

## Company Directors and Officers Duties

Once again, the duties of executive and non-executive directors pursuant to the *Corporations Act 2001* has come into question.

*ASIC v Healey & Ors (2011) FCA717* (better known as the “Centro Case”).

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### Brief facts of “Centro Case”

ASIC instituted proceedings against both executive and non-executive directors of the Centro companies alleging that the directors had breached their duties, the duties being those set out in the *Corporations Act*.

Specifically, it was alleged that the directors, in approving the financial accounts of the companies, had incorrectly classified a very large liability (\$1.5 billion) as a non-current liability when in fact they were current liabilities. They also failed to disclose guarantees entered into by the Centro Group.

The directors’ “defence”, in essence was that the company’s management and the external auditor had reviewed the financial statements and the annual directors’ report and they had failed to identify any errors in the accounts and the directors in effect adopted their advice.

The core of ASIC’s complaint was that the directors (executive and non-executive) had failed to take reasonable steps to comply with their statutory obligations; that they had failed to apply their **own** minds to the reports and their accuracy; they had not properly reviewed the financial statements nor the directors’ report in order to ascertain whether they were correct as far as they knew or ought to have known.

### Decision

Justice Middleton of the Federal Court of Australia essentially found in favour of ASIC. Good news for ASIC and bad news for the directors!

Broadly, the Court found that the directors were, or ought to have been, aware of the liabilities and the guarantees and, importantly, were aware, or ought have been, aware of relevant accounting principles as to how those matters ought be dealt with in the financial accounts of the company.

The Court found that the directors had failed to take reasonable steps to satisfy themselves as to the contents of the financial statements; failed to make inquiries of management, the Board Audit Committee or other directors as to the statements. As a consequence the Court found that the directors had breached their duty of care and diligence under Corporations Law.

In the reasons for judgment, the Court, among other things, indicated that whilst directors are entitled to delegate the preparation of the financial accounts and also the day to day affairs of a company, directors are however required to diligently and intelligently interest themselves in the information obtained, understand the information, and apply an enquiring mind as to their responsibilities. In short, not just rely upon advice of management or external advisors.

The Court also said that directors are expected to have the knowledge and ability to read and understand financial statements, including the way in which particular assets or liabilities are classified. Whilst directors are not required to have extensive knowledge or skill, they cannot avoid their responsibilities by merely substituting reliance upon the advice of management or company advisers as a substitute for the exercise of their own duties and responsibilities pursuant to Corporations Law.

This decision, and earlier decisions of Courts, has yet again drawn attention to the significant responsibilities and obligations on directors (both executive and non-executive). Particularly for non-executive directors, it focuses on the extensive responsibilities and duties of non-executive directors.

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