

THIRD dimension

A practical legal perspective for charities and not-for-profits

Centro case – Any implications for directors of NFPs?

ASIC v Healey & Ors [2011] FCA 717

This case explains that some duties cannot be delegated by directors to other people, such as management or external advisors. Such duties remain squarely with the directors of a company, and failure by the directors to comply with those duties can result in serious consequences. This is the case even where directors have acted honestly in carrying out their directors' duties. The Centro case also reiterates previous case law in indicating that there is a core, irreducible requirement of directors to be involved in the management of the company.

Facts

In 2009, ASIC commenced proceedings against two executive and six non-executive directors of the Centro entities on the basis that they had breached their statutory duty of care and diligence (section 180(1) of the *Corporations 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 being non-current liabilities (when they were, in fact, current liabilities), and the statements also failed to disclose US\$1.75 billion in guarantees. Both Centro management and Centro's external auditor, Pricewaterhouse Coopers, had previously reviewed the financial statements and had failed to identify these two significant errors.

Issue

Whether directors 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:

- (a) whether or not the information the statements and report contain is consistent with the director's own knowledge of the company's affairs; and
- (b) that the statements and report do not omit material matters known to the directors or material matters that should be known to them (in this instance being the classification of liabilities and the omission of the reference to the guarantees).

Note: Section 180(1) of the *Corporations Act* requires a director to exercise his or her powers and discharge his or her duties with the degree of care and diligence that a reasonable person would exercise if they were a director of the company in the company's circumstances.

Implications for NFPs

- This case confirms that directors need to have basic financial skills to be able to adequately interpret any financial reports prepared for the company. Any directors deficient in those financial skills should seriously consider getting some training in this area.
- Directors need to be aware of which directors' duties can legally be delegated to others, and which cannot.
- Although it is good practice, and also very common, to have board committees to assist the board in its management and governance of an NFP company, the existence and role of such committees is not to the exclusion of the role and responsibility of a director.
- Although this case dealt specifically with the duties of directors pursuant to the *Corporations Act* (in the not for profit context that would apply to public companies limited by guarantee), the principles could also equally apply to committee members of incorporated associations or trustees or governors of any other not for profit legal structure.

Held

Duty of care and diligence

1. Justice Middleton of the Federal Court of Australia held that each of the directors, both the executive and non-executive, had breached their duty of care and diligence by failing to:
 - (a) take all reasonable steps to focus and consider for each of themselves individually the content of the financial statements; and
 - (b) make enquiries of management, the board audit committee or other directors as to proposed statements in the financial statements.
2. *"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 take a diligent and intelligent interest in the information available to him*

or her, to understand that information, and applying an enquiring mind to the responsibilities placed upon him or her... 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."

3. In this case His Honour found that the omissions in the relevant financial statements were matters that "could have been seen as apparent without difficulty" and that each of the directors should have enquired further into the matters revealed by the financial statements.
4. 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. This does not require directors to be familiar with every accounting standard, but does require directors to be sufficiently aware and knowledgeable to understand what is being approved.

To what extent can directors delegate responsibility to, and rely upon, others?

5. This case held that directors are not required to have infinite knowledge or ability, and they are entitled to:
 - (a) delegate to others;
 - (b) seek help in carrying out their responsibilities; and
 - (c) rely upon others.

Nevertheless, there is a limit to the extent of this reliance. The *Corporations Act* sometimes explicitly requires that directors carry out a certain task, such as the annual directors' report being made in accordance with a resolution of the directors. Hence the *Corporations Act* imposes ultimate responsibility for some matters upon the board in a manner which cannot be delegated to others.

6. *"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."*

Use of board committees

7. Centro had a committee of directors called the 'board audit and risk management committee'. This committee had responsibility for overseeing the preparation of the financial statements and reports, reviewing and reporting to the board that financial information provided to the board was accurate and reliable. However, His Honour held that although an audit committee has an important role of oversight and monitoring, this is not to the exclusion of the role of a director to consider the financial accounts for himself or herself.

The Centro directors have not yet indicated whether they will seek to appeal this decision.

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