
Managing Financial Difficulties and Insolvency in Charities - CC12

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What is this guidance about?

1. All charity trustees have a fundamental duty to protect the assets of their charity and to apply them properly for the objects of the charity. Given the variety of activities and sources of funds, many charities will at some point face financial uncertainty. If a charity finds itself in financial difficulties, the risk of insolvency may be greater if the trustees do not take action to address the situation.
2. The aim of this guidance is to provide advice to charity trustees, outlining steps that may be taken to lessen the risks of insolvency and describing their legal position. Potential insolvency can be a complex and detailed matter; professional advice may be necessary and we recommend that it is taken as appropriate.
3. The principles in this guidance apply to all charities. If the charity was formed under its own Act of Parliament or has been incorporated by Royal Charter or Letters Patent, then some of the details may be different.

Meanings of words and expressions used

4. In this guidance:

The **1993 Act** means the Charities Act 1993.

The **Insolvency Act** means the Insolvency Act 1986, as amended by the Insolvency Act 2000 and the enterprise Act 2002.

Charitable company means a charity which is a company formed and registered under the Companies Act 1985, or to which the provisions of that Act apply.

Endowment funds are funds which the trustees are legally required to invest or to keep and use for the charity's purposes. Endowment may be expendable or permanent. Trustees have the power to apply **expendable endowment** for the purposes of the charity.

"Going concern" means the ability of an organisation to continue in operational existence for the foreseeable future.

Governing document means any document which sets out the charity's purposes and, usually, how it is to be administered. It may be a trust deed, constitution, memorandum and articles of association, Scheme of the Commissioners, conveyance or will.

An **insolvency practitioner (IP)** is an individual qualified under Part XIII of the Insolvency Act to act in various capacities, including, in the case of corporate insolvency, as liquidator, administrator, administrative receiver or as supervisor of voluntary arrangements. In the case of personal insolvency, it is an individual qualified under that Part of the Insolvency Act to act in various capacities, including as a trustee in bankruptcy, interim receiver, or trustee or supervisor of a voluntary arrangement. It is a criminal offence to act without qualification.

Permanent endowment is property of the charity (including land, buildings, cash or investments) which the trustees may not spend as if it were income. It must be held permanently, sometimes to be used in furthering the charity's purposes, sometimes to produce an income for the charity. The trustees cannot normally spend permanent endowment without our authority.

The terms of the endowment may permit assets within the fund to be sold and reinvested, or may provide that some or all of the assets are retained indefinitely (for example, a particular building).

Restricted income funds are funds to be used for specific purposes, set out by, for example, the donor(s) or the terms of a public appeal, within (but narrower than) the objects of the charity.

Trading subsidiary means any non-charitable trading company, the majority of which is owned by one or more charities to carry out trading activities on behalf of the charity/ies with a view to raising funds in a tax-efficient manner.

Trustees means **charity trustees**. **Charity trustees** are the people who, under the charity's governing document, are responsible for the general control and management of the administration of a charity. In the charity's governing document they may be called trustees, managing trustees, committee members, or governors, or they may be referred to by some other title. **Directors** means the charity trustees of a charitable company.

Unincorporated charity means a charitable trust or association.

Unrestricted income funds are funds to be spent at the discretion of the trustees in furtherance of the objects of the charity.

Must or **need to** are used to refer to actions that the trustees, or their agents or employees, have to take by law.

Where we use terms such as the trustees **should** or we **suggest, recommend** or **advise** we are referring to actions which the trustees, their agents or employees could take, and which we consider to be good practice, but which are not legal requirements.

What is insolvency?

The law

5. The legal framework for determining and resolving insolvency for charitable companies is set out in the Insolvency Act. We recommend that, as a matter of good practice, a similar approach is adopted for unincorporated charities.

6. Charitable companies are "legal persons", can incur liabilities, and can become "insolvent". Such a charity can be deemed insolvent either:

- when it is unable to pay its debts as they fall due; or
- when the value of its assets is less than the amount of its liabilities taking into account its possible and prospective liabilities.

