

FUNDING  
& FINANCE

# Managing Financial Difficulties and Insolvency in Charities

CHARITY  
COMMISSION



## The Charity Commission

The Charity Commission is the independent regulator of charities in England and Wales. Its aim is to provide the best possible regulation of charities in England and Wales in order to increase charities' effectiveness and public confidence and trust. Most charities must register with the Commission, although some special types of charity do not have to register. There are some 180,000 registered charities in England and Wales. In Scotland the framework is different, and the Commission does not regulate Scottish charities.

The Commission provides a wide range of advice and guidance to charities and their trustees, and can often help with problems. Registered charities with an annual income over £10,000 must provide annual information to the Commission. The Commission has wide powers to intervene in the affairs of a charity where things have gone wrong.

More information about the Commission together with a range of guidance for charities can be found on our website **[www.charitycommission.gov.uk](http://www.charitycommission.gov.uk)**.

All Commission publications referred to in this publication may be viewed on, or downloaded from, our website.

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## Summary

All charity trustees have a fundamental duty to protect the assets of their charity and to use them to further the purposes of the charity for the public benefit. Given the variety of activities that charities undertake, the different types of funding that they receive and the effect that any changes in the economic climate will have on their funding sources, 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 prompt action to address the situation.

# A. Introduction

## A1. What is this guidance about?

This guidance provides advice and information for trustees of charities that are facing financial difficulties. It will also be of general use to charities that want to minimise the risk of insolvency by putting in place effective financial management.

The guidance also gives advice on aspects of the Insolvency Act 1986, as amended by the Insolvency Act 2000 and the Enterprise Act 2002. It describes;

- how it applies to charitable companies; and
- how some of the tests under the Insolvency Act can be used by unincorporated charities to help assess their own position.

Where we refer to 'insolvency' in this guidance, it is a convenient term we use in relation to all charities regardless of their legal structure. Where there is a legal distinction between what applies to incorporated and unincorporated charities, it is made clear in the text.

Insolvency is a complex matter and we strongly recommend that professional advice is taken as soon as the trustees are aware that the charity is facing an insolvency situation.

## A2. 'Must' and 'should': what we mean

In this guidance, where we use 'must', we mean it is a specific legal or regulatory requirement affecting trustees or a charity. Trustees must comply with these requirements. To help you easily identify those sections which contain a legal or regulatory requirement we have used the **L** symbol next to the section heading.

We use 'should' for items we regard as minimum good practice, but for which there is no specific legal requirement. Trustees should follow good practice guidance unless there is a good reason not to.

We also offer less formal advice and recommendations that trustees may find helpful in the management of their charity.

## A3. Previous guidance

This version of Managing Financial Difficulties and Insolvency in Charities has been updated and rewritten in a new format but contains no change in policy.

## A4. Scope of this guidance

The guidance aims to explain:

- the key elements of effective financial management and the role of trustees;

- the meaning of insolvency;
- options when facing potential insolvency;
- the personal liabilities trustees might potentially incur; and
- the role of the Charity Commission where charities are facing insolvency or are insolvent.

The information and advice in this guidance is relevant to charities of all sizes and structures. However, some of the details may be different if a charity:

- is unincorporated (ie not established as a company under the Companies Act);
- was established by an Act of Parliament;
- has been incorporated by Royal Charter or Letters Patent; or
- is an Industrial and Provident Society.

## A5. The meaning of some terms used in this guidance

The **1993 Act** means the Charities Act 1993, as amended by the Charities Act 2006.

**Bankruptcy** is a procedure that is available to insolvent individuals - someone who has insufficient assets with which to pay their debts and liabilities. The assets of the bankrupt individual are realised and distributed to those who are owed money.

**Charitable company** means a charity which is a company formed and registered under the Companies Acts.

A **custodian trustee** is a corporation appointed to have the custody, as distinct from the management, of trust property. A custodian trustee is not a charity trustee.

**Endowment funds** are funds which are held subject to specific trusts which are declared by the donors. An endowment fund may be a charity in its own right or a special trust of a charity. An endowment fund may be expendable or permanent.

