
Centro Case Summary

ASIC v Healey & Ors [2011] FCA 717

1. Background

In October 2009, the Australian Securities and Investment Commission (**ASIC**) commenced proceedings against two executives and six non-executive directors of the Centro entities. The two executives were former chief executive officer and managing director Andrew Scott and former chief financial officer Romano Nenna (who was the only defendant who was not a director). The six non-executive directors were former non-executive chairman Brian Healey, current non-executive chairman Paul Cooper, and former non-executive directors Peter Wilkinson, Sam Kavourakis and Peter Goldie, and current non-executive director Jim Hall.

ASIC sought declarations that each of the defendants had breached their statutory duty of care and diligence owed to the Centro entities and thereby contravened ss. 180(1), 601FD(1) and 344(1) of the Corporations Act 2001 (C'th)(the **Act**) in approving consolidated financial accounts for the Centro entities for the financial year ending 30 June 2007. The consolidated financial statements incorrectly classified \$1.5 billion in debt as non-current liabilities (when they were in fact *current* liabilities) and failed to disclose US\$1.75 billion in guarantees (which was found to be a material event which had been entered into post the balance date). This was in circumstances where both Centro management and Centro's external auditor, Pricewaterhouse Coopers (**PwC**), had previously reviewed the financial statements and the directors' report and had failed to identify any such errors.

Prior to the hearing of the case, the former CFO, Mr Nenna, admitted having contravened ss.180(1) and 601FD(3) of the Act and therefore the case focussed on ASIC's allegations against the defendant directors each of whom, with the exception of the former CEO Mr Scott, were non-executive directors on the relevant Centro boards at the time.

2. Key issues

The key question before the Court was whether directors of substantial publicly listed entities are required to apply their own minds to, and carry out a careful review of, the proposed financial statements and the proposed directors' report, to determine that the information they contain is consistent with the director's own knowledge of the company's affairs, and that they do not omit material matters known to them or material matters that *should be* known to them.

ASIC alleged that the directors breached s.344(1) of the Act by failing to take all reasonable steps to comply with or secure compliance by the Centro entities with certain financial reporting obligations contained in ss.295A (which states that a directors' declaration in relation to financial statements under s.295 must only be made after the CEO or CFO have given the directors a declaration in the form specified in the Act), 296 (which requires financial reports to comply with accounting standards), 297 (which requires financial statements and notes to give a true and fair view of the financial position and performance of an entity) and 298 (which requires certain information to be included in an annual directors' report).

Relying on the same conduct, ASIC also alleged that the defendant directors had contravened ss. 180(1) and 601FD(3) of the Act. Section 180(1) requires a director and officer to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they were a director or officer of the corporation in the corporation's circumstances. Section 601FD(1)(b) sets out a similar obligation for officers of the responsibility entity of a registered scheme.

3. Decision

On 27 June 2011, Justice Middleton of the Federal Court of Australia handed down his decision finding that each director was aware of the current interest bearing liabilities and the guarantees, and was aware of or should have been aware of the relevant accounting principles which would have alerted each director to the apparent error in the proposed financial statements. In doing so, His Honour held that each of the directors:

- failed to take all reasonable steps to focus and consider for himself the content of the financial statements, particularly as to short-term debt and whether the guarantees should have been disclosed;
- failed to make enquiries of management, the board audit committee or other directors as to proposed statements in the financial statements relating to the short-term debt and guarantees, and failed to have apparent errors corrected; and
- failed to request that the directors be given declarations required under s.295A of the Act.

Having made these findings, Middleton J held that each of the defendant directors had breached their duty of care and diligence in relation to the Centro entities (thereby contravening ss.180(1) and 601FD(3)) and had failed to take all reasonable steps to ensure compliance with the financial reporting obligations in the Act (in contravention of s.344). His Honour also held that the former CFO had contravened ss.180(1) and 601FD(3) of the Act.

What was required of the directors?

Justice Middleton held that:

“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. What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her. Such a responsibility arises in this proceeding in adopting and approving the financial statements. Because of their nature and importance, the directors must understand and focus upon the content of financial statements, and if necessary, make further enquiries if matters revealed in these financial statements call for such enquiries.”

