



5. Trustees and governance

5.9 Winding up - the steps involved and alternative options

What is meant by 'winding up'?

'Winding up' is simply another term for 'liquidation' which is the process by which an organisation is brought to an end, and the assets and property of the organisation redistributed.

Can a charity be wound up?

In certain situations a charity can either be wound up or its assets transferred to another charity. This is a complex area of law, and trustees must ensure that they act lawfully. The governing document of the charity (the 'constitution') should be consulted to see whether a 'dissolution clause' is in place, outlining the steps that are necessary to close down the charity. If, however, there is no dissolution clause in the constitution the Charity Commission will need to implement one for the charity. If this is necessary the committee should contact the Charity Commission for advice before making any recommendations to the members or undertaking any further action.

Why would a charity need to consider winding up?

A charity that continues to operate without a viable future may be wasting funds that could be better used by winding up the charity and transferring its

assets to another charity. Winding up a charity can be a positive step to either acknowledge that the charity's mission is complete or obsolete, or that charitable funds can no longer be effectively applied by that organisation. Alternatively trustees may need to consider winding up a charity if it is likely to become insolvent.

It is illegal for a company to trade when it is insolvent, so trustees must be aware of when the charity has reached this point so as to avoid acting illegally. In practice there are two separate tests for insolvency, and failure of either might be an indication of insolvency:

1. the charity cannot pay its debts as they fall due for payment;
2. the value of its liabilities (outgoings or debts) exceeds the value of its assets.

Your liability as a trustee/member

An emotional attachment to a charity and its cause often prevents trustees from winding up their charity, when it becomes clear that it no longer has a viable future. An unincorporated charity cannot technically be insolvent though as it has no legal identity separate to its members and trustees, which means that any liability of the charity is the liability of its trustees or members, regardless of whether they have acted properly or not.

Likewise, trustees of a charitable company should minimise their expenditure when it becomes apparent that insolvency is unavoidable, otherwise they can be forced to contribute toward the payment of the charity's debts.

What are the alternatives to winding up?

Before the management committee/board of a charity makes a final decision to wind up, the following alternative options should be considered:

- Cutting or curtailing planned expenditure so that the level of outgoings is reduced to below the level of income/assets.
- Developing alternative sources of funding or launching an emergency appeal. Care must be taken that any such funds raised are sufficiently unrestricted to pay the existing creditors. Trustees must ensure that donors are informed that new funds raised may be used to meet the charity's debts.
- Carrying out a review of the charity's commitments to see whether they are legally binding or discretionary. Even where contractual agreements exist there may be scope for renegotiation.
- Discontinuing some activities of the charity or transferring some activities into other charities or companies. It may be possible to release the value of fixed assets and investments (i.e. turn them in to cash) to pay off creditors.
- Borrow money from supporters of the charity, possibly on an interest-free basis. Alternatively money could be borrowed from a bank on commercial terms, or the charity could enter into sale and leaseback arrangements for some of its assets.
- Look at the possibility of broadening the objects of the charity, if appropriate to do so. For example, a charity may be set up with a specific target but it may then find in the course of its work that additional needs have become apparent. If this occurs there are several ways of responding to the situation. A charity's governing document should include a power of amendment, or if not the trustees of an unincorporated can seek Charity Commission authority to broaden its objects. A charity with the power of amendment should ensure that new objects accord with their trusts. The beneficiaries are key; new objects should be to the advantage of current beneficiaries and should not conflict with other objects.
- Merge with other charities with similar objects or negotiate with them to help meet outstanding commitments. Care needs to be taken to ensure that any such plans result in creditors being satisfactorily paid. Transferring assets out of a charity may otherwise increase the risk of personal liability for the trustees.

What do you need to consider if you are looking to merge?

If a charity is considering the possibility of a merger the main issues to consider are:

- Types of merger - the process will be determined by the outcome sought; a new charity may be formed to take the assets of two existing charities, one may dissolve and pass its assets to another, or one charity may become a subsidiary of another.
- Charitable objects - a charity must always act within the terms of its objects. It is important for charities that are combining to have compatible objects, so if they differ the objects will need to be amended.
- The role of the Charity Commission - where there are problems with a charity's ability to amend its objects, the Charity Commission can implement a cy-pres scheme. The Charity Commission can be involved in making a scheme where a permanent endowment is held and the receiving charity is a company.
- Issues to be considered - structural and practical issues need to be addressed, such as the constitution of the trustee board, membership, internal organisation and of course a name.
- Possible future liabilities - a charity receiving the assets and activities of another charity can take over liabilities; particular areas of concern may be VAT, the transfer of employees, and a defined benefit

pension scheme with ongoing liabilities.

