As a Board Director are you sufficiently financially savvy?

CICM Trainer, Jean Pousson, poses that question to directors and gives some pointers for them to consider.

RECENT accounting scandals in the UK (Tesco, Carillion, Conviviality, and more recently Patisserie Valerie) have put the roles of external auditors, regulators, banks and naturally Boards into the spotlight again. While there are numerous ongoing enquiries, it is still timely for directors to ask themselves if they are personally comfortable with their financial capabilities, or do they rely on the finance director or CFO with blind faith?

External auditors can provide false comfort. It is not their remit to spot fraud and very few frauds are uncovered by external auditors. Of course, there have been cases where the external auditors have been proven to be negligent, but they cannot be blamed for everything as it is logistically and commercially impossible for them to inspect every transaction within a business. This was reinforced in April 2018 by Michelle Hinchcliffe, KPMG Head of Audit, who said: 'saying that the audit is a true and fair account is not the same as giving a clean bill of health'.

However, should you feel uneasy about any matter you should ask the auditors to dig deep into that particular area of concern.

The relationship between the auditors and your FD/CFO also merits some attention. Watch out for snippets like 'we need to manage the auditors' or 'we need to be careful and not disclose too much'. This suggests that the finance function is trying to hide something. Ask yourself why?

Conversely, a relationship that is too friendly may suggest that the auditors place too much trust in the FD/CFO. Keep an eye on the tenure of the relationship to ensure that trust has not morphed into comfort resulting in a weaker audit.

ACCOUNTING POLICIES

Do you fully understand the accounting policies that you have chosen and approved? Could you explain them to a junior member of staff?

There have been instances (Tesco, Carillion) where the accounting policies were described as 'aggressive', (chosen to improved profits). Be mindful of what I call 'loophole talk', this is where the conversation focuses on accepting obscure definitions and sections of accounting standards to justify a decision.

I accept that business is complex and sometimes these conversations need to take place. I also accept that sometimes auditors may not agree with management. This is quite legitimate, but when it seems that loopholes are sought to improve financial performance, be wary.

A powering share price or a very high valuation (or even a very good offer to buy the business) does not necessarily mean that the business is in great financial shape. History teaches us that many acquisitions can often be overpriced and carried out for the wrong reason. This should not distract the Board, and directors should not see this as recompense for their financial stewardship.

Professionals, like private equity investors, banks, rating agencies, do not always get it right. Recently, a banking client of mine took a decision to increase its lending exposure to an existing client, and a key factor in that call was that Private Equity investors, who had a good reputation with an extensive due diligence process, had just invested. The whole thing went wrong resulting not only in a loss but also in many lost hours to manage the distressed situation.

BOARD DASHBOARD

Do you fully understand all the items on the dashboard? Are the KPIs aligned to the strategic Key Success Factors? Does it appear busy or unnecessarily complicated? Is the finance division unable to present figures in real time, or very quickly? If not, why not?

Are there non-financial metrics as well? Do you track new customers? A business that is unable to attract new customers worries me and it should worry you too.

CONNECTIONS IN FINANCIAL STATEMENTS

This is the subject of another article altogether, but it's the ability to establish connections between items in the major financial statements and sometimes reality. Here are some to watch out for:

- Increase in Debtors/Trade Receivables not in line with increase in sales.
- Presence of large accrued income under current assets, i.e. work done but not yet invoiced
- Intangibles make up a disproportionate percentage of total assets and are not being amortised properly.
- Little or no investment in tangible assets. Every business needs to invest non-discretionary capital expenditure (i.e. when things need to be replaced).
- Exceptional items in the Profit and Loss/ Income Statement that keep re-appearing each year.
- Profit margins in excess of typical businesses of that type.
- Increases in borrowings that cannot be explained properly, or that are attributed to cashflow problems.
- And when all else fails, refer to the cash analysis and position from the banking records. That doesn't lie. Cash is a reality check.

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