



Managing financial difficulties – what you need to know

In the current economic climate and with a second spending review on the horizon, the reality is that more and more charities and other voluntary sector organisations are, or soon will be, facing financial difficulties and unfortunately in some cases, insolvency.

Trustees need to be able to recognise when their organisation might be heading towards financial difficulties and be aware of what action they need to take if the charity is approaching insolvency and what to do if insolvency is unavoidable.

What is insolvency?

A charity may be insolvent if:

- the charity cannot pay its debts as they fall due for payment
- the value of its liabilities exceeds the value of its assets

In practice there are two separate tests for insolvency and failure of either might be an indication of insolvency:

The cash flow or short-term liquidity test: this shows whether a charity has sufficient, easily accessible resources available with which to meet all of its liabilities as they fall due and to continue to meet them in the short term.

The balance sheet test: this 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 above.

What are your responsibilities?

- 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
- 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
- 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 and updates are provided and the financial position, budgets and financial projections of the charity are fully considered

What to do if you think you may be insolvent

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 must 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.

It is recommended 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. Trustees should contact the charity's accountant, insolvency practitioner or other professional advisor to discuss the options and seek their help and advice. Trustees should draw up a complete list of all the assets and liabilities of the charity to determine whether the charity is solvent or not. A charity can approach an independent insolvency practitioner, but should consider contacting their own auditor or professional accountant first (if they have one).

If in doubt

- Seek professional advice, as early as possible
- Review financial management controls
- Maintain an asset/ liability register
- Check budgets and actual expenditure frequently
- Contact Manchester Community Central for support

Further information can be found at:

Managing Financial Difficulties pdf www.manchestercommunitycentral.org/all-our-factsheets

Companies House www.companieshouse.gov.uk

Charity Finance Directors Group www.cfdg.org.uk

Charity Commission www.charitycommission.gov.uk

HM Revenue and Customs www.hmrc.gov.uk

The Insolvency Practitioners Association -search facility (allows you to search for 'Manchester Practitioners')

www.insolvency-practitioners.org.uk/ipsearch.aspx

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