Financial Appraisal Guide – Contents

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1 Introduction

This guide provides advice on how to conduct a financial appraisal of a business using financial analysis.

Financial appraisals of potential providers are carried out to understand and minimise the financial risk to the Council. The scope and effort of the financial appraisal should be proportionate to the size of the risk to the council and the value and length of the contract. This risk includes situations when the Council may be in breach of its statutory duty to provide services, lose funds or be unable to recover them, incur extra costs, receive bad publicity, or has to re-provision services at a higher cost if the provider fails.

As part of the Council's formal tendering procurement processes, Finance is required under financial regulations to check that suppliers of goods and services to the Council can demonstrate a stable and appropriately substantive financial background.

The accounts will tell a story if you understand them, and may also highlight things that you need to find out about.

For example, an appraisal may highlight that a company is propped up by director's loans. Additional security could be needed, such as a director's guarantee to reduce the risk to the council.

Another example is if a company is attempting to get enhanced capital allowances for a future development, it is the company's forecasts rather than the past accounts that are key.

The outcome from a financial appraisal is pass or fail in the bidding / tender process. The Project Manager or Sponsor for the procurement ultimately make the final assessment however an accountant needs to consider whether the business in question can deliver the project/services or goods. Each appraisal will need to take account of the various risks to the council on failure to deliver and the contract value.

The Procurement team will provide advice and support on the risks associated with the delivery of the supplies or services and the assurance that the proposed contract will give.

Disclaimer:

Whilst this guide provides advice it is not intended to be an exhaustive guide and additional or professional advice may be required before making any decisions.

It is impossible to cover every different scenario in this guide. As such if appraisals are applied by the wrong person a response saying 'the guide didn't say that' is not acceptable. This guide still needs to be used by the intelligent user. If in doubt please contact the financial reporting team or your service accounting team.

2 Key messages

An assessment of a business should take non financial factors into account and should not solely rely on the application of the financial appraisal.

It is important to fully understand the business structure you are appraising including holding companies, subsidiaries and associates. The Council's Legal Services Commercial Team can assist in relation to this if needed.

Knowledge of the business industry would also be advantageous; however access to at least industry averages/norms for financial ratios is essential when applying financial appraisal techniques.

When comparing financial information it is essential to have access to at least 3 years audited accounts from the bidder or, for UK registered companies, Companies House. Audited accounts should be obtained if possible, but summarised information held by credit reference agencies can also be used in some circumstances.

Credit reference agencies do provide alongside credit scores an indication of the value of contracts that could be awarded and how much credit to extend to a business however these should be checked against the results from your own financial appraisal.

3 Summary

Financial Assessment

Your service accountant will carry out all financial assessments. You will need to provide your accountant with the necessary documentation as follows. The financial assessment should cover the prime bidder, sub-contractors (if known), and, if applicable, the ultimate parent company or owners. It should include bank references, an analysis of the last three years' audited accounts and any other published information that may have a bearing on the company's financial position or ownership (e.g. credit facilities, debt rating, current take-over activity, restructuring, new capital investment, etc).

When comparing businesses within an industry or a holding company against a subsidiary ensure you understand which accounting standards they are following. As all listed companies in the EU must prepare International Financial Reporting Standards (IFRS) consolidated accounts. It is not unusual for a holding company to be IFRS compliant whilst its subsidiary due to its size still reports under United Kingdom Generally Accepted Accounting Practices (UKGAAP). If this is the case reliable comparisons may be difficult to make as changes to the accounts arising from the adoption of IFRS are complex and you should ensure you have sufficient training to interpret these accounts and understand the potential differences between accounts prepared under IFRS and those under UKGAAP.

Any analysis should draw attention to any significant items, including trading results and their trend, cash movements and balance sheet strengths and weaknesses.

Care should be taken if doubts exist about a supplier's financial standing, particularly for a higher value contract for more than 12 months. The Council must be confident of a supplier's ability to fulfil the contract.

The result of a financial appraisal is often a clear-cut pass/fail opinion. Outcomes are then reported as "Acceptable", "Questionable / Acceptable subject to an approved risk assessment" or "Poor / Not acceptable" to the requesting department. The use of **Appendix 1** will help with this.

It should be noted that each test within an appraisal should not be looked at in isolation. You will need to build up a picture of the organisation through the processes outlined in this guide. A business may fail to score well on the credit report but actually be in a strong position when the financial analysis is completed. Investigating a business and its business sector it trades in may provide some additional context.

