



STEWARDSHIP & RISK

Insolvent Trading: The Duty Every Director Underestimates

Reasonable suspicion of insolvency is enough to trigger this duty. Certainty is not required

Volunteer directors of associations often assume the insolvent trading duty is a commercial sector concern, something relevant to company directors running for-profit businesses, not people generously giving their time to a membership organisation. This assumption is wrong, and it is wrong in a way that carries serious personal consequences.

Which rules apply to your association?

The law depends on how your association is set up. A **company limited by guarantee** follows the Corporations Act 2001 (Cth) and its constitution. An **incorporated association** follows its state or territory associations Act and its rules. A **registered charity** also follows the ACNC Act and the ACNC Governance Standards, and some Corporations Act rules are replaced for charities that are companies. Check your own governing documents, and get advice before decisions with legal consequences.

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The Duty Applies To Your Association Too

Section 588G of the Corporations Act 2001 (Cth) imposes a duty on every director to prevent their company from incurring a debt while the company is insolvent, or where incurring that debt would itself cause insolvency. This applies to a company limited by guarantee exactly as it applies to a commercial company, including CLGs that are registered charities. The exemptions some other sections of the Act extend to not-for-profits do not extend to this one. If your association is a CLG, your directors carry this duty regardless of how the organisation is otherwise regulated. Incorporated associations have equivalent or similar obligations under their state or territory Act, and every registered charity must not operate while insolvent under ACNC Governance Standard 5.

The Threshold Is Lower Than Most Directors Assume

The duty is triggered not by certainty of insolvency, but by reasonable grounds for suspecting it, and that suspicion can be attributed to a director either because they actually held it or because a reasonable person in a like position would have. Insolvency itself is assessed using the cash flow test, whether the organisation can pay its debts as and when they fall due, not the balance sheet test of whether total assets exceed total liabilities. An organisation can hold substantial assets and still be insolvent in the sense this duty cares about, if it cannot meet its immediate payment obligations as they arise.

A director does not need to know for certain that the organisation is insolvent before this duty bites. Reasonable grounds for suspecting it is enough, and that is a considerably lower bar than most volunteer directors assume protects them.

What Is Actually At Stake

The consequences of breaching this duty are severe: personal liability to compensate for the debts incurred, civil penalties for an individual of up to the greater of 5,000 penalty units (\$1.82 million at the penalty unit value applying from 1 July 2026) or three times the benefit obtained or detriment avoided, disqualification from managing any corporation, and in cases involving dishonesty, criminal prosecution, which is not something the safe harbour protection discussed below can shield a director from. A further point deserves specific attention given the record keeping discipline this series has argued for throughout: where an organisation's books and records are inadequate, the law presumes, in recovery proceedings, that the company was insolvent throughout the period its records were deficient, unless the director proves otherwise, connecting directly to the financial oversight and minute-taking discipline covered earlier in this quarter. Poor records do not just make a defence harder to mount. They actively work against the director in a dispute.

The Safe Harbour: A Proactive Path, Not A Loophole

Section 588GA provides a defence, but one that requires active, documented, good-faith effort rather than passive hope. A director who, once they suspect financial difficulty, begins developing a course of action reasonably likely to produce a better outcome than immediate administration or liquidation, and who pursues it, can be protected from civil liability for debts incurred in connection with that plan. The protection comes with strict preconditions that a board cannot overlook: the organisation must be meeting its employee entitlements, including superannuation, and must be substantially up to date with its tax reporting obligations. A board that has let either lapse cannot access this protection no matter how its restructuring efforts otherwise are.

- Monitor cash flow, not just the balance sheet, connecting directly to the Finance, Audit and Risk committee discipline discussed earlier in this quarter, since a healthy asset position does not protect against this specific duty.
- Treat reasonable suspicion of financial difficulty as the trigger for action, not certainty, and document the board's response from that point forward.
- Confirm employee entitlements and tax reporting are current before assuming safe harbour protection would actually be available if it were ever needed.
- Maintain adequate financial records at all times, not only when a problem is suspected, since inadequate records work against the organisation retrospectively under the law's insolvency presumption.
- Seek professional advice immediately once concern arises, since the safe harbour protection depends on the board actively developing and pursuing a credible plan, not simply continuing to trade and hoping the position improves.

This is not a duty reserved for commercial company directors. It sits, quietly, underneath every association structured as a company limited by guarantee, and it rewards exactly the financial stewardship discipline this series has argued for throughout, oversight, honest documentation, and early action, over the instinct to keep trading and hope the position improves on its own.

This is one of the practical governance topics built into our Board Director course, alongside the papers, tools and frameworks that turn the principle into your board's actual practice. [Explore the course](#)

Annie Gibbins

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BOARDROOM ACTION WORKSHEET

Insolvent Trading: The Duty Every Director Underestimates

Turn the resource into evidence, a decision and an accountable next step. Keep the completed record in your association's approved board records system.

1 What is the issue or decision?

State the governance question in one clear sentence.

2 What evidence do we already have?

Record the facts, source documents and stakeholder evidence available now.

3 What evidence is still needed?

Identify the legal, regulatory, financial, member or operational information still required.

4 What is the agreed next action?

Capture the owner, timeframe and how the matter will return to the board.

Action owner	Review date	Board decision or resolution

General education, not legal, financial, tax, clinical or governance advice. Confirm specifics at the relevant primary source or with your own qualified adviser. Nexus Leadership is operated by Lipstick Consulting Pty Ltd · ABN 15 619 120 482.

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