



Australian Government

Department of Families,
Housing, Community Services
and Indigenous Affairs

Centro case: Implications for FaHCSIA portfolio bodies

FACT SHEET

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The purpose of this fact sheet is to provide a basic overview of some of the implications of the recent Centro case to portfolio bodies operating under the *Commonwealth Authorities and Companies Act 1997* (CAC Act).

Please note: This Fact Sheet is a summary guide only and should not be considered legal advice.

Background: The Centro case

In October 2009, the Australian Securities and Investments Commission (ASIC) commenced proceedings in the Federal Court of Australia (FCA) against the former Chief Executive Officer (CEO), former Chief Financial Officer (CFO) and six non-executive directors of the Centro Properties Group and Centro Retail Group, a retail investment organisation specialising in the ownership, management and development of retail shopping centres (Centro).

ASIC argued that each of the defendants had breached their statutory duty of care and diligence owed to Centro (under the *Corporations Act 2001* [the Corporations Act]) in approving consolidated financial statements for the financial year ending 30 June 2007. ASIC also sought orders that each defendant pay pecuniary penalties and be disqualified from managing corporations.

The consolidated financial statements incorrectly classified some \$1.5 billion in debt as non-current liabilities (when they should have been classified as *current* liabilities) and failed to disclose some \$1.75 billion in guarantees given after the balance date (but before the statements were approved). The financial statements of Centro had been prepared by Centro's management and audited by Centro's external auditor. The former CEO and former CFO also failed to make a declaration of compliance under section 295A of the Corporations Act, which requires them to:

- make a declaration that in their opinion the financial records of the company have been properly maintained;
- that the financial statements of the company and the notes comply with the accounting standards;
- that the financial statements of the company and the notes give a true and fair view; and
- any other matters prescribed by regulations in relation to the financial statements are satisfied.

Justice John Middleton of the FCA found that due to these actions and omissions that the defendants had breached their duty of care and diligence and failed to take all reasonable steps to ensure compliance with the companies' financial obligations under the Corporations Act.

Justice Middleton stated 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.” (paragraph 20, ASIC v Healey & Ors [2011] FCA 717)

What are directors' responsibilities under the CAC Act and the Corporations Act?

Duties are imposed on directors and other officers of CAC Act bodies under the CAC Act (for Commonwealth authorities) and the *Corporations Act* (for CAC Act companies). Although there are some wording differences between the CAC Act and the Corporations Act, the substantive duties are the same (except for the last one in this list) and include the following:

1. **Duty to exercise care and diligence (section 22 of the CAC Act and section 180 of the Corporations Act)** – Officers are required to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would if they were an officer of a CAC Act body in the CAC Act body's circumstances and had the same office and responsibilities as the officer. As highlighted by the Federal Court's decision in the Centro case, this includes in respect of the financial statements and directors' reports, undertaking the following measures:
 - o Directors must apply their own minds to and carefully review proposed financial statements and directors' reports. They must establish whether the information contained in the documents is consistent with their knowledge of the affairs of the CAC Act body.
 - o Directors must also be confident that they have the requisite basic level of accounting knowledge to be able to read and properly understand the financial statements.
2. **Duties to act in good faith (section 23 of the CAC Act and section 181 of the Corporations Act)** – Officers have a duty to act in good faith in the best interests of the CAC Act body. They must also act for a proper purpose.
3. **Duty to disclose conflicts of interest (sections 27F and 27G of the CAC Act and sections 191 and 192 of the Corporations Act)** - Directors of CAC Act bodies are required to disclose material personal interests to the other directors of the CAC Act body. Standing notice may be given about a particular matter.
4. **Duty not to misuse position (section 24 of the CAC Act and section 182 of the Corporations Act)** – Directors and other officers must not improperly use their position to gain an advantage for themselves or someone else or cause detriment to the CAC Act body or another person.

