

Part 3

The duty to act with reasonable care skill and diligence

This fact sheet covers:

- ▶ What is the duty to act with reasonable care, skill and diligence?
- ▶ Why is taking care of the LALC's financial position (and preventing insolvent trading) an important part of this duty?
- ▶ Where can you find this duty in the *Aboriginal Land Rights Act 1983* (NSW) and model code of conduct?
- ▶ What are some tips to help you meet this duty in your role as a LALC board member?

This fact sheet is part of a toolkit which provides information on the key legal duties of Local Aboriginal Land Council (LALC) board members.



Summary

In this fact sheet, we discuss the duty to act with reasonable care, skill and diligence and explain how to meet this duty in your role as a LALC board member.

What is the duty to act with reasonable care, skill and diligence?

This duty requires you to, at all times:

- take your role as a board member seriously
- use any skills and experience you have for the benefit of the LALC
- give sufficient time, thought and energy to any tasks you undertake and to decisions you are required to make, and
- monitor the affairs, activities, strategic direction and financial position of the LALC

This duty is particularly important when it comes to the financial affairs of the LALC. The duty requires you to:

- understand the LALC's current financial position at all times, and
- prevent the LALC from continuing to take on debts if you know, ought to know or suspect that the LALC can't meet its current debts when they fall due (commonly known as the 'duty to prevent insolvent trading')



How should you use your skills and knowledge in your role as a board member?

You don't need to have any particular skills or qualifications to be a board member. However, you do need to use whatever skills and experience you have for the benefit of the LALC and put reasonable effort into tasks you take on as a board member.



Example – using your skills

- If you are a nurse on the board of a LALC, you do not need to use your nursing skills to provide medical services to members – but you do need to use your knowledge to help the board make good decisions about health service provision in the community.
- If you are a builder on the board of a LALC, you do not need to be out fixing all the LALC's properties – but you should advise the board on any basic issues on maintaining safe building standards.

If your board does not have the required skills on a particular matter, this duty requires you to ask for help from someone who does have the relevant skills and expertise.



Example – getting expert advice

- Your board may need to ask an accountant or auditor to help the board understand a complex financial transaction (such as a land development deal).
- Your board may need to consult a building surveyor to advise the board on whether the structure of a property is safe for occupants.
- Your board may need to ask a lawyer to review a contract for a property lease transaction.

What actions should you take to meet this duty?

As a board member, you must take your responsibilities seriously and put the required effort into the tasks you take on. Board members who are acting diligently will be well prepared for meetings, and will make sure they are properly informed about their LALC's operations and activities by:

- being familiar with your LALC's Community Land and Business Plan (**CLBP**), Rules and Code of Conduct
- reading board papers before board meetings
- reviewing board papers and minutes for meetings you were unable to attend, and
- following up on tasks from previous meetings you have agreed to do

You must understand the issues the board is making decisions on – you can't just rely on the opinions of others on the board and become a 'rubber stamp'. All board members have a duty to make inquiries and satisfy themselves that the LALC is being run well and is operating in a safe and efficient manner.

How does this duty apply to the decisions a board makes?

The duty of reasonable care doesn't mean that all the decisions your board makes have to be perfect. 'Reasonable' in this sense means the degree of care and diligence that a reasonable person in a like position in a LALC would exercise in the same circumstances.

Sometimes, even though a board has thoroughly researched, discussed and come to a decision on a matter (for example, approved a contract for a developer to build properties on LALC land), the outcome does not turn out as the board had hoped (for example, the project stalls due to unforeseen environmental issues).



The law recognises that often boards must make difficult operational decisions, and that no one has the ability to accurately predict the future. Just because a decision turns out not to have been beneficial for the LALC, does not mean the LALC's board members have breached their duty to act with reasonable care in making the decision. A decision about a matter will be considered to be made with reasonable care if the board can show that:

- the decision was made in good faith (ie. honestly) and for a proper purpose
- there was no conflict of interest affecting the decision
- they informed themselves about the subject matter to an appropriate extent, and
- they rationally believe that the decision was in the best interests of the LALC

This is known as the 'business judgment rule'.