- **Expendable endowment** is a fund that may be invested to produce income. Depending on the conditions attached to and the nature of the endowment, the trustees will have a legal power to convert all or part of it into an income fund which can then be spent. An expendable endowment fund differs from an ordinary income fund in that there is no actual requirement to spend the capital for the purposes of the charity unless or until the trustees decide to.
- **Permanent endowment** is capital to be used to produce an income for the charity that cannot be spent as income. The document that directs how the property should be held will probably specify that the capital should be invested and the income from the investment used for specific charitable purposes. It can also

consist of capital assets which have to be used for a specific purpose or purposes of the charity. Common examples of this type of endowment include village halls, recreation grounds, housing, museums and historic buildings.

**Going concern** means the ability of an organisation to operate for the foreseeable future.

**Governing document** means any document that 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 Commission, conveyance or will.

**Holding trustees:** Holding trustees are individuals appointed to hold the property of the charity. They can only act on the lawful instructions of the charity trustees and in accordance with any provisions contained in the governing document.

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

An **insolvency practitioner (IP)** is an authorised person who specialises in insolvency, usually an accountant or solicitor.

**Reserves** are the resources that a charity has, or can make, available to spend for any or all of the charity's purposes once it has met its commitments and made provision for its other planned expenditure.

**Restricted funds** are funds to be used for specific purposes, set out by, for example, the donor, grant maker or the terms of a public appeal. Often restricted funds can be spent at the discretion of the trustees in furtherance of some particular aspect(s) of the purposes of the charity as determined by the donor, grant maker or the terms of an appeal. Restricted funds may not be spent on any other part of the charity's work.

**Subsidiary trading company** means any non-charitable trading company, wholly owned, or the majority of which is owned, by a charity to carry out trading activities on behalf of the charity 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. The **directors** of a charitable company are the charity trustees.

**Unincorporated** charity means a charity that is **not**:

- formed and registered as a company under the Companies Act 2006;
- formed and registered as an Industrial and Provident society;
- established by a Royal Charter or Letters Patent; or
- incorporated by statute.

# B. Financial management and the role of trustees

## B1. Why is effective financial management and control important?

### The short answer

It is essential for a trustee body to have a good knowledge and understanding of the charity and its finances so that, as far as possible, the continued viability of the charity and its charitable activities can be assured.

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### In more detail

There may be rare cases where insolvency can happen overnight, for example where a charity is wholly or almost wholly dependent on grant income that is cut at short notice and cannot be replaced by other sources of income. In most other cases, provided there are proper financial controls in place, it should be possible for trustees to identify financial risks and plan for their management at an early stage, despite changes in the economic environment in which it is operating.

The overall responsibility for effective governance and the implementation of proper financial management rests

with the trustees, but may well involve all staff members whether paid or volunteers. Trustees may find it useful to read our related guidance:

- *The Hallmarks of an Effective Charity* (CC10)
- *Internal Financial Controls for Charities* (CC8)
- *Charities and Risk Management* (CC26)
- *Charities' Reserves* (CC19)
- *Big Board Talk*

## B2. What are the key elements of effective management and financial control?

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#### The short answer

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. The charity should have in place a long term strategy for the achievement of its objectives which covers finance, operations and governance. As insolvency is a financial risk, it is important for there to be regular trustee meetings at which financial reports and updates are provided and the financial position, budgets and financial projections of the charity are fully considered.

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#### In more detail

The trustees should regularly consider the overall financial position of the charity. This includes ensuring that:

- the needs of beneficiaries are met;
- the requirements of funders about service delivery are met;
- staff and volunteer resources are used effectively;

Some of the key considerations for trustees will be:

- **Budgets** including cash projections and business plans. These need to be produced at least annually, but more frequently if the financial climate makes it necessary or desirable. Expenditure is often easier to forecast than income. It is important that expenditure predictions take account of all known liabilities and contingencies.
- **Effective internal financial controls** should be put in place (see our guidance *Internal Financial Controls for Charities (CC8)*). This includes controls over both expenditure and income and properly understanding and accounting for Value Added Tax (VAT), income tax and National Insurance liabilities through Pay As You Earn (PAYE). These are all statutory liabilities and errors in accounting may result in large and unexpected liabilities and penalties. Information about tax matters can be obtained from H M Revenue and Customs (HMRC) .
- **Actual results** as the year progresses should be monitored against budget. We recommend that the trustees review the charity's financial position and its performance against budgets and future projections at least once a

month, but the extent of the review will vary according to the size and stability of the charity. Proper analysis of financial trends and changes in budget predictions may help to assist early identification of financial problems.

