Promote+Ed
Positive change

SECTOR FINANCIAL HEALTH ASSESSMENT

DATA COLLECTION AND FURTHER ANALYSIS

Introduction

Promote-ed is an online forum of practitioners from within the Skills sector. With over 1,500 registered users, we are able to gather intelligence and confidentially analyse the impact of DFE and ESFA Policy implementation across the sector.

Our aim is to influence change for good. We are not sponsored by anyone, are objectives and our opinions and are not influenced by stakeholders and we are not frightened to voice our opinions but these are presented to improve the operation of policy, systems and process.

Being the only true independent representative body for the sector, we have no fear of repercussions from the ESFA and others where there is a history of providers operating through fear. This in itself is not a healthy business environment and must in itself come to an end.

Promote-ed produced a report titled 'Managing Financial Risk in The Skills Sector' on the 18th February 2021 which highlighted serious concerns about the methodology used for determining the financial health of providers in the sector, inconsistency of application, lack of transparency and above all a disconnect between financial health scores and contract award / management. The report is attached at Annex 1

Since then we have received significant interest in our work from MP's, Press and other stakeholders.

This report takes forward those findings through a detailed analysis of the accounts of providers in the sector.

Our findings are revealing, disturbing and underline further the conclusions from our first report – that ESFA processes are not fit for purpose, that there is a lack of transparency in determining the financial health of providers and little apparent linkage between assessment and determination of further action.

We welcome comments from interested parties to these findings as we take forward our objective of achieving beneficial change and equity for all providers in the sector.

It should be noted that since the publication of our first report, not all comments have been positive, particularly from some providers who do not come out of the conclusions from this work positively. We do not take kindly to threats of any sort, it merely strengthens our resolve.

Further Work Undertaken

We have been asked to undertake some specific work concerning financial health of providers, focussing on the larger providers in the sector.

We have taken as our starting point the ESFA's own allocations spreadsheet for 2018/19 to include AEB provision, Adult Loans, Procured Apprenticeship and Levy Spend.

We have then ranked providers by size and analysed in detail the accounts of the top 50 providers, irrespective of ownership structures to determine what their financial health scores would be and the extent to which the accounts in themselves identify other matters.

It must be said that no provider is doing anything wrong in the way in which they prepare their accounts. Nearly all of the accounts reviewed were subject to independent audit so we have assumed they were produced in-accordance with pertinent accounting standards and whilst the structures of many of the providers reviewed were complex, there is nothing to indicate that this is not allowed by accounting and legal convention.

However, as with the ESFA's own determination that with funding, providers must operate within the spirit as well as the letter of the rules, the same should apply to financial accounts, the resulting financial health and the impact this has on any contract allocation or indeed cap on turnover.
Our work has 'tested' the conclusions of our first report.

Executive Summary

The conclusions from our work are both stark and concerning. The detailed data analysis, undertaken by senior finance professionals, which is open to scrutiny on request has identified:

- The ESFA do not publish transparently the results of their work on financial health for the private training sector – this has no basis, does not accord with the Nolan Principles and it is clear that the results of our work do not support the ESFA complying with it's own guidance
- Disturbingly, there are providers who accounts for 2020 are late, numerous instances where accounts are not filed beyond the 9 month time limit established by Companies House, and the changing of year ends to delay filing of results.
- In some cases, ownership is off-shore such that it is impossible to determine the ultimate accounts of the parent company and the resultant financial health score.
- Examination of changes in turnover between years show significant increases for some providers – yet with Inadequate financial health. It is difficult to understand how this can be allowed to happen and more importantly it is not consistent with the ESFA's own directions on funding limits resulting from the financial health determinations.
- A large number of accounts, particularly for the largest providers are masked in complex layers of ownership (commonly 5 and up to 10) with on many occasions the only difference between the trading entity which holds the ESFA registration and the ultimate ownership in terms of the accounts being significant levels of debt, rendering a change from the financial health score from Outstanding to Inadequate. This is the NORM not the exception.
- Privately owned providers with simple accounting structures are SIGNIFICANTLY DISADVANTAGED by the approach apparently taken because commonly any debt they need to raise to support business growth or solvency will be contained in their trading entity and as such reflect in their financial health scores. This is not equitable, nor in the spirit of NOLAN

Overall, our findings support the conclusions from our first report at Annex 1. Indeed, the findings are of significant concern about the robustness of the ESFA process for financial health assessment, its lack of transparency and the overall conduct of such measures.

The ESFA needs to undertake an urgent review of the accounts of all providers, prior to the commencement of any ROATP refresh and certainly before the AEB procurement process.

It is clear that either:

- ESFA know the process is flawed but simply choose to ignore the findings
- Ask questions of providers but do not have the expertise to fully understand the explanations they are being given
- Simply do not understand how to interpret a set of accounts, assess where risk lies and ultimately place an appropriate determination.

Without such action, the ESFA places significant levels of public funding at risk and faces Legal Challenge in the forthcoming ROATP and AEB processes.

Outcomes - Findings

Quantum of Funding Used

Analysis of the ESFA's own data for 2018/19 shows the following:

All funding except 16-19 Study Programmes consumed £3.05bn of which £1.4bn was spent by the 100 largest providers. Analysis of these provider types across the 100 providers provides the following information

Top 100	Private Providers	College/University	Employer Provider	Other
Number of Providers	24	64	9	3

If we dissect this information further and restrict the data to only Apprenticeship provision, both procured and Levy spending the analysis shows the top 100 providers spent a total of £840m out of a total of £1.7bn

Top 100	Private Providers	College/University	Employer Provider	Other
Number of Providers	37	52	8	3

This is consistent with the data that there are more private providers focussed on Apprenticeship provision than Colleges in the market place.

