



BURTON
SWEET

CORPORATE RECOVERY



BRIEFING NOTE

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CHARITIES & INSOLVENCY

Many charities have seen their incomes fall during the recession, and any resurgence in contributions, particularly from the corporate sector, is unlikely to happen in the near future.

With increasing constraints likely to hit public sector spending for the foreseeable future, resulting in reduced access to grants and the possibility of contracts not being renewed, life may well remain difficult for the charitable sector for some time to come.

Faced with that scenario, trustees need to be aware of their duties in the context of possible insolvency, and of the steps that they should take to avoid exposure to potential risks of personal liability.

There are two standard definitions of insolvency:

- where the charity's liabilities (including contingent or prospective liabilities) exceed its assets; or
- where the charity is unable to meet its debts as and when they fall due for payment.

In either case it is important to distinguish between assets held for the general purposes of the charity, and those which are restricted.

Most charities are either incorporated (most often as companies limited by guarantee, or possibly registered under the Industrial and Provident Societies Act), or unincorporated (perhaps set up as a trust). Some may be established under an act of Parliament or Royal Charter.

An unincorporated charity does not have a legal personality in its own right. This means that, if the charity does not have

sufficient assets to meet its liabilities, the trustees may be jointly and severally liable to meet the shortfall from their personal resources. A trustee who has to pay more than his fair share may be entitled to claim some reimbursement from the other trustees – provided, of course, that they have the means to pay. In a “worst case” scenario, a trustee could become personally insolvent, placing at risk all his personal assets and property.

The position of trustees of incorporated charities is very similar to that of directors of commercial companies. The Companies Act 2006 sets out a statutory code of directors' duties which, in the context of charities, impose a duty to act in the way in which they, in good faith, consider most likely to achieve the purposes of the charity. However, when a charity faces insolvency, or the risk of insolvency, then the interests of creditors must be put above those of the charity itself.

Although the sudden loss of a contract or income stream can cause insolvency to arise overnight, it is rare. Normally the financial position deteriorates over a period of time and the onset of insolvency is, at least in its early stages, a gradual process. It is crucial for trustees to be alert to the warning signs and to take action at the earliest possible stage. The earlier steps are taken to resolve the situation, the greater the prospects of successfully overcoming the difficulties.

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It is more important than ever to have a clear strategy in place, with a true understanding of the strengths of the charity and of the opportunities open to it. That in turn gives a clear focus for management. The plan needs to include relevant financial information and forecasts, preferably developed in conjunction with external advisers who can bring an objective and independent perspective. Assumptions should be tested and re-tested assumptions, and the plan updated in the light of changing conditions.

With the plan in place, then performance and progress against that plan should be regularly reviewed, with a particular emphasis on cash flow. Although it may be appropriate to set up a sub-committee to undertake the monitoring it is important to remember that, in the event of failure, all trustees will be equally responsible, and trustees may be required to justify their decisions with hindsight. It is therefore vital that the evidence is available in the form of notes of decisions made and of the reasons for them, and minutes of important meetings.

If the worst happens, and a charity goes into liquidation, the liquidator will be under a legal obligation to investigate the charity's affairs with a view to maximising its assets for the benefit of creditors. This will include reviewing the conduct of the trustees with a view to identifying any breaches in their duties and, if any are found, then bringing claims against them on behalf of the charity.

One of the claims which will be considered is that of wrongful trading. Where a charity has gone into insolvent liquidation and, at some point before the start of the liquidation, a trustee

knew or ought to have known that there was no reasonable prospect of avoiding liquidation but failed to take every possible step to minimise the loss to creditors, then he can be required to make a contribution to the assets of the charity.

Often, a charity's financial problems arise, not from the activities of the charity itself, but from losses in a trading subsidiary. Trustees should be alert to their duty to use the assets of the charity solely for charitable purposes and not to support an ailing trading activity.

Trustees should also be aware that, in any formal insolvency, the insolvency practitioner is required to send a report on the trustees' conduct to the Secretary of State for Business, Innovation and Skills. The purpose of the report is to enable the Secretary of State to consider making an application to Court for the trustees to be disqualified from taking part in the management of any limited company for between 2 and 15 years. Very clearly, this could have potentially serious consequences for trustees with other business interests.

Trustees who can show that they took every reasonable step to minimise the potential loss to creditors are protected from the risk of personal liability. In general, this means promptly seeking advice from an insolvency practitioner and acting on that advice. At Burton Sweet Corporate Recovery we have vast experience in dealing with assignments involving insolvency and potential insolvency, be they large or small, straightforward or complex. Charities specialists within Burton Sweet have an unrivalled reputation for their expertise in the field. Our objective is to give clear, professional advice when it is most needed.

IMPORTANT NOTE:

This briefing note is intended for general information only. It is not, and does not purport to be, a comprehensive statement of the law. It is not a substitute for specific advice which should be sought for specific cases. We cannot accept responsibility for any action (or decision not to take action) made in reliance on the content of this publication.

Burton Sweet Corporate Recovery is a leading firm of specialist insolvency practitioners with offices in nine locations:

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