

DIRECTOR SKILLS TEST IMPROVES ON TICK A BOX GOVERNANCE APPROACH

A two hour questionnaire is all it takes to know whether the company board is fit to govern.

by **Con Livissianis**

The Exemplar Performance Advantage director's test consists of 130 questions designed to examine every aspect of boardroom competency. It's a warts 'n' all review that would have outed the infamous boards of HIH, One.Tel and Ansett. The test starts with mathematics and spelling and moves through the fiery hoops of ASX Corporate Governance Council principles, the United States Sarbanes-Oxley Act and Australia's Corporate Law Economic Reform Program No 9, giving due diligence to profit and loss statements, cash flow reporting, balance sheet management and case study scenarios using every day examples.

The test establishes the practical skill level of current and prospective directors, as well as finance and accounting staff. It is an objective method of quantifying skills. All the questions stem from first hand experience over 30 years in accounting and executive management.

Nothing surprises me anymore: for example one director sidled up to me and asked what DSO stood for and he'd been reading the board papers for years. DSO stands for *day sales outstanding*, as any debtors clerk would know. One can't rely on the auditors or the paper presented. It is up to the directors to challenge and question the executives to assure themselves the information provided is accurate, timely and can be used in the strategic decision making process.

In one sad corporate wreck, I saw a colleague sent to Long Bay for five years. She naively neglected the *separation of duties and internal controls* and blindly did her chairman's bidding; this ultimately led to a charge of *fraudulent misappropriation of funds*. Naivety does not cut it in the court room.

It feels like I have seen it all after working as a Certified Practising Accountant and Chief Executive Officer right on the coal face of cost projection and analysis, from the punctilious to the perfidious. My rolodex lists Berg, Cave, Goldberg, Kaldor, Kahlbetzer, Strauss and Weiss as proof. While I was consulting, I saw the possibilities for the Exemplar Performance Advantage Skills Tools. I had used a rudimentary model when training executives and then had the opportunity to refine it and put it on-line.

The test isn't a simple pass or fail but designed to highlight strengths and weaknesses, targeting areas for training and improvement. The Director's Review recognises that directors aren't masters of the corporate universe, far from it. With huge burdens and ever increasing regulation, combined with calls for accountability, boards need a litmus test. The review offers a clear and solid indication of how competently the responsibilities of a board would be handled.

A board's strength in strategy may hide a weakness in reporting. It just isn't sufficient to say, 'We have a lawyer that does that' or 'an accountant who does this'. The key to boardroom savvy is to have the knowledge and strength of conviction to drill down to the details wherever an anomaly occurs.

Details include the gearing ratio calculated by dividing the total liabilities by the shareholders' funds. This varies from industry to industry, but the acceptable ratio is 3:1 (\$3 of liabilities to \$1 of shareholder funds). If it goes to 5:1, this means that either the

shareholder funds have been depleted or the company has taken too much debt. Either way, it sends up a flare that can herald the arrival of the bank's investigative accountant. This is something every director should know, but this is not always the case. And it is these financial literacy lapses that bring a company to its knees.

Once a bank realises they have a financial illiterate in their midst they begin circling. If directors boned up on 'bank-speak', many a foreclosure could be avoided. There is a large information gap between banks and customers, made wider by the lack of financial skills of some directors. The high-wire act of bank negotiation can't be delegated to the accountant. The value of the business can be destroyed, simply by not presenting your financial information correctly.

The majority of companies that began as a Small to Medium Enterprise, and that was most of them, grew without directors taking time out to educate themselves in risk management or financial controls. This is often the core of the problem. You can't succeed as a director unless you understand the workings of each level of the business.



DIRECTORS! TRY THIS QUICK QUIZ

Q1. What do the letters DSO stand for?

A1. If you answered "something to do with debtors" you are partly right. But did you realise that a high out of control DSO (days sales outstanding) could cause you to run out of cash?

Q2. What is the gearing ratio meant to measure?

A2. If you answered total liabilities as a proportion of total equity then you are correct. Did you know that banks are especially keen on this measurement and that a low gearing ratio is a sign of a riskaverse board.

Q3. Why were the sections of CLERP 9 dealing with executive remuneration so controversial?

A3. Because listed companies had to divulge remuneration paid to directors: the five highest paid company executives and the five highest paid executives of the consolidated group. This has already created upward salary pressures on companies that have executives whose salaries are well below that of similar companies.

Q4. Is it possible for a CEO to mislead the board?

A4. Yes – for example ASIC is charging Jim Selik, the founder and former CEO of Pan Pharmaceuticals! ASIC alleges that he failed to advise the board on four occasions of the receipt of three critical letters and one audit report from the TGA (Therapeutic Goods Administration) that led to the biggest recall in Australian history, the loss of the company's manufacturing licence and the eventual liquidation of the company.

Source: *Exemplar Performance Advantage*

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