Most importantly, these significant levels of Public Sector spending make it important, in the ESFA's own words to ensure that financial health is reviewed and only providers with the appropriate strength should be able to function in the market – this is a key aspect of the ROATP refresh guidance for 2021 and indeed a PASS / FAIL of the current AEB tender process and the previous Traineeship process.

Top 100	Private Providers	College/University	Employer Provider	Other
Number of Providers	13	1	4	2
%	70%	5%	20%	10%

The above information is stark. 70% of the providers in the top 20 are private training providers, consuming the majority of the £400m. Of the top 10 providers, 70% are from the private sector spending more than £200m of the total £400m identified above.

The importance of therefore reviewing closely the financial health of each of these providers is important.

A methodology exists, established by the ESFA itself, which we have previously acknowledged but as we shall demonstrate there are serious flaws in either its application or use and indeed transparency.

Analysis of the Accounts - Financial Health Scores

We set out to review the largest 50 accounts of providers involved with Apprenticeships, both Levy and Procured Apprenticeships. This is representative of the total funding as shown above, with a slight tendency for there to be more private providers than other providers.

The results of our analysis were revealing:

Of the top 50, 26 of these were private training providers:

- Of them, 11 were owned by Private Equity or equivalent.
- Not one of the PE businesses had a simple ownership structure with one or two layers of ownership
- Most of the PE businesses had accounts with between 3 and 8 levels of ownership
- In many cases, the turnover of the ultimate holding company was the same as the trading entity with the ESFA registration apart from significant levels of debt which impacted adversely on every financial health score criteria
- The process for scoring the provider was complicated and time-consuming
- Producing the financial health score against the ultimate holding company for 7 out of the 11 providers produced a score of INADEQUATE compared with no change of scoring for the privately owned providers. In some cases you could not determine the score because of off-shore ownership structures

The remaining 15 private training providers were owned by their directors.

- Not one of these providers had an ownership structure of more than 2 layers
- Not one of these providers had debt contained in other visible structures
- The process for scoring the provider was simple and transparent.
- No providers score changed as a result of the review of financial health scoring between the trading company and the ultimate holding company

16 of the providers were Colleges of Further Education – we did not review the scores of these providers but they are subject to far more transparent reporting requirements

6 of the providers were employer providers, some of which were major PLC's and the trade contained within the PLC accounts. On each occasion, the provider scored OUTSTANDING financial health.

There were 2 remaining providers- both of which are Charities. Their accounts were simple to analyse and resulted in appropriate assessments.

We have no doubt there are reasons for the ownership structures of the providers reviewed.

However, what is difficult to understand is the inequity of the results that arise between those in the main which are Private Equity owned and those providers privately owned, yet it is apparent the ESFA cannot be using their own methodology in a robust manner.

As we have said, those providers which are privately equity owned, and a number of them have changed ownership in the past two years will have sought and obtained approval from the ESFA for a change of control. It is therefore surprising that the ESFA did not raise questions of structure and resultant financial health, or indeed they did and it is simply that the results are not transparent and the scoring waived for the purposes of the ESFA's own financial health assessment.

We do not find the results surprising but the apparent in-action by the ESFA to be of significant concern. It endorses our work in the original report at Annex 1.

Filing of Accounts

A recommendation in our first report was the need to determine a fixed date for the filing of accounts and for a year end unless there are clear legitimate exceptions – such as the case of an employer provider who is a PLC with different reporting requirements.

Analysis of year end dates from the largest 50 providers identified the following:

- All Colleges and Universities had the same year end of the 31/7 – 32% in total
- Of the Private providers (26) – 8 (31%) recorded 31st July as their year end with the second most popular date being 31st December (7) – 27%, with the balance across the full year.
- Just less than 50% already use 31st July as their year end. It would therefore be reasonable to suggest that the ESFA requirement all providers to file accounts to 31st July would not be an unreasonable suggestion
- Of greater concern was the promptness in filing accounts after the respective year end. Companies House allows 9 months from the year end to file under normal circumstances but good practice would indicate that using 4 months as a benchmark when Public Funding is being used is not un-reasonable:
    - Not one Private Provider filed their accounts within 4 months of the year end
    - One large provider has still not filed its 2019 accounts at all
    - Only 4 of the 26 providers (15%) have so far filed their 2020 accounts
    - The majority of providers filed their 2019 accounts, either after the 9 month deadline or very close the deadline set by Companies House

Again, no-body is arguing that any laws have been broken or rules breached. However, the process of reviewing financial health is improved if it is undertaken at least close to the year end or in the current period. It is common knowledge the ESFA use the filing of accounts as an approach to reviewing the financial health scores. The results of this work show that most accounts are not reviewed for nearly 12 months after the year end and there is limited work undertaken 'in year' on reviewing financial performance.

The ESFA Financial Health Test - The World Has Moved On!

Our previous report identified weaknesses in the financial health scoring mechanism undertaken by the ESFA and the approach used. We expect the ESFA to use other intelligence to derive the final score but this cannot be assessed or reviewed because the process is not transparent.

We have however identified that consistently the ESFA cannot be following their own rules if they use the parental set of accounts for review as determined by their own methodology and we have challenged the expertise of staff or regularity undertaking such work.

ESFA Challenge of Providers

We have asked a sample of providers for their views on how the ESFA interact with them on reviewing financial health. The results of this work is as follows:

- The ESFA only review the financial health of our business when our accounts have been filed with companies house – they then ask for the information to enable them to undertake the scoring mechanism – The is the most common comment we receive from providers
- Some providers have never had any questions or challenge from the ESFA regarding their financial health as part of their monitoring and management
- For those providers that have acquired other providers – the ESFA have never asked for an opening balance sheet which shows how the acquisition has been funded and how that is reflected in the trading accounts or parental accounts
- The ESFA have never provided a finance professional to undertake such a review or to ask questions. There is a feeling amongst providers that the individuals undertaking such work have limited experience of finance and hence the level of challenge is either non existent or very limited
- Change of control processes are normally a Yes with little due diligence undertaken by the ESFA.