Remember

Taking calculated risks that might not work out is OK – but making reckless, ill-informed decisions without thinking about the consequences could be a breach of this duty.

Examples of how this duty works

Examples of situations that involve the duty to act reasonable care, skill and diligence are below.



Example – the proud but busy board member

You were delighted when your LALC's members elected you to the board. It's a LALC with a strong reputation in the network, and you are proud to be involved in governing the organisation.

You eagerly attended your first few monthly board meetings. However, since then things have become busy in your work and family life and you are finding it hard to attend regular meetings. You turn up when you can, but even then you have rarely had time to look at the board minutes and paperwork. You console yourself by thinking 'Oh well, I'm just a volunteer' and occasionally say to yourself 'They are lucky to even have someone with my business experience on the board anyway'. Also, you feel that the Chairperson is a smart woman so the decisions the board are making in your absence are probably fine.

The legal duty

If you accept a position as a board member (even if reluctantly!) you have a legal duty to exercise reasonable care, skill and diligence in governing the LALC.

Not being able to attend an occasional board meeting is OK, but failing to attend regular meetings, without approved leave of absence, and failing to pay attention to the 'goings-on' of the board and the LALC, could be indicators of a breach of this duty.

If anything goes wrong in the LALC (for example, it gets into financial trouble and starts to trade while insolvent, or someone starts to defraud the finances) you could be legally responsible. It will not be a defence to say, 'I wasn't at the meeting when they made that decision' or 'I'm just a volunteer'.

If you can no longer commit to giving the board and your role the time required, you should carefully consider whether you should remain on the board.



Example – the worried board member and an inaccurate media release

You are on the board of a LALC involved in a dispute with a local government council that is getting lots of media attention.

At a board meeting, the CEO hands around a number of papers, including a media release about the dispute for the board's approval. You are not quite sure if the media release is accurate and you are concerned that some of the statements in the media release are not backed by fact or possibly are an exaggeration. However, there is a lot of business to get through at the meeting and you decide not to speak up and make an issue of it.

The legal duty

As a board member you have a duty to make proper inquiries when you are unsure about something.

Don't rely on others, especially when you have a feeling something is wrong, or you need more information to satisfy yourself of the right decision to make. The media release could contain inaccurate or untrue statements and could leave your LALC open to complaints, damage to its reputation or even legal action. Your duty is to ask probing questions, and guide and protect the LALC and its reputation.

Why is taking care of the LALC's financial position (and preventing insolvent trading) an important part of this duty?

A key aspect of the duty of reasonable care, skill and diligence is your legal responsibility to understand the finances of the LALC and exercise overall control over its financial affairs. Board members are accountable for a LALC's solvency (which means the LALC's ability to pay its debts when they are due).



Note

You need to understand your LALC's current financial position so you can make informed decisions about whether the LALC can responsibly enter new transactions, contracts or take on other financial commitments or debts.

It's unacceptable to think 'Oh I don't have to think about the dollars, that is the CEO and Chairperson's job!' – **all board members have a duty to properly inform themselves about the LALC's financial position and take part in financial decisions.**

While this duty applies to all board members, the actions required to comply with the duty will be affected by your LALC's financial size.

If you are on the board of a small LALC that has limited funding and assets and spends very little money from month-to-month, the financial reports will probably not be very complicated and you should be able to understand your LALC's financial position.

Alternatively, if you are on the board of a large, well-funded LALC which owns many properties, runs a number of community services and has a number of employees and a large annual turnover, your responsibility to understand the finances is going to be correspondingly larger and may therefore require more of your time and attention.

The most important aspect of the duty to use reasonable care when dealing with the finances of the LALC and the requirement to prevent insolvent trading. While the term 'trading' is a business term that does not necessarily fit well into the LALC environment, the duty still applies to LALCs. **Read the box below carefully so you understand this duty.**



Caution – the duty to prevent insolvent trading

As a board member, your key duty regarding the finances of your LALC is to make sure it's solvent – that is, that it's able to pay its debts when they are due.