- **Sources of income and expenditure** should be analysed. Risks of insolvency are reduced by having diverse sources of income and a core of secure funding, avoiding over-dependence on any one source. Possible problems such as uncertainty over grant funding, taxation and VAT and penalty clauses within contracts will need to be identified. For additional information about contracts and associated issues, see our guidance *Charities and Public Service Delivery: An Introduction and Overview* (CC37).
- **Risk and reserves policies** should be in place and reviewed on a regular basis (see our guidance on *Charities and reserves* (CC19) and *Charities and Risk Management* (CC26)). Identifying risk and understanding why reserves need to be held is an important part of the planning and budgetary process. It may be possible, for example to draw on reserves in difficult financial times.
- **Professional advice** should be taken before entering transactions which may give rise to significant future financial commitments. These might include building contracts, lease arrangements and borrowings. The

trustees should satisfy themselves that it is likely that they will be able 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 or the charity does not have sufficient realisable assets to cover the relevant liability incurred.

- **Performance against contracts, grant and funding arrangements** should be monitored and reviewed against the appropriate information required by the terms of that funding. Action should be taken on a timely basis where performance falls short of that which is agreed or specified.
  - **Investments:** where a charity holds investments, the trustees should ensure that procedures are in place to:
    - monitor investment performance including the performance of investments in trading subsidiaries (see *Trustees, trading and tax* (CC35)); and
    - consider the need to maintain a diversified portfolio;
- Professional advice will normally need to be taken when investing charitable funds. More information on investing charitable funds can be found in our guidance *Investment of Charitable Funds: Basic Principles* (CC14).

- An **unexpected accident** or incident which leads to a loss for the charity or a claim against it by a third party could present it with financial difficulties which may even lead to insolvency. It may be possible to cover against such losses by taking out various types of insurance. Exactly which ones will be the 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).
- A **merger** with another charity or charities should, in any case, be considered regularly as it could be a

way to continue or improve the services offered to beneficiaries. If a charity is, or might be, facing financial difficulties, a merger is one of the options that should be high on the agenda at an early stage. As an alternative to a full merger, it might be possible to transfer certain operations or activities to another charity in order to provide an uninterrupted service to the charity's beneficiaries. See our guidance on collaborative working *Collaborative working and mergers resources*.

## B3. How can particular funds be used?



### The short answer

It is important for planning purposes that the trustees are aware of the ways in which their charity's assets and resources can be used. Some funds can be used for all of a charity's purposes and some have restrictions on use placed on them by their donors.

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### In more detail

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 and assessing the solvency of a charity.

It is a breach of trust to use endowment or restricted funds for purposes other than those for which they were given by the donor. The 1993 Act now provides a simplified procedure for the expenditure of permanent endowment which is applicable to most charities. For larger permanent endowment funds it may be necessary to seek our approval before the trustees can spend the capital.

However, section 31 of the Trustee Act 2000 provides that a trustee is entitled to pay out of (or be reimbursed from) the charity's funds any expenses that have been properly incurred on behalf

of the charity. In the case of an unincorporated charity, this may mean that permanent endowment or restricted funds of that charity could be used to cover the liabilities of the charity. These permanent or restricted funds may be available to the charity if there are no other assets available. However the trustees may need to take professional advice about this.

It is important to determine whether endowment or restricted funds are in fact separate charities, perhaps linked by way of a uniting direction or by way of common trusteeship. The funds belonging to separate charities are only able to be used to settle the debts of the specific charity that they belong to.

A charitable company cannot hold permanent endowment as part of its corporate property. However, a charitable company can act as a corporate trustee of a permanently

endowed charity. If the company is facing insolvency, these permanently endowed funds (and any other funds held on special trusts) would not normally be available as part of the company's corporate property to settle debts not relating to the permanent endowment or special trusts.

A charity may have substantial funds tied up in functional fixed assets, eg its premises, a hospital building or a care

home. This type of asset is normally used to enable the charity to carry out its purposes (or functions). Unless effected by way of a sale and leaseback arrangement, disposal of these assets could result in the charity being unable to continue its charitable operations. 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.

