get it right on… Closing Down

This factsheet is intended as an overview of the procedures available to groups wishing to wind up or close down. It is not a statement of the law and organisations must get independent legal advice before they proceed to close down.

There may be a number of reasons why an organisation may wish (or have to) wind up:

- Funding may have run out and no further funding is likely in the foreseeable future
- The need for the organisation no longer exists or it has fulfilled its purposes
- The organisation plans to merge with another body
- The organisation is unincorporated and is about to become a limited company.

There are two key factors in determining which procedures an organisation must use to wind up:

- Whether it is solvent (that is, able to pay off all its debts) or insolvent
- Whether or not it is incorporated (that is, a limited company or community benefit society).

SOLVENCY

There are two traditional tests used by accountants to determine whether an organisation is solvent or not: the **cash flow test** and the **balance sheet test**. In order to be solvent, an organisation must be able to pass **both** tests. If it cannot, then the organisation should seek legal advice and the advice of its accountants as soon as possible.

Cash Flow Test

This means that the organisation has enough money or other assets to pay its debts as they become due in the short term or in the foreseeable future. An organisation might be in financial difficulties under the cash flow test because it:

- is having to spend from its reserves to meet its current commitments
- has to take out additional security to finance borrowings
- is being chased by creditors for overdue or unpaid bills.

Balance Sheet Test

This test estimates the true value of all the assets of the organisation and also the amount of its actual and potential debts (liabilities). If all its assets, when converted into cash, are able to meet its debts/liabilities (including likely future claims such as pending employment tribunal or court cases) then it will pass the balance sheet test. If the organisation is solvent but not a company or community benefit society, then it must follow the procedures in its constitution or deed of trust about winding up or dissolution. If the organisation is a charity, it must have final 'nil balance' accounts prepared to show what assets were left and where they were transferred or donated and must first have received permission from OSCR to dissolve.

For an unincorporated association, the winding up procedure will usually involve holding a general meeting and passing a resolution to dissolve once all the organisation's debts have been paid. The constitutions of unincorporated charities will require that any assets left over must be transferred to another charity with similar objects or used for similar charitable purposes or applied.

In the case of a charitable trust, the resolution to dissolve must be passed by the trustees according to the procedure contained in its Deed of Trust.

If the organisation is solvent and a limited company, it can make use of the 'Voluntary Striking Off and Dissolution' procedure under section 652 of the Companies Act 1985. The company must also pass a special resolution in a general meeting of its members to wind up as solvent. If it is also a charity, it must receive permission from OSCR and subsequently send a final 'nil balance' account to OSCR, which will then remove it from the Register of Charities. Alternatively a company can make use of a **members' voluntary liquidation.**

If the organisation is solvent and a community benefit society (formerly industrial and provident society), it can make use of the voluntary dissolution procedure under section 55 of the Industrial and Provident Societies Act 1965. You can find more information on this from the Financial Service Authority's website

WINDING UP A SOLVENT COMPANY

Members' voluntary liquidation

This procedure allows a solvent company to put itself into liquidation where, for example, it is being sold off or the purposes of the company have come to an end. The members appoint their own choice of insolvency practitioner as liquidator. Creditors do not have to be notified. The company must be able to pay its debts in full within 12 months. If the liquidator considers that this will not be possible, a meeting of creditors must be held and the liquidation becomes a creditors' voluntary liquidation.

Voluntary Striking Off and Dissolution

If a company wishes to cease to trade while still solvent, it can use the voluntary striking off and dissolution procedure through Companies House. In order to use the procedure it must be able to show that, in the 3 months prior to making its application for dissolution and striking off, it has not traded or otherwise carried on business or changed its name.

What must the company do before applying?

A company cannot apply for dissolution and striking off if it has settled trading or business debts in the previous three months. It is therefore very important that all business debts are settled before the application is made and that the directors are confident that there are no outstanding creditors or likely future claims against the company. The company should also have disposed of all its assets, because from the date of dissolution, any assets held by a dissolved company will belong to the Crown. The company's bank account (if still open) will be frozen and any credit balance in the account will be passed to the Crown.

Before making the application, the company must warn all those with whom it deals (for example, members, creditors, debtors, employees, contractors, the local authority or other partner organisations) that it is proposing to be voluntarily struck off. This is to give them the opportunity to object if they wish and have their objections dealt with.

