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Corporate Law Bulletin

The implications of the Centro case for directors

Introduction

The Centro case is more correctly described as a decision by Mr Justice Middleton in the Federal Court of Australia in civil penalty proceedings commenced by ASIC against eight (8) directors and former executives of the Centro Properties Group (Centro) based on their failure to ensure that the financial statements for the year ended 30 June 2007 for Centro Properties Ltd, Centro Property Trust and Centro Retail Trust were in order. The "mischief" identified by ASIC and attributable to seven (7) of the Centro directors and the former chief financial officer was that certain liabilities reported in the financial statements as non current liabilities should have been reported as current liabilities as the obligation to pay was within 12 months.

What exactly happened?

In ASIC's view, AASB101 applied, which classifies liabilities as "current" if they are payable within 12 months. A liability with a longer term repayment period becomes a "non current" liability. Section 344 of the *Corporations Act 2001* ("the Act") requires a company to comply with the accounting provisions namely:

- The true and fair view provisions (s298(1A)); and
- The accounting standards (s296).

The misclassification of liabilities in the 30 June 2007 financial statements caused by describing significant liabilities as non current liabilities, instead of as current liabilities, meant that the financial statements were wrong.

This mischief meant that the 30 June financial statements for 2007 for Centro Properties Ltd, Centro Property Trust and Centro Retail Trust did not show a true and fair view of the financial position of those entities and reflected inadequate care being taken by the directors and the chief financial officer at the time by signing off on those statements. They did not pay enough attention to whether the financial statements were correct.

Isn't this an accounting problem?

No. The trial judge said that this was a failure attributed to the directors and chief financial officer at the time. The courts' reasoning flowed from an examination of sections 180 and 344 of the Act i.e.

- Section 180, because directors were not diligent and careful in their classification of the liabilities; and
- Section 344, because directors failed to take reasonable steps to secure compliance with relevant provisions of the Act (e.g. s298 (1A) and s296) and failed to enquire into the deficiencies of treatment.

What are the implications?

The immediate implications suggest that the financial statements found to be defective should be amended by a board and replacement financial statements be lodged with ASIC. (This occurred.)

The case clearly shows that directors cannot solely rely on measures such as:

- The CEO and CFO declaration of compliance (section 295A). This declaration heightens the accountability of the CEO and CFO, but does not provide directors with a defence if the CEO and CFO get it wrong.
- Having an active audit committee in place. Indeed, Centro had such a committee in place.

It is the wording in section 344 of the Act that caught the Centro directors and they were not able to prove that they took all reasonable steps to comply with and to procure compliance with the accounting provisions. Directors don't need to be accountants as a result of the Centro case. However, it is clear that directors should be careful and questioning when considering the accounts and understand the contents before adoption.

The immediate public interest lies in the civil penalty orders the court might impose on each of the defendants as a consequence of ASIC achieving a "win" in this case.

The civil penalty provisions in the Act will now expose each of the Centro defendants to these possible penalties:

- a fine or pecuniary penalty of up to $200 000;
- a disqualification order preventing a defendant from becoming or continuing to be a director of a company for a specified period.

What lies ahead?

At present, it is not known whether the defendants will appeal the decision. In the absence of an appeal, a civil penalty hearing is the next development which will also be an aspect carefully monitored by the business community given the inroads of personal liability of directors which the Centro case uncovers. There is some comfort for directors coming out of this decision, ie that the liability of directors found here was central to the underlying facts of the case and there is nothing to suggest directors need to fully understand all the accounting standards or to transition into accountants.

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