This evidence is concerning given the large amounts of Public Funding being used. It is of particular concern considering the increased emphasis on financial health and the importance attached to it for both current tenders (AEB) and the forthcoming ROATP refresh process.

Reasons for Layers of Ownership

It is not the purpose of this review to determine the reasons for multi layers of ownership where in essence the only difference between the trading entity and the ultimate holding company is high levels of debt. The emergence of Bidco's, Midco's and Topco's have become more common place in the past 5 years, not just with the ESFA funded providers but with private sector transactions more generally. We pass no comment on why this should happen.

However, the ESFA's own financial health assessment criteria (whilst it provides for this in terms of reviewing parental accounts) has not kept up with the changes in ownership structures and hence the change in risk profile of providers.

5 years ago, such structures were not as common and we repeat whilst no rules have been broken, the fact that such structures have emerged, and we would argue for motivations other than the ESFA financial health assessment, the result is profound and of significant benefit to such providers compared to other privately owned providers.

We are sure the ESFA have satisfied themselves with such structures, the motivation for such and its desirability with organisation using Public funding and indeed that the process is equitable for all providers concerning including taxes such as capital gains and corporation tax.

If they have satisfied themselves, it would be simple for the ESFA to make transparent to the provider base changes to the financial assessment criteria in much the same way they do in allowing amortisation of intangible assets to be added back to profit.

We urge the ESFA to review this critical aspect of assessing financial health with urgency as part of the AEB tendering and ROATP refresh process. Consistent application of the existing process using Parental account as the basis will render many of the larger providers ineligible to participate in both processes and could result in costly legal action by stakeholders and delay, disrupting the market further.

Funding Growth or Solvency

Funding growth typically in a privately owned provider is through the raising of debt. The costs of such debt appear on the balance sheet and the cost of servicing such debt is a charge to the profit and loss account. The impact of this is to negatively impact on both the profitability and gearing scores for a provider, reducing their apparent financial health. This is indeed, true – such debt places greater risk on the business.

The position is not the same for the majority of privately owned providers owned by private equity. The accounts of such providers show, both in the notes to the accounts and with filings by companies house, continual new debt being raised and debentures being actioned. However, in the main – these are not reflected in the trading entity of the company, placing them at an advantage to privately owned companies where they do not have ownership of the private equity organisation. Similarly, the decision to take and accept more debt ultimately sits with the holding company – this is where the risk lies but not the company were the financial assessment is undertaken. We repeat, no rules are being broken.

But the treatment for the same transaction is not equitable and produces very different outcomes for what is the same trading organisation. This is a result of the ESFA's own processes not changing or keeping up with the changing funding structures of business.

Intangibles

We commented in our previous report about how the recording of intangible can dramatically change the financial health score. We do not repeat this but it is a further example of where accounting treatment has changed and taxation changes have made this more common place.

Until recently intangible arose through the purchase of goodwill from an acquisition and is written off against profits – ie: amortised.

More recently intangible have grown as a feature of accounts through the capitalisation of research and development expenditure where new tax benefits arise from such work. There has been an explosion of organisations making R&D tax claims, including those in the training sector. During the period of development, which is expected to be greater than one year – profits are increased through the capitalisation of expenditure, improving the ESFA profitability score and it also increases the shareholder fund scores, improving the gearing score as well as the creation of a debtor for the tax due improving the solvency score.

However, the ESFA allows the amortisation cost to be added back to profits so the business gains a double benefit each year. We can only assume this is an error and is not intended.

EBITDA

One of the most common features used for assessing financial strength and underlying performance is EBITDA – in essence profit before interest, tax, depreciation and amortisation.
This definition is widespread in the financial world.

However, the ESFA choose to use a different measure – that of Profit AFTER tax with depreciation and amortisation added back but no adjustment for interest.

We do not understand the reason or rationale for such a calculation.

Indeed, if interest was allowed to be added back for those businesses that are privately equity owned then this is the largest item generally that changes a trading profit to a trading loss in the holding company. This does not obviate the need to address the underlying levels of debt impacting on the solvency and gearing scores but that could be addressed in a different way.

The ESFA should therefore in our opinion commission appropriately qualified professionals to produce an equitable methodology for assessing the financial health of all providers. This should be published, applied consistently and the result published in an open and transparent manner. We cannot see any reason why this should not be adopted with urgency. Importantly, this should be undertaken with independence, without influence from any of the provider organisations or stakeholders.

ESFA Oversight

Our users have reported, and our own experiences provide sufficient evidence that ESFA oversight of financial health lacks rigour. Indeed, it questions whether the ESFA does indeed know of the outcomes of our review – after all the conclusions have not been difficult to determine by an organisation that is entirely self funded and staffed by volunteers.
We can only conclude that either:

- The ESFA know whats happening and consciously choose to ignore it
- don't know whats happening which indicates in itself significant concern given every change of control has to be approved by them and they have 3 months to undertake this
- they are asking questions and not getting straight answers
- there is another reason which we too don't have the answer too.

What is clear is that the process is flawed, lacks rigour and is neither transparent or equitable.
You could argue that changing ownership and generating investment from for example private equity is desirable for the sector. We see that argument and there is evidence to support such arguments.

