**Purpose and nature of Corporations Act**

The main purpose of the Corporations Act is to regulate the operations of companies in Australia.

Impact of the Act on company formation, operation and governance\* includes:

* Powers and duties of directors
* Written constitution
* Replaceable Rules
* Prospectus
* Rights of shareholders

\*Corporate governance is the set of policies, laws, and institutions affecting the way a corporation is directed, administered or controlled.

**Director**

**Appointment of director**

To be a director a person must

* Be over 18 yrs.
* Not be disqualified from managing a corporation.
* Give a signed consent.

Disqualification

* Convicted of an offence related to a corporation.
* Became a bankrupt
* In the last seven years, as an officer of 2 or more companies, was proved responsible for its failure.

**Powers of directors**

Directors can

* exercise all powers set out in the constitution, except where the constitution requires that power is exerted through an AGM e.g. declare dividends subject to shareholder approval,
* manage the business e.g. issue shares and debentures, make decisions that are financial but also ethical,
* execute negotiable instruments e.g. sign cheques,
* delegate their powers e.g. to a managing director to manage day to day operations.
* have access to information e.g. inspect the books, be fully informed and attend all meetings.

**Duties of directors**

Directors should

1. Exercise the degree of care and diligence that a reasonable person in a similar position would exercise. (Business Judgment rule)

*Business Judgment Rule*

A director who makes a business judgment with care and diligence is one who:

**•** makes the judgment in good faith (a sincere intention to deal fairly with others)

**•** does not have a material personal interest in the outcome

**•** is reasonably informed about the situation.

**•** believes rationally that the decision is in the best interests of the company

1. Act in good faith (honestly and sincerely) in the interests of the company. Directors must avoid conflicts of interest, disclose conflicts and manage any conflicts that arise.
2. Disclose any material personal interest in the affairs of the company.(Duty to disclose)

*Duty to disclose*

A director is required to disclose:

* Strong interest and potential conflicts which might affect his impartiality(unprejudiced) in a decision.
* the extent of his interest and how it affects the company.

Where an interest exists, he must not be involved in the decision or vote on it.

1. Not make improper use of information or improper use of their position as a director.
2. Ensure the company does not trade while insolvent. Report to the liquidator if the company is being wound up.
3. Ensure relevant information is lodged with ASIC .e.g. financial reporting

*Financial Records*

Directors are required to ensure that a company complies with obligations on

* Keeping financial records
* Preparing financial reports to show financial position and performance
* ‘True and fair’ financial statements are prepared and audited.

**Liabilities of director**

Directors

* who allow a company to incur a debt which would make it insolvent or
* who allow an insolvent company to incur a debt

may find themselves liable for the debt.

Directors who fail to perform their duties may be:

* Guilty of a criminal offence with a penalty of up to $200,000 and imprisonment up to 5 years.
* Prohibited from managing a company.

***Review Questions***

1. What is the main purpose of the Corporations Act?

*Suggested Answer:*

The main purpose of the Corporations Act is to regulate the operations of companies in Australia.

Impact of the Act on company formation, operation and governance includes powers and duties of directors, written constitution, replaceable rules, prospectus and rights of shareholders.

1. A. Friend has been invited to join the board of a small Australian Company. He was told that it would not involve a huge work load, ‘just attending meetings and signing documents’. Advise him on the importance of devoting time to his duties and potential liabilities of a director

*Suggested Answer:*

Company directors must remain fully informed and involved in company meetings. They have wide ranging power to affect the running of the company and to make financial and ethical decisions.

Directors are required to be honest, have caution in communicating with others on behalf of the company, and be knowledgeable about what is occurring in the company and to work to ensure debts can always be paid.

They must be cautious at all times and remain fully informed as they may be personally liable –this means they must pay careful attention at meetings and only sign documentation that they understand and agree with. If not, they may find themselves liable for the debt they cause the company to incur.

1. Explain the ‘business judgment rule’, using an example.

*Suggested Answer:*

A director makes a business judgment with the care and diligence if he:

**•** makes the judgment in good faith

**•** does not have a material personal interest in the outcome

**•** is reasonably informed about the situation

**•** believes rationally that the decision is in the best interests of the company

For example, in making a decision to invest in one of two companies, a director must be fully informed about the nature of the investments and prospects. If he has part ownership in one company he must disclose it and refrain from the decision because of the conflict of interest. He must also make sure the decision he made is in best interest of the company and the decision is not bias to any party.