” is the amount recorded as the net surplus or deficit (as the case may be) in the financial statements of an institution before one-off or non-recurring abnormal items.

“Overall viability score” means the simple average of the scores for each of the viability indicators for the financial year being assessed. It is possible for this average to be between -2 and 5.

“Overall sustainability score” means the simple average of the scores for each of the sustainability indicators which can be calculated for the financial year being assessed. The achievement of SAC Domestic funding allocation or EFTS is not able to be calculated on a future view so the number of indicators entering the average will vary. This average will fall within the range -2 and 5.

“Qualifying undrawn borrowing facilities” means the portion of a borrowing facility that the TEI has requested be included following declaration that the facility meets the agreed criteria.

“Readily liquefiable resources” means resources that are either already cash, will convert to cash readily in the normal course of business or investments of a liquid nature that could easily be converted into cash. Where qualifying undrawn borrowing facilities are included in liquid resources, that undrawn facility will be included in this category. Current assets of cash and bank balances, receivables and short-term investments will fall within this definition. Readily liquefiable long-term investments like government stock are also within the definition. Current assets excluded from the definition include Prepayments, Inventory, Trust assets and other unclassified current assets.

“**Reforecast**”, in respect of an institution, means any financial forecast or similar document which is prepared by or for an institution in relation to a financial year in respect of which there is already a council-approved group budget, and which is either approved by the council of the institution as an amendment to or update of that group budget or regarded by the chief executive or vice-chancellor of that institution as forecasting or reflecting, more accurately overall than that group budget, that institution’s likely actual financial performance for that period; and includes any working papers and assumptions upon which that financial forecast is based.

“**Short-term overdrafts**” means overdrafts that are inherently short-term in nature. Overdrafts will typically be presented as a current liability within the financial statements of an organisation. Some overdrafts are part of committed cash advance facilities taken out for the purpose of funding long-term capital works programmes. If the overdraft is part of a long-term (more than two year) funding facility it would be excluded from the above definition.

“**Surplus liquidity**” means liquidity levels beyond minimum acceptable levels as represented by the liquid funds ratio. A liquid funds ratio score of 3 or more is acceptable for this purpose. This will be achieved if liquid assets less any short-term overdrafts are more than 8% of cash outflow (payments) from operations. For example: using a hypothetical TEI with cash outflow from operations of \$100 million, \$6 million of total debt and \$13 million of liquid assets. This TEI has \$5 million of surplus liquidity ($\$13 \text{ million} - \$100\text{m} \times 8\%$). The debt repayment calculation would now involve a debt calculation of \$1 million ($\$6 \text{ million total debt less } \$5\text{m surplus liquidity}$).

“**Trend**” refers to the difference between the average of the first and second data point and the two most recent data points in the series. Where this difference is less than 0.5 it is considered a stable trend. Where this difference is -0.5 or more this is considered a negative trend. Where this difference is +0.5 or greater this is considered a positive trend. Both stable and positive trends are considered a favourable trend.

“**Trend point**” means a point used to evaluate for the trend and variability in financial viability indicators measure. This measure considers the overall viability scores calculated within this framework over the last 5 years. Each trend point represents the overall viability score calculated using the financial statements for that year. The first trend point uses the oldest financial statements information (in the series) and the last trend point uses the most recent financial statements.

“**Total debt**” is bank overdrafts, finance leases and term debt whether classified as current or term liabilities within the financial statements of the institution. Should other financing arrangements be utilised with similar characteristics to the above they would also fall within this definition.

“**Total income**” is the amount recorded as total revenue or total income in the financial statements of an institution.

“**Variability in trend points**” means the difference in value between the highest and lowest trend points over the last 5 years for the institution. High variability is considered if the sum of the largest variance above and below a trend line is more than one. This trend line is formed using the average of the first and second trend points and the average of the fourth and fifth trend points.

