

THE CENTRO EXPERIENCE

A WAKE UP CALL FOR DIRECTORS

*An association of Australia's
senior finance executives from
the nation's business enterprises.*



The Centro Property Group decision in the Federal Court has thrown into sharp relief the roles and responsibilities of directors and most particularly their declaration that the financial statements are true and fair.

Presided over by Mr. Justice Middleton, the Court's findings provided a "wake-up" call for directors and, by implication, the senior executives working closely with them.

Importantly, this case has not led to any changes in law but it does clarify the responsibilities of directors of Australian public companies and the scrutiny they can expect to face from regulators and the market.

Key lessons from the decision are that directors:

- Have a duty and responsibility to read, understand and consider the contents of financial statements before approving them;
- Need to understand the basis on which the financial statements have been prepared and to satisfy themselves in relation to the accuracy of those financial statements;
- Must be familiar with the fundamentals of the business and have the requisite financial literacy required to understand basic accounting conventions - even where these have recently changed.

Clearly the CFO, in addition to responsibilities under Section 295 of the Corporations Act, has an important role in assisting directors to better understand what are, in many cases, complex financial statements and to articulate what exposures, if any, are included as well as the risks associated with such exposures.

This guide provides you with some important background to the Centro decision. It identifies the areas that directors should now be focusing on such as their involvement in, and review of, the Annual Report and the financial statement compilation process. This includes the Operational Financial Review, Directors' Report, the Remuneration Report and any other public announcements relating to the financial statements and results such as media releases and analyst briefings/packs. Similar issues may also arise in respect of half-yearly financial statements.

You will find guidelines to assist CFOs in this process are included for each area of focus.

For most of you this guide will only reaffirm that the processes you have in place are more than adequate. However, remember as you approach these tasks that the rule of thumb for best practice governance in this area is – NO SURPRISES.



Terry Bowen
President

2012

The Centro Decision in Brief

The Facts

- The case concerned the role and responsibilities of directors in relation to financial reporting.
- It found that the financial statements failed to:
 - Properly classify certain interest bearing liabilities as current. In the restated financial statements, the current liabilities increased from \$1.1B to \$2.6B in one case, and from nil to \$598m in another case
 - Disclose guarantees of short-term liabilities of approximately US\$1.7B given after balance date as a material non-adjusting subsequent event.
- ASIC alleged directors contravened the Corporations Act:
 - S344(1) – director to take reasonable steps to comply with financial reporting obligations in Part 2M.3
 - S180(1) – duty to act with care and diligence.

The Findings

Justice Middleton found that in approving the financial statements, each director failed to take all reasonable steps required of them to exercise the degree of care and diligence the law requires of them in that the directors:

- knew or should have known of current interest bearing liabilities and guarantees
- were aware or should have been aware of relevant accounting principles
- could and should have made relevant enquiries, in order to take all reasonable steps required.

The Penalties

ASIC had sought fines and disqualifications for each of the eight defendants – two executives and six non-executive directors. While the sentencing resulted in a \$30,000 fine for the group's former chief executive officer and a two year management disqualification for the former chief financial officer, no orders were made against the six Centro non-executive directors.

Focus area	Key questions	CFO input
Technical Update and Pro-forma accounts	<p>Have the directors been fully briefed on all accounting updates during the past year and their implications on the financial statements?</p> <p>Was a pro-forma set of financial statements agreed with the auditors well in advance of the year-end, and were the impacts of technical and disclosure changes explained to directors.</p> <p>What evidence is there?</p>	<p>Standing agenda item for each Audit Committee meeting.</p> <p>Pro-forma financial statements should be tabled at an audit committee meeting no later than the meeting scheduled prior to the meeting at which the accounts are discussed.</p> <p>Audit Committee minutes.</p>
“Key judgements” and non-routine transactions	<p>Is there evidence of a review performed by the directors on key judgements made in the financial statements?</p> <p>Have the directors had access to internal and/or expert’s reports to support key judgements in the financial statements?</p> <p>What process exists for a post balance sheet events review, and what is the director’s input to this process?</p>	<p>Prepare a summary of these key judgments as part of the presentation to the Audit Committee and Board on the financial statements.</p> <p>Have available relevant reports and refer to them in the above summary.</p> <p>Ensure that a process is implemented.</p>
Material business and other issues	<p>Have major transactions and material items discussed at board meetings been considered by the board, and appropriately disclosed in the annual report where required?</p> <p>Have directors had adequate opportunity to question management about the treatment and disclosure of such items in the annual report?</p>	<p>Should be included in the summary to the Audit Committee and Board. Institute a tracking mechanism/process to ensure that these matters are addressed.</p> <p>Ensure that directors have this opportunity as an integral part of the Annual Report and Financial Statement compilation process.</p>
Annual report/ financial statements compilation process	<p>Is there a formal timetable for the compilation of the annual report and financial statements?</p> <p>Is there adequate time set aside in the process for the directors to proactively participate and so fully understand the process?</p> <p>Is evidence retained of questions raised by the directors on the draft annual reports, as well as management’s responses?</p>	<p>CFO has overall responsibility. Consider a review of this process by internal audit.</p> <p>Timetable should be agreed with Board and then extended if required. Provide documentation to Board in timely manner.</p> <p>Fully document all discussions to adequately demonstrate the diligent process of individual directors in the review process.</p>
Discussions with management about results and disclosure	<p>Does management provide directors with explanatory information on the financial statements i.e. ‘left hand notes’?</p> <p>Is there evidence available (i.e. minutes, or a log) to record questions raised by directors, responses from management and any required changes to the annual report?</p>	<p>Consider implementation if not already done.</p> <p>Once again fully document all discussions and action.</p>

