Financial Red Flags Checklist for Non-Executive Directors

A practical guide to monitoring financial health and governance

Purpose

This checklist supports non-executive directors (NEDs) and board members in fulfilling their financial oversight duties. Use it to systematically review board packs, identify warning signs early, and ask the right questions before issues escalate.

How to Use This Checklist

- Review this checklist before each board meeting alongside your board pack
- Flag any indicators that apply, and note specific questions to raise
- Track patterns over time — isolated issues may be benign; recurring ones rarely are
- Escalate concerns through the audit committee chair or board chair, as appropriate
- Request follow-up evidence and action plans where red flags are identified

1. Cash Flow, Liquidity, and Sustainability

Red Flag Indicator	Key Questions to Ask
Profits increasing but operating cash flow negative or declining	What is driving the profit/cash divergence? (Check: receivables aging, inventory build, revenue recognition policies)
Repeated short-term borrowing close to payroll dates, with vague "timing" explanations	Do we have a 13-week rolling cash forecast? What is our liquidity headroom under stress scenarios?
Revenue concentration: >30–40% from single customer/funder, with contract renewal pending	What is our contingency plan if this contract is not renewed? Are covenants at risk?
Strong revenue growth but gross margin declining and operating margin flat or falling	Is this growth value-creating? What is driving margin erosion? (pricing power, mix, cost discipline)
Chronic operating losses funded by repeated equity raises, with no credible path to breakeven	What is the realistic timeline to profitability? Cost of capital vs returns?

Table 1: Cash flow and sustainability warning signs

Board action: Insist on forward-looking cash forecasts, covenant headroom analysis, and scenario planning.

2. Financial Statements and Accounting Quality

Red Flag Indicator	Key Questions to Ask
Large gap between statutory profit and "adjusted" metrics, with recurring "one-off" items	Are these truly non-recurring? Should incentives be based on adjusted figures?
Aggressive accounting changes (longer asset lives, capitalising more costs, revenue recognition shifts) with limited rationale	What is peer practice? Has this been discussed with auditors? Impact on comparability?
Short-term liabilities misclassified as long-term, or material lease/guarantee commitments buried in notes	What is our true liquidity position? Do stakeholders understand our obligations?
Complex off-balance-sheet arrangements or related-party transactions without transparent board discussion	Are these arms-length? Properly disclosed? Auditor comfortable?
Frequent restatements, corrections or late manual adjustments to reported numbers	What is the root cause? Do we have a data integrity or capability issue?

Table 2: Accounting and reporting quality issues

Board action: Challenge management on accounting judgements; meet privately with auditors to understand their level of comfort.

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3. Budgeting, Forecasting, and Performance Management

Red Flag Indicator	Key Questions to Ask
Material budget variances (>10%) explained only in vague terms ("slightly behind plan")	What are the specific operational drivers? What corrective actions are underway?
Forecasts consistently missed over multiple quarters, with no change to forecasting approach	Do we need independent challenge? Should we back-test our forecast accuracy?
KPI dashboards highlight growth but downplay margins, cash conversion, leverage or covenant headroom	Are we tracking the right metrics? Are incentives aligned with sustainable value creation?
No robust annual budget process, or budget not aligned with strategy and capital structure	How do we know if we are on track? What is our budget governance framework?
End-of-period revenue spikes, unusual discounting or shipment patterns not supported by demand	Is revenue recognition appropriate? Are we pulling forward sales?

Table 3: Forecasting and performance tracking concerns

Board action: Require variance analysis with operational detail; ensure forecasting process includes scenario analysis and independent review.

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4. Capital Structure, Covenants, and Going Concern

Red Flag Indicator	Key Questions to Ask
Tight or deteriorating headroom on bank covenants (interest cover, leverage, liquidity ratios)	What is our headroom under downside scenarios? Refinancing plan? Waiver risk?
Repeated short-term borrowing to meet payroll, tax or supplier obligations	Is this structural or truly timing? What would a 3-month cash crisis look like?
Heavy reliance on single lender or shareholder funding, with informal or undocumented terms	Are terms market-standard? What if this source withdraws?
Large unhedged exposures (FX, interest rate, commodity) with no clear risk policy	What is our risk appetite? Should we hedge? What is the board's risk tolerance?
Going-concern "material uncertainty" or "emphasis of matter" in audit report, with minimal board discussion	Do we need independent financial advice? Should we be taking action now?