7. These two tests have a legal basis for **charitable companies**, as they are aspects of the definition of inability to pay debts in s.123 of the Insolvency Act. (See paragraph 10 for the position when a charitable company is acting as trustee.)

8. Unincorporated charities are not "legal persons" and cannot technically incur liabilities, which are instead incurred by their trustees, acting on their behalf. Unincorporated charities

cannot, therefore, technically become insolvent. However, a charity may reach the financial state where the value of the assets in the trust which are available to the trustees to settle their liabilities (see below) are insufficient. In the context of unincorporated charities "insolvency" is used to describe this situation, and the tests referred to in paragraph 6 may be relevant when deciding whether an unincorporated charity has reached it.

9. As long as the decision to incur a liability on behalf of the charity was properly made (eg at a meeting of which full notice had been given to all of the trustees), then each and every trustee shares responsibility for that liability, unless the terms of the agreement incurring the liability specify otherwise. Trustees normally have a right of recourse to the trust assets for reimbursement of liabilities properly incurred. In most circumstances both the responsibility and the right of recourse remain even after an individual has retired as a trustee (but note that this is not the case when the liability stems from a contract of employment - any claims against the trustees under that contract are against the trustee body as it stands at the time). The concern for trustees is that, unless the debts and liabilities have been incurred on the basis that they will only have to be met if there are sufficient funds in the trust to do so, the trustees may have to meet the debts and liabilities personally if there are in fact insufficient funds in the trust.

10. A charitable company's position in relation to permanent endowment and restricted income funds it holds as trustee is as described in paragraph 9 for individual charity trustees (a company cannot hold such funds as part of its own corporate property as it is implicit that a company is free to spend any or all of its property). Funds that are held by a company as

trustee are not part of the company's property for the purposes of the law of corporate insolvency.

Tests for insolvency

11. The first of the tests referred to in paragraph 6 can be seen as a cash flow or short-term liquidity test. It shows whether a charity has sufficient resources available (cash, short-term debtors, investments etc) to meet all of its immediate liabilities and to continue to do so in the short term. What constitutes "the short term" will vary according to the circumstances of each charity, but will normally be identifiable from the various budgetary periods adopted. In particular a detailed cash flow forecast showing anticipated receipts and payments during the period under review is normally necessary.

12. The second test is seen as a balance sheet test and focuses on the overall asset position of a charity. It will show whether the charity has enough assets (fixed and current) to meet all of its actual and anticipated liabilities, both in the short term and the long term.

Indicators

13. There are a number of other indicators that a charity might be running the risk of insolvency. It is impracticable to provide a comprehensive list as the situation will vary from one charity to another, but here we give some general advice which it may be helpful to bear in mind.

14. Some general signs of possible difficulties are:

- current assets plus investments are less than current liabilities (see paragraph 11);
- total assets and foreseeable income are less than total liabilities and expected expenditure (see paragraph 12);

- regularly having to spend from reserves because incoming resources are not enough to meet all of the charity's commitments;
- a need to provide additional security for long-term borrowings; and
- pressure from creditors who are chasing overdue payments.

15. These indicators ought not to be looked at in isolation. They are broad indicators and further detailed analysis would be required before any conclusions on solvency could be made.

16. Care must also be taken to look at indicators in relation to different types of funds, ie unrestricted income or restricted funds (both income and endowment). Assets within restricted funds can only be used to settle liabilities which are properly attributable to the administration of those funds for the purposes for which they are held.

Continuing when apparently insolvent

17. Despite failing the tests and appearing insolvent, many organisations continue as going concerns and are not forced to wind up. Charities may, in the short term, be forced to operate over and above agreed credit terms, or to resort to short-term financing, whilst they await an expected large influx of cash. This may arise, for instance, in the case of administrative delays in the payment of a grant.

18. We recommend that the trustees of any charity that appears to be insolvent seek professional advice from an insolvency practitioner before any remedial action is taken. The Insolvency Service web site includes a database of all insolvency practitioners accessible on www.insolvency-service.co.uk/newipsearch.

