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Back to Basics: Financial Literacy for Board Members

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These days, it is nigh impossible to discuss the selection process of members to corporate boards without also raising the question of diversity.

As recent headlines, including the one involving Apple, remind us, diversity on a board of directors is a hot topic for not just shareholders and investors, but also for the company itself.

The received wisdom is that diversity adds a greater depth of thought, experience, knowledge and perspective to a company and how it does business.

And as any investor knows, diversification is a handy tool for minimising risk.

While social diversity based on gender, age, ethnicity, geography

and religion often attracts the most attention, there has been a marked trend, in recent years, towards professional diversity.

Instead of recruiting board members exclusively from within the relevant industry, companies are increasingly appointing those with expertise from other industries and backgrounds such as marketing, information technology, human resources, accounting and law.

Diversity of this nature, however, brings its own complications. While directors with specialised knowledge from their own (unrelated) fields may well expand the depth and breadth of the decision making process in the boardroom, it remains critical that they can hold their own when it comes to financial literacy.

THE CENTRO CASE

In a recent Australian Federal Court case, the directors of an Australian-listed company, Centro Properties Group, had accepted, among other things, the classification of a number of borrowings in the company's annual accounts as non-current liabilities when they were, in fact, current.

The court found that all eight directors had breached their statutory duty of care and diligence.

It ruled that they should not have certified the truth and fairness of the financial statements without making further enquiries, this despite the fact that the external auditors had reviewed and certified the company's financial statements.

The court specifically addressed the issue of board diversity. It pointed out that while a board should include persons with varied experience, and while directors "are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company", they are "not relieved of the duty to pay attention to the company's affairs which might

reasonably be expected to attract inquiry, even outside the area of (their) expertise”.

ONE PLUS ONE EQUALS . . .

Although the Centro decision is not binding outside Australia, it is the latest salvo in a growing body of international jurisprudence that requires directors to have certain minimum financial knowledge and skills.

No director is expected to be an expert in every aspect of a company’s business, but in terms of financial literacy, a director is expected to at least be able to understand and appropriately analyse financial reports.

This does not mean, of course, that companies should abandon the goal of board diversity and just look for directors with financial expertise.

Rather, it’s a timely reminder that they should take precautionary measures to ensure that every director has a minimal level of financial literacy that will allow them to make informed decisions.

For the board as a whole, this could take the form of mandatory training, including continuing education on financial issues, or perhaps special meetings to go over financial details prior to voting in the board meeting.

For individual board members, relying on the expertise of fellow board members is not enough. Neither is reliance on external assistance. Of course, a director could, and should, do both, but a working knowledge of financial statements is critical, as is the ability to actively survey information and make assessments with a questioning mind.

This is all the more critical since the Accounting and Corporate Regulatory Authority (ACRA) has announced that it is stepping up

its Financial Reporting Surveillance Programme, which involves the review of selected financial statements (in particular, that of certain listed companies) to detect financial reporting breaches.

NEW COURSE

When a financial reporting breach is established, ACRA will impose regulatory sanctions on directors which may include prosecution leading to fines and/or imprisonment.

In this regard, SID has collaborated with the Institute of Singapore Chartered Accountants to launch a new course "Director Financial Reporting Essentials", targeted at directors who are not from an accounting or financial background.

The course is supported by ACRA and will be a prelude to the current module on "Financial Governance" conducted as part of SID's Effective Board Leadership programme. ■