Plain English Guide to

The Responsibilities of a Director

Being appointed as a Director of a company is very important. Not only does it increase your personal day-to-day responsibilities, it also increases the responsibility and accountability you have to the company and its shareholders.

A Director has an obligation to ensure that a company operates at the highest possible standards, complies with the relevant legislation governing corporations and that it attends to basic "housekeeping" tasks appropriately.

The penalties that can be applied to Directors who fail to meet these obligations are considerable. If you are a Director of a company, make sure that you understand your rights and obligations – you could be exposed to a number of legal liabilities!

What is the role of a director?

Directors are generally responsible for controlling a company's business. The rules setting out the powers and functions of directors are usually encompassed in the company's constitution. Each company will operate slightly differently and if you are offered a director's role, familiarise yourself with the constitution so that you can fully understand what is expected of you.

Whatever the company, all directors should be up-to-date with what the company is doing. This includes:

- Knowing how any proposed actions will affect the company's performance, particularly if it involves a significant sum of money;
- Getting appropriate legal and accounting advice when needed;
- Taking an active role in directors' meetings;
- Ensuring they have access to up-to-date financial data that can be used to assess the company's performance.

Saying "I did not know" is no excuse, you are liable for the actions of every director

Can anyone be a director?

It is illegal to act as a director or company secretary (or to manage a company) without Court consent if you have previously been declared bankrupt or have been convicted of various offences, eg. fraud, insolvent trading or breaching directors' duties.

If you are not allowed to be a company director or secretary, you are not permitted to manage a company and there are serious legal consequences for setting up “dummy” directors if you are effectively managing the company yourself.

What are the legal obligations of directors?

A director has a duty to the company, including its shareholders, employees and creditors, as well as to its regulators to:

- Act honestly and carefully;
- Know what the company is doing;
- Take care when handling other people’s money;
- Make sure the company can pay its debts;
- Ensure that proper financial records are kept;
- Act in the company’s best interests;
- Use any information gained through the director’s position properly and ethically.

What do you have to tell ASIC about your company?

Every year you must:

- Pay your company’s annual review fee;
- Pass a solvency resolution;
- and, Keep ASIC informed of changes in your company details.

Do you have to keep records and registers?

Directors are personally responsible for maintaining proper company records and must ensure that the company keeps up-to-date financial records that:

- Explain the company’s financial position and performance;
- Correctly record and explain its transactions.

Small proprietary companies (defined by the Corporations Act) may not have to prepare annual financial reports, but must retain financial records for managing and measuring the company’s progress, tax and financing capacity.

Large proprietary companies, public companies and non-profit public companies must prepare financial reports, have them audited and lodge them with ASIC.

What financial records does a company have to keep?

A company is generally expected to keep the following financial records:

- General ledgers recording all the company's transactions and balances;
- Cash records e.g. bank statements, deposit books and petty cash records;
- Debtor and sales records e.g. delivery dockets, invoices and statements, lists of debtors and their balances and lists of all sales transactions;
- Creditor and purchases records e.g. purchase orders, invoices and statements received and paid, lists of creditors and lists of all purchases;
- Wages and superannuation records;
- A register of property, plant and equipment showing transactions and balances in relation to individual items;
- Inventory records;
- Investment records e.g. contract notes, dividend or interest notices;
- Tax returns and calculations e.g. income tax, group tax, fringe benefits tax and GST returns and statements;
- Deeds, contracts and agreements.

What is corporate governance?

Directors of a company are responsible for corporate governance activities – the processes by which an organisation is directed, controlled and held to account.

A good corporate governance program within a company incorporates two very important elements: planning and monitoring. The company must have a systematic way of managing its compliance with the relevant legislation that applies to their business eg. the Corporations Act, the Occupational Health & Safety Act, the Trade Practices Act, the Income Tax Act and many more.

In addition to this planning, the company must also have in place a process for monitoring its activities, identifying any breaches of compliance and subsequently rectifying them.

How do you know what legislation applies and whether your company is compliant?

An experienced commercial lawyer will be able to advise which legislation applies to a particular company. In addition, the lawyer will be able to audit a company's records and practices to ensure compliance, or provide advice and assistance in reducing the risk of non-compliance.

Risk management is a key element of a director's role and a good corporate governance program is essential. Time and resources spent in ensuring compliance now can save considerable costs and resources spent in defending a court action later.

What happens if a director doesn't fulfil their obligations?

If a director is found to have been negligent in their duty, or dishonest, significant penalties can be imposed on such director personally.

As the company watchdog, the Australian Securities and Investment Commission (ASIC) investigates corporate crime and may take various steps against directors who fail in their duties. Penalties such as hefty fines, damages payments, or even jail terms have all been imposed on company directors in the past.

What happens to the directors if the company is found to be trading while insolvent?

Allowing a company to trade while insolvent could have serious ramifications for individual directors. If a director is found to have knowingly allowed a company to trade while in financial difficulty, he/ she could be held personally liable for the debts incurred to liquidators or creditors - and could even be found guilty of criminal action.

Typical signs of financial difficulty which are indicators of insolvency include:

- Difficulty paying trade suppliers and other creditors within their trading terms;
- Difficulty meeting loan repayments on time or keeping within overdraft limits;
- Legal action being taken or threatened by trade suppliers or other creditors over money owed to them;
- Low operating cash flow from the main business;
- Trade suppliers refusing to extend further credit to the company;
- Trade suppliers requiring COD;
- and, The company not making its group tax, workers compensation premium or BAS statements on time.

If you are a director and suspect that your company may be insolvent, seek advice from an accountant or experienced commercial lawyer as to the steps you should take to limit the downside to directors. Don't simply ignore the situation, it's not worth the risk.

Most importantly, if you are in any doubt as to your responsibilities as a director, or whether your company is compliant with the relevant Acts, seek advice immediately.