Yet that is a different discussion. Such investment is designed to accelerate growth and many recent reports in this sector indicate that risk increases dis-proportionately with fast growing providers. If this is the case, it follows, that scrutiny of such providers, determining the correct financial health criteria and applying the ESFA's own published contract limits on growth should be more rigorously enforced. Again, we are not implying that any rules or laws have been broken. **We are simply identifying very clearly that the current process is flawed and not fit for purpose.**

Financial Health and Contract Growth and Awards

Our previous report identified this issue. The disconnect between a binary score on financial health – pass or fail and the resultant contract award for tenders and quite possibly the ability to grow as part of the ROATP contract refresh.

Put bluntly a provider scoring SATISFACTORY for financial health can grow exponentially with levy funded provision with little direct control by the ESFA, unless of course the new ROATP refresh will control this in future. There is a fix to this – for the ESFA to use its own published criteria, amended to reflect current practice and the financial environment and have a practice of regular review and monitoring of management accounts as well as delayed financial accounts.

This does not stop growth for a provider – it is not a negative, but it will result in providers becoming more conscious of determining where they want to grow, rather than chasing after new funding contracts.

Overall Conclusions and Next Steps

We have demonstrated comprehensively that the process for assessing the financial health of providers is broken, is inequitable and is not fit for purpose.

The reaction to our first report supports this – many people have been shocked by how out of date the processes used are, the risks taken by the ESFA and the resultant risk of challenge in the near future.

It is easily fixable – does not require the ESFA to spend 12 months internally reviewing and consulting on new requirements. It can be achieved prior to the commencement of the new contract year and requirements included in the contract between providers and the ESFA such as year ends and the requirement to file accounts within 4 months. (or whatever timescale is chosen). The ESFA is not best placed to do this, there are too many examples of where they have been unable to read a set of accounts properly and therefore we highly recommend they commission a reputable firm of accountants to produce new criteria and indeed consideration be given to them undertaking the assessment process going forward with rigour. This should be independent of any relationships they have with providers.

Without urgent changes, the risk in the sector increases – particularly as providers will have suffered financially through COVID and the importance of getting financial health correct becomes critical.

A vibrant market will remain but the oversight will be more robust.

We welcome the opportunity to discuss the findings of our report and its underlying data analysis with Ministers, Officials, The Press and other interested parties.

Our aim is to influence changes to the system of financial health assessment which will improve the control of Public Funding, Reduce risk and ensure Provider act within the spirit of the rules that are in place. Without changes to existing systems, the ESFA and Parliament places itself with increased risk to Legal challenge and ultimately resulting in Providers being unfairly treated.

ANNEX 1 MANAGING FINANCIAL RISK IN THE SKILLS SECTOR

A DISCUSSION DOCUMENT PREPARED BY PROMOTE-ED

Promote+Ed
Positive change

Executive Summary

Promote-ed is an online forum of practitioners from within the Skills sector. With over 1,500 registered users, we are able to gather intelligence and confidentially analyse the impact of the Department for Education (DFE) and the Education and Skills Funding Agency (ESFA) Policy implementation across the sector.

Our aim is to influence change for good. We are not sponsored by anyone, our objectives and opinions are not influenced by stakeholders and we are not frightened to voice our opinions but these are presented to improve the operation of policy, systems and process.

Being the only true independent representative body for the sector, we have no fear of repercussions from the ESFA and others where there is a history of providers operating through fear. This in itself is not a healthy business environment and must in itself come to an end.

Whilst COVID can be blamed for many things, and recognising the need for strong accountability and transparency, it is vital that procurement processes are clear and most importantly they result in outcomes that have long term benefit to the sector and most importantly learners and where relevant employers.

This document is intended as a point of discussion for effectively Managing Financial Risk within the Skills Sector.

Introduction

COVID has brought the need for Government to make procurement decisions quickly. In some cases, this has given rise to criticism and adverse publicity through an apparent failure to adequately consider appropriate procurement processes resulting in awards of contracts to organisations who have poor financial health and / or have only recently been established at Companies House.

The ESFA and DFE are rightly putting an increasing emphasis on financial health to manage risk in the sector to the extent that for the most recent tenders, financial health has become a PASS / FAIL binary judgement. Whilst no-one could argue about this principle, there are some significant flaws in their procedures which in our opinion put them open to significant legal challenge.

The assessments made by the ESFA of financial health have not changed for years – since then we have had a pandemic leading to financial strain on many businesses and a changing dynamic in terms of ownership structures of many providers both in this sector and outside the education sector.

The recent Public Accounts Committee (PAC) report commented strongly on the deteriorating financial health of the College sector and identified weakness in the processes adopted by the ESFA. However, lessons do not seem to have been learnt, and there does not seem to be any change to what in our opinion are 'flawed' processes. Whilst outside the scope of this document, the recent Notice of Improvement for Hull College, the third in the past five years and with over £50m invested into the organisation by the ESFA is a demonstration that intervention measures and in particular financial monitoring lack rigour.

Risk ultimately sits where the ownership lies – both in terms of decision making and the appetite for future funding of a business. This is where the failings of the existing mechanisms become stark.

Promote-ed is calling for the following urgent changes to the way in which the financial assessment of providers is undertaken:

1) It is unacceptable that providers can 'play the game' whilst within the rules of the Companies Acts to:

   a. Extend year ends
   b. Delay unnecessary the publication of accounts
   c. Hide the ownership of their companies from the reader of such accounts
   d. In the context of the impact of COVID-19 19, 'adjust' their accounts for 2020, e.g. accruing income from 2021, in a bid to hide the real impact of the virus on their business.

We are calling on the ESFA to require all providers to close their accounts within 4 months of the year end and consider setting the 31st July being the year end for all registered providers in the sector. It is a healthy discipline to conclude and file your accounts promptly (indeed many do but simply sit on them for 9 months).

2) The ESFA should impose with immediate effect an assessment that the financial health assessment should be undertaken on the ultimate holding company, not the trading company with the only exceptions being where there is substantive other trade

within the holding company – there are too many examples of where the debt in the training company has been stripped out into a TOPCO.