Preventative action

19. Insolvency can happen overnight, for example where a charity is dependent on grant income which is cut and not replaced by other sources of income. It may also creep up slowly over several years and remain unchecked until the charity can no longer finance its activities.

20. It is essential for a trustee body to have a good knowledge and understanding of the charity and its finances. Although it can be difficult to prevent the overnight collapse, even if it is anticipated, it ought to be possible to prevent or delay the onset of creeping insolvency.

21. The action necessary can be summed up as being "effective management and control". The responsibility for creating this environment rests with the trustees, but will involve all staff members whether paid or volunteers. Trustees may find it useful to read our guidance **The Hallmarks of an Effective Charity (CC60)**.

Management and financial control

22. The trustee body should be made up of people who are able to devote time to running the charity and possess the appropriate skills and abilities.

23. There ought to be regular trustee meetings at which financial reports are provided and fully considered.

24. We recommend that budgets, including cash projections, and business plans be produced at least on an annual basis. Expenditure is often easier to forecast than income and so it is important that expenditure projections include all known liabilities and contingencies.

25. As the year progresses actual results ought to be monitored against budget. We recommend that the trustees review the financial position at least once a month, but this will vary according to the size and stability of the charity. Proper analysis of financial trends and variances from budget may help to assist early identification of financial problems.

26. Sources of income and expenditure ought to be analysed, identifying key components. Risks of insolvency are reduced by having a diversity of income sources and a core of secure funding, avoiding over-dependence on any one source. Possible problems such as uncertainty over grant funding and penalty clauses within contracts may need to be identified - for additional information about contracts see our guidance **Charities and Contracts (CC37)**.

27. We advise trustees to seek and take professional advice before entering certain transactions which may give rise to considerable future financial commitments such as building contracts, lease arrangements and borrowings. The trustees ought to satisfy themselves that it will be possible to meet such commitments in full. Trustees of unincorporated charities may face a higher risk of personal liability where financial commitments have to be met from an uncertain source of future income.

28. Where a charity has investments we recommend that the trustees ensure that procedures are in place to monitor performance. They should consider the need to maintain a diversified portfolio. Normally appropriate professional advice will need to be taken when investing charitable funds. This includes authorised investments in trading subsidiaries when they are in the best interests of the charity. Trustees have a duty to ensure that the investment criteria set out in **Charities and**

Trading (CC35) have been properly met and carry out regular reviews of the continued viability of the subsidiary. More information on this can be found in our guidance **Investment of Charitable Funds (CC14)**.

29. We recommend that strong internal financial controls be established. Please see our guidance **Internal Financial Controls for Charities (CC8)**.

30. This includes properly accounting for Value Added Tax (VAT), income tax through Pay As You Earn (PAYE) and National Insurance liabilities. These are all statutory liabilities and errors in accounting may result in large and unexpected liabilities and penalties. We cannot give advice on tax matters - trustees should contact the Customs and Excise National Advice Service (08450 109000) or the Inland Revenue Charities Helpline (08453 020203), as appropriate.

31. An unexpected accident which leads to a loss for the charity or a claim against it by a third party could present financial difficulties to the charity and may even lead to insolvency. It is possible to cover against such losses by taking out various types of insurance; exactly which ones will be most appropriate will vary from charity to charity, depending on their circumstances and activities. Further details can be found in our guidance **Charities and Insurance (CC49)**.

32. The trustees need also to have regard to controls other than financial ones. Without going into detail these can include organisational controls for getting the best out of staff performance and ensuring that the charity operates in line with its trusts and the expectations of both its beneficiaries and the donating public.

Structure of funds

33. All the funds of the charity should be identified between:

- unrestricted income funds;
- restricted income funds; and
- endowment funds (either permanent endowment or expendable endowment).

34. It is a breach of trust to use restricted funds for purposes other than those for which they were given and the capital of permanent endowment funds can only be spent in particular circumstances with our approval (see **Expenditure and Replacement of Permanent Endowment (CC38)**).