5. **Duty not to misuse information (section 25 of the CAC Act and section 183 of the Corporations Act)** - Directors and other officers must not improperly use information obtained because they are a director of a CAC Act body to gain an advantage for themselves or someone else or cause detriment to the CAC Act body or another person.

6. **Duty not to trade whilst insolvent (section 588G of the Corporations Act)** – In relation to CAC Act Companies, Directors must prevent a company incurring a debt if the company is insolvent (or if the company will become insolvent by incurring a debt). Directors are exposed to personal liability if the company incurs a debt and is or then becomes insolvent, and there are at the time reasonable grounds for suspecting the companies insolvency. The definitions of ‘solvency’ and ‘insolvency’ are as follows:
 - “A person is solvent if, and only if, the person is able to pay all the person’s debts, as and when they became due and payable.” (Section 95A (1) of the Corporations Act).
 - “A person who is not solvent is insolvent” (section 95A (2) of the Corporations Act).

7. **Duty to act in accordance with other provisions of the CAC Act or enabling legislation of a Commonwealth authority (Section 27A of the CAC Act).**
Australian Public Service Staff and Agency Heads that are required to comply with the CAC Act and the enabling legislation of an authority in the course of the performance of their duties as APS employees or Agency Heads will not breach sections 22-26.

Both the CAC Act and the Corporations Act also include some administrative directors’ rights such as the right to access books (section 27L of the CAC Act and section 198F of the Corporations Act).

The consequences and penalties for breach of the duties include:

- Pecuniary penalties (of up to \$200,000);
- Compensation orders for damages suffered by the CAC Act body;
- Disqualification; and
- Potential criminal liability.

Of course, there are numerous other duties imposed on directors and officers under other legislation (eg workplace health and safety, environmental and consumer and competition legislation). This Fact Sheet does not address those duties.

Certain directors are also required to sign off compliance reports stating that their company or authority has complied with the provisions of the Corporations Act and/or CAC Act. For further information on this process please see Finance Circular 2008/05, *Compliance Reporting – CAC Act Bodies*.

What can directors do to reduce risk?

The following measures may assist Directors and executive staff of CAC Act bodies to meet their CAC Act or Corporations Act duties:

- Read Finance Circulars on compliance issues (Finance Circular 2008/05 *Compliance Reporting – CAC Act Bodies* and Finance Circular 2011/06 *CAC Act Compliance: Departmental Responsibilities* are available at: <http://www.finance.gov.au/publications/finance-circulars/index.html>)
- Be aware of your duties;
- Be proactive and diligent in your duties;
- Foster a compliance culture – implement and make use of training and compliance programs;
- Be demanding - ensure Board papers are of a high standard and are sent in sufficient time before board meetings (for Directors);
- Control the flow of information given to the Board to ensure that they keep the amount of paperwork to be read and digested within manageable levels. The complexity and volume of information presented to the Board cannot be an excuse for directors failing to properly read and understand important documents provided to them such as financial statements;
- Directors participating from a remote location (including by teleconference) should always have the relevant documents on hand during a board discussion;
- Avoid risky time frames;
- Get professional advice on material issues and, for senior managers, bring material issues to the attention of the Board even if the matter appears obvious or the Board is commercially astute;
- Ask questions and have review processes in place;
- Identify, disclose and quickly address any potential conflicts;
- Ensure your CAC Act body has an effective whistle-blowing policy in place;
- Don't keep problems to yourself – discuss them with your peers;
- Carefully read and understand draft financial statements, notes and other accompanying papers; and
- Undertake training to improve your skills and understanding (such as company director courses, reading financial statements training).

Portfolio bodies should also note that the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* which applies to the Indigenous corporate sector is aligned with the modern corporate governance standards in *the Corporations Act 2001*.

Contact Details

Further details can be obtained from:

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Acknowledgements

Minter Ellison Lawyers (2011); *'Duties of CAC Act bodies Directors - Snapshot Summary'*; Canberra.