Appendix 3: Financial Monitoring Framework reviews

Version 2.1 (December 2011): summary of changes made

1. The definitions for the Liquid Funds ratio and the Quick ratio have been amended to allow for the inclusion of undrawn borrowing facilities.
2. Within the Liquid Funds ratio the existing term “liquid assets” is amended to “liquid resources”. This will allow a TEI to be able to apply to have undrawn borrowing facilities included within the term liquid resources. TEIs will be asked to confirm they meet a series of criteria if they are seeking to have undrawn borrowing facilities included within the FMF calculations.
3. The criteria for inclusion of undrawn borrowing facilities are:
 - 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 criteria¹⁴ 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%.
4. Due to liquidity being held for unexpected and/or extreme events, a TEI may fail to hold strong liquidity balances as it responds to the scenario unfolding. In relation to each of the three ratios noted above, an exclusion is permitted if the TEI has provided the TEC sufficient documentation to provide comfort that this guideline would have been achieved but for events of the nature that liquidity is held to manage.
5. The TEC requires that any borrowing facility to be incorporated in the FMF to cover the years proposed, or for the TEI to already be in discussions with the TEC about a revised consent.
6. Within the Quick ratio the existing term “readily liquefiable assets” is amended to “readily liquefiable resources”. Where a TEI is seeking to have undrawn borrowing facilities included within liquid resources and can confirm that, if drawn down, the borrowing facility would be recognised as a term liability the undrawn borrowing capacity would be included as a readily liquefiable resource.

¹⁴ The thresholds in relation to each of these elements are aligned to the FMF low risk thresholds.

Version 2.0 (November 2010): summary of changes made

1. The scoring table for the viability measures of operating surplus and net cash flow from operations measures have been amended. This change means that the 3% and 111% accepted sector guidelines form the start not the middle of the 3 (low risk) scoring band. The bands for the scores 4 and 5 are also increased by 1%.
2. A change has occurred to the measures that make up the sustainability dimension. This change decreases the emphasis of the FMF on asset returns. Good (or poor) long term viability now enters the sustainability calculation through the new measure below. The changes are:
 - removing the measure “Return on net assets”; and
 - adding the measure “3-year average viability”.
3. The calculation methodology for two sustainability measures has been changed so that a longer-term perspective is taken;
 - the measures return on property, plant and equipment employed becomes a 3-year average; and
 - the measures debt servicing uses 3-year average earnings not a single years earning.
4. The source data for achievement of EFTS has been changed. This moves from using EFTS supplied in the TEC financial statement templates to using the domestic SAC funding allocation (\$) for the TEI as agreed with the TEC each year. The measure now compares the agreed funding allocation (not EFTS) and the actual domestic delivered SAC funding (\$) on an annual basis as supplied by TEIs through their Single Data Return (SDR).
5. There is an amended calculation of the future view – it now looks at more than just a single year’s data:
 - with a historical year of 2009, the viability future view would be weighted as 67% on 2010 and 33% on 2011; and
 - with a historical year of 2009, the sustainability future view would be weighted as 20% on 2011 and 80% on 2012.
6. Two terminology changes have occurred:
 - The views will now be called “historical” and “future”. This replaces the previous naming of “current” and “future”. A TEI’s most recent audited result will remain the basis of the renamed historical view. While the audited accounts may be the most current record of actual results about a TEI, as audited results they are, by definition, relating to a historical period in time.
 - The term property, plant and equipment is used rather than the older accounting term of fixed assets.
7. The way of combining the historical and future views has changed:
 - Previously this was achieved through a 3x3 matrix with the matrix providing an overall risk rating score depending on how the historical and future risk ratings

interacted. A second matrix was added to this process to deal with scenarios where low confidence exists in the forecast. The overall risk rating score is now achieved through a scale that combines the historical and future scores with increased weighting on the future view if TEC has higher confidence in the forecasts.