## **B4. What does a balance sheet tell trustees about a charity's financial position?**

### **The short answer**

It tells them whether the charity has sufficient (realisable) assets to meet its actual and contingent liabilities at a particular date.

Balance sheets are normally prepared on the basis that the charity will continue as a going concern for the foreseeable future. Functional fixed assets such as office premises or vehicles, for example can be shown at either cost or market value in a balance sheet. If the charity can no longer operate as a going concern then trustees will need to consider the basis of the valuation when assessing solvency.

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### **In more detail**

If the going concern assumption, referred to above, no longer holds true, then trustees will need to consider an alternative valuation for their functional fixed assets – perhaps a forced sale value.

Also, certain future commitments or contingent liabilities may not be shown on the balance sheet but still need to be taken into consideration. The trustees must determine whether such commitments are legally binding.

Some commitments may not be legally binding, but if not honoured, might expose the charity to reputational risk that is so significant that settlement can be justified.

There may also be new liabilities to be taken into account which would only arise on liquidation, such as redundancy costs for staff, costs incurred in realising assets and professional charges.

# C. What is insolvency?

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### C1. What does insolvency mean in law?

#### The short answer

There is no statutory definition of 'insolvent' although the Insolvency Act 1986, when referring to a state of insolvency, uses the phrase "unable to pay its debts". In practice there are two separate tests for insolvency and failure of either might be an indication of insolvency:

- the charity cannot pay its debts as they fall due for payment;
- the value of its liabilities exceeds the value of its assets.

An unincorporated charity cannot technically be insolvent as it has no legal identity separate to its members and trustees. This means that any liability of the charity is the liability of its trustees or members. However, the term 'insolvency' is used in this guidance to describe a situation where a charity's available assets are not sufficient to cover the liabilities of the trustees or members.

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#### In more detail

Section 123 of the 1986 Act provides that a company is deemed to be unable to pay its debts where:

- the company has not paid, secured or settled a claim for a sum due to a creditor exceeding £750 within three months of having been served with a statutory demand;
- a creditor has attempted an enforcement process against the company in respect of a debt without success;
- it is proven to the satisfaction of the court that the company is unable to pay its debts as they fall due (cash flow test);

- it is proven to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account contingent and prospective liabilities (balance sheet test).

Generally insolvency law aims to rescue or restructure a business rather than liquidate it. A rescue can maximise the return for creditors. A rescue often involves selling a business (free of its liabilities) to another party and using the proceeds of sale to pay its creditors. This is not usually relevant to charitable companies as it is unlikely that an insolvent charity's 'business' will be sold to another party to pay off its creditors.

## C2. How can trustees tell if their charity might be facing insolvency?

### The short answer

The basic tests are set out in C1 above:

The **cash flow or short-term liquidity test** shows whether a charity has sufficient easily accessible resources available to meet all of its liabilities as they fall due and to continue to meet them in the short term. Simply, can the charity pay its debts when they fall due for repayment?.

The **balance sheet test** 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. The balance sheet test is not normally sufficient on its own to determine whether a charity is insolvent and is normally applied together with the cash flow or short term liquidity test above.

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### In more detail

There are a number of other indicators that a charity might be running the risk of insolvency. It is not possible to provide a comprehensive list as the situation will vary from one charity to another, but listed in the box below are some questions that trustees might find useful to ask themselves:

#### What is the charity's financial position?

- Do we consider the risk of insolvency in our general risk assessment?
- When did we last carry out an insolvency risk assessment?

- Are our current assets plus investments less than our current liabilities?
- Are our total assets and foreseeable income less than our total liabilities and expected expenditure?
- Do we regularly have to spend our reserves because our incoming resources are not enough to meet all of the charity's commitments?
- Is there a need to provide additional security for long-term borrowings?

- Are we under pressure from creditors who are chasing overdue payments?
- Is our charity relying on using cash from restricted funds to finance general day to day needs because there are no unrestricted funds available?
- Is our charity reliant on bank loans with unclear renewal or extension options in order to continue its operations?
- Have we adequate financial reporting in place and do the trustees fully consider those reports?
- Have we breached our banking covenants or exceeded our borrowing facilities with no immediate means of restoring the situation?
- Does the charity have potential significant contingent liabilities?

The answers to these questions ought not to be looked at in isolation. Further detailed analysis would be required before any conclusions on solvency could be made.

