



CHARITY COMMISSION
FOR ENGLAND AND WALES

GUIDANCE

Managing a charity's finances: planning, managing difficulties and insolvency (CC12)



JUNE 2010 (UPDATED JANUARY 2016)
New format January 2017

Contents

1. Introduction	2
2. Managing finances: the important messages for trustees	4
3. Financial management and the role of trustees	5
4. What is insolvency?	9
5. Dealing with potential insolvency	12
6. Liability of trustees	16
7. The role of the commission	18
8. Technical terms used in this guidance	20

1. Introduction

1.1 What is this guidance about?

In this guidance, the Charity Commission (the commission) sets out the factors that it expects trustees to take account of in the face of financial difficulties or insolvency. It covers 4 main issues:

- what trustees should do to comply with their duties to manage and safeguard their charity's assets
- how trustees can ensure they are fully aware of the financial health of their charity
- rescue mechanisms and alternatives for a charity facing financial difficulties and/or potential insolvency
- what insolvency means for a charity and its trustees

1.2 Relevance to all charities

The information and advice in this guidance are 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 2006)
- was established by an act of Parliament
- has been incorporated by Royal Charter or Letters Patent
- is an Industrial and Provident Society

1.3 Insolvency

It's important to note that where the commission refers to 'insolvency' in this guidance, it is a convenient term used 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 the commission strongly recommends that professional advice is taken as soon as the trustees are aware that the charity is facing an insolvency situation.

1.4 'Must' and 'should': what the commission means

In this guidance:

- 'must' means something is a legal or regulatory requirement or duty that trustees must comply with
- 'should' means something is good practice that the commission expects trustees to follow and apply to their charity

Following the good practice specified in this guidance will help you to run your charity effectively, avoid difficulties and comply with your legal duties. Charities vary in terms of their size and activities. Consider and decide how best to apply this good practice to your charity's circumstances. The commission expects you to be able to explain and justify your approach, particularly if you decide not to follow good practice in this guidance.

In some cases you will be unable to comply with your legal duties if you don't follow the good practice. For example:

Your legal duty	It's vital that you
Act in your charity's best interests	Deal with conflicts of interest
Manage your charity's resources responsibly	Implement appropriate financial controls Manage risks
Act with reasonable care and skill	Take appropriate advice when you need to, for example when buying or selling land, or investing (in some cases this is a legal requirement)

Trustees who act in breach of their legal duties can be held responsible for consequences that flow from such a breach and for any loss the charity incurs as a result. When the commission looks into cases of potential breach of trust or duty or other misconduct or mismanagement, it may take account of evidence that trustees have exposed the charity, its assets or its beneficiaries to harm or undue risk by not following good practice.

Technical terms used in this guidance are defined in section 8.

2. Managing finances: the important messages for trustees

Understanding and managing the financial health of a charity is a vital part of trustees' compliance with their legal duties to:

- act in the interests of their charity and its beneficiaries
- protect and safeguard the assets of their charity
- act with reasonable care and skill

As the charity regulator, the commission expects trustees to discharge these duties by regularly assessing and monitoring the overall financial position of their charity and by taking steps to ensure that its funds can continue to be used for the purposes for which they were given. Where their charity has to close, the commission expects trustees to have planned for an orderly shutdown.

This means that trustees should:

- recognise that charities do have to wind up for a variety of reasons and plan for what will happen to their charity's beneficiaries (particularly vulnerable beneficiaries), staff and assets if that is the only option (section 4.2)
- be able to recognise at an early stage when the charity is facing financial difficulties - in particular, whether their charity is a 'going concern' (section 4.2)?
- ensure that they regularly receive and consider robust, up to date financial management information (section 3.2)
- analyse and review sources of income - dependency on one source of funding can leave a charity vulnerable to increased financial risk and diversification of sources can protect against this (section 3.2)
- regularly review planned and proposed expenditure - is there anything that the charity can do more efficiently or could stop doing altogether (section 3.2)?
- regularly review risk and reserves policies - the risk policy will identify and update risks that the charity is exposed to, and the reserves policy will set out what reserves are for and when they can be used (section 3.2)
- take rescue action when the charity cannot pay its debts as they fall due and/or the value of its liabilities is more than that of its assets - they will normally need to take professional advice where there is a risk of potential insolvency (or a similar situation for unincorporated charities) (section 5.1)
- recognise that once the charity has reached the stage of liquidation or winding up, their primary duty is to pay the charity's debts (section 5.5)

3. Financial management and the role of trustees

3.1 Why is effective financial management and control important?

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.

There may be 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, trustees should be able to identify financial risks and plan for their management at an early stage, despite changes in the economic environment in which the charity 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 should read the commission's related guidance:

- **Internal financial controls for charities (CC8)**
- **Charities and risk management (CC26)**
- **Charity reserves: building resilience (CC19)**
- **Managing charity assets and resources (CC25)**
- **Charity governance, finance and resilience: 15 questions trustees should ask**

3.2 What are the key elements of effective management and financial control?

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, management accounts, budgets, financial projections and updates are provided. These will enable the trustees to be fully aware of the charity's overall financial position now and in the future.

They should ensure that:

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

Trustees should:

- consider 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.

- ensure that they have effective internal financial controls in place

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 **HM Revenue and Customs (HMRC)**.

- monitor actual results as the year progresses against budget

The commission recommends that the trustees review the charity's financial position and its performance against budgets and future projections at least quarterly, 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.

- analyse their charity's sources of income and expenditure

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. The commission's guidance **Charities and public service delivery: an introduction (CC37)** gives further information.

- ensure that they have robust **risk** and **reserves** policies in place and review them on a regular basis

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.