35. An understanding of the nature of the separate funds of a charity is crucial to the understanding of its financial position. Such considerations must be taken into account when analysing the solvency of a charity.

Functional fixed assets

36. Similarly the charity may have substantial funds tied up in functional fixed assets. They are normally for continuing use by the charity and disposal could result in a reduction of activity or even defeat the objects of the charity. It may be difficult to realise the value of such assets quickly, and any disposal is likely to be part of an overall restructuring of activities.

Reserves policy

37. We recommend that charities have a coherent reserves policy. This involves identifying the level of free reserves it needs to ensure that operations continue in accordance with its overall strategy. The process of managing reserves will provide a useful tool in stabilising the charity and early identification of approaching insolvency.

*Recognition and value
of assets and liabilities*

38. For further information please see our guidance **Charities' Reserves (CC19)**. We have also produced two reports which deal with the subject in greater detail - **Charity Reserves (RS3)** and **Small Charities and Reserves (RS5)**. All are available on our website or in printed form.

39. Balance sheets are normally prepared on the basis that the charity will continue as a going concern into the foreseeable future. Functional fixed assets can then be shown at either cost or market value. The exception to this is where there is evidence that the fixed asset is impaired (causing a permanent diminution in value); it must then be shown at the lower value.

40. While the going concern assumption holds true it could be more appropriate to use open market values for assets when considering solvency. However, the value of assets may need to be changed if the going concern basis is no longer applicable since there may be forced sale at lower values.

41. Also, it could be that there are liabilities not on the balance sheet such as future commitments and contingencies, which ought to be taken into consideration. The trustees must determine whether such commitments are legally binding. They should also consider whether there are commitments which, whilst not legally binding, are of significant reputational risk to the charity should they not be honoured, and therefore may be in effect morally binding.

42. There may also be new liabilities which only become clear on liquidation, such as redundancy costs for staff, costs incurred in realising assets, and professional charges.

Dealing with an insolvent situation

43. If effective management and financial control is exercised then insolvency can be prevented or foreseen in its early stages. It is in the gap between the identification of approaching insolvency and the actual commencement of insolvency proceedings (or, in the case of an unincorporated charity, arriving at the point where the trustees are actually faced with the possibility of personal liability) that the trustees can most effectively take action in order to rectify the position.

44. We recommend that appropriate professional advice is taken at an early stage, since corrective action needs to be carefully considered and planned. Such advice should be in writing, and any remedial action suggested should be monitored along with budgets and cashflows. The accuracy of these will depend on reliable financial information, which will now be of even greater importance. In exercising control over this process the trustees are advised to meet more frequently and minute key decisions.

45. When the directors of a charitable company know, or ought to know, that there is no reasonable prospect of avoiding insolvent liquidation they must from that time take every step necessary to minimise the potential loss to the company's creditors. This may involve cutting down or stopping some or all of the charity's activities (eg not paying out grants even if already promised). The paying of professional fees for advice obtained is, however, justifiable on the ground that the trustees are taking the proper steps to find the best way to meet the claims of the charity's creditors.

46. The decision to wind up an unincorporated charity will normally be one taken voluntarily

in accordance with the provisions of the charity's governing document.

47. Similarly, members of charitable companies can voluntarily place the company into liquidation. The company, or its directors or creditors can commence compulsory liquidation or other debt management proceedings under the Insolvency Act.

48. The court will not normally order the compulsory liquidation of a charitable company on the ground of inability to pay debts until after a creditor has either:

- issued a formal legal notice called a "statutory demand", and the demand has not been met; or
- obtained a court judgement against the charity, in relation to a claim against it, and that claim has not been satisfied.

49. In these circumstances the creditor can petition the court to wind up the company. Once a charitable company is being wound up, whether voluntarily or compulsorily, it is placed under the management of an insolvency practitioner as liquidator. It is then too late for the directors to take action of their own to bring the charity out of insolvency.

50. Although unincorporated charities cannot be compulsorily wound up their trustees may face similar legal demands from creditors in relation to liabilities that they have incurred on behalf of the charity.

