Accounts Monitoring Review
Net current liabilities

About our accounts monitoring reports

Charities' accounts are publicly available on our website. Each year, we monitor a sample to check compliance with the Charities Statement of Recommended Practice (SORP) and to identify issues of regulatory concern. We are publishing a series of reports on our findings, which will help trustees to manage the risks that their charity faces and improve reporting standards.

The scope and purpose of this review

This review looked at the accounts of charities with net current liabilities. In other words, their current debts are more than the funds available to cover them. We chose this area because of the perceived risk that such charities may not be able to meet their debts when they fall due and therefore could be facing insolvency.

How we carried out the review

We used the information in Part B of the Annual Return to identify charities that had reported net current liabilities in their most recent accounts, those with a year end during 2012 in most cases. Part B provides summary information from the annual accounts, including the total current assets and creditors due within one year. Only charities with an income of over £500,000 are required to complete Part B and therefore our review has only considered these larger charities.

We identified 1,348 charities which reported net current liabilities. We then randomly selected 98 of those charities for follow up. We reviewed the charities' trustees' annual report and accounts to assess their view of the risk that their situation posed to the charity's financial position and their response to it.

What we found

The size of the charities' net current liabilities

The total short term creditors across the 98 charities was £471.1m, just over double the short term assets of £229.8m that those charities held. Their overall net current liabilities of £241.3m represented a quarter of the charities' annual income of £893.2m. Two charities accounted for £149.2m of the overall net current liabilities and £410m of the overall income. The size of the individual net current liabilities across the sample is shown in the table.

Net current liability	Number of charities	Total net current liability
More than £15m	2	£149.2m
£2m - £15m	10	£60.7m
£0.5m - £2m	24	£22.8m
Less than £0.5m	62	£8.6m
Total	98	£241.3m

How the charities are funding their net current liabilities

We found that the charities were relying on a range of funding sources to ensure that they could pay their creditors when they fell due. We have summarised each charity's main source of funding as follows:

- Deferred income (28 charities). Deferred income is payments received in advance of delivering the services paid for. The amount paid in advance is shown as a short term liability. The main examples were school and professional fees. Many of the schools and professional associations in the sample have found operating in this way to be sustainable but, as we shall see, others have not.
- Bank loans or overdrafts (28 charities). The amounts due for repayment within 1 year are included in short term liabilities. This category includes charities that had borrowed to fund capital projects as well as those using borrowing facilities to pay their debts, often secured against properties that the charities owned. These charities may become vulnerable if the facilities are withdrawn.
- The timing of grant payments (8 charities). These charities had made decisions in the current financial year to give grants in the following financial year. A grant is recorded as a liability as soon as the charity decides to award it. Grant-awarding charities should be in a secure financial position, since they can control both the amount of grants given and when they are paid. The two largest charities are in this category.
- Long-term investments (7 charities). These charities hold investments classed as long-term in their accounts that they may be able to draw on in the short term. These charities may become vulnerable if their long-term assets are insufficient to meet their debts or cannot be accessed quickly enough.
- Third party support (6 charities). These charities relied on assurances of continuing support from their main funder(s) to enable them to continue operating. The main example was charities primarily funded by local authorities. These charities are dependent on decisions made by their main funder(s).
- A combination of sources (11 charities). These charities did not appear to have a clear main source of funding.

The remaining 10 charities have significant financial difficulties. All of them had received auditors' reports containing either a qualification (1 charity) or an emphasis of matter paragraph (9 charities) relevant to going concern. An emphasis of matter draws users' attention to matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements. 5 of the 10 charities are schools or colleges.

The impact of net current liabilities on the charities' ability to continue to operate

The charities can be placed into one of two categories, depending on their financial situation:

- 42 charities did not discuss the net current liabilities issue in their trustees' annual reports, and therefore presumably did not consider it to be a significant problem. However, they missed the opportunity to explain their funding model, how risk was being managed and how they planned to continue to operate. As we would expect, this group included many of the educational, professional and grant-making charities.
- 56 charities discussed the issue in their trustees' annual reports, and provided information on how they planned to address it. They included the 10 charities whose auditors had highlighted going concern problems. The most fundamental of these actions included restructuring of the charity and plans to merge with other charities.

What action we took

We looked in more detail at the 10 charities whose auditors had highlighted going concern problems, including a review of the more recent accounts now submitted by 5 of the charities. We found that:

- 5 charities are now in liquidation or are no longer operating. All were involved in education or training. The activities of 2 of these charities, both schools, have continued. One has transferred to a newly formed charity and the other to a 'Free School'.
- 3 charities appear to be taking action to make their financial positions more secure. 2 of these charities have secured additional income.
- The final 2 charities do not appear to be taking appropriate action to deal with the problem and we will be contacting these charities to obtain up to date information from them.

A separate finding was that one charity had submitted draft accounts to us, with no audit report. Their accounts for the following year are also overdue. We will be contacting this charity to remind them that they are required to submit audited accounts to us within 10 months of their year end.

Lessons for other charities

The findings from our review emphasise the importance of trustees having a good understanding of their charity's activities and its financial position, so that the financial risks can be identified and managed. Communicating the financial position of a charity is a key requirement of the SORP and it is important to funders, donors and other stakeholders who support or rely on the charity.

If a charity is in financial difficulties, trustees must take prompt action in order to reduce the risk of insolvency. Insolvency is a complex matter and trustees need to take professional advice as soon as they are aware that their charity is facing an insolvency situation. Where a charity is unincorporated, the responsibility for meeting its liabilities ultimately falls upon the trustees.

We have published guidance on our website, *Managing financial difficulties and insolvency in charities* (CC12), to help the trustees of charities facing financial problems.