3) The current financial health criteria used – applying a historic profitability, solvency and gearing score is outdated and inadequate given some providers administer more than £50m of public funding.

4) The 'contract limits' – published by the ESFA but never historically enforced represent a strong discipline if driven from a strong process for assessing financial health. These limits should be published for each provider, together with their contract allocations each year to aide transparency, openness and the Nolan principles.

Furthermore and in the light of the findings of this document (and to prevent the risk of legal challenge to the ESFA)

5) The ESFA should urgently suspend the current Adult Education Budget (AEB) tendering process given the inadequacies of the financial assessment methodology and the total disconnect between financial health and contract award. Without such a review, the ESFA and Public Purse leaves itself open to legal challenge.

6) In the light of the findings from this report, the ESFA should radically change the manner in which its assessment of financial health is conducted for the forthcoming Register of Apprenticeship Training Providers (ROATP) refresh process, due to commence in May. This is particularly so in the context of which 'vehicle' or business is assessed for the purposes of financial health assessments and with a focus on ownership and structures.

7) The importance and process of reviewing financial health has never been so important – it's a kin to the financial fair play calculations undertaken in football where every one of the clubs accounts are assessed and challenged by a professional team at the English Premier League or English Football League. The ESFA should implement a robust process where financial health is reviewed by a team of professionals who understand the reading of accounts and indeed how easy it is for a determined provider to change the picture painted.

For a Government department, administering and allocating £bn's of funds each year and with the emphasis on reducing risk through improved financial health, the existing processes are not fit for purpose.

Promote-ed has significant evidence that the processes implemented by the ESFA are not administered by professionally qualified personnel. This puts the ESFA itself at risk of challenge and makes the process unfair and equitable.

Promote-ed wish to see positive change and above all a provider base that has strong finances and a transparent mechanism for all aspects of measuring financial health of providers and the sector as a whole. It is clear the current system and those administering it have failed in their diligence to this important task.

We seek the PAC to urgently review this important area of the ESFA work.

ESFA Public Procurement beats Outcomes
Examples of Flaws in the System

AEB

Early February saw the launch of the latest ESFA tendering process. Landing in peoples inboxes on a Saturday and with a relatively short submission date, there is up to £73m on offer, split between £7m for the adult offer and £66m for non-devolved AEB across England.

Whilst we all respect the need for following public procurement rules there would appear to be at first glance great opportunities for providers. Indeed, in boxes were hot over that weekend and linked-in alive with people getting excited about the latest 'opportunity'.

Exactly the same was the case with the recent 19+ Traineeship tender. Whilst accurate data is not yet published, of the 400+ bidders acknowledged by the ESFA, certainly more than 60% were unsuccessful, whether through non-compliant tendering or simply not answering the questions appropriately in the eyes of the expert 'markers'.

Reports of many providers with no experience of Traineeships receiving significant contract awards and some doubling their turnover overnight give cause for concern. There is no issue with 'winners and losers' in any procurement exercise but it is clear that the Traineeship tender was flawed. Linked-in Is full of providers advertising for individuals to lead new Traineeship divisions and simply looking at the accounts of some of these providers on Companies House gives significant cause for concern.

Clearly there have been no lessons learned – we have almost exactly the same process for the AEB tender as the Traineeship tender – although whilst the amounts on offer are similar in terms of the quantum being bid for, we have a far more mature market place and hence there will be more bids, both in quantity and quality!.

That is a good thing, but only if you are a winner and in my eyes the process is driving everything – with little attention given to the desired outcomes. Wee might be naïve however and the, outcomes have already been determined;

Less providers but no provider who is able to build a significant business from AEB in the future.

Assessing Financial Health - The Process and its Importance

The process for the assessment of the financial health of all providers in a publicly funded market place or indeed a privately funded market is common place and cannot be argued against.

It enables the contracting organisation to monitor and manage the risk profile of its contractors, to establish 'credit' worthiness and scores to limit the level of contracts issued and ultimate risk and also demonstrates a transparent mechanism for procurement that all potential contractors are treated consistently and fair – thus avoiding any challenge in the courts and respecting good practice procurement rules.

There is no argument with the above, combined with a package of other measures such as OFSTED results, monitoring reports, 'intelligence' and other relevant factors.

The process for assessing financial health within the ESFA funded sector is well established. For Schools there is a robust process with specific requirements on Trusts to file accounts and for assessments to be made of the accounts and financial health.

Similar processes apply to Colleges and there are exemptions for Colleges to some of the financial health monitoring mechanisms. Promote-ed does not object to this process – Schools and Colleges are funded by Grant and there are different requirements of them by statute.

The process for assessing financial health of providers is undertaken by the ESFA using a published criteria which results in:

- an overall score,
- a subsequent determination of the financial health category and
- specified limits on the level of contract that can be held arising from the financial health score and historical turnover.

Information received from promote-ed registered users would indicate that the review of the financial health category when a provider has submitted its accounts has become more common in the past two years – prior to that, the process was spasmodic and appeared to lack any form of rigour.

However, reports of inexperienced members of staff undertaking this fundamental piece of work from the ESFA are common place.

We do not understand why those financial health classifications for providers are not published, nor why the arising contract limits are also not published – this is a significant omission in terms of transparency. It does not breach any confidentiality because the accounts are published and in the public domain as the evidence contained in this report demonstrates.

The criteria used is based on the evaluation of historical financial statements – many of them published more than 9 months after the year end and in some notable examples further significant delays through the movement of a yearend or extension of the accounting period.

