

AUSTRALIAN INSTITUTE
of COMPANY DIRECTORS

FIFTY MATTERS TO BE CONSIDERED BEFORE SIGNING A COMPANY'S FINANCIAL STATEMENTS

3RD EDITION



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Introduction

The *Corporations Act 2001* (Cth) requires listed companies, certain public companies and certain proprietary limited companies, to prepare financial reports for in accordance with the Australian Accounting Standards.

Section 295(1) of the *Corporations Act 2001* (Cth) lists the content of a financial report as including:

- a) *the financial statements;*
- b) *the notes to the financial statements;*
- c) *the directors' declaration.*

The responsibility for the financial report (including the directors' declaration) is that of the board of directors. This responsibility cannot be delegated to others and is made as a resolution of the board.

According to Section 295(4) of the *Corporations Act 2001* (Cth), the directors' declaration must state:

- *whether, in the directors' opinion, the financial statements and notes to the accounts are drawn up in compliance with accounting standards;*
- *whether, in the directors' opinion, the financial statements and notes to the accounts are drawn up so as to give a true and fair view of the financial position and performance of the company; and*
- *whether, in the directors' opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.*

Although directors are not expected to be accounting experts in financial reporting requirements, they are expected to have sufficient financial knowledge of accounting principles and practices, as well as an understanding of the company's business and how it is reflected in the financial report. In applying their skill,

competence and diligence, they should:

- read, understand and review the contents of the financial report;
- determine that the information they contain is consistent with a directors understanding of the business;
- ensure that, as far as possible and reasonable, the information included is accurate;
- challenge the accounting treatments applied in the financial report, seeking appropriate professional advice where relevant;
- examine the adequacy of disclosures and whether there are any material matters known to you that have been omitted; and
- ensure the independence of the auditor is not compromised in fact or appearance.

It is a director's responsibility to be satisfied that:

- accounting systems applied are adequate;
- appropriate expertise is applied;
- the due process is sound;
- essential elements of the process are scrutinised and tested by directors;
- where appropriate, independent expert advice is obtained.

This will lead to a director's confidence in the integrity of the outputs of the financial and management systems.

The following checklist does not attempt to examine all areas that may be 'critical' to every company. Clearly this cannot be done as each company has its own unique critical areas. A more comprehensive listing (110 questions) can be found in Chapter 8 of Dianne Azoor Hughes' *Financial Fundamentals for Directors*, AICD, 2014. There is also further material at <http://www.asic.gov.au/regulatory-resources/financial-reporting-and-audit/directors-and-financial-reporting/>.

Within each area there are a number of questions. The directors should consider each question, where relevant. It is expected that the answers will be obtained from management. If an answer is not considered satisfactory, the topic should be pursued

Overview

1. Do the financial statements make sense and provide a 'true and fair' view of the financial performance, position and cash flows of the company?
2. What are the major areas involving a higher degree of subjectivity, discretion and/or judgement, and have these areas been subject to additional scrutiny and disclosed properly?

Accounting standard framework, regulations and controls

Compliance with accounting standards

Accounting standards have the force of the law and must be followed when preparing financial statements.

3. What are the key accounting standards and accounting policy choices that affect the company and how does management ensure compliance with these standards?
4. Have there been any major amendments to existing accounting standards, or issues of new accounting standards, in the last year that affect the financial statements? If so, how?
5. Could the company's treatment of any accounting issues be reasonably challenged?
6. Where the company prepares special purpose financial reports, what justification exists to ascertain there are no users of the financial reports that are unable to command financial reports justified to their specific needs?

Compliance with government regulations

Directors take final responsibility for the company's adherence to the law and government regulations.

7. What are the major government regulations affecting the company's operations?
8. How does management ensure compliance with these regulations?
9. Have there been any investigations/audits undertaken for compliance with government regulations during the year? If so, what was the outcome?
10. Has any legal action been taken, or been threatened to be taken, for non-compliance with government regulations and, in particular, environmental or safety regulations?

Compliance with the company's policies and procedures

A comprehensive manual of policies and procedures helps to ensure that good practices are applied in all areas of operation.

11. Is there a detailed accounting procedures manual? If so, how often is it updated?
12. How recently have the internal or external auditors reviewed the manual? Was it satisfactory?
13. How does management ensure compliance by all operations with the company's established accounting policies and procedures?
14. How does management ensure that there have been no major breakdowns in internal controls that may have a material effect on the financial statements, either now or in the future?

Additional listed company considerations

Directors take final responsibility for the company's adherence to the law and government regulations.

15. Do disclosure and reporting procedures comply with the Australian Stock Exchange listing rules?
16. Has senior management (CEO and CFO) provided written assurance in some detail that proper accounts and records have been maintained and compliance with Accounting Standards, interpretations, listing requirements, and board policies?
17. Have all topics/issues/events, which have been the subject of continuous disclosure notices during the year, been properly reflected in the financial statements? Conversely, with the benefit of hindsight, have all material issues/topics/events reflected in the financial statements been properly announced through continuous disclosure notices?

