

## Insolvency and Charities

Press coverage of a leaked confidential report into a charity providing housing and support highlights the implications of charity law in an insolvency situation

Extracts from a confidential report by BDO into housing charity, the Novas Scarman Group, have been leaked to wikileaks. The resulting coverage provides a reminder that insolvency practitioners advising charities may face a range of interesting issues.

Charity trustees acting as volunteers may be less familiar with the risks of insolvency and the procedures involved than the directors of commercial companies. Insolvency practitioners may be involved at an early stage to help the charity trustees assess the charity's financial position, and advise on options available.

The first step for charity trustees is to ensure that they are confident that the charity is solvent. As the Charity Commission guidance says:

***Do all the charity trustees know the two main tests for insolvency? They should all understand the cashflow and balance sheet tests***

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

to be possible to prevent or delay the onset of creeping insolvency."

It may be helpful to circulate key guidance material, including Charity Commission guidance note CC12 - Managing Financial Difficulties and Insolvency in Charities.

Do all the charity trustees know the two main tests for insolvency? They should all understand the cashflow and balance sheet tests. It may be helpful to invite the treasurer to refresh trustees' memories and understand the implications of the results. (Technically, the term insolvency is only applied to charitable companies, but the Charity Commission suggests that the tests are useful for all types of charity.)

The charity trustees should, of course, be sure that they understand whether the charity is solvent, whether there is a risk that it will become insolvent, and whether there is a reasonable prospect of avoiding insolvency, and all these issues will need to be reviewed regularly.

A financial review also provides the opportunity to consider the health of the charity more generally.



# Briefing Note - July 2009

Issues to consider are likely to include the following:

**Governance:** Demonstrating the effectiveness of the trustee body. This may be a prompt to:

- carry out a 'skills audit' to assess the capabilities of the charity trustees and identify ways to fill any gaps;
- review the charity's governing document to ensure that it continues to be a 'good fit' for the organisation;
- ensure that the board understands the structure of the charity – including any trading subsidiaries;
- review the manner in which financial and other management information is presented to the trustees.

Perhaps the most difficult aspect is the need to ensure that the charity trustees are able to exercise independent judgment when considering plans proposed by the chief executive or other staff while not undermining management authority or de-motivating staff.

**Contracts:** It may be appropriate to terminate or renegotiate contracts with suppliers and others in response to changing financial circumstances. It may be necessary to review the termination provisions to establish whether the charity has the right to terminate contracts early.

**Freeing restricted assets:** Charity trustees should understand the permanent endowment and restricted funds held by the charity. It may be helpful to approach funders to loosen the terms on which restricted funding was given or to take advantage of the new rules under the Charities Act 2006 allowing the restrictions on permanent endowment to be removed or loosened.

**Employment:** Have the charity's standard terms of employment been reviewed recently? It may be

necessary to take difficult decisions about the benefits the charity can afford to offer. Introducing such changes is not straightforward and appropriate professional advice should be taken.

**Merger and Collaboration:** the Charity Commission and other agencies are encouraging charities to consider whether merger offers a way of better meeting the needs of beneficiaries. Merger will not always be a solution but the trustees should consider the possibility, make appropriate records, and ensure that they are able to communicate the reasons for their decision to funders and others.

## Useful Resources

- Charity Commission guidance:
  - CC12 – Managing Financial Difficulties and Insolvency in Charities
  - The economic downturn – 15 questions trustees need to ask
- One Plus: One Parent Families – the OSCR Case Study

*The Charity Team at Michelmores can advise on the issues above and other legal queries relevant to charities.*



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