CA PLUS
COMMUNITY ACCOUNTING

Insolvency and Closing down – notes from our website

It will come as no surprise that an increasing number of organisations are facing closure in these challenging times. While there are numerous sources of support with establishing your charity or enterprise, when it comes to closure, it is surprising how alone one can feel. As with most things, it can be simple or become very complex. Much depends on the legal form of the organisation and, of course, the state of the finances.

Groups can close for many reasons:

- In extremely rare cases, an organisation might conclude that it has achieved its objectives and so the trustees agree to close down gracefully;
- Sometimes people just get tired of the battle to obtain funding, key staff leave and the trustees just don't have the energy any more;
- Sometimes closure is a painful but calculated decision to end activity before the trouble starts;
- Unfortunately, there is often a tendency to bury heads in the sand, the trouble arrives and it all ends in tears.

Alarm bells

On a regular basis, any organisation should check that its finances are in good order. The phrase 'going concern' is used in company accounts to give some assurance that closure is not imminent. There is a balance sheet test "do the assets exceed the liabilities?" and a cash flow test "will the company be able to pay its debts as they fall due?". Good financial reports, consideration of reserves and prudent management are all important here. And you should regularly assess the potential costs of redundancy.

So what happens in practice?

In a situation where the organisation has assets (the good things like money in the bank) which exceed its liabilities (things you owe other people), then it can be relatively simple. It is perfectly possible to pay all your debts, make your staff redundant in the proper way, pay the gas bill, the tax, and of course the accountants. Whatever's left can be distributed in accordance with your governing document. For most charities, this might involve donating the remaining funds to a similar charity.

You need to inform your regulatory body, who will remove you from their own register, and comply with their requirements. Companies House for example, require

a specific form to be filed. They apparently do not require final accounts, but of course, if you are a company, you still need to comply with company law and produce them.

And don’t forget that even if the entity has closed, someone, usually the last one out the door, needs to keep the accounting records; in the case of a charity, for at least six years. The administration of closure can usually be carried out by the remaining paid staff or volunteers. You don’t need to pay professionals to do this.

The problems arise when the liabilities exceed the assets. This situation can be more difficult for an unincorporated association. There is nothing to stop individual creditors who want their cash, pursuing whoever they hold responsible for what they are owed. We hear occasionally of former trustees being required to pay out of their own pockets for redundancy owed to former staff. It is rare, but if you ignore the writing on the wall and just collapse when the cash runs out, there can be painful consequences.

In the worst case scenario for an incorporated entity, one or more of your creditors (including unpaid staff) can apply to the court to have your company wound up. It’s like Her Majesty’s Revenue and Customs (HMRC) trying to get a football club closed down. If the court agrees they will appoint a licensed insolvency practitioner (liquidator) who will sell the assets to get money for the creditors – after taking their cut of course.

Alternatively a company’s members or creditors themselves may approach a liquidator (a “voluntary liquidation”). At CA Plus, we’ve had three cases recently where we were owed money. The group themselves went into a ‘creditors voluntary liquidation’. The liquidator, surprise surprise, took the lot with nothing left for the other creditors like little old CA Plus.

Some believe that incorporated status removes any risk – this is not so. Personal liability can still arise if there is any evidence of wrongful or fraudulent trading, or if you treat one creditor more favourably to the detriment of others. Limited liability status does not remove the duty of care.

The VCS is amazingly resilient, but sometimes, common sense goes out of the window and we carry on despite the obvious signs that all is not well. My advice – put budgeting and planning and good financial reports at the top of your list.