If the trustees consider that their charity might not be able to continue to operate due to its financial situation, they should consider the following actions:

- Contacting the charity's accountant, insolvency practitioner or other professional advisor to discuss the

options open to them and seek their help and advice. Trustees should take a careful note of what advice they have been given, and the reasons for any of their decisions made as a consequence of that advice.

- Drawing up a complete list of all the assets and liabilities of the charity to determine whether the charity is solvent or not. This needs to take into account the additional costs of closure which might include:
  - fees for legal and financial advice;
  - redundancy/holiday/maternity pay;
  - rent for the remaining period of the lease on equipment or premises;
  - any extra costs involved in withdrawing from leases eg dilapidations;
  - pension obligations. Our guidance *Defined Benefit Pension Schemes: Questions and Answers* gives more information.
- Identifying endowment and restricted funds. These are generally considered to be, in effect, separate charities with their own trusts governing expenditure and can only be used for the purposes for which they were given (but see section B3). Depending on the terms under which they were given, some unspent restricted income funding may need to be returned to the funders.

### C3. Can a charity continue to operate when apparently insolvent?

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#### The short answer

Yes, but only if great care is exercised. Despite failing the tests referred to above at a particular point in time and therefore appearing insolvent, an organisation may, depending on the precise circumstances, continue as a going concern and not be forced to wind up.

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#### In more detail

Charities may, in the short term, have to operate over and above agreed credit terms, or to resort to short-term financing, whilst they await an expected influx of cash. For example, this may arise when there are administrative delays in the payment of a grant.

However, directors of charitable companies will need to ensure that the company does not continue to trade if they knew or ought to have concluded that there was no reasonable prospect that the company would avoid insolvent liquidation. This is known as **wrongful trading** and if proved in court can entail personal liability for the directors. Trading while insolvent may not necessarily be wrongful if there is a reasonable prospect of avoiding insolvent liquidation.

We recommend that the trustees of any charity that appears to be insolvent take professional advice

before any remedial action is taken. A charity can approach an independent insolvency practitioner, but should consider contacting their own auditor or professional accountant first (if they have one). Their auditor or accountant may be able to recommend an insolvency practitioner who specialises in charities. The charity's internal accountant, finance director or treasurer might also be able to offer support to the trustees in deciding whether there is an alternative to insolvency proceedings. They may also be able to comment on how the charity's procedures could be changed in order to ensure there is sufficient evidence that the trustees have acted properly in the circumstances. The Insolvency Service web site includes a database of all insolvency practitioners on <http://www.insolvency-service.co.uk/newipsearch.htm>.

## D. Dealing with potential insolvency

### D1. How should a charity address potential insolvency?

If effective financial management and controls are in place, then insolvency may 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 that the trustees must take action in order to rectify the position. In the case of an unincorporated charity this point will be where the trustees are actually faced with the possibility of personal liability.

We recommend that appropriate professional advice is taken at an early stage because 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 new or revised budgets and cash flows. 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 record key decisions, including the reasons for the decisions and any arrangements made.

## D2. What steps might a charity consider taking where insolvency issues are identified?

### The short answer

The steps that the trustees can consider taking to deal with issues such as shortage of income and the establishment of more effective structures and procedures will depend very much on the nature of each individual charity and the reasons for the financial difficulties it faces.

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### In more detail

Set out below are two key areas for consideration by the trustees and under each are suggestions for the type of action that might be appropriate.

#### **Dealing with shortages of incoming resources:**

- Develop alternative sources of funding or launch an emergency appeal. Care must be taken that any 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.
- Carry 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.

- Discuss the charity's situation with its bank, particularly where loans are secured against the property of the charity.
- Review existing borrowing or loan facilities.
- Seek new facilities to provide a bridging facility until sufficient income is received. This course of action should only be taken if it is certain that such income will actually be received. This might be the case where a settlement from a sizeable legacy is anticipated or a property is being sold. Borrowing is only normally appropriate as a temporary measure – there are costs attached (arrangement fees and interest) and trustees will need to check their borrowing powers in the charity's governing document. In addition, in an economic downturn it may be difficult to get a loan at all.

- Communicate with stakeholders or members who may be able to offer help which will enable a charity to get through a period of financial difficulties.
- Look at other means to cut or curtail planned expenditure to try and bring the level of outgoings below the level of receipts.