You must not allow your LALC to continue to take on further debts if you know or reasonably suspect that the LALC can't pay its current debts when they are due, or will be unable to do so if it takes on the further debt.

Many LALCs operate on a very tight budget and sometimes sail 'close to the line' in terms of their finances. For example, income may fluctuate from year to year, or a funding stream that your LALC relies heavily on may be cut without much notice. These circumstances make it very difficult to gauge a LALC's true financial position at any point in time.

Occasionally LALCs get into financial trouble. As a board member, it can be very difficult to distinguish between a temporary lack of cash flow and a dire financial situation. (For more information on this topic, see [our fact sheet on insolvency and your organisation](#)).

Some of the potential warning signs or indicators of insolvency may include:

- continuing losses over successive financial reporting periods
- overdue tax debts, for example 'pay-as-you-go' (PAYG) instalments, GST, and superannuation guarantee contributions
- increasing levels of bad or doubtful debts, the collapse of a significant creditor or withdrawal of a major source of funding
- inability to borrow funds or get loan approvals
- cheques issued by the LALC being returned dishonoured, cheques being issued post-dated (that is, dated after the date on which they are actually written), or not being sent out on time
- delays in paying suppliers resulting in stricter credit terms or suppliers insisting on 'cash on delivery'
- payment to creditors outside trading terms
- payment to creditors of rounded sums which are not reconcilable to specific invoices
- legal proceedings being initiated or threatened by creditors, including the Australian Taxation Office or court decisions being made against the LALC, and
- inability to produce timely and accurate information on the organisation's financial performance and position

If your LALC has any of the above indicators of insolvency, your legal duty is to:

- **Take action immediately** – do not do nothing and hope for the best.
- **Inform yourself of the LALC's financial situation** – stay informed about the financial affairs of the LALC, and regularly assess the LALC's solvency. Investigate and fully understand the financial difficulties your LALC is experiencing.
- **Seek professional advice** – ask an accountant, insolvency expert or auditor to look over your LALC's finances (again, do this as early as possible as a professional may be able to advise of immediate actions you can take to address the situation). Consider and act appropriately on any advice received in a timely manner.
- **Do not approve any further debts** – this includes not entering into transactions, contracts or arrangements requiring payment (for example, contracts for buying goods and services, hiring staff).
- **Agree as a board on a plan of action and implement it (based on professional advice)** - this may include making hard but necessary decisions, for example to close services, reduce staff hours or hold-off on projects. It may also include an agreement about at what point the board might need to seek advice on other options.

Example of how this duty works

An example of a situation that involves the duty to prevent insolvent trading is below.



Example – the board member and the urgent repairs

You are a board member for a LALC which employs 15 staff.

You had a fair understanding of the financial position of your LALC in July last year, when the board approved the yearly financial statements.

At that time, the CEO gave a detailed briefing to the board about the finances and you understood that, although the organisation had 'sailed pretty close to the wind' all year, at the end of the financial year the organisation managed to achieve a surplus of \$20,000.

Eight months later, you attend a board meeting and the CEO tells you and the other board members that the LALC needs to enter into a contract to get substantial repairs done to two LALC properties at a cost of \$50,000. The CEO tells you that the repairs are extremely urgent and asks the board to approve the signing of the repair contracts there and then, so the works can begin immediately.

You feel that if you asked any questions you would be seen to be holding up the process, and would frustrate the CEO and the Chairperson, who look stressed.

The legal duty

The legal duty to act with reasonable care, skill and diligence includes a duty to monitor the financial situation of your LALC – and in particular a duty to not incur new debts if you know or suspect your LALC can't meet them when they are due.

The only way you can be sure not to breach this duty is to ensure you have a clear understanding of the LALC's current financial position. It is not sufficient to rely on your financial knowledge from eight months ago.

