**When Charity Ends Part 3**

This is part three of a three part series of articles setting out the options for charities when the personal fulfilment of undertaking their charitable enterprise has been destroyed by regulation and red tape. Part one was on how to cease an unincorporated (non-company) charity. Part two looked at how to cease an incorporated (company) charity and this part will look at accounting for the merging of charities. Some of the accounting issues may not be particularly accessible to non-accountants; but the charities professional advisor will be able to give a more details.

**Accounting for charity combinations**

There are a number of accounting options available to a charity merging with another or being subsuming into a larger charity. The methods I recommend are:

* Merging of equals method
* Subsumed into a larger charity method
* Acquisition accounting

**Merger of equals**

The accounting for the merging of equals is to simply add every line item on the income and expenditure account and the balance sheet together for both charities for this year and last. To use this method the charities need to be of similar size and both charities need to be involved in the management of the new merged entity. The income and expenditure and balance sheet should look like the two charities were always merged. Here is an example with two charities that both run identical private ambulances in different parts of the country. The charities merge at the end of 2014.

 Charity A Charity B Merged

 2013 2014 2013 2014 2013 2014

Income 100 120 60 80 160 200

Expenses 90 110 30 50 120 160

Surplus 10 10 30 30 40 40

Ambulance 200 190 200 190 400 380

Overdraft (180) (170) (20) (nil) (200) (170)

Amounts owing (30) (20) (20) (Nil) (50) (20)

Net assets (10) (Nil) 160 190 150 190

The financial statements for the merged entity look like they have been merged for the whole period, notwithstanding that they only merged at the end of the second year. This is the correct treatment where equals (or nearly equals) merge.

Rules around the use of merger accounting

The use of the merger method set out in the first example is restricted to entities that are truly merging and “come together in a partnership for the mutual sharing of risks and benefits”. If one party is not represented in the final merged entity, then merger accounting is not available. Further restriction on the use of merger accounting includes:

1. no party to the combination is portrayed as either acquirer or acquiree, either by its own board or management or by that of another party to the combination;
2. there is no significant change to the classes of beneficiaries of the combining entities or the purpose of the benefits provided as a result of the combination; and
3. all parties to the combination, as represented by the members of the board, participate in establishing the management structure of the combined entity and in selecting the management personnel, and such decisions are made on the basis of a consensus between the parties to the combination rather than purely by exercise of voting rights.

**A charity being subsumed into a larger one**

Using the same example with two charities that both run identical private ambulances in different parts of the country, but for this second example I will assume that charity B is giving up and simply giving their charitable company, their ambulance and their bank account and all debts etc… to A and walking away. The “merger method” set out above is not available in these circumstances. In this type of situation, the successor charity treats the transaction as a gift or donation. For simplicity I am assuming that charity A has agreed to liquidate Charity B after it takes it over and this will cost €5, in addition charity B has to make a part time employee redundant and this will cost €15 – so the costs of liquidation are in total €20.

 Pre takeover After takeover

 Charity A Charity A

 2013 2014 2013 2014

Income 100 120 100 120

 Donation from charity B 170 (190 – 20 windup exp.)

Total income 100 290

Expenses 90 110 90 110

Surplus 10 10 10 180

Ambulance 200 190 200 380

Overdraft (180) (170) (180) (170)

Amounts owing (30) (20) (30) (40) (20 + 20 windup exp.)

Net assets (10) Nil (10) 170

Note that the financial statements for A for 2013 do not change as the acquisition was made at the end of 2014. At the end of 2014, A took over all of the assets and liabilities of B, so these are added to A’s assets and liabilities with an additional amount provided of €20 to cover the cost of winding up B. As B has been wound up, financial statements for 2014 will not be needed for B but a statement of affairs will be prepared for a voluntary strike off or liquidation (see previous articles).

In the example above, the net figure transferred is treated as a “donation” in charity A. If charity B had an overall deficit (more debts than assets) the net deficit transferred would be treated as an extra expense in A.

**Acquisition accounting**

Where one charity acquires another, either by paying for the other entity or by taking over the other charities debts; then a different method of accounting called “acquisition accounting” is used. This method is appropriate where there is a more commercial aspect to the transaction or where the acquired charity is quite large or complex. Smaller charities will use the “subsumed into a larger charity” method set out above; the acquisition method set out here is generally used for the acquisition of €100,000+ income charities; although there is no absolute cut off amount between the two methods. Smaller charities have been known to use the acquisition method and larger charities may use the “subsumed into a larger charity” method; the charity directors are free to choose the most appropriate method themselves.

Acquisition accounting requires the acquisition be accounted for by:

* revaluing all of the assets and liabilities of the acquired charity to fair value (market value) and add them up to see what net assets are being acquired – note this can be negative where there is an overall deficit;
* Calculate how much is paid, and this is often Nil;
* Subtract the amount paid from the net assets acquired and this is goodwill; which can be a positive number (liabilities exceed assets) or negative (assets exceed liabilities)
* Goodwill in a charity would normally be written off to expenses or income in the year of the acquisition.

As an example a charity has a building and a mortgage and an overdraft and agrees to surrender the whole thing for no payment into a larger national charity:

 Example 1 Example 2

Building market value 100,000 100,000

Mortgage 80,000 80,000

Overdraft 25,000 5,000

Net -5,000 15,000

Payment received for surrendering Nil Nil

Goodwill 5,000 -15,000

The accounting standard in respect of goodwill requires that in example 1 the positive goodwill of €5,000 would be written off over the life of the goodwill (how long the charities good name will last if it ceased doing good deeds immediately) which is usually one year but could be as long as 20 years in some cases. The accounting standard in respect of negative goodwill requires that in example 2 the negative goodwill of €15,000 would be written off over the remaining useful life of the building, but often the negative goodwill in a charity is treated in accordance with “substance over legal form” argument as a “donation” and booked as income in year one. Acquisition accounting would normally require the assistance of professional advisors.

Conclusion

After the merger or acquisition, an empty “shell” company will be left over and this should be liquidated or arrange to be voluntarily struck off. Where the empty shell left over, is not a company, it is still important to still go through the process of winding up as set out in part 1 and 2 of this article.