51. Where the trustees of an unincorporated charity see that there is no reasonable prospect of avoiding insolvency, it is in their own financial interests to ensure that, by cutting down or stopping some or all of the charity's

Dealing with shortages of incoming resources

Restructuring the charity's operation

activities, there will remain in the trust sufficient property to indemnify the trustees against the cost of meeting all the debts and liabilities which they have incurred in the administration of the charity.

52. The type of action taken depends upon the nature of each individual charity and the reasons for the insolvency, and can include the following.

53. Methods used could include:

- Cutting or curtailing planned expenditure so that the level of outgoings is reduced to below the level of receipts.
- Developing alternative sources of funding or launching an emergency appeal. Care must be taken that any such funds raised are sufficiently unrestricted to pay the existing creditors. Trustees must ensure that donors are informed that new funds raised may be used to meet the charity's debts.
- Carrying out a review of commitments to see whether they are legally binding or discretionary. Even where contractual agreements exist there may be scope for renegotiation.

54. This may include discontinuing some activities of the charity or transferring some activities into other charities or companies. It may be possible to realise fixed assets and investments to pay off creditors.

55. There may also be opportunities to merge with other charities with similar objects or to

negotiate with them to help meet outstanding commitments.

56. Care needs to be taken to ensure that any such plans result in creditors being satisfactorily paid. Transferring assets out of a charity may otherwise increase the risk of personal liability for the trustees.

Refinancing

57. Where possible a charity could borrow money from its supporters, possibly on an interest-free basis. Alternatively money could be borrowed from a bank on commercial terms, or the charity could enter into sale and leaseback arrangements for some of its assets.

58. Where a charity has permanent endowment it may be possible to seek authority from us to borrow from these funds. More information on this can be found in **Expenditure and Replacement of Permanent Endowment (CC38)**.

59. In all cases the charity needs to be clear on its planned use of the money and that repayment will be possible.

Company voluntary arrangements

60. Under section 1 to 7B of the Insolvency Act a charitable company may enter into a company voluntary agreement (CVA) with its creditors where the creditors will agree to accept a reduction in their debt or a delay in payment. A CVA can be proposed by the directors of the company, or by an administrator or liquidator. The proposal and the arrangement must be supervised and administered by an insolvency practitioner.

61. It is possible for the trustees of an unincorporated charity facing insolvency to enter into an informal arrangement with those of their creditors whose claims have been

generated as a result of trust activity. The creditors under such an arrangement might agree to defer payment of the debts and liabilities which the trustees have incurred on behalf of their charity, and/or agree to reduce the size of their claims. Such an arrangement is outside the provisions of the Insolvency Act: if the arrangement is legally binding, it will only bind those creditors who are party to it. It is recommended that appropriate professional advice is taken before entering into such an agreement.

62. Detail of the various types of company insolvency proceedings (other than CVAs) can be found in the Appendix to this guidance.

Liability of trustees

Trustees' duty

63. Charity trustees have a duty to act prudently in administering the financial affairs of the charity. They must ensure prudent financial management and compliance with the law, including insolvency law. The legal position of charity trustees in an insolvent situation varies according to how the charity is constituted.

Unincorporated charities

64. As is stated in paragraph 9, where a liability has been properly incurred by the trustees of an unincorporated charity, but the charity does not have sufficient assets to meet the liability, those trustees may have to meet the shortfall personally. How this deficit is to be shared between the trustees can depend on the terms of the agreement which gave rise to the liability, but normally the creditor will be able to sue any of the trustees for the whole liability. A trustee who has to pay more than his or her share may claim a fair contribution from the other trustees. This means in effect that any deficit will be shared

Charitable companies

equally between those of the trustees who can be found, and who have the means to pay, unless they agree otherwise among themselves.

