

IN a landmark decision, the Federal Court has found that executives and directors of troubled property group Centro breached the Corporations Act by signing off on financial reports that failed to disclose billions of dollars of short-term debt.

The ruling in Melbourne today comes as a significant win for the Australian Securities and Investments Commission, which poured considerable resources into the case following a string of high-profile losses.

Handing down his decision, Justice John Middleton said the directors failed to apply their minds to the financial statements; otherwise they would have picked up the errors.

After reading a summary of the judgment, Justice Middleton warned ASIC to consider its next step "very carefully" as the watchdog prepares its case for penalties.

"There has been no suggestion made that the directors were dishonest," he said.

"They relied upon extensive advice and processes that were not called into question."

The decision is likely to have repercussions for company directors around the country, potentially increasing the onus on them to scrutinise accounts as part of their due care and diligence.

Source: The Australian, 27/6/11

Overview of decision

The breaches in this case

The breaches related to disclosure in the 2007 annual financial reports of Centro Properties Group (CNP) and Centro Retail Group (CER). Both reports classified liabilities as "non-current", when these should have been classified as current liabilities. The amounts involved were \$1.5 billion in the case of CNP and \$500 million in the case of CER. The reports of CNP also did not disclose material guarantees given by CNP entities after the relevant reporting date as post balance date disclosures.

No relief from liability

The directors sought relief from liability on the basis of ss1317S and 1318 of the Corporations Act. To provide relief from liability, it must appear to the Court that the directors acted "honestly". Justice Middleton held that the conduct of the directors that was found to be in breach of statutory duties was undertaken honestly.

Nevertheless, Justice Middleton declined to grant relief from liability. In declining to grant relief, he was conscious of the need to promote the policy rationale of general deterrence given the "*seriousness of the contraventions*" involved. He did not, however, consider this policy rationale warranted granting the more severe orders sought by ASIC.

In making declarations of contravention, Justice Middleton identified a number of key facts which supported his findings. In summary, he considered that the directors:

- knew or ought to have known that the current liabilities were larger than disclosed, and that the guarantees had been granted;
- ought to have known that the accounts did not comply with the Corporations Act;

- failed to properly read, understand and give sufficient attention to the content of the financial reports as they related to current liabilities and the guarantees;
- failed to consider or properly consider the content of the financial reports as they related to current liabilities and the guarantees;
- failed to make enquiry or adequate enquiry of management, the Audit Committee and other members of the Board concerning the apparent deficiencies in the reports;
- failed to have the apparent deficiencies in the reports corrected;
- failed to take steps to ensure they had sufficient knowledge about the requirement for CFO / CEO sign-off on the accounts in compliance with the Corporations Act and failed to take steps to ensure that the sign-off was received; and
- failed to read, understand and give sufficient attention to the management representation letter provided to the directors.

In respect of Mr. Nenna, Justice Middleton relied on the fact that Mr. Nenna recommended approval of the accounts and the directors' report in circumstances where he:

- knew that the current liabilities were larger than disclosed and that the guarantees were granted;
- knew that a major liability had been wrongly classified in the consolidated balance sheet of CNP lodged with the ASX;
- ought to have known that the accounts did not comply with the Corporations Act or the accounting standards; and
- failed to take all reasonable steps to rectify that non-compliance.

Justice Middleton's orders are summarised below:

Defendant	Declaration of contravention of Corporations Act made?	Pecuniary penalty?	Disqualified from managing corporations?	Costs orders made?
Non-executive directors (Mr Healey, Mr Murakis, Mr Hall, Mr [redacted], Mr Goldie and Mr [redacted])	Yes - the non-executive directors were found to have: <ul style="list-style-type: none"> • breached s180(1) and 601FD(3) by having failed to exercise the required degree of care and diligence; and • breached s344 by having failed to take all reasonable steps to secure compliance with certain Corporations Act provisions governing the preparation of accounts. Justice Middleton did not grant relief from liability under s1317S or s1318.	No	No	1/8th of ASIC's costs in the penalties proceeding. 1/7th of ASIC's costs in the earlier liabilities proceedings (reflecting that Mr Nenna was not ordered to pay any of ASIC's costs for that proceeding because he did not contest liability).
Mr Scott (former managing director and [redacted])	As for the non-executive directors.	\$30,000	No	1/8th of ASIC's costs in the penalties proceeding. 1/7th of ASIC's costs in the earlier liability proceeding.

Mr Nenna (former	Yes - Mr Nenna was found to have: <ul style="list-style-type: none"> • breached ss180(1) and 601FD(3) by having failed to exercise the required degree of care and diligence; and • contrary to s601FD(1)(f), failed to take all reasonable steps to secure compliance with certain Corporations Act provisions governing the preparation of accounts. 	No	2 years from 10 October 2011	1/8th of ASIC's costs for the penalties proceeding. Mr Nenna was not ordered to pay any of ASIC's costs for the earlier liability proceeding because he did not contest liability.
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