'Mission vs mammon' dilemma needs emotional intelligence

IPs helping charities in financial difficulty need to recognise the sector's unique pressures and characteristics, say **David Fendt**, **Clare Mills** and **Adam Stephens**

A pandemic, followed by an economic crunch with high inflation and rising interest rates, the decline in the use of cash, significant change through Brexit… As with every other economic sector in the UK, charities (a term which in this article also includes voluntary, community and social enterprises) are feeling the effects.

Giving and income

According to Clare Mills, director of policy and communications at trade body Charity Finance Group, the popular perception is that charities receive all their income from public donations. But the reality is that across the sector, there is a wide variety of business models and income streams.

Restructuring professionals called in to advise may come across public donations, legacies, community fundraising (e.g. collecting sponsorship money for challenge events), commissioned services (e.g. adult social care, education, housing and homelessness, youth work), grants (e.g. from trusts, foundations and the public sector), trading income (e.g. selling space at events, training courses, property income (e.g. room/building hire), social enterprise activities, corporate partnerships (e.g. sponsorship of events and projects), and investment income.

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The public response to the invasion of Ukraine helped make 2022 the most generous year on record for giving, with an estimated £12.7 billion in donations.[1] However, it is also estimated that inflation may have eroded the value of this generosity by more than £500 million.[2]

Mills explains: "For those charities that hold contracts to deliver public services, inflation has significantly increased costs. Many such contracts are already subsidised by charities through other income-generating activities. On grants, although some funders have independently increased their grant funding to recognise the impact of inflation, this is discretionary and is not universal. For charities with property assets, the move to remote working has also had an impact on

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their ability to rent out surplus or underused space. For those that organise in-person events, the significant switch to digital or virtual events and training has also reduced those opportunities."

Mills adds: "The silver lining is that charities are seeing greater returns on their investments, but we know many charities used the bulk of their reserves to support operating costs during the pandemic. Despite the support offered by the government to businesses, not all charities could make use of the funding on offer due to their business models and structures."

Under pressure

Charities, like most sectors, are under pressure to increase wages in line with inflation. In a (very) few cases, charity staff have been striking over pay, but more widely vacancies are left unfilled and retaining staff is increasingly difficult, with some lower paid workers leaving the charity sector altogether in search of higher pay.

Costs throughout the supply chain have increased. Energy prices have had a particular impact on charities providing essential human services such as hospices, accommodation for people in housing need, and disability support, where energy is essential to keep people warm and safe, and to operate life-supporting and enhancing equipment.

A different but equally serious pressure comes from rising demand for services, with 81% of charities saying that demand for their services has increased compared with a year ago.[4] Anecdotally, charity leaders are also reporting people with more complex needs. For example, debt advice queries now also reveal issues with housing, employment, mental and physical health, and more.

Legal structures

It is against the above background that IPs will be called into charities to guide them through the difficult times ahead. However, doing so comes with various unique challenges.

The main point to determine at the outset is the charity's legal structure, of which there is a wide variety [see panel on next page]. Some will be incorporated (which means a separate legal personality, protecting the trustees/directors/members by limiting their liability), whereas other will be unincorporated (meaning that the people who run it are likely to be personally responsible for its debts and other liabilities). It may be that the people managing an unincorporated organisation have not been made aware of their potential exposure, so an IP should explore the question of structures and personal liability with care.

All the information about the governance and legal structure should be set out in the organisation's governing document (which, depending on the structure, could be a 'constitution', 'memorandum & articles of association' or 'trust deed').[5]

As Adam Stephens, an IP and partner at Evelyn Partners, highlights: "The legal structure isn't just an arcane academic point – it can limit the insolvency options. An unincorporated trust, where the trustees are personally liable, probably means that the customary suite of insolvency options are unavailable.

"Certain incorporated structures may also require particular considerations. For example, Royal Charter companies have much more limited options, and a charitable incorporated organisation requires a modified CVA procedure."

An organisation might be registered with the FCA, rather than Companies House, as is the case for community benefit or industrial and provident societies. This is not too troublesome to deal with, but means that you need to know where to send your various statutory forms (and investigate their format – often a modestly adjusted Companies House form will suffice).

Asset lock and restricted funds

Next, it is important to understand whether any assets are held on particular trusts, which make them unavailable to creditors. This could be a permanent endowment fund, or property. These assets would be ring-fenced and fall outside of the corporate property of the charity, and cannot be sold or used for security to meet creditors' claims. There are some potential options to deal with this, including the possibility of asking the settlor, or seeking the permission of The Charity Commission, for a change in the purpose of the trust.

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Related to this is the term 'restricted funds', which is often seen on a charity's balance sheet. This may equate to assets held on trust, but not necessarily, and the two should not be taken to be equivalent.