- take professional advice 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 as far as possible 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 liability incurred.

- monitor and review:

- performance against contracts
- grant and funding arrangements 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.

- where a charity **holds investments**, ensure that procedures are in place to:

- monitor investment performance including the performance of investments in trading subsidiaries
- consider the need to maintain a diversified portfolio
- take professional advice where appropriate when investing funds

- recognise that 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 get cover against such losses by taking out various types of **insurance**. Exactly which insurance will be the most appropriate will vary from charity to charity, depending on their circumstances and activities.

- regularly consider **a merger** with another charity or charities 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.

3.3 How can particular funds be used?

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.

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 funds or restricted funds for purposes other than those for which they were given by the donor. The charities act now provides a simplified procedure for the expenditure of permanent endowment funds which is applicable to most charities. For larger permanent endowment funds it may be necessary to seek the **commission's approval** before the trustees can spend the capital.

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 should 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 fixed assets, for example its premises, a hospital building or a care home. This type of functional asset is normally used to enable the charity to carry out its purposes (or functions). Unless it's done 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.

3.4 What does a balance sheet tell trustees about a charity's financial position?

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.

If the going concern assumption 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.

4. What is insolvency?

4.1 What does insolvency mean in law?

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' (see section 4.2). In practice there are 2 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.

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 3 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.

4.2 How can trustees tell if their charity might be facing insolvency?

The basic tests are set out in section 4.1.

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.

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 are some questions that trustees might find useful to ask themselves.

What is the charity's financial position?

Trustees should consider these questions:

- 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:

- contact the charity's auditor or accountant, insolvency practitioner or other professional adviser 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
- draw 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
 - identify 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 (see section 3.3). Depending on the terms under which they were given, some unspent restricted income funding may need to be returned to the funders.

4.3 Can a charity continue to operate when apparently insolvent?

Yes, but only if great care is exercised. Despite failing the tests referred to 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.

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.

The commission recommends 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 website** includes a database of all insolvency practitioners.

5. Dealing with potential insolvency

5.1 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 should 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.

The commission recommends 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.

5.2 What steps might a charity consider taking where insolvency is a possibility?

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 on the nature of each individual charity and the reasons for the financial difficulties it faces.

The following are 2 key areas for consideration by the trustees and under each are suggestions for the type of action that might be appropriate.

If dealing with shortages of incoming resources the trustees should:

- look at finding alternative sources of funding or launching an emergency appeal
Care should be taken that any funds raised are sufficiently unrestricted to pay the existing creditors. Trustees should 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 some circumstances 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

If thinking about restructuring the charity's operations trustees should consider:

- discontinuing some of the charity's activities
- the possibility of realising 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.

- 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
- 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
- using the powers contained in the charities act to spend permanent endowment - where a charity has permanent endowment it may be possible to seek authority from the commission to borrow from these funds

5.3 What does administration mean for a charitable company?

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

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 section 5.4)
- get a better realisation of assets than would be possible if the company went into liquidation (see section 5.5)

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.

5.4 Can a charity enter into an arrangement with its creditors?

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.

Charitable companies

Under 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 2 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. Trustees should take appropriate professional advice before entering into such an agreement.

5.5 What does liquidation or winding up mean for the charity trustees?

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

This means that the trustees should note the following:

- payments to creditors are the trustees' primary responsibility and should be scheduled in accordance with their priority
- a charity could contravene the provisions of the insolvency act if it paid grants to beneficiaries or made a transfer to another charity in anticipation of insolvency so that other creditors do not get a fair settlement - this means that trustees should not apply the charity's funds for its purposes if it could be construed that the application could be seen to have this effect (a 'preferential transaction')
- 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 agree to enter into a voluntary arrangement with its creditors - 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

The differences that apply to different charity structures are:

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)
- obtained a court judgment 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 2 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.

6. Liability of trustees

6.1 What is the general duty of a charity trustee?

Charity trustees have a duty to act in the interests of their charity and protect and safeguard its assets. They must exercise proper 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 (see section 5.5).

6.2 What is the position for a trustee of a charitable company?

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/trustees 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 and trustees should take professional advice on this issue.

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.178 - 180 of the charities act.

Use of corporate property

As mentioned in section 3.3, 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.

6.3 What is the position for a trustee of an unincorporated charity?

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.

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.

6.4 What is the position of an incorporated trustee body?

The charities act allows for the **incorporation of the trustee body** of an unincorporated charity (rather than the charity itself). 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.

6.5 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.

7. The role of the commission

7.1 What is the role of the commission when a charity is facing insolvency?

The commission cannot become involved in the internal administration of a charity, including restructuring and refinancing. When solvency is an issue, it 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 look at the commission's guidance on GOV.UK.

7.2 What is the role of the commission where there is mismanagement, maladministration or risk to charity property?

Where there is suspicion of mismanagement, maladministration or risk to property held for charitable purposes, the commission may open **an inquiry under section 46 of the charities act**.

Where a charity is under a section 46 inquiry the commission has the power to appoint an interim manager under s.76 of the charities 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 the commission's powers where it is satisfied that the trustees have not acted properly, or where it perceives 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 the commission 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.

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

7.3 What are the procedures for removing a charity from the register of charities?

Trustees have a duty to tell the commission when their charity has wound up. Under s.34 of the charities act the commission has a duty to **remove charities** from the register of charities where they cease to exist or do not operate.

Charitable companies

The commission would expect the liquidator to liaise with them regarding any documentation required for the charity's removal from its register on its being dissolved. It would also expect the liquidator subsequently to inform them 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 advice from the commission.

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**.

8. Technical terms used in this guidance

The **charities act** means the Charities Act 2011.

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: 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
- incorporated by statute