The Whittington Hospital NHS Trust

ITEM: 3
Appendix 4

MEETING:	Trust Board 18th January 2006

TITLE:	**Finance Report – Appendix 4 Draft Financial Risk Rating**

SUMMARY:

A draft financial risk rating has been calculated and details are attached for two potential scenarios.

This draft is based on current year values, including some estimates and is for illustrative purposes. Further information/updates will be brought to future meetings.

ACTION:	**Information**

REPORT FROM:	**Trish Donovan** **Deputy Director of Finance**

SPONSORED BY:	**Susan Sorensen** **Director of Finance**

1. Financial Risk Rating

Monitor's financial risk rating for Foundation Trusts is calculated based on five indicators, each of which carries a weighting that is applied to reach an overall weighted score. The total of these weighted scores, subject to over-riding rules, is the organisation's risk rating (on a range of 1 to 5, with 1 being the weakest).

1.1 The five indicators are :

- **Achievement of Plan (weighting 25%)**

  This is measured as EBITDA (Earnings Before Interest Taxation Depreciation and Amortisation) achieved expressed as a % of plan.

  This measure looks at past performance and indicates the Trust's ability to accurately forecast performance and deliver it's financial plan.

  (a fully achieved plan would score 100%)

- **Underlying Performance (weighting 25%)**

  This is measured as the EBITDA margin which is operating earnings expressed as a % of income

  This measure looks at operating efficiency and indicates the Trust's cost to income ratio.

  (a margin of 10% indicates very strong performance)

- **Financial Efficiency (1) – Return on Assets (weighting 12.5%)**

  This is measured as the surplus generated, before dividends, expressed as a % of the average value of the Trust's owned assets. (ie assets excluding donated items).

  This measure indicates the efficiency of asset use by relating the surplus generated in proportion to the funds invested by the Trust to generate the surplus.

  (a return of 5% would indicate high efficiency)

- **Financial Efficiency (2) – I&E Surplus Margin (weighting 12.5%)**

  This is measured as the surplus, after payment of dividends, on Income and Expenditure expressed as a % of total income.

  This measure indicates the organisations ability to break-even whilst covering the cost of capital to the public sector.

  (a margin of 2% indicates strong performance ; break-even would result in performance of 0% which is middle of the range)

- ### Liquidity (weighting 25%)

This is measured as the number of days of operating expenses that are covered by the Trust's current assets (including any credit facility).

Expressed in days, this measure indicates the Trust's short-term ability to meet operational costs.

(cover of 35 days is considered strong performance and <10 days weak)

2. Draft Trust Risk Rating Calculation

The five indicators have been calculated for the Trust's 2005/06 position under two scenarios :

A) that break-even is achieved
B) that a deficit of £1.5m is incurred

The results are summarised in the table below and initially indicate a risk rating of 3 for scenario A and 2 for scenario B, however these ratings are then subject to overriding rules that limit the overall rating to 2 in both cases, as detailed at section 3 below :

Scenario A – Assumes Break-Even achieved on I&E for 2005/06

Indicator	Weight	Rating Categories					Actual Score	Weighted Score
		1	2	3	4	5		
Achievement of Plan (EBITDA achieved as % of plan)	25%	100	80	60	25	<25	5.00	**1.25**
Underlying Performance (EBITDA Margin)	25%	10	8	4	0	<0	3.00	**0.75**
Financial Efficiency 1 – Return on Assets	12.5%	5	4	2	-3	<-3	3.00	**0.38**
Financial Efficiency 2 – I&E Surplus Margin	12.5%	2	1	0	-3	<-3	3.00	**0.38**
Liquidity Ratio (days)	25%	35	25	15	10	<10	1.00	**0.25**
RISK RATING								**3.00**

Scenario B – Assumes Deficit of £1.5m incurred on I&E for 2005/06

Indicator	Weight	Rating Categories					Actual Score	Weighted Score
		1	2	3	4	5		
Achievement of Plan (EBITDA achieved as % of plan)	25%	100	80	60	25	<25	4.00	**1.00**
Underlying Performance (EBITDA Margin)	25%	10	8	4	0	<0	3.00	**0.75**
Financial Efficiency 1 – Return on Assets	12.5%	5	4	2	-3	<-3	3.00	**0.38**
Financial Efficiency 2 – I&E Surplus Margin	12.5%	2	1	0	-3	<-3	2.00	**0.25**
Liquidity Ratio (days)	25%	35	25	15	10	<10	1.00	**0.25**
RISK RATING								**2.63**

3. Overriding Rules

The risk rating is calculated as indicated in the tables above and is then subject to 10 overriding rules. Should the rules apply, the overall risk rating will be limited as detailed below :

	If the following Condition Applies	Rating Limited to a maximum of
1	Plan not submitted on time	3
2	Plan submitted not complete	3
3	PDC Dividend not paid in full	2
4	Lowest ranked indicator is a 1	2
5	One financial efficiency indicator is a 1 or a 2	3
6	Both financial efficiency indicators are 1 or 2	2
7	Both financial efficiency indicators are 1	1
8	Unplanned breach of PBC (prudential borrowing code)	2
9	Previous year's rating was worse (ie in any year cannot be more than 2 points better than previous year)	△ 2
10	Less than 1 year as an NHSFT (no FT will be rated 5 in their first year)	4

3.1 Application of Overriding Rules to Draft Trust Rating

Rule 10 would apply, should a rating of 5 be calculated.