These factors may sometimes give conflicting indications of an organisation's position and no two organisations are ever exactly the same – the accounts will often reflect the role and nature of the organisation's business and what is acceptable in one business sector may not be in another. Take into account the nature of the business sector in which the business operates. E.g. a recruitment agency may have very little tangible assets. Overall the final recommendation for an appraisal is taken by arriving at a professional view of all these factors and assessing what a company's financial position is. Often the accounts of a "failing" company/organisation are very self-evident.

Unless exceptional special circumstances exist, no award should be made to a provider or applicant assessed as "Poor / Not acceptable". This must be agreed by the relevant Executive Director AND endorsed by the Chief Finance Officer.

On some occasions the financial appraisal of an organisation is seen as being border-line in nature i.e. satisfactory apart from one identified financial risk. In these cases the opinion of finance may be "Questionable / Acceptable subject to an approved risk assessment" being properly carried out and approved to show that the risk can be mitigated.

Again unless exceptional special circumstances exist, no award should be made to a provider or applicant assessed as "Acceptable subject to an approved risk assessment", unless a risk analysis is properly carried out and approved by the relevant Executive Director AND endorsed by the Chief Finance Officerr, showing that the risk is acceptable or can be mitigated to an acceptable level.

In both these cases, the exceptional special circumstances may include where there would be no, or negligible risk to the Council if the provider suddenly ceased trading.

Alternatively there may be circumstances where there is no realistic alternative for providing a required service.

Therefore what do the three outcomes mean for procurement?

Acceptable – The finance team advise that from the accounts: (a) the organisation has sufficient resources to support a contract application: and (b), the organisation is financially sound and potentially stable enough to remain in business for the period required.

The procurement manager and department remains responsible for ensuring that all other processes (and risk assessments) required for the procurement are completed satisfactorily in accordance with approved Council procedures.

Questionable / Acceptable subject to an approved risk assessment - In these cases, the finance team advise that the bidder may be acceptable subject to a specific risk analysis being carried out and being approved by the relevant Executive Director.

Not acceptable - If the financial appraisal outcome is "not acceptable" then the finance team consider the organisation in question to not be financially sound, insolvent or the level of financial risk to be too high to award the contract.

4 Recommended approach

4.1 Key Objectives

The key objective is to analyse a business' financial position and determine the level of risk that it would represent to the authority, having regard to the contract requirements and value. The assessment of risk should be based on sound business judgement rather than just the application of financial ratios.

Most significant procurement contracts will be over the EU threshold and therefore the EU procurement rules, and the mandatory grounds for excluding a bidder from a procurement process under those rules, will apply. Please contact procurement for further information.

Once the appropriate accounts and credit reports, plus any additional information that would be useful, have been obtained the council must apply commercial judgement to the contract in question. There are some occasions when the numbers will suggest a clear cut decision. A business that is consistently trading unprofitably, with a net deficit and little or no working capital may be a clear case for exclusion. However, often the situation will not be clear cut and judgement must be applied.

4.2 Associated Risks

The level of appraisal needed should be considered in relation to the amount of risk the council is exposed to. If the council is contracting to buy goods but not pay for them until they are delivered and the goods can be purchased from more than one supplier there is minimal risk to the council. If the goods are bespoke then the amount of risk the council is exposed to is increased and likewise so should the level of appraisal.

If the council is entering a contract where the contractor will be delivering services that the council has a statutory duty to provide or where the council's reputation could be harmed if the contract fails or the contractor ceases trading before completion, then a full financial appraisal should be undertaken.

4.3 Financial appraisal

Only suitably experienced officers should conduct a financial appraisal, calling on specialised expertise as necessary.

At least 3 years audited accounts should be requested from bidders as part of the tender process. The Companies Act 1989 requires that companies registered in the UK should have their accounts filed at Companies House within either 9 months of the end of the relevant account period for a private company, or 6 months in the case of a public company. The appraiser should determine when the last accounts were filed and the date of signature on the balance sheet and directors' report. The appraiser should also establish if more up-to-date information is available or should be available. If the latter, establish why it is not – for example, have later accounts been audited but not filed?

Small companies can file abbreviated accounts but are still required to prepare full accounts for their shareholders. Further information regarding filing dates for all types of companies can be found on the Companies House website.

