Directors take Notice- Centro case

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Directors must me diligently review company accounts

On 27 June 2011, the Federal Court handed down a decision in the Centro case which reinforces the need for directors to have a fundamental understanding of financial statements and how to apply the knowledge they had or should have acquired to perform that task.

Background

The Australian Securities and Investments Commission ("ASIC") won its case in the Federal Court ("the Court") against property giant Centro when the Court ruled that the Centro's directors were liable for signing off on faulty accounts in 2007.

ASIC argued that Centro's directors had breached their duties under Sections 180 and 344 of the Corporations Act ("the Act") because its 2007 annual accounts had not complied with the Act and accounting standards in regard to the following:

- a number of borrowings were misclassified as "non-current liabilities" when they were in fact "current liabilities";
- Centro had given some guarantees as part of a transaction just after the end of the 2007 financial year, but the directors had not deemed this to be a material post balance date event that they should disclose in the annual report; and
- the board of directors had not ensured that the CEO and CFO had provided the declaration of compliance required by Section 295A of the Act.

Misclassifications of Liabilities in Balance Sheet

The directors of Centro argued that they could not be expected to know whether the liabilities in question were current liabilities within the meaning of the relevant accounting standards on the basis that there had been a change in the relevant accounting standard which created some greyness in interpretation, and that the documentation relating to the borrowings were complex.

The Court dismissed the directors' arguments on the grounds that:

- the accounting standard meaning of non-current liability was "straightforward" and summarised in Centro's own notes to the accounts;
- even if there had been greyness, the directors had not shown how that greyness resulted in their failure to notice the misclassification; and
- the complexity of the documentation was irrelevant- the directors knew the borrowings were maturing in the short term, but they failed to query why the borrowings had not been classified as current liabilities.

Disclosure of Material Post Balance Date Events

The Court held that the directors were aware of the need to disclose post balance date events and of the magnitude of certain guarantees given by the company post balance date.

Accordingly, the Court determined that the directors should have turned their minds to the issue of whether disclosure of the guarantees was required. There was no evidence that they had done so. Relying on general assurances from management and the auditors about the accounts' compliance with statutory requirements did not excuse failure to raise that specific issue.

Section 295A Certificate

The Court held that the directors had breached their duties by not taking all reasonable steps to ensure compliance with Section 295A of the Act because they could not establish to the satisfaction of the Court (and ASIC) that the CEO and CFO have declared that, in their opinion, the annual accounts complied with the accounting standards (amongst other things).

Ramifications for Directors

Whilst not laying down a general financial literacy standard for directors, it is clear that the Court is of the belief that a certain level of financial literacy is an essential qualification for directors.

Directors cannot delegate their specific responsibilities under the Act in relation to the accounts of the company.

In regard to complexity of documentation required in relation to certain transactions, Boards must ensure that they receive meaningful information, not merely data.