Table 4: Liquidity, leverage and solvency risks

Board action: Require regular covenant tracking dashboards; discuss refinancing strategy well in advance of maturities.

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5. Internal Controls, Audit and Fraud Risk

Red Flag Indicator	Key Questions to Ask
External auditor management-letter findings repeating year-on-year (poor reconciliations, weak segregation of duties)	What is the remediation plan? Owners? Timeline? Board tracking mechanism?
Board packs delivered late, with inconsistencies between schedules and heavy manual adjustments	Do we have a finance function capability issue? Systems investment needed?
High dependency on a few key finance staff, limited cross-cover, resistance to automation	What is our succession plan? Key-person risk?
Whistleblowing, internal audit or compliance issues not tracked to closure, or similar incidents recurring	Is our speak-up culture working? Are we learning from incidents?
Material related-party transactions with minimal documentation, benchmarking or independent review	Are these arms-length? Conflicts of interest managed? Disclosed appropriately?

Table 5: Control environment and fraud-risk signals

Board action: Ensure audit committee has private sessions with internal and external auditors; require time-bound action plans for control deficiencies.

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6. Governance, Behaviour and Culture

Red Flag Indicator	Key Questions to Ask

Defensive, dismissive or evasive responses when directors ask probing financial questions	Is this a one-off or a pattern? Do we have a culture problem?
CEO dominance, excessive deference from executives, or board culture that discourages challenge	Are NEDs truly independent? Do we need board effectiveness review?
Audit committee rarely challenges management, rarely meets privately with auditors, or auditor changes without clear rationale	Is the audit committee fit for purpose? Do we have the right skills and independence?
Board lacking financial literacy, sector knowledge or independence; very long tenures with no refresh	Do we have the right mix of skills? When did we last assess board composition?
Executive incentives heavily weighted to short-term earnings/revenue, with weak links to risk, cash and controls	Are incentives aligned with long-term value and culture? Clawback provisions in place?

Table 6: Cultural and governance warning signs

Board action: Escalate behavioural concerns to the chair; consider an independent board evaluation; review board composition and the skills matrix annually.

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7. Reporting Quality and Transparency

Red Flag Indicator	**Key Questions to Ask**
Financial reports not timely (e.g. >30–45 days after period-end in steady state)	What is causing delay? Systems? People? Process?
Complex presentations with key numbers buried in appendices; insufficient cash-flow and balance-sheet analysis	Can we simplify reporting? Focus on what matters for decision-making?
Non-GAAP measures featured prominently without clear reconciliations, definitions or board-approved policies	Are these measures appropriate? Consistently applied? Understood by all stakeholders?
Inconsistent narrative: board papers, investor updates and press releases tell different stories or downplay risks	Are we being transparent? Reputation risk?
Stakeholder concerns (lenders, customers, employees, donors) about financial health not formally raised to board	Are we hearing from all stakeholders? Do we have blind spots?

Table 7: Transparency and reporting integrity

Board action: Set clear reporting standards and timeliness expectations; ensure consistent messaging across all stakeholder communications.

When to Escalate

Escalate immediately if:

- Multiple red flags are present across several categories
- Management is dismissive of legitimate concerns or fails to provide evidence

- Going-concern issues are emerging or covenant breaches are imminent
- You suspect fraud, material misstatement, or serious control failures
- Auditors express significant concerns (privately or in writing)

Escalation routes:

1. Raise formally at audit committee (with private auditor session if needed)
2. Discuss with board chair or senior independent director
3. Seek independent financial or legal advice (board has right to do so)
4. Consider whistle-blowing obligations if illegal conduct suspected
5. In extremis: consider resignation with public statement if fiduciary duties cannot be fulfilled

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Your Fiduciary Duty

As a non-executive director, you have a legal duty to act with reasonable care, skill, and diligence[17]. This means:

- You must apply the knowledge and experience reasonably expected of someone in your position
- You cannot simply rely on management assurances — you must probe, challenge, and verify
- Ignorance or inattention is not a defence if things go wrong
- You have a duty to speak up when you see red flags, and to act if your concerns are not addressed

Good practice:

- Keep contemporaneous notes of concerns raised and responses received
- Request and retain supporting documents for major decisions
- Ensure board minutes accurately reflect dissent or concerns where appropriate
- Invest in your own financial literacy — take "finance for non-financial directors" training if needed

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