65. Where a charity has been incorporated under the Companies Acts the company is itself normally liable for the debts which the directors have incurred on its behalf. Charitable companies are normally limited by guarantee and the *members* of the company will have no liability for the debts of the company beyond the (usually nominal) amount of their guarantee. The directors will normally themselves have no personal liability for the company's debts, because they act as agents of the company (unless, of course, they personally guarantee the payment of the debts).

66. However, as agents of the company, the directors:

- owe certain fiduciary duties to it, and may be liable to make payments to it, if loss results from the breach of those duties; and
- may in some cases lose their usual protection from direct personal liability to the people with whom they deal on behalf of the company.

67. For example:

- As mentioned in paragraph 10, assets held by a charitable company as trustee, rather than as part of its corporate property, do not form part of the property available for distribution to the company's creditors in accordance with the law of company insolvency. Only liabilities which have been properly incurred in the administration of the particular trust can

be met out of the trust property. It could be a breach of the charitable company's duty as trustee to allow assets held on trust to be distributed to its creditors as if those assets were simply a part of the charity's corporate property. Any director, liquidator etc who is responsible for committing the charitable company to such a breach of duty could be in breach of his or her fiduciary duty towards the charity. They could, therefore, be liable to make good a loss of its trust property.

- In the course of winding up a charitable company which is unable to meet all its debts, a director can be ordered by the court to contribute to the assets of the company if it appears that, some time prior to winding up, he or she:
 - knew, or ought to have known, that there was no reasonable prospect of the charity avoiding the position where it would be unable to meet all its debts; but
 - continued to do business without taking every step with a view to minimising potential losses to the charity's creditors.

The contribution is required specifically for the purpose of reducing the creditors' losses. The director is judged by the standards of a reasonable director as well as by reference to his or her individual capabilities.

- If someone acts as a director of a charitable company while disqualified from doing so he or she becomes directly liable to creditors for any liabilities of the company incurred while he or she is involved in its

management. This applies whether or not he or she has been formally appointed as a director. Full details of such matters are in the Company Directors Disqualification Act 1986. Acting as a trustee while disqualified is also an offence under s.73 of the 1993 Act.

Incorporated trustees

68. Part VII of the 1993 Act allows for the incorporation of the trustee body of an unincorporated charity. This means that the trustee body as a whole will be able to enter into contracts or other commitments as a corporate entity rather than as individual trustees, but the individual trustees still retain personal liability for the debts of the charity. More information about this can be found in our guidance **Incorporation of Charity Trustees (CC43)**.

Custodian and holding trustees

69. Unincorporated charities will often place property in the name of one or more holding trustees or a custodian trustee. As long as such trustees do not exercise any managerial or financial control for the charity but merely hold the property on behalf of the charity they are not charity trustees, and will not therefore have personal liability for any of the charity's debts. However, a custodian trustee can be held liable if it allows or assists the charity trustees to commit a breach of trust.

The role of the Charity Commission

70. We are precluded by law from becoming involved in the internal administration of a charity, including restructuring and refinancing. Questions of financial viability must remain a matter for the charity trustees and their professional advisers.

71. When solvency is an issue we may have a regulatory interest. In these cases we may need to ensure that proper management and control of the charity exists and that the trustees are aware of their responsibilities and duties in such difficult circumstances.

72. The reasons for insolvency are not always apparent, so we may request detailed financial and administrative information in order to determine whether:

- sound financial and administrative controls exist;
- prompt and accurate information is available on which the trustees can base their decisions;
- the charity trustees have a clear plan as to how the insolvency problem will be addressed;
- proper professional advice has been appropriately taken;
- any cessation or winding up is conducted in a proper and orderly manner; and
- any assets left over after all debts are paid have been properly applied for charitable purposes.

73. Where there is suspicion of mismanagement or maladministration we may open an inquiry under s.8 of the 1993 Act. This is dealt with in our guidance **Complaints about Charities (CC47)**.

74. Where a charity is under a s.8 inquiry we have the power to appoint a receiver and manager under s.18 of the 1993 Act (not to be confused with a receiver appointed in the interests of a secured creditor of a charity

whether under the Insolvency Act or otherwise).