THE CENTRO EXPERIENCE - A WAKE UP CALL FOR DIRECTORS

Focus area	Key questions	CFO input
External auditor's areas of focus	Has the board discussed the key areas of audit focus and key areas of business and financial risk with the auditors?	This is a key area for involvement for the CFO.
	Have the auditors identified and discussed aggressive accounting policies with the directors?	Differences of opinion with auditors regarding your adoption of accounting policies will be a major issue for Boards in the current environment.
	Have the directors considered the policies and the auditor's concerns and taken action? Are these considerations and actions documented?	Where possible any such differences should be resolved or an appropriate compromise reached before it is discussed at the audit committee or board.
Focus area	Are the directors provided with copies of 'final sign offs' from the CEO, CFO and other key management and finance executives on the completeness and accuracy of the information submitted for consolidation and compilation?	<p>A final management letter should be signed by the CEO and CFO and tabled with the final accounts.</p> <p>Copies of all associated management letters should be available to all directors.</p> <p>Prepare a paper from the CEO/CFO explaining the process undertaken to sign off the S295 statement, including the involvement of internal audit in reviewing the process for internal sign offs.</p>
	Have management explained to the directors the implication of any missing or qualified 'sign off' documents?	<p>All anomalies in the sign off process (however small) should be discussed with the board.</p> <p>Institute process for aligning representations to Board and external auditor.</p>
Reconciliation of financial statements with management accounts	Have the directors been provided with a document that reconciles the management accounts to the financial statements'.	This should be a continuous process as part of your reporting to the board and not just done at year end particularly if the difference is large. (No surprises).
	Is there a document evidencing questions raised by directors and responses given by management in relation to material reconciling items?	Once again fully document.
Enterprise risk including fraud	Has the enterprise risk management team (or equivalent) reported to the board on business and financial risk?	An updated enterprise risk management report should be tabled at the audit committee meeting at which the financial statements are being reviewed.
	Have these risks been adequately disclosed and reported in the annual report?	Cross reference these risks to the financial statements where possible.

Focus area	Key questions	CFO input
Consistency of corporate communications	Do the directors review any additional disclosures made in other year-end briefing packs, ASX returns, disclosure documents and communications to ensure consistency and maintain their diligent review?	Ensure that directors have this opportunity as an integral part of the Annual Report and Financial Statement compilation process. Consider review of documents as part of audit process.
Directors' Report	<p>Have the directors worked through a check list with management to ensure that their report includes all required disclosures?</p> <p>Has the remuneration report been tested with investors to mitigate possible AGM rejection?</p> <p>Have the findings of this market testing been discussed with the board?</p> <p>Have the new ASX Corporate Governance rules been complied with?</p>	<p>Develop check list and include discussions with the board as part of the Annual Report and Financial Statement compilation process.</p> <p>Ensure adequate testing is undertaken.</p> <p>Ensure that directors have this opportunity as an integral part of the Annual Report and Financial Statement compilation process.</p> <p>Demonstrate compliance to the board.</p>

This document is provided as general information only and does not consider your specific objectives, situation or needs. We accept no duty of care or liability to you or anyone else regarding this document and we are not responsible to you or anyone else for any loss suffered in connection with the use of this document or any of its content.



Group of 100 Inc.

Level 20
28 Freshwater Place
Southbank VIC 3006

Tel: +61 3 9606 9661
g100@group100.com.au

The Group of 100 is an association of Australia's senior finance executives from Australia's largest business enterprises whose primary purpose is to advance Australia's financial competitiveness.