If in rare circumstances the audited accounts are not available for the most recent year then management accounts and projections including cash flow forecasts may be used as an indication. Remember however that these may not be wholly reliable.

To support the financial appraisal of bidders, the following information should accompany the tender submissions:

1 Details of the organisation

(i) A copy of the Constitution or Articles of Association (in the case of companies) in order to establish the business structure.

(ii) Copies of the most recent signed Financial Accounts and Annual Report together with copies of the previous two years Accounts (Therefore three years in total)

(iii) The Financial Accounts should be accompanied by an independent Auditors Certificate and the telephone number of the Auditor/Accountant.

(iv) Charities will be required to provide a copy of the signed accounts with Auditors statement/Accountants Report/Independent examiners statement in accordance with the Charity Commission regulations.

2 Other organisations - The Council cannot discount new businesses, employee start-up businesses, sole traders, charities, not for profit organisations and Limited Liability Partnerships (LLP) from a tendering process on the basis they do not have 3 years audited accounts.

(i) If Audited Accounts are unavailable, a copy of the Business Plan and a statement should be provided showing actual expenditure and income to date, accompanied by a projection to the end of the financial year.

(ii) It would be useful to have a letter and statements from the Company's bankers providing assurance that funds are in place to ensure the delivery of the tender.

(iii) A credit check will show County Court Judgements (CCJs), gazettes and the history of the directors, i.e. have any of the directors been involved in past companies which went into forced or voluntary winding up. www.companycheck.co.uk is a free website to obtain lists of directors and their past companies without running a credit report. From here you can see if there was a gazette notice filed against the company. Then that gazette can be obtained from Companies House to see what section the gazette relates to. i.e. Section 652 of the Companies Act is a dissolution without there being an insolvency or debt situation so this particular notice should not have any negative impact on the companies financial check. Please note that the above does not affect the finances of the applicant but gives you a risk profile of the directors running the company.

Details of previous contracts including values that the business in question has entered into may be of use as these can help demonstrate what the business is capable of. Obtaining references from previous contracts may prove beneficial if timescales allow.

Over emphasis on historical data may not be a helpful guide to the current financial standing, the financial position of the business may have significantly strengthened or weakened in the period between the last published accounts and the start of the new contract. This period can be as long as 18 months depending on whether the company has changed it's reporting date.

A parent company or other owner of the business could provide a deed of guarantee as security. Specific advice should be sought from Legal on proposed company structures to ensure that any guarantees offered are appropriate and enforceable. Particular care should be taken where consortia bids may be submitted. The Guarantor (usually the ultimate parent company of the Contractor) needs to agree to guarantee the Contractor's due performance of its duties or obligations under the contract. Under certain circumstances personal guarantees from directors are more desirable than a parent company or directors guarantee due to the legal complexities when seeking reimbursement through the courts.

5 Initial analysis

Initially a check should be made on the company's title and its registered number at Companies House (if UK based), establishing whether it is trading or dormant and whether it is owned by another company. The status of the company's accounts should also be checked i.e. the last accounting period for which statements have been filed should be noted and whether the accounts are overdue.

A free service on the Companies House website (WebCHeck - Select and Access Company Information) or www.companycheck.co.uk are useful resources for this information, providing access to registered UK company annual reports, accounts, details of directors, dissolved companies, disqualified directors and insolvency details. This service does not however indicate whether a company is in receivership, administration or liquidation.

Where the company in question is a sole trader or a partnership, annual accounts may be more difficult to obtain. In this situation please ask the company to provide annual accounts and an auditors certificate if available. In any case when analysing a sole trader or a partnership please contact the financial reporting team.

The majority of the information above is also available from a credit check report. Contact your finance team representative for further information on how to obtain this.

5.1 Turnover and contract limit

A contract limit is the size of contract that is considered safe to award to a supplier, based on a simple comparison of the annual contract value to the annual (or average) turnover. The Office of Government Commerce suggests that local authorities using this approach would generally apply a maximum limit of 25% annual contract value to turnover. The following three questions could be used as a guide for the contract limit:

- A financial strength issue – can the business cope financially with this size of contract or the asset requirement?
- A capacity issue – does the business have the resource to carry out the work?
- A dependency issue – will the business become over-dependent on this contract?