75. Such appointments can be made where we are satisfied that the trustees have not acted properly, or where we perceive there to be a risk to charitable property. In some cases the appointment may be made in co-operation with the trustees.

76. A receiver and manager can be given a range of instructions by us and normally fulfils the role of the trustees for the duration of his or her appointment. This may include reviewing the overall viability of the charity.

Dissolution of insolvent charities

77. Trustees have a duty to tell us when their charity has wound up. Under s.3(4) of the 1993 Act we have a duty to remove charities from the Central Register of Charities where they cease to exist or do not operate.

78. Charitable companies can be dissolved without winding up, but if they are wound up, this will be done through formal insolvency proceedings whether voluntarily taken or not.

79. We would expect the liquidator to liaise with us regarding any documentation required for the charity's removal from our Register on its being dissolved. We would also expect the liquidator subsequently to inform us when the liquidation is complete and the company has been dissolved under the Companies Act 1985.

80. For an unincorporated charity no statutory insolvency proceedings exist. It will be up to the charity trustees to carry out the orderly winding

Legal duties to keep the Register up to date

Charitable companies

Unincorporated charities

up of the charity, taking appropriate professional advice as necessary. All assets and liabilities must be identified. Any assets left over after distribution to meet the proper claims of creditors must be applied by the trustees in accordance with the dissolution provision in the governing document of the charity. If there is no such dissolution provision they should seek our advice.

81. To fulfil the legal requirements, the trustees should then, after applying all the charity's property, send to us:

- a copy of the resolution to wind up the charity;
- the final set of accounts which, for charities with income or expenditure above £10,000 in the period to which the accounts relate, is subject to the appropriate statutory external scrutiny (we will need to be notified when there are insufficient funds to meet the costs of external scrutiny upon cessation due to insolvency); and
- a statement of the final distribution of assets if this is not shown in the accounts (this should be signed by the trustees and, preferably, the external auditor or examiner).

82. Once we are satisfied with the information sent to us the charity will be removed from the Register.

Appendix

Types of proceedings

A1. The following are the legal proceedings for which the Insolvency Act makes provision (apart from CVAs) and as such are only applicable to **charitable companies**.

A2. **Winding up.** When a charitable company reaches the end of its useful life (because it can no longer pay its debts, for example) it can be placed into liquidation (see paragraphs A13 and A14). The Official Receiver or an insolvency practitioner will be appointed liquidator to wind up the charity's affairs, realise its assets and distribute the proceeds to the creditors. Any surplus remaining after payment of the creditors will be distributed in accordance with the company's memorandum and articles.

A3. **Moratorium.** Where the directors of an eligible company intend to make a proposal for a voluntary arrangement, they may take steps to obtain a moratorium for the company. This is effected by submitting the proposed voluntary arrangement to the courts with the approval of a nominee who must be an insolvency practitioner. The principal effects of such a moratorium are to prevent a petition being presented for the winding up of the company, and to prevent a petition for an administration order being presented or the appointment of an administrative receiver. It also stops a landlord exercising any right of forfeiture of premises let to the company and stops the enforcement of any security over the company's property for the duration of the moratorium.

A4. A company is eligible to apply for such a moratorium if, in particular, it satisfies any two of the requirements for being a small company, as specified in s247 (3) of the Companies Act 1985. These are currently a turnover not more

than £2.8m, balance sheet total not more than £1.4m and the number of employees not more than 50. It may be excluded from eligibility if, for instance, an administration order is already in force, an administrative receiver has been appointed, a voluntary arrangement is already in place or an earlier moratorium has been in force in the previous twelve months.

A5. **Administration.** This applies to charities that are limited companies. Changes introduced by the Enterprise Act 2002 (Schedule B1) have streamlined the administration process to make it faster, fairer and focused on rescue by:

- Introducing routes into administration without court orders for floating charge holders, companies (ie charities themselves) and their directors.
- Removing bureaucracy and providing clear time limits.
- Helping to rescue viable companies (charities) and achieve better results for the creditors of companies (charities) that cannot be saved.

