

## Risk Assessment Criteria for Tertiary Institutions

Pursuant to section 195A of the Education Act 1989 (incorporating all amendments), the Secretary for Education hereby publishes criteria for assessing the level of risk to the operation and long-term viability of tertiary institutions.

Nothing in this notice limits or affects the duties of tertiary councils under section 181 of the Education Act 1989 or any other duties or obligations of institutions or councils under any enactment, regulation or order.

### Introduction

Under sections 195B to 195D of the Education Act 1989, the nature of the action available to the Secretary or the Minister depends upon an assessment of the level of risk to the institution or the operation or long-term viability of the institution. The levels of risk and the nature of the actions available are:

- Level 1: If the Secretary has reasonable grounds to believe that an institution may be at risk, the Secretary may require the council of the institution to provide specified information or reports about the operation, management or financial position of the institution at a given time (section 195B).
- Level 2: If the Minister considers on reasonable grounds that the operation or long-term viability of an institution is at risk, the Minister may appoint a Crown Observer to the institution (section 195C).
- Level 3: If the Minister believes on reasonable grounds that there is a serious risk to the operation or long-term viability of an institution and other methods of reducing that risk have failed or appear likely to fail, the Minister may dissolve the council of the institution and appoint a Commissioner to act in its place (section 195D).

After consultation with institution councils, the Secretary has determined (pursuant to section 195A of the Education Act 1989) criteria for assessing the level of risk to the operation and long-term viability of institutions. Those criteria are contained in the table set out below.

The greater the number of criteria which an institution meets, the greater the level of risk to its operation and long-term viability. The more adverse the position of an institution with respect to any of the criteria (for example, the greater the extent to which its Liquid Funds Ratio is less than 12.0%), the greater the level of risk to its operation and long-term viability.

### Defined Terms

Words and phrases defined in the Education Act 1989 (and not defined below) bear the same meanings in this notice.

In this notice:

“Approved Borrowing Agreement” means an agreement between an institution and a third party, under which the institution may borrow money, issue debentures or otherwise raise money, which has been entered into by the institution with the written consent of the Secretary pursuant to section 192 of the Education Act 1989 (including any such agreement as it may be modified from time to time with the written consent of the Secretary).

“audited” means, in respect of an institution and any financial statements or financial statements component relating to any financial year of that institution:

- (a) the audited financial statements or audited financial statements component (as the case may be) for that financial year; or
- (b) (except in relation to risk criteria 22 below) if no such audited financial statements or audited financial statements component (as the case may be) for that financial year have or has been submitted to the Secretary within 120 days of the end of the relevant financial year, until they are or it is so submitted the unaudited financial statements or relevant financial statements component (as the case may be) in respect of that financial year most recently submitted to the Secretary.

“Available Credit Lines” is the aggregate amount able to be borrowed by an institution under any committed borrowing facility, less any amounts actually borrowed under those facilities, as at the balance date to which any audited actual or budgeted (as the case may be) statement of financial position for an institution relates.

“Debt” is the total of amounts recorded as debt in the audited or budgeted (as the case may be) statement of financial position of an institution, whether or not interest is payable on that debt.

“debt/equity ratio” means a ratio of debt to equity (however that ratio, that debt and that equity are calculated and described).

“Default Event”, in respect of an institution which is party to an Approved Borrowing Agreement, means any event or circumstance (however described) which (i) constitutes a default (however described) by that institution under that Approved Borrowing Agreement and/or (ii) results (or may result) in the date for repayment of any amount owing by the institution under that Approved Borrowing Agreement being advanced and/or (iii) entitles (or may entitle) any lender under that Approved Borrowing Agreement to require early repayment by that institution of any such amount, to refuse to advance any further amount to that institution, to review loans made by it to that institution or to take or refuse to take any other action under that Approved Borrowing Agreement.

“Default Debt/Equity Ratio” in respect of an institution is the ratio calculated as follows and expressed as a percentage:

$$\frac{\text{Debt}}{\text{Debt} + \text{Equity}}$$

“Default Interest Cover Ratio” in respect of an institution is the ratio calculated as follows:

$$\frac{\text{Operating Surplus} / \text{Deficit} + \text{Depreciation} + \text{Amortisation} + \text{Interest Expense}}{\text{Interest Expense}}$$

“Equity” is the amount recorded as equity in the audited actual or budgeted (as the case may be) statement of financial position of an institution.

“financial statements component” means a statement of financial position, statement of financial performance or statement of cash flows.

“interest cover ratio” means a ratio of surplus from operations to interest expense (however that ratio, that surplus and that expense are calculated and described).

“Interest Expense” is the amount recorded as interest expense in the audited annual or budgeted (as the case may be) statement of financial performance of an institution.

