
*ASPECTS OF CORPORATE DELEGATION, RELIANCE AND
FINANCIAL REPORTING
LESSONS FROM AUSTRALIAN SECURITIES AND INVESTMENTS
COMMISSION V HEALEY (2011) 29 ACLC 11-67*

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This case note assesses the impact of the recent decision in the Federal Court of Australia on the duties of company directors with regard to financial reporting. The case is important because it established *Negligence* as a new test for determining a contravention of s 344(1) of the *Corporations Act 2001* (Cth). Up to this point in time an offence under the Act had to be the result of *Dishonesty*. For this reason, the case imposes a greater duty of care on company directors with regard to reliance on delegation in meeting their obligations under the Act.

I INTRODUCTION

The case against the directors was focused on the failure to disclose the correct amount of current liabilities in the 2007 annual reports of the Centro Properties Group. The current liabilities had been understated by \$1.5 billion which had been classified as non-current liabilities. The directors had also failed to disclose guarantees (current liabilities) by an associated company of approximately US\$1.75 billion that had been given after balance date but before the joint board meeting of 6 September 2007. The joint board meeting of 6 September 2007 was the meeting at which the directors resolved to approve the financial reports for the year ending 30 June 2007. In addition, there was another Centro company which had wrongly classified as current liabilities \$500 million as non-current liabilities. ASIC's case was that the errors were so obvious that it could be readily inferred that the directors were negligent to have failed to detect them.

Section 180 of the *Corporations Act 2001* (Cth) requires directors to take reasonable steps to place themselves in a position to be able to guide and monitor the company's management. However, the Corporations Act does not require directors to be qualified and experienced accountants or auditors nor are they responsible for the preparation of the financial reports. They are required by s 344 to take all reasonable steps to secure compliance with the financial reporting obligations imposed by Parts 2M.2 and 2M.3 and in this regard must exercise diligence and care. The *Act* states that a person commits an offence if they contravene s 344(1) and the contravention is dishonest. Therefore, according to the *Act* for a contravention to be an offence it must be proven to be the result of dishonesty.

The decision by Middleton J¹ was that the directors had failed to exercise the statutory duty of care and diligence by approving inaccurate financial reports and had therefore breached their duty under s 344. In reaching this decision, Middleton J introduced the element of negligence² as a basis for determining a contravention of a director's obligations under the *Act*.

II DISHONESTY V NEGLIGENCE (SECTION 344)

The decision by Middleton J established that dishonesty is no longer the only reason for a court to conclude that directors have contravened the Act. The case revolved around the directors being held liable for not ensuring that the information contained in the financial reports was consistent with their own knowledge of the company's affairs. The issue here

¹ *Australian Securities and Investments Commission v Healey* (2011) 29 ACLC 11-067.

² *Ibid* 1 247 [127].

being that whilst the directors may not have been acting dishonestly there was a degree of negligence Middleton J provided the following explanation for his decision:³

The director's obligation, under s 344 is to take all reasonable steps to comply, or secure compliance, with Pt 2M.3 (which deals with financial reports, directors' reports, audit, reporting to members and lodgement with ASIC). They are under the same duty with respect to the financial records which the entity must keep under Pt 2M.2. If they fail to take all reasonable steps to comply or secure compliance, they contravene the Act.

In response to the argument that directors relied upon the expertise of the chief executive officer and chief financial officer, Middleton J made the following observations in rebuttal to this as a defence against any breach of the Act by directors:⁴

S 295A says that in the case of a listed entity, the directors' declaration for a full financial year must be made only after each person who performs a chief executive function or a chief financial officer function has given the directors a declaration. The declaration must say whether, in the opinion of the person giving it:

- The financial records of the entity have been properly maintained in accordance with s 286;
- The financial statements and notes comply with the accounting standards;
- The financial statements and notes give a true and fair view; and
- Any other matters prescribed by the regulations are satisfied (none have yet been prescribed): s 295A(2).

However, even here the extent of reliance should not be taken too far. The purpose of the introduction of s 295A was according to the Explanatory Memorandum to the Bill introducing the requirement to "ensure that those who are responsible for the preparation of financial statements are accountable for their content thereby heightening the accountability of senior management": Explanatory Memorandum, paragraph 4.330. S 295A was not to detract from the responsibilities otherwise imposed upon directors.