When considering the amount of a contract using the above approach you may need to take further information into account. For example a supplier may have recently invested in resources, or production capacity and be able to demonstrate that it can manage the contract even though the above test may reveal a ratio over the 25% maximum limit usually applied.

Another issue is that by averaging turnover to young or quickly expanding businesses may well fall short of the contract value in question. This being the case, if the supplier can provide further information to demonstrate they can easily cope with a large contract then this must be taken into account.

The comparison should take into account the nature of the supplier. Where there have been significant changes in turnover or where the supplier has not been trading over the full three-year period, a judgement should be taken on the individual case. If it is not possible to make an assessment, for example where the bidding supplier is a new business, or a specially formed consortium, it may be appropriate to look at a potential guarantor's contract limit. There may be other ways of limiting or managing any risk.

The calculation of the contract limit is just the first stage of a full financial assessment. Bidders should only be eliminated on the strength of turnover alone if they are clearly of insufficient size to deliver satisfactorily the goods or service required.

5.2 Profit and loss

When looking at an organisation's financial statements a good place to start is with the profit and loss (P&L) account (income statement under IFRS). If the companies P&L is showing a loss or losses over a number of years this does not necessarily mean the organisation is insolvent. Businesses that have recently started trading often show a loss during their early years and their balance sheet may show they are financially stable. Likewise a well established organisation may sometimes make a loss for a short period if for example undergoing a restructure or when developing new products.

When analysing P&L accounts you need to look much further than turnover and profit numbers. You will need to look at the correlation of the change in cost of sales and the up/down-turn in turnover/profits. Which costs have increased or decreased? If gross profit remained the same despite an increase in turnover it could point to certain costs draining the business or that variable costs are not under control.

5.3 Cash flow

The cash flow statement shows the inflows and outflows of cash classified under the following headings:

UKGAAP

- Operating activities
- Dividends from joint ventures and associates
- Returns on investments and servicing of finance
- Taxation
- Capital expenditure and financial investments
- Acquisitions and disposals
- Equity dividends paid

- Management of liquid resources
- Financing

IFRS

- Operating activities
- Investing activities
- Financing activities
- Net increase (decrease) in cash and cash equivalents
- Cash and cash equivalents at the beginning of the period
- Cash and cash equivalents at the end of the period

The cash flow statement therefore shows cash generation and cash absorption of a business for a financial year. This includes investment in capital as well as operating activities. The statement also eliminates non-cash accounting items (such as depreciation and the effects of accruals accounting) to reveal the underlying cash performance of the business.

The cash flow statement can then be used to work out if there is sufficient cash flow to cover working capital requirements, capital repayments and interest.

5.4 Balance sheet

The balance sheet is probably the most important financial statement when completing a financial analysis. It is this statement that builds up a picture of a business as this statement shows balances of asset and liabilities at their cumulative values. The P&L is just for that one reporting period. Most investment appraisal ratios are based on the balance sheet, these are covered in more detail in section 6 below.

5.5 Review of financial accounts

In addition to reviewing the core financial statements as mentioned in section 6 below the explanatory notes to the accounts should be reviewed. They may provide additional information as to which section of the business is making a loss, which section is bolstering the business, why creditors have increased, provide further information regarding contingent liabilities, financial commitments and post balance sheet events.

5.6 Deed of guarantee / indemnity

Where a business in question has a less than ideal financial standing or the contract under discussion is of a high value and the owner of the business (parent company or otherwise) has a better financial standing, then a guarantee should be sought. Any such guarantee should be discussed in detail with the Legal Services Commercial Team before proceeding.

6 Key ratios for analysis

Accounting ratios are an aid for analysing the relationship between different items within the financial statements and help to highlight areas that should be subjected to more detailed questioning. **Appendix 1** should be used to obtain a clear result from ratios. The list below includes some ratios not included within appendix 1 which may be useful when pulling together a more detailed analysis.

It should be noted that accounts prepared under IFRS can produce very different ratios to those prepared under UKGAAP.

There are 3 types of ratio:

1. Financial structure
2. Operating performance
3. Investment ratios

6.1 Financial structure ratios are an assessment of whether a business is likely to experience cash flow problems, whether the business is adequately financed and from what sources. The main areas are liquidity and gearing.