8. The FMF was not showing the intelligence that existed within the organisation about unique scenarios relevant to different TEIs. An “air of intelligence to the system” will now be incorporated into the monitoring framework in two ways:
 - Where more detailed analysis of a TEI’s result is required this analysis will form a view about whether the overall FMF risk rating reflects the financial risks within the TEI. This will augment (but not change) the FMF rating with a view (negative, neutral or positive) and occur if a TEI receives an overall FMF risk rating other than low risk.
 - The level of reporting will be driven by the lower of FMF rating or the overall risk rating. If a TEI has a low FMF rating but other concerns mean TEC considers the TEI high risk, TEC will request more frequent reporting from the TEI.
9. Aligning reporting to level of overall risk. An improved consistency will occur around financial reporting requirements through alignment to a mix of the overall FMF risk rating and the overall TEI risk assessment. This would result in the financial reporting requirements occurring as per the table below:

Outcome of the overall FMF risk rating and the overall TEI risk assessment	Financial reporting level of risk
<ul style="list-style-type: none"> · Low FMF risk & low overall risk assessment or · Moderate FMF risk & positive outlook combined with a Low overall risk assessment 	Low risk
<ul style="list-style-type: none"> · Low FMF risk & moderate overall risk assessment or · Moderate FMF risk (neutral or negative outlook) & Low overall risk assessment · Moderate FMF risk & Moderate overall risk assessment · A High FMF risk with a positive outlook & Low overall risk assessment 	Moderate risk
<ul style="list-style-type: none"> · High FMF risk with a neutral or negative outlook or · A High FMF risk with a positive outlook & Moderate overall risk assessment · High risk overall risk assessment 	High risk

Appendix 4: Guidelines for assumptions when completing 3-year financial forecasts

For the forecasting information to be useful then the TEC must have confidence in the underlying assumptions used and also be confident that the TEI has the capacity and intention to implement plans that are likely to deliver the forecast as submitted.

To assist this process occurring, TEC is issuing guidance around assumptions to be used by TEIs when completing their 3-year forecasts. These guidelines are provided to improve the quality and usability of the forecasts submitted by TEIs to the TEC including their usage in the FMF. These guidelines will be available from the TEC website (typically from September of each year).

With the forecasts entering the risk assessment processes, TEC will review and test the forecast information supplied and supporting assumptions.

The guidelines are provided to inform discussions between TEC and TEIs on the forecasts and related assumptions. Concerns that TEC may have in relation to forecasts fall into 4 distinct categories:

- the forecast relies on events which have yet to occur, e.g. a lending approval being granted or a restructuring plan being implemented;
- the forecast relies on assumptions which contradict stated government policy e.g. assuming growth in domestic Equivalent Full Time Students being funded;
- the forecast creates scenarios that are seen as unlikely to occur without further supporting information, e.g. Full Time Employee numbers increase but personnel costs decrease; or
- the forecasts fail to align with other information being supplied by the TEI, e.g. capital asset management returns or Single Data Returns indicate a different outlook from the 3-year forecasts.

The purpose of discussions is:


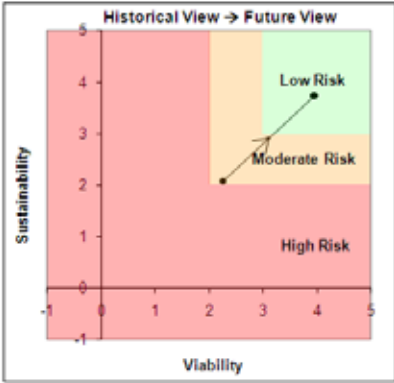
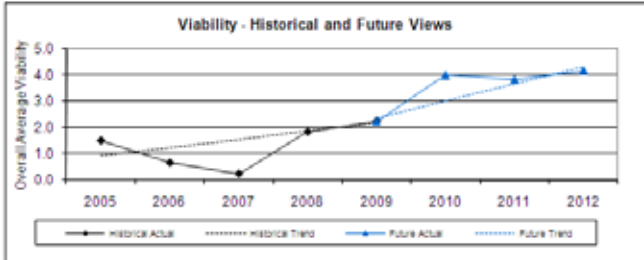
- to provide context to the formulaic FMF rating;
- to discuss issues of concern arising from the FMF rating; and
- to gain confidence in the next 3-year forecast information and aligned assumptions.