In itself, forming such an important assessment, based on such old data is fraught with risk, and whilst COVID cannot be blamed for everything – the resultant financial impact and health of the sector has changed during the past 12 months which will last for many years to come

It is therefore surprising and disappointing that the ESFA have decided not to significantly change or modify their financial assessments for the recent and current tendering processes and the forthcoming ROATP refresh given the impact of COVID and financial risk profile of the sector. We recommend this is done urgently and both the AEB and ROATP refresh processes are delayed until this process has been completed. Without such a review there is a high risk of legal challenge in relation to contract awards and the determination of the ROATP refresh.

Flaws with the Current Process and Outcomes

We have analysed a number of accounts that are in the public domain of providers as well as summarising the comments and discussions we have received from registered users of Promote-ed over the past few months. The number of calls received on this subject increase daily.

Our work has been revealing but not surprising. RISK will inevitably increase because of the impact of COVID but this is not a COVID issue – its is about strengthening the mechanism for assessing financial health as well as monitoring.

We are surprised that the ESFA have not modified their approach to reviewing financial health of providers – especially since when the provider relief scheme was established, the ESFA itself rejected many providers applications on the basis of them failing to provide accurate and appropriate financial information.

Providers are becoming more aware that the assessment of financial health is becoming more important. Traditionally, the filing of accounts was a process conducted well after the year end and the 'accounts were what they were' rather than being prepared to present the best possible position.

Awareness of the Financial Health Assessment

In the past three months, the most common question asked of the promote-ed team by registered users who are mainly private providers is – 'where can I find the financial assessment publication and how to I calculate my financial health.'

This is consistent with many of the questions being asked of the ESFA and published in both the current AEB tender and previous traineeship tender.

Whilst the ESFA have repeated in February information relevant to the ROATP refresh of the existence of the document which has remained unchanged for many years, there remains a gap in knowledge of providers in the sector.

The Financial Health Assessment Criteria

It goes without ssaying that having a criteria for assessing financial health and using it robustly and consistently is better than having nothing.

With that comment, the ESFA should be credited, But the criteria used is outdated, un-changed and ignores experience during that time.

The existing criteria is focussed on historical information to deliver a score against three measures – Profitability, Solvency and Gearing.

There is nothing wrong with the principles used but as we shall demonstrate using case studies from within the sector, that the criteria is not fit for purpose and disconnects in almost all cases, the financial health assessment and any resultant contract awards.

For example, with the current AEB contract – financial health is a binary judgement as part of the mandatory assessment of a provider. There is nothing wrong with that (assuming the financial health assessment is undertaken appropriately – see below) but there is then a total disconnect between any financial health assessment and contract award – That cannot be correct.

Applying the Criteria delivering Very Different Results - Examples

A financial health assessment is used to determine overall risk, health and influence contract award in public and private sector procurement – that is commonplace.

As such, the process and criteria used should be:

- As up to date a possible
- Adjusted to reflect past experiences
- Assess a range of criteria that are not inter-linked
- Provide an assessment of an organisation where ultimately the decision making, ownership and risk sits – the ultimate holding company.

We consider all of these in the context of the ESFA's processes in this document but here we consider the need to adjust criteria to reflect on past experiences and ensure results remain valid.

The ESFA criteria has not changed for at least 10 years as we know it. Since then, there has been some notable financial issues in the sector that have often gone un-detected by the ESFA both in the College and the PTP sector in relation to financial health and the impact of owners taking decisions which impact on the business sustainability. These include First4Skills, ESG, Learndirect in the PTP sector and Hull College and others in the College sector. The PAC report acknowledges that ESFA action has been at best tardy in some of the College financial health examples.

We have also seen a change in the ownership structures of providers during this time, the emergence of TOPCO's within these structures, the impact of COVID on financial health and a progressive move to remove contracts – particularly regarding Apprenticeships and the emergence of the DAS. All of this changes the risk profile for the ESFA.

Disappointingly, the criteria used to assess financial health has not changed at all during this period. Is this because there is a view that the process is robust or that the ESFA may not itself recognise the changing financial dynamic of the sector and the providers within it. It is hard to believe that the examples provided above have not warranted a move towards at least refining the criteria and / or scoring mechanism and to align more fully the financial health score and grade to the contract awards or the overall contract allocation for a provider – that in itself will reduce risk to the public purse.

A simple look at the criteria for anyone who understands the mechanism of a set of accounts will tell you that the three criteria the ESFA use – Profitability, Solvency and Gearing are INTER LINKED as illustrated below:

Case Study A - Accruals of Income

Some but not all providers (including most of the large providers) accrue income into their accounts on the basis that the profile of income received lags behind the costs incurred in delivery. This is perfectly acceptable as an accounting principle but is not universally applied across the sector.

The impact of accruing income can be stark to the financial health scores as illustrated below:

Provider A

- The profit and loss account breaks even or records a small profit or loss but the provider does not accrue income as described above.
- The provider undertakes the financial assessment scores and scores:

  0 for profitability
  30 for solvency
  50 for gearing

- The provider scores 80 and therefore has an INADEQUATE financial health score
- The provider then decides to accrue £100,000 of income into its accounts at the year end:

  50 for profitability
  100 for solvency
  20 for gearing

- The provider scores 180 and has a GOOD financial health score

The provider has done nothing to change the financial health of its business – it has simply made an accrual of income resulting in ALL of the scores returning positive.

Case Study B - Declaration of Dividends

A provider declares a dividend on the day of its year end and files its accounts. It would result in no change to it's profitability but it would reduce the share holder funds impacting on its gearing and increase its creditors – impacting on its solvency.