It is apparent that the legislative scheme imposes overall responsibility for the financial report and the directors' report upon the directors. When the Bill for the legislation that introduced s 295A was introduced, the Explanatory Memorandum also stated that:

... having executive sign off to the board of directors is the preferred option. This approach will retain the overall responsibility of directors for the financial statements but will at the same time impose a specific requirement on those responsible for preparing the statements to turn their minds to the actual legal requirements and compliance with the accounting standards.

There is little doubt that there may be liability under s 344 and the civil penalty provisions for directors who have not taken all reasonable steps to ensure compliance with the requirements prescribed in s 295A. This will be so whether the director was responsible for making the declaration or was merely one of the board members who failed to ensure that the declaration was obtained.⁵ In this case, the decision⁶ was that a particular declaration was not a

³ Ibid.

⁴ Ibid 1 248 [130] – [134].

⁵ Ibid [133].

⁶ Ibid 1 323 [507].

declaration of the opinion of the CEO and CFO as to the matters specified in s 295A(2)(a), (b) and (d) and therefore did not satisfy the requirements of the section.⁷

Further, the obligation that a director may have to make a declaration under s 295A⁸, is in addition to the responsibility that the director has pursuant to s 344 which requires the director to take all reasonable steps to ensure compliance with the financial records and financial reporting requirements.⁹

III SECTION 295

Section 295 requires the directors to form an opinion with all due care and diligence. It has been held that, at a minimum, the directors must inform themselves as to the financial affairs of the company to the extent necessary to form each year the opinion required.¹⁰

In response to this particular issue Middleton J stated the following:¹¹

Whilst the Act now requires that the annual directors' report be prepared by the entity, rather than by the directors themselves, the report must be made in accordance with a resolution of the directors and must be signed by a director. Whilst the obligation to "prepare" it is placed on the entity, the directors have an important responsibility for the contents of the report. Additionally, the financial report which a company must prepare must contain a declaration by the directors that the financial statements comply with the accounting standards and give a true and fair view, and must contain the directors' opinion as to whether there are reasonable grounds to believe that the entity will be unable to pay its debts as and when they become due and payable and as to whether the financial statements are in accordance with the law: s 295(4).

Whilst, again, the obligation to "prepare" the directors' declaration is placed on the entity, the directors have a primary responsibility for the declaration. In essence, the Act requires directors to take particular responsibility for the company's financial reports.

This is not to say that directors are not entitled to seek assistance in carrying out their responsibilities, and may rely on others.

For instance, directors are entitled to rely upon declarations by the CEO and the chief financial officer, such as made pursuant to s 295A of the Act.

IV THE DECISION

The finding¹² was that there had been a failure to comply with the relevant AASBs, and as a result there was a failure to give a true and fair view, which was contrary to the provisions of s 296 and 297. In turn there was a failure to disclose information in the terms of s 299 and 299A which meant that the financial reports did not comply with s 298.

⁷ Ibid 1 324 [510].

⁸ *Corporations Act 2001* (Cth) s 295A(8).

⁹ Ibid 1 248 [134].

¹⁰ Ibid 1 250 [146].

¹¹ Ibid 1 248 [128] – [129].

¹² Ibid 1 332 [574].

Each director was held to have:

- not taken all reasonable steps to focus and consider for himself the content of the financial statements, particularly as to short-term debt and whether the guarantees should have been disclosed.
- failed to make enquiries of management, the BARMC or other directors as to proposed statements in the financial statements relating to the short-term debt and guarantees, and failed to have apparent errors corrected.
- failed to request that the directors be given declarations pursuant to s 295A of the Act which accorded with its requirements, after failing to consider the requirements of s 295A and read the management representation letter.
- to have been aware of or should have been aware of the relevant accounting principles which would have alerted each director to the apparent error in the proposed financial statements. They could then and should have made the relevant enquiries, if they had taken all the reasonable steps required of them.
- failed focus upon or properly consider the issues the subject of ASIC's allegations. Each director may have had different reasons for not focusing.
 - For instance, Mr Scott did not focus, as he was concentrating on the key risk areas and investors, and did not consider the existence of current debt liabilities as a problem. Mr Scott considered that the concern of investors at the time was with total liabilities. Mr Scott *assumed* that management and the advisors would bring to his attention any information necessary, and did not turn his mind specifically to the guarantees or to short-term debt.
 - The other directors relied solely on management and their advisors to be properly informed of information relevantly to be put into the financial statements.