### **Restructuring the charity's operations:**

- Consider discontinuing some of the charity's activities.
- It may be possible to realise fixed assets and investments. The agreement of a secured lender would be needed if assets have a charge over them. However a secured lender would be unlikely to give consent to a disposal to pay off other creditors.
- There may be opportunities to merge with other charities with similar purposes or to negotiate with them to
  - help meet outstanding commitments. Great care needs to be taken to ensure that any action results in creditors not being disadvantaged.
  - Consider refinancing. Raising further finance against a charity's assets is a way that organisations that are under pressure might be able to raise adequate funds to enable them to continue their operations.
  - Where a charity has permanent endowment it may be possible to seek authority from us to borrow from these funds.
  - The trustees might be able to use the powers contained in the 1993 Act to spend permanent endowment.
  - In all cases the charity needs to be clear on its planned use of the money and that repayment will be possible.

## D3. What does administration mean for a charitable company?



### The short answer

Administration is a court procedure that gives a company some breathing space from any action by creditors – in effect it is a rescue process.

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### In more detail

A court can grant an administration order to enable a company to:

- survive, in whole or in part, as an ongoing business;
- organise a voluntary arrangement or compromise with its creditors (see D4);
- get a better realisation of assets than would be possible if the company went into liquidation (see D5).

The procedure is managed by an administrator, who must be an authorised insolvency practitioner.

When a company goes into administration, an administrator is appointed to act in the interests of all the creditors of the company and attempt to rescue it as a going concern.

## D4. Can a charity enter into an arrangement with its creditors?

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#### The short answer

When facing potential insolvency, charities can consider entering into an arrangement with their creditors as a rescue mechanism to avoid compulsory liquidation or winding up. The nature of the arrangement will depend on whether it is incorporated or not.

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#### In more detail

**Charitable companies:** Under s.1 to s.7B of the Insolvency Act, a charitable company may enter into a Company Voluntary Arrangement (CVA) with its creditors. The creditors may agree, as part of the arrangement, to accept a reduction in their debt and/or a delay in payment. The directors would need to apply to the court with the help of an authorised insolvency practitioner, who would supervise the arrangement and pay the creditors in line with the accepted proposals.

A CVA can be implemented during an administration.

The Insolvency Act 2000 introduced a new procedure to enable a small company to obtain a moratorium where a CVA is proposed. A moratorium provides a breathing space to give a company's directors time to put a rescue plan to its creditors. It prevents the company's creditors from proceeding against the company during

the relevant period, whilst allowing the directors to remain largely in control of the company.

A company is eligible for a moratorium where it can satisfy two or more of the following criteria:

- a turnover of less than £6.5 million;
- a balance sheet total of less than £3.26 million;
- less than 50 employees.

If a company is already in administration, liquidation or administrative receivership, it is already protected from the actions of creditors by these procedures and so would not need to seek a moratorium. In addition, a moratorium is not available where a company currently has a CVA in place or has already had a moratorium in the previous 12 months and the proposed CVA did not come into effect or ended prematurely.

**Unincorporated charities:** It is possible for the trustees of an unincorporated charity facing insolvency to enter into an informal arrangement with their creditors. The creditors under such an arrangement might agree to defer payment of the debts and liabilities that the trustees have incurred on behalf of their charity, and/or agree to

reduce the size of their claims. Such an arrangement falls outside the provisions of the Insolvency Act. If the arrangement is legally binding, it will only bind those creditors who are party to the agreement. We recommend that appropriate professional advice is taken before entering into such an agreement.

## D5. What is the next step if these rescue mechanisms are not appropriate?

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#### The short answer

If the rescue mechanisms described above are not possible, then liquidation or winding up is the last resort.

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#### In more detail

**Charitable companies:** 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. Paying professional fees for advice obtained is justifiable if incurred with a view to ensuring the best outcome for the charity's creditors.

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 (this applies to sums greater than £750 which then remain unpaid for 21 days); or
- obtained a court judgement against the charity, in relation to a claim against it, and that claim has not been satisfied.

- 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.

Members of charitable companies can voluntarily place the company into liquidation. Where the members of a company pass a resolution to liquidate the charity, this will be a **creditors' voluntary liquidation** if the company is insolvent. It will be a **members' voluntary liquidation** if the company is solvent. The main difference between the two is that in a creditors' voluntary liquidation, the creditors rather than the members control the choice of insolvency practitioner.