One of the main challenges in dealing with the charitable sector can be the absence of complete, accurate, and historic legal and accounting records, particularly with charities set up many years, possibly centuries, ago. An IP will often end up acting like a detective, piecing together the puzzle to work out if the restricted assets are held on trust.

Understanding missions

Stephens adds: "Perhaps the most unique matter we have encountered in the charitable sector is the need for emotional intelligence: understanding the motivations for the management and trustees, and to be able to modestly articulate that back to them. There is the 'mission versus mammon' challenge. These organisations are, by and large, not motivated to make profits for personal gain but, rather, are motivated to make profits in order to further the charity's mission."

An IP should be mindful to frame solutions, if at all possible, around the mission (which might include safeguarding the legacy of the organisation).

Trustees' roles

Charities may feature some, or all, of the following roles:

1) All charities will have **trustees**;
2) Charitable companies may have **directors**;
3) For some entities, such as charitable incorporated organisations (CIOs) and charitable companies limited by guarantee, the trustees will also be **members**, with

Legal structures

Incorporated legal structures

	Who controls	Who is the regulator?	Limited liability?	Profit distribution?	Charitable status available?
Charitable incorporated organisation (CIO)	Board of trustees	The Charity Commission	Yes	No	Yes, automatic
Company Limited by Guarantee (CLG)	Board of directors	Companies House (and Charity Commission if it has charitable status)	Yes	Usually no	Yes (if purposes are solely charitable)

Unincorporated legal structures

	Who controls	Who is the regulator?	Limited liability?	Profit distribution?	Charitable status available?
Charitable trust	Board of trustees	The Charity Commission	No	No	Yes
Unincorporated association	Management committee	The Charity Commission	No	No	Yes (if purposes are solely charitable)

Other legal structures

Companies limited by shares:

• Limited by shares, meaning it is owned by shareholders who have certain rights.

• Regulated by Companies House.

Companies limited by guarantee:

• Limited by guarantee, meaning it has guarantors and a 'guaranteed amount'.

• Many companies that have no charitable purpose also adopt this legal structure.

• Regulated by Companies House.

Community interest companies (limited by shares or guarantee):

• A limited company, with special additional features, created for the use of people who want to conduct a business or other activity for community benefit.

• Regulated by the Office of the Regulator of Community Interest Companies, and Companies House.

Community benefit societies:

• Formed primarily for the benefit of people who are not members of the society and this must be in the interest of the community at large.

• Regulated by the Financial Conduct Authority.

Co-operative societies:

• Formed primarily to benefit its own members who will participate in the primary business of the society.

• It signs up to The International Cooperative Alliances' values and principles.

• Regulated by the Financial Conduct Authority.

Limited liability partnerships:

• A separate legal entity from its members (partners) who are only liable for the amount of money they invest, plus any personal guarantees.

• Incorporated at Companies House and can only be used by profit-making businesses.

• Regulated by Companies House.

Donor advised funds (DAFs):

• An alternative to having a personal (family) standalone charitable foundation.

• Set up with a DAF provider such as the CAF Charitable Trust.

Source: NVCO

powers to pass any relevant resolutions (perhaps placing the organisation into liquidation).

Most readers will likely be familiar with the differences between these roles, but it should be established at the outset what role(s) 'trustees' (the customary catch-all term for all three) play in the organisation. Importantly, these roles are also distinct from senior management with executive responsibility for the organisation. Trustees do not customarily have day-to-day responsibility (even if, for organisations registered at Companies House, they are likely to be recorded as *de jure* directors).

Charities are facing unprecedented challenges in this economic climate, and IPs will need to guide them through these difficult times, whilst at the same time recognising the sector's unique pressures and characteristics.

1 https://www.cafonline.org/docs/default-source/about-us-research/uk_giving_2023.pdf
2 https://www.probonoeconomics.com/news/pbe-reacts-ons-inflation-stats-september-2022
3 https://www.thinknpc.org/resource-hub/recognising-social-value/
4 https://www.cafonline.org/about-us/press-office/cost-of-living-charities-still-struggling-to-meet-demand-and-cover-costs
5 The NCVO information on governing documents can help clarify exactly what type of charitable organisation you are dealing with: https://www.ncvo.org.uk/help-and-guidance/setting-up/choosing-your-legal-structure/#/

David Fendt is a senior associate in the insolvency department at Russell-Cooke. **Clare Mills** is director of policy and communications at Charity Finance Group. **Adam Stephens** is a partner and insolvency practitioner at Evelyn Partners.

***Pippa Garland**, partner, charity law at Russell-Cooke also contributed to this article.*