The CEO may well be focussed on the day-to-day running of the LALC, and that's why it's your duty to look at the bigger picture. Ask for the financial information you need to confirm that the LALC can afford these renovations. Get professional advice if needed. Be satisfied that the LALC can meet all its debts – this is a duty of all board members, not just the Chairperson.

This situation might also require you to exercise your duty to use reasonable care and skill to inquire about current health and safety issues arising out of the need for urgent maintenance works. Are the tenants safe in the properties? Does the LALC need to re-accommodate them while you work out the finances and arrange for the repairs? What are the risks currently posed by the repair work? What can be done to eliminate these risks while you work out a feasible plan to get the repair work done?

Where can you find this duty in the *Aboriginal Land Rights Act 1983* (NSW) and model code of conduct?

The wording of this duty may not be exactly the same, but its elements can be found in [section 176 of the *Aboriginal Land Rights Act 1983* \(NSW\) \(ALR Act\)](#) and in the [model code of conduct](#).



Requirements under section 176 of the ALR Act

[Section 176 of the ALR Act](#) sets out how every board and staff member must act and behave. The duty to act with reasonable care, skill and diligence is reflected in the wording of this section by requiring board members to exercise a reasonable degree of care and diligence in their role:

- (1) *Every councillor, Board member and member of staff of an Aboriginal Land Council or an advisory committee, must:*
 - (a) *act honestly and **exercise a reasonable degree of care and diligence** in carrying out his or her functions under this or any other Act, and*
 - (b) *act for a proper purpose in carrying out his or her functions under this or any other Act, and*
 - (c) *not use his or her office or position for personal advantage, and*
 - (d) *not use his or her office or position to the detriment of an Aboriginal Land Council.*



Requirements under the model code of conduct

The model code of conduct for LALCs in [Schedule 3 of the ALR Regulations](#) sets out in further detail how board members must act and behave.

The duty to act with reasonable care, skill and diligence is reflected in the following clause of the model code of conduct:

- **Clause 9** requires officers of the LALC to exercise due care and diligence in performing their duties and ensure that their knowledge, skills and technical competencies suffice to discharge their responsibilities.

Tips to help you meet this duty in your role as a LALC board member



Tips

- **Prepare for and attend board meetings** - read the papers and financial statements before the meeting. If you regularly find you can't do this, consider whether you should continue to serve on the board, as you may risk falling in breach of this duty.
- **Ask questions and speak up** - if you don't understand something or want further information, make sure you speak up. Ask questions and seek clarification about matters, discussions or proposed resolutions. Don't simply go along with the rest of the board if you disagree with their views or decision.
- **Take action** – make sure you follow up on things you said you would do between meetings. Adopt a culture of having 'action' items in your minutes and reviewing the status of actions items at the following meeting. Follow up immediately on any problems identified in the financial statements or audits. Make sure the board takes action if there is a concern about whether debts can be paid on time.
- **Make considered decisions** - when making a decision or taking action, ask yourself, 'Have I exercised the degree of care and thoroughness that a reasonable person in my position would give to this kind of decision or situation?' If you need more information to make your decision, speak up and make sure you get it. You don't need to make perfect decisions, but you do need to make thoughtful, considered ones.
- **Keep yourself informed** - know what events and activities are being undertaken by the LALC and ensure that proper care has been taken to protect the LALC and all those involved (for example, making sure health and safety matters have been addressed, checking that insurance is up to date).
- **Understand financial information** - make sure you are receiving clear information about the finances of your LALC. If they are presented in a format that you find confusing, ask that they be presented in a basic overview or simplified format. If you need to, get training in basic financial literacy so you can improve your understanding of the LALC's finances. If you don't receive any financial information at all, consider your position carefully. You could be at risk of breaching this duty – and ignorance is not a defence.
- **Proceed with caution** - take special care when committing to large contracts, spending funds of the LALC or borrowing funds for the LALC to use. Avoid undertaking activities that might place undue risks on the LALC's funds or assets.



More information

Justice Connect's LALC Service provides free legal information, training and advice to LALCs. To find out more visit [our website](#) or [contact the LALC Service](#).