**Unincorporated charities:** 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.

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

Where the trustees of an unincorporated charity see that there is no reasonable prospect of avoiding insolvency, their duty to act prudently may involve cutting down or stopping some or all of the charity's activities. This means that there is more likelihood that sufficient property will remain in the charity to cover the costs of meeting the debts and liabilities they have incurred in the administration of the charity.

If a charity is facing insolvency, the trustees should bear in mind the following points:

- Payments to creditors should be scheduled in accordance with their priority.

- The charity's assets should not be removed. However, in a winding up cash is important and if buyers are found for the charity's non-cash assets, they can be sold. In doing this the trustees must always keep in mind the need to maximise the funds available to pay the charity's creditors.
- If the charity is small or its operations are simple and straightforward and it has been unable to appoint a professional liquidator, the trustees may have to decide to try to get agreement from its creditors to enter into a voluntary arrangement with them.

It is essential that the charity trustees keep a full written record of all decisions and actions taken through any closing down period and the reasoning behind them. The process of taking full detailed minutes can encourage a structured thought process and will help to protect those taking the decisions.

# E. Liability of trustees

## E1. What is the general duty of a charity trustee?

### L

Charity trustees have a duty to act prudently and reasonably 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 the legal structure of the charity.

## E2. What is the position for a trustee of a charitable company?

### L

### The short answer

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 themselves will normally have no personal liability for the company's debts, because the company has a separate legal identity (unless, for example, they personally guarantee the payment of the debts). However there are certain limited circumstances involving fraud, transactions at an under value, wrongful trading or breach of trust where directors may face personal liability.

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### In more detail

- As officers 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 for the debts of the company.

As mentioned in B3, 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 concluded, 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 referred to above 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 qualifications and 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.

## E3. What is the position for a trustee of an unincorporated charity?

### L

#### The short answer

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 are likely to have to meet the shortfall personally.

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#### In more detail

How this liability is to be shared between the trustees can depend on the terms of the agreement that gave rise to it, 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 their share may claim a fair contribution from the other trustees. This means, in effect that any liability will be shared equally between those of the trustees who can be found, and who have the means to pay, unless they agree otherwise among themselves.

As long as the decision to incur a liability on behalf of the charity was properly made in accordance with its governing document, then each and every trustee shares the responsibility for that liability (unless the terms of the agreement incurring the liability specify otherwise). Trustees normally have a right under the Trustee Act 2000 to look to the charity's assets for reimbursement of any liabilities properly incurred. In most

circumstances both the responsibility and the right to reimbursement remain even after a trustee has retired (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 stood at the time the contract was breached).

The concern for trustees is that, in the absence of any relevant insurance, they will have to meet any debts and liabilities out of their own pocket if the charity cannot meet them. This will not be the case where the debts and liabilities have been incurred on the basis that the other party has agreed that they will only have to be met if there are sufficient funds in the charity to do so. For example, this type of clause is sometimes included in property leases. If the liabilities of the charity are more than the trustees' personal assets, the trustees themselves could be forced into personal bankruptcy or individual voluntary arrangements.

## **E4. What is the position of an incorporated trustee body?**



Part 6 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).

## **E5. What is the position of custodian and holding trustees?**



Unincorporated charities will often place property in the name of one or more holding trustees or a custodian trustee. As long as they 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.

## F. The role of the Charity Commission

### F1. What is the role of the Charity Commission when a charity is facing insolvency?

Although we are precluded by law from becoming involved in the internal administration of a charity, including restructuring and refinancing, when solvency is an issue, we may have a regulatory interest. However, questions of financial viability must remain a matter for the charity trustees and their professional advisers.

If a charity requires advice about the use of permanent endowment or restricted funds or wishes to enquire about the exercise of any of the Commission's statutory powers, it should contact us at an early stage.

### F2. What is the role of the Charity Commission where there is mismanagement, maladministration or risk to charity property?



#### The short answer

Where there is suspicion of mismanagement, maladministration or risk to property held for charitable purposes, we may open an inquiry under section 8 of the 1993 Act. This is dealt with in our guidance *Complaints about Charities* (CC47).