The differences between the individual analysis of each director provided by ASIC, in the authors' view, do not detract from the above position pertaining to each director and the findings I make. Whether, for instance, a director went through the financial statements 'line by line', he is not thereby taking all reasonable steps, if the director in doing so is not focussed for himself upon the task and considering for himself the statutory requirements and applying the knowledge he has of the affairs of the company.

The failure to notice certain omissions may well be explicable – but here the directors, in some cases on their own admission, clearly looked solely to management and external advisors. If they had acted, as Senior Counsel for ASIC suggested, as the final filter, taking care to read and understand the financial accounts, the errors may have been discovered earlier than they were.

Middleton J ruled that in relation to each director in his capacity as a director (or officer) of each relevant entity each director failed to take the following reasonable steps and failed to

take the following steps that a reasonable person would have taken if they were in the director's position:

- (a) to properly read, understand and give sufficient attention to the content of the financial statements prior to participating in the resolutions occurring on 6 September 2007 in so far as they related to:
 - (i) the classification of liabilities as either current or non-current;
 - (ii) the disclosure of guarantees relating to Super LLC and Centro NP LLC.
- (b) to consider or properly consider the content of the financial statements prior to participating in the resolutions occurring on 6 September 2007 in so far as they related to:
 - (i) the classification of liabilities as either current or non-current;
 - (ii) the disclosure of guarantees relating to Super LLC and Centro NP LLC.
- (c) to raise or make enquiry or adequate enquiry with management, the BARMC and other members of the Board prior to participating in the resolutions occurring on 6 September 2007:
 - (i) the apparent failure of the financial statements to properly classify current and non-current liabilities;
 - (ii) the apparent failure of the financial statements to properly disclose the guarantees relating to Super LLC and Centro NP LLC.
- (d) to have the apparent failures with respect to the financial statements corrected prior to participating in the resolutions occurring on 6 September 2007;
- (e) prior to participating in the resolutions on 6 September 2007;
 - (i) to take the necessary steps to ensure they had a sufficient knowledge of the requirements of s 295A;
 - (ii) to read, understand and give sufficient attention to the management representation letter provided to the directors;
 - (iii) to request that the directors be given a declaration pursuant to s 295A of the Act which accords with its requirements.
- (f) not participating in the resolutions occurring on 6 September 2007 prior to being given a declaration pursuant to s 295A of the Act.

Under the circumstances, each director was held to have contravened ss 180(1), 601FD(3) and 344(1) of the Act in that:

- (a) each director failed to take all reasonable steps to secure compliance with each of the provisions of the Act alleged against them;

- (b) each director failed to take all steps that a reasonable person would take if they were in each director's position to ensure compliance by the relevant entity with each of the provisions of the Act alleged against them;
- (c) each director failed to exercise the degree of care and diligence required by failing to take each of the steps I have found that each director failed to take in the course of his review of the financial statements.

Once the Court was satisfied that a person had contravened the above provisions, it is incumbent upon it to make a declaration of contravention (see s 1317E). S 1317E(2) provides that the declaration must specify the following:

- (a) the Court that made the declaration;
- (b) the civil penalty provision that was contravened;
- (c) the person who contravened the provision;
- (d) the conduct that constituted the contravention;
- (e) if the contravention is of a corporation/scheme civil penalty provision - the corporation or registered scheme to which the conduct related.

V GROUNDS FOR THE DECISION

Middleton J made the following statement at [574]:

... there has been a failure to comply with the relevant AASB's, and a failure to give a true and fair view, contrary to the provisions of s 296 and 297, and a failure to disclose information in the terms of s 299 and 299A so as to not comply with s 298.

The grounds for the decision against the directors was more fully identified by Middleton J at [583]:

I find that each director failed to take the following reasonable steps and failed to take the following steps that a reasonable person would have taken if they were in the director's position:

- (a) to properly read, understand and give sufficient attention to the content of the financial statements prior to participating in the resolutions occurring on 6 September 2007 in so far as they related to:
 - (i) the classification of liabilities as either current or non-current;
 - (ii) the disclosure of guarantees relating to Super LLC and Centro NP LLC.