6.1.1 Acid test ratio – also known as the liquidity or quick ratio.

(Current assets – stock) / Current liabilities

The liquidity of an organisation is measured by the acid test ratio to see how easily it will be able to meet its short term (current) debts with the current assets that are readily available to it. To accurately compare if the current liabilities of an organisation are covered by the current assets is to remove the least liquid element from the ratio – stock. Ideally these ratios should be at least 1:1 or greater (i.e. there should be at least £1 of current assets to each £1 of current liability). The lower the ratio is below 1:1, so then the greater the risk is. Many organisations and business sectors can survive and trade with ratios much lower and others have liquidity problems with ratios much higher, which we then have to take a view on.

6.1.2 Debt – Equity ratio – a measure of gearing

(Long term debt / net worth) * 100 = %

This ratio highlights the relative importance of long term debt in the capital structure of a business

A high debt/equity ratio generally means that an organisation has been aggressive in financing its growth with debt. This can result in low profits as a result of the additional interest payments made.

If a lot of debt is used to finance increased operations (high debt to equity), the business could potentially generate more earnings than it would have without this financing. However, the cost of this debt financing may outweigh the return that the organisation generates on the debt through investment and business activities and become too much for the organisation to handle. This can lead to bankruptcy.

If the gearing ratio is high, the organisation may be committed to substantial interest payments, and may be limited in its ability to raise further funds, to support either expansion or short term liquidity. So the higher a gearing ratio is, then the greater the risk becomes. An organisation with high gearing is more vulnerable to downturns in the business cycle because the business must continue to make repayments regardless of how bad sales are. A greater proportion of equity provides a cushion and is seen as a measure of financial strength.

There is no ideal ratio for debt/equity ratio it really depends on the industry in which the business operates. For example, capital-intensive industries such as car manufacturing tend to have a debt/equity ratio above 2, while IT companies have a debt/equity of under 0.5. You may need to seek further advice around industries and industry norms.

6.1.3 Interest cover

(Operating profit / interest charges)

This ratio shows the number of times operating profit covers a business' interest payments. It also highlights how far profits can fall before it becomes unable to pay the interest on the business' debt. The higher the ratio the better. If the interest payments are intercompany they would usually have a lower level of risk associated with them.

6.2 **Operating performance ratios** are the key ratios used in all types of analysis.

6.2.1 Return on Capital Employed (ROCE)

(Operating profit / capital employed) * 100 = %

ROCE is the most important measure of the overall efficiency of the management of the business because it compares the profits of the business to the capital used to generate them. The net assets of an organisation represent the capital employed to support its operations and liquidity. For small businesses with simple accounts, this can be seen as their net worth. For larger organisations who may have intangible assets (such as Goodwill) included in their asset total, then the value of the 'intangibles' should be deducted from the shareholders funds to arrive at a more effective net worth.

If the net worth is negative then this indicates that the organisation could be 'technically insolvent', (i.e. that it owes more than it owns). When an organisation reaches this point, then its ability to continue to carry on trading is at far greater risk, especially if its creditors demand payment, it could go into administration or be wound up.

Capital employed is the total of shareholders funds and long term debt or expressed in terms of assets as total assets less current liabilities. Operating profit is used because loans are included in the capital employed and therefore the return on them must be calculated before charging interest on them. The higher the ROCE the better. ROCE will vary by industry and as such industry averages should be obtained before making any assumptions.

6.2.2 Return on total assets

(Operating profit / total assets) * 100 = %

Return on total assets is a ratio that measures an organisation's earnings against its total net assets. The ratio is considered an indicator of how effectively an organisation is using its assets to generate earnings before contractual obligations must be paid or in other words a measure of how good an organisation is at 'squeezing' earnings out of the assets employed in its business.

6.2.3 Gross profit ratio

(Sales – cost of sales / turnover) * 100 = %

This ratio can give an indication of how efficient production is within an organisation compared to other years and competitors. A gross loss would indicate that an organisation was selling below cost.

6.2.4 Operating profit ratio

(Profit before interest and tax (PBIT) / turnover) * 100 =%

This ratio is one of the best measures of the company's ability to generate profits from the business before deducting interest and tax which have nothing to do with operating efficiency. This ratio needs to be compared to industry averages to be meaningful.

6.2.5 Collection period or debtor days ratio

(Average debtors x number of days in period) / Turnover

This gives an estimate of the number of days between the dates of credit sales and when the payment has been received for them. It is a good indicator of the liquidity of debtors. It must be compared to industry averages as credit terms can vary considerably between industries.