Provider B

- The Profit and loss account shows a profit of £30,000 (with positive reserves in the balance sheet) after declaring a dividend of £50,000 which is not un-common in the sector. This is undertaken on the day of the year end
- The provider undertakes the financial assessment scores as follows:

  0 for profitability because dividends are deducted from profits after tax
  20 for gearing because the shareholder reserves are reduced because of the impact of the dividend being declared

Creditors increasing by the value of the dividend impacting adversely on solvency scores – 50

- The provider scores 70 and therefore has an INADEQUATE financial health score
- The provider simply declares the dividend the day following the year end:

 60 for profitability
 80 for solvency
 100 for gearing

- The provider scores 240 and has an OUTSTANDING financial health score

Again, the provider has done nothing to change the financial health of its business – it has simply declared its dividend after the year end and not before.

Case Study C - Capitalisation of Intangibles

Provider C is struggling to demonstrate a profit in its accounts and knows that it will score 0 for is profitability score, which will also impact adversely on its gearing score.

The SMT review what expenditure is contained in the profit and loss account which is able to be classified as research and development. The provider has been developing new curriculum, on-line learning and a VLE to support its learners and so they make the decision to capitalise this expenditure into an intangible asset.

The resultant impact is to increase the profitability score to 70 points and to increase the gearing score to 80 points, turning an INADEQUATE rated provider again into a provider now rated GOOD.

Furthermore, the benefit to the provider in future is that the write-off of the intangible asset and the cost associated with this which is charged to the Profit and Loss account in subsequent years in actually added back using the ESFA calculations so there is never a recognised 'charge' for this in the ESFA calculator.

Nothing has changed with the provider in terms of its underlying financial health but it has gone from INADEQUATE to GOOD with the stroke of a pen.

Theses three case studies – and there are many more demonstrate how the three criteria are totally interlinked – not surprising given for every DEBIT in accounting there has to be a corresponding CREDIT.

These examples highlight the fundamental flaws with the current system of assessment.

Of even greater concern is the lack of correlation with the financial health assessment and limits on contract awards.

The ESFA's own process and criteria provides for this but we cannot find any evidence that suggests this is used. Indeed, the most recent tender process DISCONNECTS the financial health assessment from the subsequent contract award – increasing risk and discrediting the financial health assessment in the first place.

To illustrate this for the current AEB process.

Provider D

- Has filed it's most recent accounts at 31st July 2019. The financial accounts show a SATISFACTORY financial health score on a turnover of £1.5m
- The provider passes the AEB financial health score – PASS
- The provider is a sub-contractor for existing AEB but doesn't hold a previous contract
- Provider D is successful in scoring 500 points by answering the three questions in the tender documents well.
- Provider D is allocated in Block 1 what it has bid for - £2m

So Provider D with only a SATISFACTORY financial health score now has £3.5 of turnover following the tender process but has grown by 125% instantly.

There is no process or criteria to link contract awards to financial health which increases financial risk to the public sector.

Delays in Filing Financial Statements

It is a common practice for companies, particularly where the financial results are poor to deliberately delay filing of their accounts as late as possible and indeed are prepared to pay the relatively small late filing penalties to avoid their accounts being in the public domain.

Whilst this is common practice, it does not make it right, particularly where the majority of a providers income comes from the public sector and where transparency and openness should be of equal importance. We are aware of providers from 2019 who has still not filed their accounts and some large providers where the filing of their accounts was over 12 months past the year end.

For listed companies – there are defined time-scales for filing of accounts and announcing results to avoid manipulation of the market and share price sensitivity issues and this equally applies to Schools, Trusts and Colleges.

Whilst providers are doing nothing illegal – it makes the process of assessment of financial health that more difficult and effective and penalises those providers who are operating both within the spirit and letter of the rules

The position is worse than simply filing accounts late. A simple examination of a small number of the larger providers recent filings with Companies House identifies that many of them, not unsurprisingly have taken on more debt during the past six months. For many, this has arisen after their proposed 31st July year ends and whilst there may be a note to the accounts in the form of a post balance sheet event note, or even a comment regarding going concern, the simple facts are that the accounts containing such indebtedness will not be in the public domain or with the ESFA much before April 2022.

We are therefore calling on the ESFA to require all providers to close their accounts within 4 months of the year end as a condition of funding. It is a healthy discipline to conclude and file your accounts promptly.

Extending Year Ends

Changing or extending a year end is another way of delaying the filing of accounts into the public domain. Whilst there will be be sometimes legitimate reasons under certain circumstances to change or extend a year end, it can present added risk.

Again, examination of Companies House for a selected number of providers in the sector from the existing ROATP register indicates this is more common place than you would expect.
Whilst we do not have the benefit of assessing whether such changes are reasonable or prudent, there is no doubt it reduces transparency and openness.

For this reason, we recommend the ESFA should consider setting the 31st July or another date being the year end for all registered providers in the sector.

Holding Companies and TOPCOs

The majority of providers on ROATP have simple company structures in terms of the visibility of trading, demonstrating in one set of accounts the true picture of profitability, solvency and external debt despite that this is reviewed historically and is not subject to the benefit of more up to date scrutiny where the financial position of a provider can change significantly – either positively or negatively.

The over-riding principle has to be that the entity where ultimately the ownership and risk sits should be the entity that is subject to the financial health assessment. This is illustrated at a basic level where dividends are deducted from profits (a common remuneration feature for owners and directors) in the ESFA assessment and cannot be argued as being anything other than reasonable.

The ESFA's own process allows for the review of parent accounts:

> ***4. Parent Companies***
> *18: If your organisation is part of a wider group of companies or is classed as a subsidiary, you must submit full financial statements for the ultimate UK parent company. You must also submit those of the contracting or applying organisation.*
> *19: If an organisation fails to submit its ultimate UK parent company accounts, this may result in the award of an 'Inadequate' grade.*
> *20: If your ultimate UK parent company does not produce consolidated accounts, you are required to supply the accounts for their non-dormant subsidiaries.*
> *21: If your ultimate parent company is registered outside of the UK, you must supply the full financial statements for your UK parent company.*

But as we shall demonstrate below, this is not always the case and the ESFA do not follow their own guidance.