- (b) to consider or properly consider the content of the financial statements prior to participating in the resolutions occurring on 6 September 2007 in so far as they related to:
 - (i) the classification of liabilities as either current or non-current;
 - (ii) the disclosure of guarantees relating to Super LLC and Centro NP LLC.
- (c) to raise or make enquiry or adequate enquiry with management, the BARMC and other members of the Board prior to participating in the resolutions occurring on 6 September 2007:
 - (i) the apparent failure of the financial statements to properly classify current and non-current liabilities;
 - (ii) the apparent failure of the financial statements to properly disclose the guarantees relating to Super LLC and Centro NP LLC.
- (d) to have the apparent failures with respect to the financial statements corrected prior to participating in the resolutions occurring on 6 September 2007;
- (e) prior to participating in the resolutions on 6 September 2007;
 - (i) to take the necessary steps to ensure they had a sufficient knowledge of the requirements of s 295A;
 - (ii) to read, understand and give sufficient attention to the management representation letter provided to the directors;
 - (iii) to request that the directors be given a declaration pursuant to s 295A of the Act which accords with its requirements.
- (f) not participating in the resolutions occurring on 6 September 2007 prior to being given a declaration pursuant to s 295A of the Act.

VI PENALTIES AND DECISION

On the 31 August 2011, Middleton J handed down the penalties imposed on the defendants.¹³ With respect to the relief from liability sought by the directors on the basis of s1317S and s1318, these sections provide relief from liability if it appears to the Court that the directors acted honestly. Whilst the directors were not found to have acted dishonestly Middleton J declined to grant relief. His decision was based on the need to promote the policy rationale of general deterrence in view of the seriousness of the contraventions. However, he considered that the more severe orders sought by ASIC were not warranted under this policy rationale.

Table 1
Summary of penalties in the judgment

Defendants	<i>Corporations Act</i> Declarations of contravention?	Pecuniary penalty?	Disqualification from managing corporations?	Orders made for costs?
Six (6) non-executive directors	Yes! • Breached s180(1) and 601FD(3) by failure to	No!	No!	1/8th of ASIC's costs in the penalties proceeding.

¹³ *Australian Securities and Investments Commission v Healey (No 2)* (2011) 29 ACLC 11-068.

	<p><i>exercise required degree of care and diligence; and</i></p> <ul style="list-style-type: none"> • <i>Breached s 344 by failure to take all reasonable steps to secure compliance with certain provisions of the Corporations Act governing the preparation of accounts.</i> <p>Middleton J did not grant relief from liability under s1317S or s1318.</p>			<p>1/7th of ASIC's costs in the earlier liabilities proceedings. This reflects that the former CFO did not contest liability.</p>
The former managing director and CEO	<p>Yes!</p> <p>Same as for the non-executive directors above.</p>	<p>Yes!</p> <p>\$30,000</p>	<p>No!</p>	<p>1/8th of ASIC's costs in the penalties proceeding.</p> <p>1/7th of ASIC's costs in the earlier liabilities proceedings.</p>
The former CFO	<p>Yes!</p> <ul style="list-style-type: none"> • <i>Breached s180(1) and 601FD(3) by failure to exercise required degree of care and diligence; and</i> • <i>Contrary to s601FD(1) had failed to take all reasonable steps to secure compliance with certain provisions of the Corporations Act governing the preparation of accounts.</i> 	<p>No!</p>	<p>Yes!</p> <p>Two (2) years from 10 October 2011.</p>	<p>1/8th of ASIC's costs in the penalties proceeding.</p> <p>Because the CFO did not contest the earlier liability proceedings no costs for that were awarded.</p>

A class action was settled, in May 2012, against the auditors and companies for \$200 million, with the legal costs of \$15 million and IMF funders receiving \$60 million and leaving the shareholders to divide the remaining \$125 million for their losses.¹⁴

VII LEGACY

The applications of the principles developed in this case, while not confined to listed public companies, are more relevant to these entities because of the reporting requirements contained within s 292 of the *Corporations Act*. Small proprietary companies have much lower and restricted reporting obligations than listed public companies that are required to produce half yearly financial and director's reports.¹⁵

The central question in the proceeding has been whether directors of substantial publicly listed entities 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 that the information they

¹⁴ Leonie Wood, '\$200m Centro deal approved', *The Age* (online), 20 June 2012 <<http://www.theage.com.au/business/200m-centro-deal-approved-20120619-20m2d.html>>

¹⁵ *Corporations Act 2001* (Cth), s302.

contain is consistent with the director's knowledge of the company's affairs, and that they do not omit material matters known to them or material matters that should be known to them.¹⁶

Middleton J importantly recognised that the directors and officer breaches were not a mere technical lapse, but director oversight of financial reporting was a fundamental aspect of shareholder protection and market integrity.¹⁷ However, the court was also cognisant that placing too great an onus on board functions may create an impossible impediment to business and addressed this issue:

I do not consider this requirement overburdens a director, or as argued before me, would cause the boardrooms of Australia to empty overnight. Directors are generally well remunerated and hold positions of prestige, and the office of director will continue to attract competent, diligence and intelligent people.¹⁸

Perhaps the most enduring legacy of this case has been on the related issues of reliance and delegation more broadly.¹⁹ It was readily accepted that directors are not expected to be perfect or to have, '... infinite knowledge or ability.'²⁰ Delegation by directors in compiling books of accounts is a commonplace and a legitimate business practice. However, in ratifying and validating financial statements, directors must purposefully apply their individual discerning judgement, even if that requires further inquiry.²¹

Importantly, even in situations where a director may be appointed to exploit a particular expertise, he or she is not expected to constrain his or her consideration or interest to areas within his or her ken.²² A director is not entitled to rely exclusively or unconditionally upon management or external consultants regardless of their calibre or qualifications. 'No director stood back, armed with his own knowledge, and looked at and considered for himself the financial statements.'²³

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.²⁴

Herein lies a fine distinction worthy of greater analysis. It has long been recognised that company directors may delegate their responsibilities and rely upon competent advice limited some restrictions. However, directors may not abrogate their responsibilities and functions. The *Corporations Act* provides, that subject to any constitutional impediments, directors may delegate "any of their powers"²⁵ with the caveat that:

- (a) the director believed on reasonable grounds at all times that the delegate would exercise the power in conformity with the duties imposed on directors of the company by this Act and the company's constitution (if any); and

¹⁶ *ASIC V Healey* (2011) 29 ACLC 11-067, 1 228 [13] (emphasis added).

¹⁷ *Ibid* 1 228 [15].

¹⁸ *Ibid*.

¹⁹ See *Corporations Act 2001* (Cth), ss 189 190 198D and discussion below.

²⁰ *ASIC V Healey* (2011) 29 ACLC 11-067, 1 229 [20].

²¹ *Ibid*.

²² *Ibid* 1 228 [18].

²³ *Ibid* 1 332 [569].

²⁴ *Ibid* 1 257 [175].

²⁵ *Corporations Act 2001* (Cth), s198D.

(b) the director believed:

- (i) on reasonable grounds; and
- (ii) in good faith; and
- (iii) after making proper inquiry if the circumstances indicated the need for inquiry; that the delegate was reliable and competent in relation to the power delegated.²⁶

Moreover, a director is entitled to reliance upon expert advice if:

(b) the reliance was [made](#):

- (i) in good faith; and
- (ii) after making an independent assessment of the [information](#) or advice, having regard to the [director](#)'s knowledge of the [corporation](#) and the complexity of the structure and operations of the [corporation](#);²⁷

These sections were inserted into the *Corporations Act* to clarify the vexing issue of directors performing duties of a multifarious nature that may be outside their ken, so as not to create an “overly conservative approach to management” and extinguishing entrepreneurship.²⁸ Striking the balance between good corporate governance and shareholder protection and entrepreneurship in terms of delegation and reliance upon advice has proven historically difficult.

Delegation, as the word is generally used, does not imply a parting with powers by the person who grants the delegation, but points rather to a conferring of an authority to do things which otherwise the person would have to do himself... [It] is never used by legal writers...as implying that the delegating person parts with his power in such a manner as to denude himself of his rights...[The] word “delegate” means little more than an agent”.²⁹

More recently, the Supreme Court of South Australia has interpreted the issue as simply as the extent of independent judgement required by a director when turning his or her mind to advice received is to do “no more than that they, having listened to and assessed what their colleagues have to say, must bring their own mind to bear on the issue using such skill and judgment as they may possess”.³⁰

In summary, abrogation of duty is inappropriate for a fiduciary (a director) under any circumstances, while, at least some, independent judgment and consideration (recognising the subjective knowledge possessed by the individual in question) is mandated in all cases.

²⁶ *Corporations Act 2001* (Cth), s190(2).

²⁷ *Corporations Act 2001* (Cth), s189.

²⁸ Explanatory Memorandum *Corporate Law Economic Reform Program Bill 1998*, paragraph 6.22.

²⁹ *Huth v Clarke* (1890) 25 QBD 391 at 395 per Wills J.

³⁰ *Southern Resources Ltd v Residues Treatment and Trading Co Ltd* (1990) 3 ACSR 207 at 225.