In terms of the draft ratings tabled at section 2 above, rule 4 will apply and the overall rating in this case would be limited to 2 for both scenarios. This is because the liquidity ratio scored 1 and if any indicator scores a 1 the overall rating is limited by this rule to a 2.

In this draft, the liquidity calculation includes an estimated credit facility of £3.5m, which is equal to the Trust's current cash brokerage and has been used for illustration only. It is likely that a higher credit facility would be sought and this would increase the liquidity ratio such that the overall rating would not be restricted by this rule.

In order to achieve a liquidity score of 3 (middle range), a credit facility of £6.5m would be required for scenario A and £8m for scenario B

4. Assumptions & Detailed Calculations

These are attached at Annex A

Values used for calculation of draft Financial Risk Rating

Income & Expenditure	SCENARIO A		SCENARIO B	
	Assuming Balance for 2005/06 - based on plan as at Mth 8		Assuming Deficit of £1.5m for 2005/06 - based on plan as at Mth 8	
	Plan	**Forecast**	**Plan**	**Forecast**
Income	129,010	129,010	129,010	128,510
Expenditure	121,433	121,433	121,433	122,433
Depreciation	4,495	4,495	4,495	4,495
Operating Surplus	3,082	3,082	3,082	1,582
Dividend	3,048	3,048	3,048	3,048
Interest Payable	34	34	34	34
NET Surplus / (deficit)	0	0	0	-1,500
EBITDA	**7,577**	**7,577**	**7,577**	**6,077**

Balance Sheet	at 01 April '06	Balanced Forecast	as at April '06	Forecast £1.5m deficit
Fixed Assets	97,680	100,799	97,680	100,799
Debtors	9,372	6,095	9,372	6,095
Stock	1,205	1,259	1,205	1,259
Cash	386	7,044	386	7,044
	10,963	14,398	10,963	14,398
Creditors (excl provisions)	10,355	14,736	10,355	16,236
provisions	2,314	2,201	2,314	2,201
net current assets / -liabilities	-1,706	-2,539	-1,706	-4,039
net total assets	**95,974**	**98,260**	**95,974**	**96,760**
PDC	49,921	49,921	49,921	49,921
Revaluation reserve	44,298	46,641	44,298	46,641
Donation Reserve	1,358	1,301	1,358	1,301
I&E Reserve	397	397	397	-1,103
	95,974	**98,260**	**95,974**	**96,760**
		0		0

Detailed calculation of earios for draft Financial Risk Rating

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Annex A
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			Scenario A (break-even)	Scenario B (£1.5M deficit)
EBITDA (achievement of plan) (%)				
prior year performance - ability of trust to forecast accurately and deliver plan				
Actual			7,577	6,077
Planned			7,577	7,577
ACTUAL EBITDA FOR PRIOR YEAR / PLANNED EBITDA FOR PRIOR YEAR			1.00	0.80
			100%	80%
EBITDA MARGIN (%)				
underlying performance - operating earnings as a % of total income				
EBITDA			7,577	6,077
Income			129,010	128,510
EBITDA / TOTAL INCOME			0.06	0.05
			6%	5%
RETURN ON ASSETS (%)				
efficiency of use of assets				
I&E SURPLUS OR DEFICIT	A		0.00	-1,500.00
ADD BACK DIVIDENDS	B		3,048.00	3,048.00
	C (A+B)		3,048.00	1,548.00
TOTAL EQUITY (AVERAGE BALANCE)	D		97,117.00	96,367.00
LESS DONATED ASSETS (AVERAGE BALANCE)	E		1,329.50	1,329.50
	F (D-E)		95,787.50	95,037.50
RETURN ON ASSETS EXCLUDING DIVIDENDS	**C/F**		0.031820	0.016288
			3%	2%
I&E SURPLUS MARGIN NET OF DIVIDENDS (%)				
ability to break even while covering cost of capital to public sector				
I&E SURPLUS OR DEFICIT / TOTAL INCOME			0.000000	-0.011672
		%	0.00	-1.17
LIQUIDITY RATIO (days)				
number of days of operating costs that can be covered by current assets				
CASH	A		7,044.00	7,044.00
AVAILABLE CREDIT FACILITY	B		3,500.00	3,500.00
DEBTORS	C		6,095.00	6,095.00
CREDITORS	D		-14,736.00	-16,236.00
= CURRENT ASSETS + SHORT TERM CREDIT	E (sum A to D)		1,903.00	403.00
OPERATING EXPENSES	F		121,433.00	122,433.00
OPERATING EXPENSES PER DAY	G (F/365)		332.69	335.43
LIQUIDITY RATIO (days)	E/G		5.72	1.20
CURRENT ASSETS + SHORT TERM CREDIT / OPERATING EXPENSES PER DAY			6	1