“liabilities to assets ratio” means a ratio of the value of liabilities to the value of assets (however that ratio, that value of assets and that value of liabilities are calculated and described).

“Liquid Funds” is the total of amounts recorded in the audited or budgeted (as the case may be) statement of financial position of an institution in the form of cash or securities or other investments which can be as readily converted into cash.

“Liquid Funds Ratio” in respect of an institution is the ratio calculated as follows and expressed as a percentage:

Liquid Funds + Available Credit Lines

Operating Cash Payments

“Maximum Permitted Debt/Equity Ratio”, in respect of an institution which is party to an Approved Borrowing Agreement, means a debt/equity ratio specified in that Approved Borrowing Agreement, that institution’s exceeding which (or meeting or exceeding which) will constitute or result in a Default Event.

“Maximum Permitted Liabilities to Assets Ratio”, in respect of an institution which is party to an Approved Borrowing Agreement, means a liabilities to assets ratio specified in that Approved Borrowing Agreement, that institution’s exceeding which (or meeting or exceeding which) will constitute or result in a Default Event.

“Minimum Required Interest Cover Ratio”, in respect of an institution which is party to an Approved Borrowing Agreement, means an interest cover ratio specified in that Approved Borrowing Agreement, that institution’s failure to exceed which (or failure to achieve or exceed which) will constitute or result in a Default Event.

“Operating Cash Payments” is the amount recorded as cash paid or applied to operations in the audited annual or budgeted (as the case may be) statement of cash flows of an institution.

“Operating Cash Receipts” is the amount recorded as cash received from operations in the audited annual or budgeted (as the case may be) statement of cash flows of an institution.

“Operating Surplus/Deficit” is the amount recorded as the net surplus or deficit (as the case may be) in the audited annual or budgeted (as the case may be) statement of financial performance (financial statements component) of an institution, adjusted by deducting any non-recurring revenues and adding back any non-recurring costs (in each case as reflected in the relevant statement of financial performance). An example of non-recurring revenue is a profit on the sale of an asset. Examples, of non-recurring costs include losses on asset disposals or revaluations and restructuring costs. An item does not qualify as non-recurring simply because it is unplanned or unexpected.

“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 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 upon which that financial forecast is based.

“Total Revenue” is the amount recorded as total revenue or total income in the audited annual or budgeted (as the case may be) statement of financial performance of an institution.

“risk criteria” means any of the criteria set out below.

An “unfavourable trend”, in respect of a particular financial ratio and an institution’s audited group financial statements for five consecutive financial years, exists if:

- (a) the average of that ratio calculated with reference to the audited group financial statements for each of the third, fourth and fifth (in time) of those financial years is less favourable to that institution than the average of that ratio calculated with reference to the audited group financial statements for each of the second, third and fourth (in time) of those financial years; and
- (b) the average of that ratio calculated with reference to the audited group financial statements for each of the second, third and fourth (in time) of those financial years is less favourable to that institution than the average of that ratio calculated with reference to the audited group financial statements for each of the first, second and third (in time) of those financial years.

Other words and phrases defined in the Education Act 1989 bear the same meaning in this notice.

### Criteria for Risk Assessment

The criteria listed in the table below enable an objective assessment to be made of whether an institution or the operation or long-term viability of an institution is at risk and, if so, the level of such risk. The level of risk determines the nature of action available to the Secretary or the Minister. Each of the criteria is marked in columns 1, 2 or 3. The marking indicates which level of risk the criteria are relevant to assessing. The key to the table is:

**Level 1** = relevant to assessing whether an institution *may be at risk*

**Level 2** = relevant to assessing whether an institution *may be at risk* and/or whether the operation or long-term viability of an institution *is at risk*

**Level 3** = relevant to assessing whether an institution *may be at risk* and/or whether the operation or long-term viability of an institution *is at risk* and/or whether there is a *serious risk* to the operation or long-term viability of an institution