There a numerous examples within the sector where the trading entity is assessed by the ESFA for the purposes of the financial health assessment and grading but where the decision making, share holding and ultimately where the risk sits in another company. (i.e. the Parent Company). These are mainly but not exclusively those providers controlled by private equity.

There are complex reasons for such structures, including tax planning, including off-shore sheltering where it could be argued this should not be allowed for organisations mainly administering Public funding.

However, our focus is whether the financial grading is appropriate in the context of risk management. Taking one provider alone from Companies House, and to protect their identity, the structure of the company is as follows:

Xxxxxxxxxxxxx Training – Holds the ROATP registration and contracts – Outstanding Financial Health

Majority Owned by xxxx Limited

Which is Majority Owned by xxxx Holdings Limited

Which is Majority Owned by xxx Bidco Limited

Which is Majority Owned by xxx Midco xxxx Limited

Which is Majority Owned by xxx Midco xxxx Limited

Which is Majority Owned by xxx TopCo Limited

Which is Majority Owned by xxx Partners – Inadequate Financial Health

Eight levels of ownership, all with the same year end and ultimately the ownership and risk sitting with the 8th Level of ownership. This is not the worst example by any means. There are examples of providers with 10 Levels of ownership.

Examination of the ultimate level of ownership shows INADEQUATE financial health.

Putting this into context, if the ESFA were to terminate its contracts or the ultimate owners decided not to support the business any further – it is this level, the 8th level of ownership that ultimately would make the decision and not the Training company where the financial health assessment is OUTSTANDING at face value.

Case Study D - Analysis of a Sample of Large Provider Accounts with Turnover in excess of £10m (illustrative)

	Provider A	**Provider B**	**Provider C**	**Provider D**	**Provider E**
Status	PE Owned	PE Owned	Privately Owned	PE Owned	Privately Owned
Latest Accounts	31/07/2019	31/07/2019	31/12/2019	31/01/2020	31/03/2020
Profitability Ratio	60	100	60	-	30
Liquidity Ratio	100	100	80	100	100
Gearing Ratio	80	70	90	70	100
Total Points	240	270	230	170	230
Assessment	**OUTSTANDING**	**OUTSTANDING**	**GOOD**	**SATISFACTORY**	**GOOD**

Ultimate Ownership Accounts

	Provider A	**Provider B**	**Provider C**	**Provider D**	**Provider E**
Profitability Ratio	-	-	n/a	100	n/a
Liquidity Ratio	60	70	n/a	100	n/a
Gearing Ratio	-	-	n/a	-	n/a
Total Points	60	70	n/a	200	n/a
Assessment	**INADEQUATE**	**INADEQUATE**	**N/A**	**GOOD**	**N/A**

This simple analysis alone should give cause for concern. Two providers, together administering more than £100m of public funding.

No-one is saying any rules have been broken by any of these providers. The problem lies in the assessment process conducted by the ESFA. The process does not rigidly examine where, within a business the risk ultimately rests and does not make an assessment at the appropriate level.

We therefore recommend the PAC review urgently and recommend to The ESFA radical changes to the manner in which its assessment of financial health is conducted for the forthcoming ROATP refresh process in the light of the findings from this report, particularly in the context of which 'vehicle' is assessed for the purposes of financial health assessments and with a focus on ownership and structures.

Financial Health and Contract Limits

The existing financial health assessment criteria links financial health categories with contract turnover limits.

However, in our experience these have never been robustly applied by the ESFA and with the removal of contract allocations for Apprenticeships and Levy – almost £2.5bn of potential turnover per annum goes un-regulated using the existing mechanism where there is no link between financial health and overall turnover consumed within public sector funding.

The position appears to be getting worse. If we examine the current AEB tender process for which there is in excess of £70m available for allocation, there is a total disconnect between financial health scores and contract allocations.

Put simply, financial health is a PASS / FAIL mechanism and once past this hurdle, your financial health, turnover or indeed ownership structures bear no resemblance to any contract award.
The contract award results simply from the ability to answer 3 questions correctly, score 500 points in the marking scheme and be allocated into BLOCK 1 for contract award purposes.

So, a provider with only satisfactory financial health can get a bigger allocation than someone with outstanding financial health, simply because in the eyes of the markers they are better at answering the questions.

In reality, you can be a small provider with outstanding financial health (which is easier than larger businesses), answer the questions well and get an allocation of £1m or even £3m.

Finally, if the ESFA is serious about financial health and only contracting with the most robust providers, then it will be interesting to see how they examine the largest players. I have looked at the largest procured allocations across the market, consuming more than £30m of existing funding and reviewed their accounts – 30% of them, including two of the largest providers in the sector having an inadequate financial health rating If you look at the 'ownership' (parent accounts using the ESFA terminology) of the business and in essence where the decision making sits and where the risk lies, not with the trading entity.

We will be watching with interest how this is assessed.

We therefore recommend that the ESFA should The ESFA should urgently suspend the current AEB tendering process given the inadequacies of the financial assessment methodology and the total disconnect between financial health and contract award – without review, the ESFA and Public Purse leaves itself open to challenge.

We welcome the opportunity to discuss the findings of our report and its underlying data analysis with Ministers, Officials, The Press and other interested parties.

Our aim is to influence changes to the system of financial health assessment which will improve the control of Public Funding, Reduce risk and ensure Provider act within the spirit of the rules that are in place. Without changes to existing systems, the ESFA and Parliament places itself with increased risk to Legal challenge and ultimately resulting in Providers being unfairly treated.

Join the change for positivity!

Promote+Ed
Positive change

www.promote-ed.co.uk
hello@promote-ed.co.uk