- The register of charity mergers – introduced by the Charities Act 2006, this transfers gifts or legacies made to the merged charity to the successor charity.

If you decide that winding up is the best option, how can the winding up procedure be started?

Firstly it is necessary to establish how the charity in question can be wound up. This will depend on what kind of charity it is, what it says in the governing document and whether or not the charity has 'permanent endowment' (property that cannot be spent as income). It is likely that the charity will fall within one of the following categories:

a) The charity is also a company.

A charitable company has an automatic right to spend all of its assets on its purposes, so once this has been done the charity can be dissolved and removed from the Companies House register.

b) The charity is unincorporated and there is a dissolution clause in the governing document (as mentioned above).

If there is a clause in the governing document that will state how the charity is to be wound up and what should happen to the remaining assets, so the trustees must follow it.

c) The charity is unincorporated, there is no dissolution clause in the governing document and there is no permanent endowment.

If there is no specific dissolution clause but all of the charity's assets are expendable, the trustees may spend all of the remaining assets on the charity's objects. Alternatively, the trustees may be able to transfer the assets to another charity with similar objects.

d) The charity is unincorporated, there is no dissolution clause in the governing document and there is permanent endowment.

If a charity has permanent endowment it cannot be wound up until that permanent endowment is dealt with. The trustees could seek approval from the Charity Commission to spend the permanent endowment or they could transfer it to another charity with similar objects. Alternatively, if the trustees wanted to wind up because they could not fulfil the current objects of the charity they could consider changing the objects.

What happens after the charity is wound up?

Once it has been established how the charity should be wound up the winding up procedure can go ahead, and when the organisation has been formally wound up the following then needs to be done:

- the bank account should be closed
- all paper records that do not need to be kept should be shredded (not just thrown away)
- all computer hard drives should be cleaned or reformatted so that documents relating to the organisation are no longer available

- all headed notepaper, compliment slips etc should be destroyed
- the website should be closed down
- all email accounts should be closed
- the trustees must inform the Charity Commission (see below).

Removal of the charity from the Register

There is a requirement under The Charities Act 1993 and 2006 for the trustees of a registered charity to inform the Charity Commission that the charity no longer exists, and the Charity Commission then has to remove that charity from the Register. To fulfil these legal requirements the trustees should, after applying all of the charity's property, send to the charity commission:

- a copy of the resolution to wind up the charity;
- the final set of accounts which, for charities with income or expenditure above £10,000 in the period to which the accounts relate, is subject to the appropriate statutory external scrutiny (the charity commission will need to be notified when there are insufficient funds to meet the costs of external scrutiny upon cessation due to insolvency); and
- a statement of the final distribution of assets if this is not shown in the accounts (this should be signed by the trustees and, preferably, the external auditor or examiner).

Once the charity commission is satisfied with the information sent to them the charity will be removed from the Register. Failure to inform the Charity Commission that a charity has dissolved or wound up will lead to enquiries being made about what has happened to the charity and its assets.

Record retention after winding up

After a charity has been dissolved or wound up, the trustees must arrange for its accounting books and records to be kept for:

- at least three years after the year they were made if it is a charitable company; or
- at least six years after the year they were made if it is an unincorporated charity.

The accounting records that must be kept include cash books, invoices, receipts and any similar record of the charity's financial activities.

Further information

For more advice on the practical steps involved in winding up a charity go to following Charity Commission's guides:

- *Close or merge a charity* - www.charitycommission.gov.uk/Manage_your_charity/Merge_or_close_index.aspx.

This explains how to notify the Charity Commission that a charity is closing using online form CSD-1077, and also provides links to further information about permanent endowments.

- *Dissolution and removal from the Register of Charities* - www.charitycommission.gov.uk/library/guidance/csd1077a.pdf.

This provides very detailed guidance on how to complete online form CSD-1077, as well as setting out the specific responsibilities that trustees have within the winding up process and after winding up is complete.

Disclaimer

The information provided in this sheet is intended for guidance only. It is not a substitute for professional advice and we cannot accept any responsibility for loss occasioned as a result of any person acting or refraining from acting upon it.

For further information contact

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