No.	Criteria	Relevance of Criteria to Level of Risk		
		1	2	3
<b><i>Financial ratios calculated by reference to the latest audited group financial statements of an institution as at the time of assessment</i></b>				
1.	Operating Surplus/Deficit is negative or less than 3.0% of Total Revenue.	•		
2.	If the institution is, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Minimum Required Interest Cover Ratio, the interest cover ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of those group financial statements is less than 1.25 times that Minimum Required Interest Cover Ratio. If the institution is not, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Minimum Required Interest Cover Ratio, the Default Interest Cover Ratio is less than 3.0.	•		
3.	If the institution is, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Maximum Permitted Debt/Equity Ratio and/or a Maximum Permitted Liabilities to Assets Ratio, the debt/equity ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of those group financial statements is more than 0.75 times that Maximum Permitted Debt/Equity Ratio and/or the liabilities to assets ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of those group financial statements is more than 0.75 times that Maximum Permitted Liabilities to Assets Ratio. If the institution is not, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Maximum Permitted Debt/Equity Ratio and/or a Maximum Permitted Liabilities to Assets Ratio, the Default Debt/Equity Ratio is greater than 20%.	•		
4.	Operating Cash Receipts is less than 111% of Operating Cash Payments.	•		
4b	Operating Cash Receipts are less than Operating Cash Payments.		•	
5.	The Liquid Funds Ratio is less than 12.0%.	•		
<b><i>Financial ratios calculated by reference to the council approved group budget of an institution for the financial year current as at the time of assessment</i></b>				
6.	Operating Surplus/Deficit is negative or less than 3.0% of Total Revenue.	•		
7.	If the institution is, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Minimum Required Interest Cover Ratio, the interest cover ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of that group budget is less than 1.25 times that Minimum Required Interest Cover Ratio. If the institution is not, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Minimum Required Interest Cover Ratio, the Default Interest Cover Ratio is less than 3.0.	•		
8.	If the institution is, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Maximum Permitted Debt/Equity Ratio and/or a Maximum Permitted Liabilities to Assets Ratio, the debt/equity ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of that group budget is more than 0.75 times that Maximum Permitted Debt/Equity Ratio and/or the liabilities to assets ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of that group budget is more than 0.75 times that Maximum Permitted Liabilities to Assets Ratio. If the institution is not, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Maximum Permitted Debt/Equity Ratio and/or a Maximum Permitted Liabilities to Assets Ratio, the Default Debt/Equity Ratio is greater than 20%.	•		
9.	Operating Cash Receipts is less than 111% of Operating Cash Payments.	•		
9b	Operating Cash Receipts are less than Operating Cash Payments.		•	
10.	The Liquid Funds Ratio is less than 12.0%.	•		
<b><i>Financial ratios calculated by reference to any reforecast of an institution for the financial year current as at the time of assessment</i></b>				
11.	Operating Surplus/Deficit is negative or less than 3.0% of Total Revenue.	•		

No.	Criteria	Relevance of Criteria to Level of Risk		
		1	2	3
12.	If the institution is, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Minimum Required Interest Cover Ratio, the interest cover ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of that Reforecast is less than 1.25 times that Minimum Required Interest Cover Ratio. If the institution is not, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Minimum Required Interest Cover Ratio, the Default Interest Cover Ratio is less than 3.0.	•		
13.	If the institution is, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Maximum Permitted Debt/Equity Ratio and/or a Maximum Permitted Liabilities to Assets Ratio, the debt/equity ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of that Reforecast is more than 0.75 times that Maximum Permitted Debt/Equity Ratio and/or the liabilities to assets ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of that Reforecast is more than 0.75 times that Maximum Permitted Liabilities to Assets Ratio. If the institution is not, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Maximum Permitted Debt/Equity Ratio and/or a Maximum Permitted Liabilities to Assets Ratio, the Default Debt/Equity Ratio is greater than 20%.	•		
14.	Operating Cash Receipts is less than 111% of Operating Cash Payments.	•		
15.	The Liquidity Ratio is less than 12.0%.	•		
<b><i>Trends in financial ratio risk criteria calculated by reference to audited group financial statements of an institution for the five completed financial years immediately preceding the time of assessment</i></b>				
16.	There is an unfavourable trend in the ratio of Operating Surplus/Deficit to Total Revenue.	•		
17.	If the institution is, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Minimum Required Interest Cover Ratio, there is an unfavourable trend in the interest cover ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of those financial statements. If the institution is not, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Minimum Required Interest Cover Ratio, there is an unfavourable trend in the Default Interest Cover Ratio.	•		
18.	If the institution is, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Maximum Permitted Debt/Equity Ratio and/or a Maximum Permitted Liabilities to Assets Ratio, there is an unfavourable trend in the debt/equity ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of those financial statements and/or there is an unfavourable trend in the liabilities to assets ratio calculated in accordance with that Approved Borrowing Agreement and on the basis of those financial statements. If the institution is not, at the time of assessment, party to an Approved Borrowing Agreement which specifies a Maximum Permitted Debt/Equity Ratio and/or a Maximum Permitted Liabilities to Assets Ratio, there is an unfavourable trend in the Default Debt/Equity Ratio.	•		
19.	There is an unfavourable trend in the ratio of Operating Cash Receipts to Operating Cash Payments.	•		
20.	There is an unfavourable trend in the Liquid Funds Ratio.	•		
<b><i>Audit reports</i></b>				
21.	The latest audited group financial statements of an institution have been prepared on the assumption that the institution is not a going concern or the latest audit report for an institution (as at the time of assessment) is qualified on the grounds of failure to meet the going concern test or because of “fundamental uncertainty” relating to the financial viability of the institution.			•

