Duties of Directors

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'The business of a company is to be managed by or under the direction of the directors.'

Being a director of a company comes with certain legal duties and responsibilities. These are often confusing and can catch directors off guard when they are unaware of their obligations. Below, we explain and simplify the main responsibilities of a director. It is firstly important to note, the legal definition of director includes a person who may not be formally appointed as a director, however is acting in the capacity of a 'shadow' director.

Duty of Care and Diligence

Every director must discharge their duties and exercise their powers with a degree of care and diligence. This means that when making a business judgment, it should be made:

- In good faith for a proper purpose,
- With no material personal interest in the subject matter,
- By being reasonably informed, and
- In the best interests of the company (this must be a rational judgment)

A business judgment is any decision to take or not take action of a matter relevant to the business operations of a company.

Good Faith

Directors must discharge their duties and exercise their powers for a proper purpose and in good faith in the interests of the company. A director commits an offence if they are reckless and intentionally dishonest.

Use of Position

Any officer or employee of a company must not use their position dishonestly or recklessly gain advantage for a person (whether that be themselves or another person) or cause detriment to the company.

Use of Information

As a director, you will gain access to information as a result of your position. Any officer or employee of a company must not improperly use information to gain advantage for themselves or another person or to cause detriment to the company. It is important to note that this duty continues even after a person resigns as director.
A director commits a criminal offence is they are reckless or intentionally dishonest and fail to discharge their duties and exercise their powers in good faith in the best interests of the company or for a proper purpose, if they use their position dishonestly

Getting advice when making a business judgment

If a director relies on information or professional or expert advice from:

- An employee of the company that the director believes (on reasonable grounds) is reliable and competent in the matters concerned;
- A professional adviser or expert on a matter that the director believes on reasonable grounds to be within the person's professional expertise;
- Another officer of the company who has authority;
- A committee of directors that the director was not part of;

and the reliance was made in good faith, after making an independent assessment of the information or advice, reliance on the information will be taken to be reasonable unless the contrary can be proved.

Delegating responsibility

If a director delegates any of their responsibilities to another, the director remains responsible for the exercise of power by a delegate. If however, the director believed (on reasonable grounds) that the delegate would exercise the power legally complying with all obligations imposed on a director and the director believed in good faith and after making inquiry (if the circumstances required), the director will not be responsible for the delegate's non-compliance.

Directors obligations when company is a trustee

A director of a company who incurs a liability as trustee must discharge the whole or part of the liability if the company has not or cannot discharge the liability and the company is not entitled to be fully indemnified against the liability out of the trust assets solely because of:

- A breach of trust of the company; or
- The company was acting outside the scope of its powers as trustee; or
- A term of the trust denying or limiting the company's right to be indemnified against the liability.

The director will be liable both personally and jointly with the company and any other persons. If the director was entitled to have been fully indemnified by one or more of the other directors against the liability, they will not be liable.

Personal liability of a director if company goes into liquidation

A director may be held liable by the liquidator of the company also.

Duty not to trade whilst insolvent

As well as the general duties detailed above, directors have a duty to prevent the company from trading if it is insolvent. The definition of solvency is ‘*able to pay their debts as and when they fall due.’* When new debts are incurred by the company, directors must ensure the company can pay these debts as they fall due. Further thought needs to be given as to whether the company will become insolvent because of incurring the debt. A director must be constantly aware of the company’s financial position. If a director has been found to be trading a company whilst insolvent, they may become personally liable.

It is a defence if the director had reasonable grounds to expect and did expect the company was solvent and would remain solvent after incurring the debt and any other debts. It is also a defence if, when the debt was incurred, the director had reasonable grounds to rely on advice provided that the company was solvent. If the director was not partaking in the management of the company because of illness or some other good reason or if they took all reasonable steps to prevent the company from incurring the debt, these will also be defences against insolvent trading.

If you have just become a director of a company that you suspect is insolvent, you should contact a legal practitioner urgently. There may be available avenues of defence if you act immediately upon your appointment.

Duty to keep proper books and records

It is an obligation for each company to keep proper books and records – this means up to date financial records and evidence of all company accounts and liabilities. If a company fails to keep proper books and records, it may be an indicator of insolvency. A director is responsible for ensuring the company complies with keeping financial records adequately recording transactions.

Unreasonable director-related transaction

If a director or nominee received an unreasonable benefit either by paying money, issuing securities or incurring obligations, the director may be held liable for the loss suffered by the company because of entering into the transaction.

Preference payments

If payments are made to certain creditors which prioritise debts over other creditors, the liquidator will request these payments be paid back by creditors to become part of the pool of assets the liquidator will divide amongst creditors equally.

Director Penalty Notices

A director can be held personally liable by the ATO if they fail to lodge or remit PAYG withholding tax or pay superannuation contributions. Please refer to our detailed article on Director Penalty Notices here: How powerful is the Australian Taxation Office? Very, according to Directors Penalty Notices!

The above is general guidance only and does not replace the need to get specific advice. If you are a director and unsure of your obligations or liabilities, we strongly recommend you obtain legal advice as soon as you become aware of any of the above. Ignoring any of these issues may likely become detrimental personally.