A possible approach is for TEC to:

- meet with Chief Executive/Vice-Chancellors – discuss overall TEI strategy;
- meet with Chief Financial Officer's – turning strategy into sustainable financial outcomes; and/or
- meet with Chair/Chancellors – understand Council's perspective and how does it engage in setting financial strategy.

When the TEC reviews the financial statements for a TEI and completes the FMF rating then the TEC will make a judgement based on the assumptions tests undertaken and discussions with the TEI to arrive at a level of confidence in the forecasts submitted. This level of confidence is then used in the calculations resulting in the overall FMF risk rating.

Appendix 5: Example of a FMF output report

Financial Performance Assessment - Financial Monitoring Framework (FMF)						 Tertiary Education Commission Te Amorangi Mātauranga Mātua	
Tertiary Education Institution:		Institute of Hypothetical Results				Date of Report: Oct 10	
Viability - Historical View	2009	Actual		Version		Received	
Sustainability - Historical View	2009	Actual					
Viability - Future View	2010	(1st of 2 yrs)	Budget	Final	14/05/10		
Sustainability - Future View	2012	(2nd of 2 yrs)	Forecast	Updated	14/05/10		
Key Information ¹							
	2007 A	2008 A	2009 A	2010 B	2011 P	2012 P	
Total revenue (\$m)	95.5	98.2	107.4	109.4	112.0	106.9	TEC confidence in forecasts Moderate
Total expenses (\$m)	98.1	99.1	107.1	107.0	107.3	103.1	
Surplus (deficit) (\$m)	-2.7	-0.9	0.4	2.4	4.7	3.8	
SAC category EFTS	7,928	7,568	7,688	7,609	7,790	7,454	
International EFTS	602	492	579	594	630	690	
Total EFTS	9,725	9,314	9,657	9,494	9,709	9,297	
¹ The key information is as supplied in the TEI Financial Monitoring templates to the TEC							
Viability ²							
	2009 A	2010 B	2011 P	2012 P	FMF Score (3+) ³	Historical	Future
Operating surplus/deficit	0.3%	2.2%	4.2%	3.5%	3% or more	2.0	2.3
Core earnings	9.0%	10.8%	12.7%	11.5%	9% or more	2.0	3.3
Net cashflow from operations	108.4%	116.6%	114.6%	113.8%	111% or more	2.0	4.7
Liquid funds ratio	12.8%	16.3%	13.6%	15.3%	8% or more	4.0	4.7
Ability to service debt	1.3	6.8	9.1	32.5	3.0x or more (or no interest costs)	0.5	4.0
Quick ratio	1.9	2.5	2.3	2.4	1.5x or more	3.0	4.7
Overall Average Viability	2.3	4.0	3.8	4.2		2.3	3.9
Sustainability ²							
	2009 A	2010 B	2011 P	2012 P	FMF Score (3+) ³	Historical	Future
Debt equity ratio	4.6%	3.0%	3.8%	0.8%	7.5% or less	3.0	3.0
Achievement of EFTS	99.4%	101.7%	N/A	N/A	97% or more	5.0	NA
3-Year average viability	1.4	2.7	3.4	4.0	3 or more	1.4	3.9
3-Year ave return on property, plant and equipment	5.9%	7.3%	8.1%	8.4%	4.5% or more	3.0	4.0
Debt repayment	-199.0%	No net debt	26.6%	No net debt	200% or less	-2.0	4.8
Trend and variability in average viability	2.0	3.0	3.0	3.0		2.0	3.0
Overall Average Sustainability	2.1	3.6	3.5	3.8		2.1	3.7
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							
							
Historical 2009 FMF risk rating:				2.1	Moderate Risk		
Future FMF risk rating:				3.7	Low Risk		
Overall FMF risk rating:				2.9	Moderate Risk		
Comments							