No.	Criteria	Relevance of Criteria to Level of Risk		
		1	2	3
22.	Audited financial statements for an institution for a financial year have not been submitted to the Secretary within 120 days of the end of that financial year and there are reasonable grounds to believe that the audit report for those financial statements, when completed, may be qualified on the grounds of: a. failure to meet the going concern test (or that the delay in submission of those audited financial statements results in part from a concern that such qualification may be required) or b. because of “fundamental uncertainty” in relation to financial viability of the institution or c. on the grounds of the non-supply of information to Auditors to allow them to assess whether the TEI is a “going concern”.			•
23.	The latest audit report for an institution, as at the time of assessment, is qualified on grounds other than the going concern test.	•		
24.	Audited financial statements for an institution for a financial year have not been submitted to the Secretary within 120 days of the end of that financial year but risk criteria 22 above does not apply.	•		
<b>Compliance with borrowing covenants</b>				
25.	During the last or current financial year (as at the time of assessment), an institution breached any financial covenants under any loan agreement or other financing facility.		•	
26.	An institution has carried out a material activity which requires a consent from the Secretary of Education pursuant to section 192 of the Education Act 1989 and has not obtained such a consent.	•		
27.	An institution has not complied with all financial conditions of any consent received from the Secretary for Education under section 192 of the Education Act 1989 in the last completed or current financial year of the institution (as at the time of assessment).		•	
<b>Operations</b>				
28.	An institution has not developed and/or does not maintain internal financial and performance reporting of a nature reasonably to be expected of such an institution.		•	
29.	An institution has failed, in a material respect, to provide in a timely manner any information required to be provided pursuant to section 195B of the Education Act 1989 or section 45B of the Public Finance Act 1989.		•	
30.	There are grounds on which it can reasonably be concluded that an institution has acted, is acting, or is likely to act recklessly in a material respect.		•	
31.	There are grounds on which it can reasonably be concluded that an institution or its council has acted, is acting, or is likely to act contrary to any applicable law, regulation, order or bylaw in a material respect.		•	
32.	An institution has lost or failed to renew within the period of 18 months immediately prior to the time of assessment, or is likely to lose or fail to renew, accreditation with New Zealand Qualifications Authority or any body to which New Zealand Qualifications Authority has delegated its approval or accreditation powers (such as the Polytechnic Programmes Committee or the Colleges of Education Academic Committee), or with The New Zealand Vice Chancellors Committee for Accreditation for any qualification (other than a qualification which the institution no longer intends to offer).		•	
33.	Within the period of 18 months immediately prior to the time of assessment, an institution has not developed, and/or updated at least annually, a business plan of the nature reasonably expected of such an institution, including financial projections for the following three years.		•	
34.	Within the period of 18 months immediately prior to the time of assessment, an event has occurred or circumstance arisen which is likely, in the near future, to result in a material reduction in income, a material increase in outgoings, a material liability or a material increase in risk for an institution (having regard, in each case, to the likely impact of any mitigating actions taken or likely to be taken by the institution).		•	
35.	Where it is considered that the council is not fulfilling its statutory functions and duties, or is otherwise unable to conduct its business.			•
36.	Where council membership falls below the 12 member minimum statutory requirement, and this can be attributed to the action (or inaction) of the council, and this situation causes the council to be unable to fulfil its statutory functions and duties.			•

No.	Criteria	Relevance of Criteria to Level of Risk		
		1	2	3
37.	Where there is an inquiry or report by the Auditor-General on the affairs of the institution that concludes there are serious mismanagement issues, which could relate to the spending or management of public monies.			•
38.	The council or management (or both) of the institution has either failed or refused to take adequate steps to address a level 2 risk, or risks, within a reasonable period from the date when the risk, or risks, occurred, whether or not that risk, or risks, has resulted in the appointment of a Crown Observer.			•
<b><i>Assessment of budget and financial projections</i></b>				
39.	On the basis of the most recent (as at the time of assessment) annual budget approved by the council and any other relevant financial forecasts or projections provided by the institution to the Secretary or Minister, there are reasonable grounds to believe that the institution is not, or is likely in the near future to not be, able to pay some or all of its debts as they become due in the ordinary course of business without recourse to a Crown loan, equity injection, or other special viability funding.			•

Dated at Wellington this 25th day of February 2008.

KAREN SEWELL, Secretary for Education.

*Note:* This notice replaces the one published in the *New Zealand Gazette*, 5 February 2004, No. 11, page 261.

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