



Financial risk

TAO Audit Committee Seminar

Carl Harris, 15 June 2017

Introduction

Pervasive risks

Organisational level

Financial statement specific risks

Centro

Conduct

How should a director approach financial risk ?

Introduction

Financial risk - a broad risk as it pertains to the financial statements and the underlying considerations in compiling them.

To address this I will cover **pervasive financial risks** across the entire financial statements, right down to **key elements of the financial statements**.

I will revisit the findings of the **Centro** case and consider the surging occurrence of **Conduct** related issues.

Finally, I will discuss how should **a director should approach these risks**.

Financial risk - from the perspective of pervasive risks across the entire financial statements and individual components within the financial statements.

Pervasive risks at the financial report level

Financial risk
Pervasive risks

Risks of material misstatement at the financial report level refer to risks that relate pervasively to the financial report as a whole and potentially affect many assertions.

Risks of this nature are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level.

Auditing Standard ASA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

Financial risk

Pervasive risks

- Fraud
- Management override of controls
- Poor control environment – such as lack of management competence or lack of oversight over the preparation of the financial report
- New standards – Leases, Revenue and AASB 9
- Leases – Asset/Liability, EBITDA increase, Covenants
- Legal and regulatory issues
- Contracts
- Commitments
- Subsequent events
- Cash flow
- Going concern



Financial risk at the organisational level

Financial risk

Organisational financial risk

- Does the organisation maintain proper financial records?
- What is the organisations present financial viability?
- Actively monitor, and keep informed about, the financial position of the organisation
- Can you rely on information provided by a third party?
- What is the impact of incurring further debts?
- What options are available to deal with the financial difficulties?
- Obtain appropriate advice
- Consider and act on advice in a timely manner

Australian Securities and Investments Commission, Regulatory Guide 217 *Duty to prevent insolvent trading: Guide for directors*

Financial risk

Organisational financial risk

Factors to consider:

- History of trading losses
- Cash flow difficulties
- Difficulties selling assets or collecting debts owed to it
- Creditors not being paid in accordance with legal terms
- Commonwealth and State taxes are not being paid
- Holding back cheques for payments or forward dating cheques
- Limits of finance facilities reached
- Breach of finance facility agreement
- Unable to provide accurate financial information on a timely basis
- Qualified or modified auditor's opinion on the financial statements
- Third parties raise concerns about the organisations financial viability

Financial statement specific risks

Financial risk

Financial statement specific risks

- Judgement
- Assumptions
- Accounting estimates
- Revenue recognition
- Valuations
- Impairment
- Bonuses
- Covenants & terms in agreements
- Borrowings classification
- Account specific



Centro

Emphasised the responsibility of every director to pay attention to the business of the company, and to give due consideration and exercise his or her own judgement in light thereof.

Key findings were:

- A director should acquire at least a rudimentary understanding of the business and become familiar with the fundamentals of the business in which the corporation is engaged
- A director should keep informed about the activities of the corporation and whilst not required to have a detailed awareness of the day to day activities, a director should monitor the corporate affairs and policies
- A director should maintain familiarity with the financial status of the corporation by a regular review and understanding of financial statements
- While entitled to rely on guidance and advice from employees, advisors and other board committees, each director still needs to apply his or her own mind
- A director should have a questioning mind.

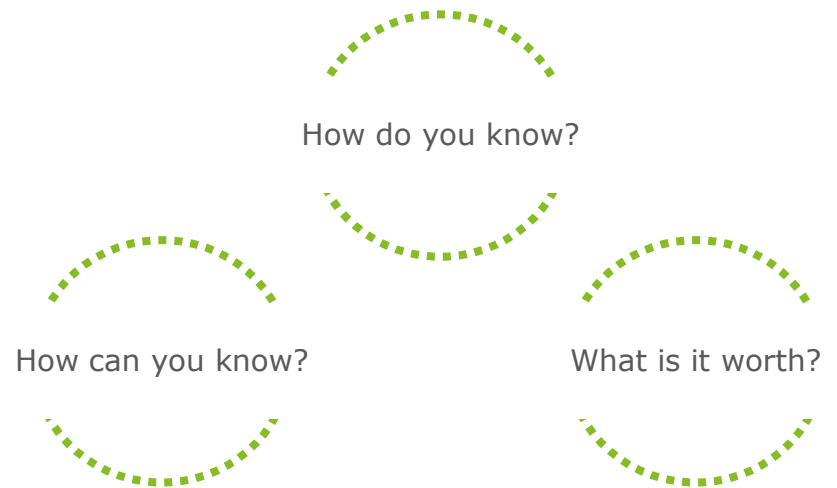
Conduct

Financial risk Conduct

In a world of social media driven communications the focus on behaviour of organisations by regulators, customers, employees, suppliers and the public is driving an expectation beyond compliance and legislative frameworks.

Embedding the organisations values and codes of conduct into its operations has never been more critical, warranted more focus, or had such rapid and broad potential consequences.

Conduct is when an organisations behaviours and practices deliver fair and suitable outcomes for customers, employees, suppliers and markets.



How should a director approach financial risk?

Financial risk

How should a director approach financial risk ?

- Aware, Vigilant, Question and Challenge
- Management (Incentives, Competence, Pressures and distractions, Changes)
- Auditors
- Experts
- Key financial risks
- Understand pressures in the business
- Major areas of judgement
- What's changed - internal / external ?
- Does next years budget reveal anything impacting the financial statements or declarations made ?
- Subsequent events
- Social media – mass, rapid comms
- Are you managing conduct risk (what is the culture in the organisation?)





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