Assets

The major concern in this area is whether assets are recorded in the financial statements at an appropriate amount: that is, not exceeding their recoverable amount.

Investments

18. How has the fair value of investments been assessed? Is the valuation based on quoted prices in an active market? Are any investments carried at cost? If yes, why?

Property, plant and equipment, intangible assets and other non-current assets

19. Have all non-current assets been independently assessed and if yes, are you satisfied with the valuation? For those non-current assets not independently assessed, how has management determined that the book value of those assets is not more than the recoverable amount?
20. Are there any additions to intangible assets during the year? Are these additions consistent with the directors' understanding of business activities?
21. Have impairment tests been carried out on all intangible assets and other non-current assets (such as loans and receivables), including goodwill?

Inventories

22. What steps have been taken to ensure that inventories are recorded at the lower cost and net realisable value?
23. What physical checks have been made to confirm inventories?

Receivables and loans

24. What steps have been taken to ensure that book values of trade receivables and loans receivable are recoverable in full?

Liabilities

The major concern in this area is whether all liabilities of the company are included in the financial statements.

25. How has it been determined that all liabilities have been included in the financial statements?
26. What are the major risks facing the company and, where warranted, have these risks been provided for?
27. How has it been determined that the level of provisions, including provisions against current, pending or threatened legal action against the company, are adequate?
28. How does management determine that there has been no breach of any terms and conditions imposed by borrowing arrangements?
29. Have all material contracts, obligations and contingent liabilities been assessed in order to determine the appropriate disclosure in the financial statements?
30. Are there any disputes with major customers and suppliers or with any regulatory authority such as the Australian Taxation Office (ATO), Australian Competition and Consumer Commission (ACCC) and the Australian Securities and Investments Commission (ASIC) that could lead to the need for provisions?

Other

Related party transactions

Directors must be especially careful in discharging their duty of care in transactions between themselves and the company.

31. How has it been ensured that all transactions with directors and director-related entities have been disclosed, irrespective of amount?

Foreign exchange exposure

Foreign exchange exposures have the potential to cause loss and directors need to be especially watchful of management in this complex area:

32. What is the policy for hedging foreign exchange risks? Who sets the policy and how often is it reviewed?
33. Are speculative foreign exchange transactions prohibited? If so, how does management ensure that there are no speculative transactions?
34. How does management monitor and control the company's foreign exchange risk, for example, use of limits and authorised counter-parties?
35. Are there any unrealised losses at year-end not recorded in the accounts?

Dividend Policy

Dividends should only be paid where profits, assets and cash are sufficient.

36. Does the company have sufficient cash to pay the dividend, having regard to future cash commitments?

Going concern

Before signing financial statements, directors must be satisfied that the company can meet its debts as and when they fall due:

37. Has a detailed cash flow forecast for a period of at least 12 months from the date of signing been prepared and reviewed by senior management and the board?
38. What are the major assumptions underlying cash flow forecast and are all loan repayments and capital commitments included?
39. Are the borrowing facilities predicted to be used in cash flow forecasts committed or uncommitted?
40. What other issues are relevant in determining that the company can pay its debts as and when they fall due, particularly during the next twelve months (in particular consider if the entity has any plans or intentions that may affect the carrying value of classification of assets and liabilities)?

External auditors

External auditors, being independent from management, provide directors with an independent view of the company's operations and internal control environment in addition to the auditor's opinion on the statutory financial statements.

41. Have the external auditors raised any major issues about their audit? If so, what action is necessary by the board?
42. Has the board been provided an opportunity to meet with the external auditors, without senior management present?

Internal auditors

Internal auditors review the effectiveness of the internal control environment used to protect the assets of the organisation and the integrity of the financial reporting system. They also review the efficiency of internal processes and procedures and can provide directors with an insight into the operations they might not be able to achieve otherwise.

43. Have directors reviewed the program for the internal audit department?
44. Have accounting or procedures manuals been reviewed and compliances checked?
45. Which operations have been audited by internal audit and did any operations receive an unsatisfactory rating? If so, what action has been taken to rectify the problem?

General

This section deals with other areas of enquiry a prudent person would make before signing financial statements, and to ensure the substance (over the form) of the financial statements prevails.

46. Has there been a proper determination of the segments of business activity so appropriate disclosures can be made?
47. Have all business areas been assessed after balance date to determine whether any adjustments are required to the financial reporting numbers or whether any disclosures that should have been made in the notes?
48. Are there any matters included in the financial statements that could be viewed as misleading?
49. Are there any material matters that remain unresolved, or where a significant uncertainty exists? If so, has there been adequate disclosure of these items in the financial statements?
50. Are any of the directors aware of anything, from their personal knowledge or warnings from outside sources, which should be considered before signing?

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