The application is made on Companies form 652a and it should be sent to Companies House It must be sworn by at least a majority of the directors of the company. The fee for submitting the application is £10. Within 7 days after submitting form 652a, the company must send copies to its **members, creditors** (contingent and prospective), employees, and any directors who did not sign the form.

If, after a period of 3 months from the date of filing, the Registrar has not received any formal objections, then the company will be struck off. As long as accounts for the last completed financial year have been filed at Companies House, no further accounts need be filed before dissolution.

However, interested parties may object if:

- The company has broken any of the conditions of its application
- The directors have not informed all interested parties
- Any of the declarations on the form are false
- Some form of action is being taken, or is pending, to recover any money owed
- Other legal action is being taken against the company
- The directors have wrongfully traded or committed a tax fraud or some other offence.

INSOLVENCY

If the organisation is insolvent, then the legal position depends on whether it is an unincorporated body (unincorporated association or trust) or a corporate body (limited company or community benefit society).

Unincorporated bodies

Because there are no statutory procedures for winding these up, it is up to the management committees or trustees to take the necessary steps themselves, with professional advice if needed. This means identifying all the assets and liabilities and using the assets to meet as many of the liabilities as possible. Creditors who are still unpaid once all the assets have been exhausted, have the right to sue the management committee members either individually or collectively, to recover payment.

It is possible for management committees or trustees whose organisations are facing insolvency to enter into an informal arrangement with some or all of their creditors. This might mean that the creditors agree to defer payment of the debts they are owed by the organisation, and/or agree to reduce the size of their claims. These agreements are not covered by the Insolvency Act and will only bind those creditors who sign them.

Management committees and trustees should take appropriate professional advice before going ahead with making arrangements with creditors. If the organisation is a registered charity, the management committee should ensure that they have sought the permission of OSCR and have sent:

- a copy of the resolution passed at a general meeting to wind up the charity
- the final set of accounts, audited or independently examined. The auditor/independent examiner must notify the Commission if there are insufficient funds to meet the costs of
- audit/examination if the organisation is winding up insolvent
- a statement of the final distribution of assets if this is not shown in the accounts, signed by the charity's trustees and, preferably, the auditor or independent examiner.

Once OSCR is satisfied with the information sent to it, it will remove the charity from the Register. However, as a result of its regulatory function to ensure that the charity's trustees have had proper control and management, in the case of insolvency, OSCR can request detailed financial and administrative information in order to determine whether:

- sound financial and administrative controls exist
- prompt and accurate information is available on which the trustees can base their decisions
- the charity trustees have a clear plan as to how the insolvency problem will be addressed
- proper professional advice has been appropriately taken
- any cessation or winding up is conducted in a proper and orderly manner
- any assets left over after all debts are paid have been properly applied for charitable purposes.

Where OSCR believes that there has been misconduct or mismanagement or there is a need to protect a charity's property, it has power to suspend or remove a trustee.

If the organisation has employees who are owed arrears of pay and/or statutory redundancy payments and it cannot afford to pay them, the employees can apply for payment from the Redundancy Payments Office (RPO). The RPO can then sue the management committee members of the organisation or charity personally for reimbursement of the payments made to the employees.

Corporate Bodies – Companies and Community Benefit Societies (CBSs)
The winding up of insolvent companies (including charitable companies) is carried out under the Insolvency Act 1986. The winding up of CBSs is carried out under section 55 of the Industrial and Provident Societies Act 1965, which contains similar procedures to those in the Insolvency Act. For brevity, all references to 'company' in this section also refer to CBSs. Once the directors or members of a company (or its creditors) suspect that it may be insolvent, there are a number of procedures open to them. These are:

- Compulsory Liquidation
- Administration
- Administrative Receivership
- Company Voluntary Arrangement (CVA)
- Creditors' Voluntary Liquidation
- Members' Voluntary Liquidation.

The Government Department responsible for dealing with bankrupt individuals and insolvent companies is the Insolvency Service). Its team of Official Receivers (ORs) handle compulsory liquidations – that is, where the company is being wound up by Court order. They investigate the circumstances behind an insolvency and make reports on the conduct of the company's directors and other officers. These reports can lead to prosecutions under the Act. The other professionals who can become involved if a company is insolvent are Insolvency Practitioners (IPs). They are accountants or solicitors who are specially licensed to act as administrative receivers, administrators or liquidators in creditors' voluntary liquidations.