6.2.6 Payment period or creditor days ratio

(Average creditors x number of days in period) / cost of sales

This gives an estimate of the number of day's credit been taken by an organisation before it pays a supplier. An increase in this figure could be an indication of cash flow problems as many businesses delay payments in order to resolve cash flow problems. As with debtor days this should be compared to industry averages and the organisation's policy for paying creditors.

6.2.7 Stock turnover

(Stock x number of days in period) / cost of sales

This ratio gives an estimate of the number of days stock is being held before it is sold. Effectively how long it takes to turn stock in cash or debtors which then can be an indication of the liquidity of stock within current assets. If the stock turnover increases it is taking longer for stock to be converted into cash or debtors. This may ultimately result in some elements of stock being sold at a reduced price or a loss; it can also be an indicator of poor stock control or a decrease in orders

6.3 **Investment ratios** are an indicator for assessing future prospects but are usually only applicable to listed companies.

6.3.1 Price to earnings (P/E) ratio

(Market price of share / earnings per share)

This is possibly the most important ratio used to assess an organisation's prospects. The higher the P/E ratio the higher the markets rating of the share will be. It identifies the number of years dividends needed to cover the market price of the share. It should not be used to compare suppliers in differing industries.

6.4 Assessment

The assessment should be undertaken to produce a picture of the business and its ultimate parent and subsidiaries if necessary. From the techniques outlined above a recommendation should be made on whether the business is desirable to contract with. If there are doubts about an organisation's financial status or there are some additional questions that need to be asked then the organisation should be contacted in order to fully understand their position. Failure to do so may bring unnecessary risks to the council.

The accumulation and analysis of this data will assist in identifying whether there are any working capital, overtrading issues, investment capacity or the risk of the supplier becoming insolvent.

<u>What is overtrading?</u>

Overtrading takes place when a business accepts work and tries to complete it, but finds that fulfilment requires greater resources – i.e. more people, working capital or net assets than are available. This is often caused by unforeseen events such as when manufacture or delivery take longer than anticipated, resulting in cash flow being impaired.

Overtrading is a common problem, and it often happens to recent start-ups and rapidly expanding businesses. Cash often has to leave the business before more cash comes into it. For example, wages and salaries are usually payable weekly or monthly. Additionally there may be other expenses that need to be met promptly, such as telephone bills and rent.

Although you may pay suppliers on credit, your customers may also pay you on credit. It doesn't take much to upset the balance.

It is also possible to run out of cash, even if your customers pay cash and do not have credit accounts. For example, you may have to pay suppliers quickly, perhaps even in advance, or you may have to hold stock for a long time. What matters is the amount of working capital and the timing of cash coming in and going out.

7 Further appraisal

At this point the focus should turn to analysing information from credit agencies and any other information that is available such as current takeovers, new capital investment, newly awarded contracts and any other information that may have a bearing on the businesses financial position or ownership.

7.1 Credit agencies

Financial data and credit ratings provided by credit agencies are useful indicators for getting a snapshot view of a supplier, although these databases only hold a summary of the financial accounts and should not be relied on as the only or main method of evaluating a bidders financial standing.

7.2 Credit ratings

Credit ratings provided by credit agencies reflect their opinion of the financial strength and ability to repay debts of a business. A low credit rating would indicate higher borrowing costs and the inability to raise cash or capital and ultimately the ability to pay its debts. However, the Council must carry out its own due diligence and cannot rely on an opinion from a credit agency.

Equifax credit reports will show a credit limit, this is provided by looking at several factors including the size of the company, the nature of the company (FTSE 100 etc), profit history, turnover, gearing ratio, creditor days, CCJ, payment history, Gazette information.

Equifax also provide a score / grade on their credit reports. This is based on current financial results v last year and uses the following grades:

Code	Description
G	Serious Gazette information
I	Company technically insolvent
M	Manual Credit limit / Score
O	Company late filing its latest accounts
N	Company classified as dormant
NA	Company has not filed any accounts yet - new company
NR	No Report
NT	Non Trading

Additionally a score and rating are provided. It maybe that when tendering it is specified that only companies with a score / grade of C and above will be accepted.