His Honour held that the omissions in the relevant financial statements were not a “mere technical oversight” but “were matters that could have been seen as apparent without difficulty upon a focussing by each director, and upon a careful and diligent consideration of the financial statements” and that in the circumstances each of the directors should have enquired further into the matters revealed by the financial statements. His Honour found that the matters not disclosed in the financial statements were either well known to the directors, or if not well known to them, were matters that should have been well known to them, and that in light of the significance of the matters that they knew, they could not have,

nor should they have, certified the truth and fairness of the financial statements, and published the annual reports in the absence of the disclosure of those significant matters.

In His Honour's view directors are required to have the ability to read and understand the financial statements, including the understanding that financial statements classify assets and liabilities as current and non-current, and what those concepts mean, and should have an understanding of the need to disclose certain events post balance sheet date. This does not require directors to be familiar with every accounting standard, but sufficiently aware and knowledgeable to understand what is being approved or adopted. Justice Middleton found that if the defendant directors had understood and applied their minds to the financial statements and recognised the importance of their task, then each director would have questioned each of the matters not disclosed.

In summary, Justice Middleton stated:

“I do consider that all that was required of the directors in this proceeding was the financial literacy to understand basic accounting conventions and proper diligence in reading the financial statements. The directors had the required accumulated knowledge of the affairs of Centro, based upon the documents placed before them and discussion at board meetings. Each director then needed to formulate his own opinion, and apply that opinion to the task of approving the financial statements.”

To what extent can directors delegate responsibility and rely on others?

Justice Middleton made it clear that directors are not required to have infinite knowledge or ability and are entitled to delegate (as noted above), seek assistance in carrying out their responsibilities and rely on others. However, His Honour held that the “extent of reliance should not be taken too far”. This is because the Act explicitly requires that the declaration required to be given by the directors under s.295(4) and the annual directors' report must be made in accordance with a resolution of the directors, and therefore the Act “imposes ultimate responsibility for those matters upon the directors in a way that they cannot delegate”.

In this case, it was found that each of the directors “looked solely to management and external advisors”. His Honour held that:

“Directors cannot substitute reliance upon the advice of management for their own attention and examination of an important matter that falls specifically within the Board's responsibilities as with the reporting obligations. The Act places upon the Board and each director the specific task of approving the financial statements. Consequently, each member of the board was charged with the responsibility of attending to and focusing on these accounts and, under these circumstances, could not delegate or ‘abdicate’ that responsibility to others.”

Centro had a committee of directors called the ‘board audit and risk management committee’ which had responsibility for (among other things) overseeing the preparation of the financial statements and reports, reviewing and reporting to the board that financial information provided to investors and the board was accurate and reliable, and monitoring compliance with the accounting standards and other requirements relating to the preparation and presentation of financial results. Nevertheless, His Honour held that whilst an audit committee has an important role of monitoring and oversight, this is not to the exclusion of the role of a director to consider the financial accounts for him or herself.

Involvement of non-executive directors in management of the company

Justice Middleton commented that “each director is placed at the apex of the structure of director and *management of a company*”. While commenting that directors do not need to have “a detailed awareness of day-to-day activities”, His Honour concluded that “the case law indicates that there is a core, irreducible requirement of directors to be *involved in the management of the company ...*” It is of concern that His Honour did not appear to clearly distinguish between the role and responsibilities of Mr Scott as a full-time member of management and executive director of the company and the role of the non-executive directors, and at times seemed to be suggesting that *non-executive* directors should be involved in the day-to-day management of a company.

4. Where to from here?

Justice Middleton is yet to determine whether any of the defendants should be relieved from liability for the contraventions, and also whether any penalties should be imposed. ASIC is seeking orders that each of the defendants pay pecuniary penalties and be disqualified from managing corporations in the future.

The matter has been set down for hearing on the question of relief from liability and penalties on 1 August 2011. Justice Middleton pointed out in the case that the directors were intelligent, experienced and conscientious people and that there was no suggestion that the directors did not honestly carry out their responsibilities as a director. His Honour asked ASIC to consider “very carefully” how far it wishes to proceed in pursuing punishment having regard to the fact that “there has been no suggestion made that the directors were dishonest” and “they relied upon extensive advice and processes that were not called into question”.

The defendants have not yet indicated whether they will seek to appeal from this decision. An appeal may be filed within 21 days of the judgment.

Full text of judgment

For further information about the Federal Court’s decision please refer to the full text judgment: [ASIC v Healey & Ors \[2011\] FCA 717](#)

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