A6. Administration is a collective procedure and an administrator is specifically required to carry out his or her functions in the interests of the company's (charity's) creditors as a whole. Even where there is no money available for the unsecured creditors, an administrator can only act in a way that does not unnecessarily harm the interests of the company's (charity's) creditors as a whole.

A7. The Enterprise Act replaces the previous four statutory purposes of administration with a single purpose made up of three objectives, which the administrator should consider in turn. The administrator must perform his/her functions with the objective of:

- (1) Rescuing the company (charity) as a going concern, which should be taken to mean as retaining as much as possible of its business.
- (2) Achieving a better result for the creditors as a whole than would be likely in an immediate winding-up, for example by sale of the business(es) or its assets. This objective can only be pursued where rescue is not reasonably practicable, or where it would give a better outcome for creditors than objective 1.
- (3) Realising the company's (charity's) property so as to make a distribution to one or more secured or preferential creditors. This objective can only be pursued where it is not reasonably practicable to achieve either of objectives 1 or 2.

A8. Administration should not be seen as an alternative to liquidation in cases where properly the affairs of the company (charity) should simply be wound up and there is no benefit to the creditors from trading on under the protection of the administration moratorium.

A9. For further information about the new administration process, please visit www.insolvency.gov.uk/draftenterprise/AdministrationGuidanceNotes.doc and also www.insolvency.gov.uk/faqaactc.htm.

A10. **Receivership (Part III)**. When a charity does not pay any creditor with a fixed charge over an asset (normally land or buildings), then that creditor may want to exercise a statutory or express power to appoint a receiver. The receiver only has a power over this asset and will normally seek to sell the asset in order to repay the creditor. The receiver cannot technically run the charity unless the receiver is

also appointed to manage it, but the trustees must follow the receiver's instructions in relation to the asset over which the charge exists.

A11. Administrative receivership (Part IV). If the charity is also a registered social landlord, a creditor with a qualifying floating charge in respect of a charitable company's property can, in very limited circumstances, appoint an insolvency practitioner as administrative receiver. The administrative receiver takes control of the charged assets and normally sells them in order to raise the funds to repay the secured creditor, although he or she can continue the company's activities if he or she thinks that would be financially beneficial.

Types of liquidation

A12. Who can act? The person acting in all of the above positions, except for that of a receiver, must be an insolvency practitioner.

A13. Compulsory liquidation. When a charitable company fails either test of insolvency (see paragraph 6) a petition may be presented to the court to put it into liquidation. If the court accepts the petition the Official Receiver becomes liquidator to wind up the charity unless and until he is replaced in accordance with the provisions of the Insolvency Act. Normally such petitions are submitted by creditors, but the directors and others can also do so.

A14. Creditors' voluntary liquidation. Alternatively the directors of an insolvent charitable company can arrange for it to be liquidated voluntarily. The members of the company must pass a resolution that the company be wound up. The members can also appoint an insolvency practitioner as liquidator, but the creditors are entitled to appoint a practitioner of their own choice to replace the members' nominee.

Significant changes from the previous version of this guidance

The previous version of this guidance was dated January 2000.

The significant changes introduced in this version are mostly to reflect relevant changes to the law introduced by the Insolvency Act 2000 and the Enterprise Act 2002. These are principally in the Appendix.

Details are also given of the Insolvency Service's database of insolvency practitioners (paragraph 18).

Other changes have been made to keep the text as up to date as possible, including appropriately placed references to recently published guidance on related subjects.

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Further Reference

For further information you may find it useful to refer to the following Charity Commission publications:

- CC2 Charities and the Charity Commission
- CC3 The Essential Trustee: What you need to know
- CC8 Internal Financial Controls for Charities
- CC14 Investment of Charitable Funds: Basic Principles
- CC19 Charities' Reserves
- CC35 Charities and Trading
- CC38 Expenditure and Replacement of Permanent Endowment
- CC43 Incorporation of Charity Trustees
- CC49 Charities and Insurance
- CC60 The Hallmarks of an Effective Charity

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