Score	Rating
95-100	A+
85-94	A
80-84	A-
75-79	B+
70-74	B
65-69	B-
60-64	C+
55-59	C
50-54	C-
45-49	D+
40-44	D
35-39	D-
30-34	E+
25-29	E
20-24	E-
15-19	F+
05-14	F
00-04	F-

As an additional data set Equifax also produce a 'Protect Score' summarising information in a different way as follows:

Score	Comment
95+	No Hidden problems
0 to 94	Normal Risk
-50 to 0	Slight Increase in risk
-200 to -50	Risk accumulating
-300 to -200	Specific past Problems – High Risk
-500 to -200	Serious Concerns
-900 to -500	Severe Risk

7.3 Signs of a failing business

It is difficult to identify if a business is failing from an initial look at a set of accounts as these are out of date and ultimately the failure can only be truly indicated by the business being in administrations or liquidation. However the following can be a help in identifying a business in financial difficulty.

- Falling cash levels
- Falling profit margins
- Increasing overdrafts compared to a static turnover
- Major reductions in staffing
- Increasing debtor and creditor days
- Larger increases in creditors than debtors
- Increasing stocks indicate a slower stock turnover
- Deteriorating liquidity
- A high proportion of short term debt
- Large write offs
- Late filing of accounts
- Qualified accounts
- Profit warnings (usually only listed companies make these statements)
- County Court Judgements (CCJs)
- Poor credit ratings

- Unusual accounting policies
- Changing auditors and banks
- Adverse press reports
- Major reductions in staffing

8 Process for Services to Follow

8.1 Services must provide the relevant number of statements of accounts and appropriate credit reports to the accountant, in order to enable them to complete the financial appraisal.

8.2 Allow an appropriate amount of time for the accountant to complete the appraisals and allowing sufficient time for any follow up work required..

8.3 Be prepared to facilitate the completion and approval of any risk assessments/analysis required if the financial appraisal is borderline in anyway (see section 3 above).

8.4 Contact the business rates, council tax and debtors teams in order to establish if any of the companies in question or owners owe the council money. There have been instances where the council is paying a business for services they have provided however they have refused to pay their rates. In instances where this is true then payments should be with held until outstanding rates etc are cleared.

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Glossary of terms

A

Accounting period – the period of time covered by the account, normally twelve months, the end of the accounting period is the balance sheet date

Accounting Policies – within the range of possible methods of accounting, a statement of the actual methods chosen and used to prepare the statement of accounts

Asset – Something of value which is measurable in monetary terms owned by the organisation that is readily convertable to cash

B

Balance Sheet – A statement of the recorded assets, liabilities and other balances at the end of an accounting period

C

Cashflow – movement in money received and paid by the organisation in the accounting period

Cashflow Statement – statement showing the cash inflows and outflows during the year

Credit Ratings – a score that a credit agency applies to a business.

Creditors – amounts owed by the organisation for work done, goods received or services rendered during the accounting period, but for which payment has not been made by the balance sheet date

Current Assets – assets which are easily converted to cash, for example stck and debtors

Current liabilities – liabilities which are easily converted to cash for example creditors

D

Debtors – amounts due to the council which relate to the accounting period but have not been received by the balance sheet date

F

Financial Statement – the position of an organisation expressed in financial terms at a particular point in time

Fixed Assets – tangible assets which have value to the council for more than one year eg land buildings equipment

G

Guarantor – usually the parent company of the contractor who will guarantee the contractors performance , duties and obligations under the proposed contract

I

IFRS – International Financial reporting standard – accounting standards under which all accounts from 2010/11 financial year are prepared and reported

L

LLP – Limited Liability Partnership

Liquidity – the ability of an organisation to turn assets into cash in order to pay debts due

R

Ratio Analysis – an aid for analysing the relationship between different items within the financial statements which helps to highlight areas that should subjected to more rigorous questioning or examination

U

UKGAAP – United Kingdom Generally Accepted Accounting Practice

Contacts

The following Finance Officers are able to carry out a financial appraisal:

Richard Walley (Financial Reporting) – ext 0708

Chris Knowles (Children's and Neighbourhoods) – ext 0392

Kelly Valente (Regeneration) – ext 0826

Tracey Evans (Social Care) – ext 2329

Ross Hutchinson (Resources and Projects) – ext 8411

Officers from Procurement and Legal should also be consulted if necessary:

Lawrence Brazier (Procurement) – 0987

Sian Porton (Legal) – 4850