Compulsory liquidation
This process is usually started when a creditor who is owed £750 or more, petitions the Court for a winding up order. The Court can make an order even if the company has no assets or disputes the debt. The directors should try to agree any debts with the creditor(s) before an order is made because of the severe effects it will have on the company. So, if your company is facing financial problems, even temporarily, you should consider seeking advice from your professional adviser, a solicitor, a qualified accountant or a licensed insolvency practitioner. Failing to do this can have serious consequences. Other organisations also offer insolvency advice and debt counselling: some of them are reputable and offer a professional service. However, some may be run by people with no obvious qualifications who appear to be motivated mainly by a desire to exploit vulnerable businesses.

Within a few days after the Court order for compulsory liquidation is made, the OR will contact the company's directors and members to notify them of this and to arrange to interview the directors. If the company has significantly large assets, an IP may be appointed as liquidator instead of the OR. The directors will be required to complete a questionnaire and co-operate with the OR in providing information, handing over books and accounts, disposing of the company's assets and discharging its liabilities.

The directors may also be required to submit a sworn statement of the company's affairs. Once the winding up order is made, the employees' are automatically dismissed and they will be told how to claim unpaid wages and redundancy or other payments due to them.

The effect of a winding up order is to remove all powers from the directors and other officers of the company and place them with the OR. The OR will aim to issue a report to the shareholders and creditors of the company within 8 weeks after the order has been made. If the company has no substantial assets, the OR will remain as liquidator and notify the creditors of the winding up within 12 weeks after the order has been made. If the company has substantial assets, an IP will be appointed as liquidator and will call a meeting of the company's creditors. If the OR or IP discovers evidence of misconduct or mismanagement by the directors or other officers, then s/he will report this within 6 months after the order is made and will report suspected criminal conduct within 10 months. This may well result in personal liability orders being made against the directors and/or criminal prosecutions.

Once the creditors have been notified of the winding up/liquidation, the liquidator will begin disposing of the company's assets and discharging its liabilities. The liquidator does this according to priorities set in the Insolvency Act. If there are not sufficient assets to meet the liabilities and debts of the company, then the creditors will be paid pro rata. This means that, if for example, the assets are only sufficient to meet 50% of the debts, then creditors will be paid 50% of their claims. Directors who are disqualified under the Company Directors Disqualification Act 1986 will also be disqualified from acting as charity trustee.

Preferential creditors are:
employees for:

- arrears of pay* for between 1 and 8 weeks (certain statutory payments are treated as arrears of pay for these purposes)
- holiday pay* for up to 6 weeks in all during the 12 months ending on the date of the insolvency
- payment for notice given* or for an employer's failure to give proper notice, for the minimum periods required law (1 week for each completed year of service up to a maximum of 12 weeks)
- a basic award of compensation for unfair dismissal made by an employment tribunal
- reasonable repayment of any fee or premium paid by an apprentice or articled clerk.

occupational pension schemes for:

- contributions due from the employer.

Some potential challenges

The governing document of an unincorporated organisation has no dissolution clause.
This is more likely to occur where an unincorporated association or trust had adopted a governing document years ago before standard models became readily available and will present difficulties if the organisation is dissolving or winding up voluntarily. It will have to call a general meeting to

pass a resolution to amend its governing document to include a dissolution clause. If it is a registered charity, it must consult OSCR before going ahead.

An unincorporated organisation is unable to call a quorate general meeting topass a resolution to dissolve.

If the organisation is a charity, it should contact OSCR for advice and assistance. If it is not a registered charity, the management committee should arrange for a meeting of all interested parties (such as the members, and any funders, stakeholders, volunteers and employees) to agree the dissolution. A copy of the resolution to dissolve should be sent to all those who were invited to the meeting. If the organisation has a small membership that is unwilling or unable to attend a meeting, then the committee should attempt to obtain their agreement in writing to dissolve the organisation.

Wrongful trading and fraudulent trading by company directors

The Insolvency Act 1989 contains a number of sanctions against directors of companies who act dishonestly or negligently while the company is trading or during its winding up. Wrongful trading is not a criminal offence: it occurs when one or more of the directors carry on the company's business when they know (or ought to know) that it is insolvent or heading for insolvency. The liquidator of an insolvent company can pursue a director for payment of its debts if s/he has been found to have traded wrongfully. Fraudulent trading is a criminal offence as it involves carrying on the business while it is insolvent or heading for insolvency and with the intention of cheating creditors. Directors can be fined, imprisoned and disqualified under the Company Directors Disqualification Act 1986 if they are found guilty of fraudulent trading.