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#### In more detail

Where a charity is under a section 8 inquiry we have the power to appoint an interim manager under s.18 of the 1993 Act (unless a liquidator had already been appointed). This

appointee should not be confused with an administrative receiver appointed in the interests of a secured creditor of a charity whether under the Insolvency Act or otherwise.

An interim manager can be appointed using our powers 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.

An interim 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.

We may also receive complaints about the trustees of a charity or the way the insolvency was handled. We would consider such complaints in the same way as other complaints about a charity.

## F3. What are the procedures for removing a charity from the Register of Charities?



### The short answer

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.

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### In more detail

Charitable companies: 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 2006

Unincorporated charities: It will be up to the charity trustees to carry out the winding up of the charity in accordance with its governing document, taking appropriate professional advice as necessary.

All assets and liabilities must be identified. Any assets left over after meeting 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.

For further information on how to remove a charity from the Register of Charities and access to the online removal form, please see *Close or merge a charity*.

# G. Sources of further information

The Charity Commission produces a wide range of publications and website guidance giving information and advice to charity trustees and the general public on a number of issues relating to charity law, regulation and good practice.

We also list here a selection of other organisations and publications which can be used as sources of information.

## G1. Charity Commission publications

The list of our guidance below is a selection based on some of the issues identified in this guidance.

*The Essential Trustee: What you need to know* (CC3)

*Internal Financial Controls for Charities* (CC8)

*Charities and Risk Management* (CC26)

*Trustees, trading and tax* (CC35)

*Charities and Insurance* (CC49)

*The Hallmarks of an Effective Charity* (CC10)

*Charities and reserves* (CC19)

*Incorporation of charity trustees* (CC43)

*Charity reporting and accounting: The essentials April 2009* (CC15b)

*Charity Reserves and Defined Benefit Pension Schemes*

*Defined Benefit Pension Schemes – Questions and Answers*

## G2. Other useful organisations and resources

The Charity Finance Directors Group (CFDG)

This is a membership organisation which helps charities manage their accounting, taxation, audit and other finance related functions. Its website has a useful Recession Watch page

CFDG  
3rd Floor  
Downstream Building  
1 London Bridge  
London SE19BG

Tel: 0845 345 3192

Email: [info@cfdg.org.uk](mailto:info@cfdg.org.uk)

Web address: [www.cfdg.org.uk](http://www.cfdg.org.uk)

## Companies House

The main functions of Companies House are to:

- incorporate and dissolve limited companies;
- examine and store company information delivered under the Companies Act 2006 and related legislation; and
- make this information available to the public

It provides guidance on liquidation and insolvency which can be viewed on [www.companieshouse.gov.uk/about/guidance.shtml](http://www.companieshouse.gov.uk/about/guidance.shtml).

Companies House  
Crown way  
Maindy  
Cardiff CF14 3UZ

Tel: 0303 1234 500

Email:

[enquiries@companies-house.gov.uk](mailto:enquiries@companies-house.gov.uk)

Web address:

[www.companieshouse.gov.uk](http://www.companieshouse.gov.uk)

### **Her Majesty's Revenue and Customs (HMRC)**

HMRC's website contains information on a range of issues of interest to charities including Gift Aid, Payroll Giving, tax reliefs and VAT.

HM Revenue and Customs Charities  
St Johns House  
Merton Road  
Liverpool  
L75 1BB

Charities helpline: 0845 302 0203

Email: [charities@hmrc.gov.uk](mailto:charities@hmrc.gov.uk)

Web address: HM Revenue & Customs:  
Home Page

### **The Insolvency Service**

The Insolvency Service website offers a wide range of advice and information on matters related to insolvency including a database of all insolvency practitioners (<http://www.insolvency-service.co.uk/newipsearch.htm>).

### **The Pensions Regulator**

The regulator works to improve confidence in work-based pensions by protecting members' benefits and encourage high standards and good practice in running pension schemes.

The Pensions Regulator

Napier House  
Trafalgar Place  
Brighton  
BN1 4DW

Tel: 01273 811800

Email: [customersupport@thepensionsregulator.gov.uk](mailto:customersupport@thepensionsregulator.gov.uk)

Web address:

[www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)

This publication can also be accessed at the Charity Commission's website: [www.charitycommission.gov.uk](http://www.charitycommission.gov.uk)

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