

## Audit & Risk Committee – 19<sup>th</sup> September 2022

### Cashflow and Solvency

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#### 1. Objective

The purpose of this paper is to update the ARC on a major forecast update, advice from FRP (insolvency and restructuring) and Turcan Connell (legal), and to agree a process from the ARC meeting to a full briefing for the Board.

#### 2. Detail

[Important note: this paper has been updated to reflect the business energy cap briefed on 21<sup>st</sup> September 2022]

#### BACKGROUND

- CMI Group is facing overwhelming financial challenges that are both structural and timing.

- [Redacted]

- [Redacted]

- [Redacted]

- [Redacted]

- [REDACTED]

- [REDACTED]

**WHAT HAS CHANGED?**

- These two scenarios by trading company, and consolidated, are attached.
- The closer that we get to the insolvency line the more pessimistic we must make the assumptions to allow time and space to stay on the right side of wrongful trading. The changes to assumptions have made the following changes:

- [REDACTED]
  - [REDACTED]

- At the moment, only the electricity bill tempered by the price cap has crystallised but it is foreseeable that the others will and, if they do, we will be unable to meet our bills as they come due for the next twelve months.

- [REDACTED]

- [REDACTED]

**WHY ARE THINGS MOVING SO FAST?**

- Trustees must be very aware of the fine line between solvent trading, insolvent trading and wrongful trading (see note of advice). As we assess this we have had to switch our forecasting and valuations from a going concern basis to a cessation basis, to be as conservative as possible.

- [REDACTED]

- [REDACTED]
- [REDACTED]
- In addition, receipts previously assumed on a going concern basis – most imminently the 7<sup>th</sup> October RFO payment, may not be received if we enter an insolvency process worsening the solvency position.

### ANALYSIS OF OPTIONS

As an Executive and as Trustees, we have an obligation to explore options and alternatives to insolvency and winding up. This is a brief overview:

#### Restructure

- [REDACTED]

#### Additional public funding

- We have had frank conversations with Screen Scotland/Creative Scotland, Aberdeen City Council and City of Edinburgh Council. While all sympathetic, the reality of the current environment is that they will not be able to extend new or additional funding.

#### Are there options for any legacy parts of the group to continue?

- [REDACTED]
- [REDACTED]

- [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

**LONGER TERM PROGNOSIS**

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

**REMAINING OPTIONS AND CONSIDERATIONS**

[REDACTED]  
[REDACTED]  
[REDACTED]

[REDACTED]  
[REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

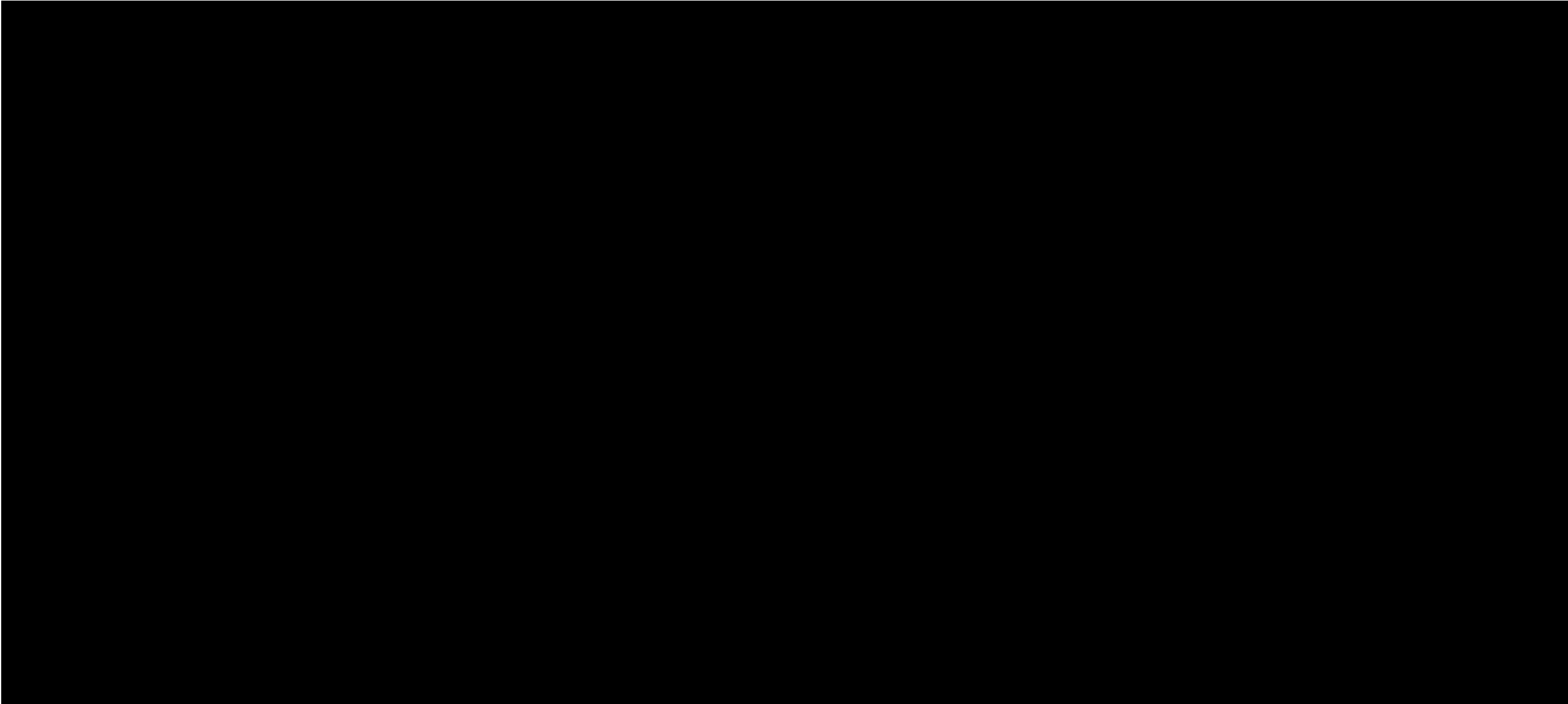
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[REDACTED]

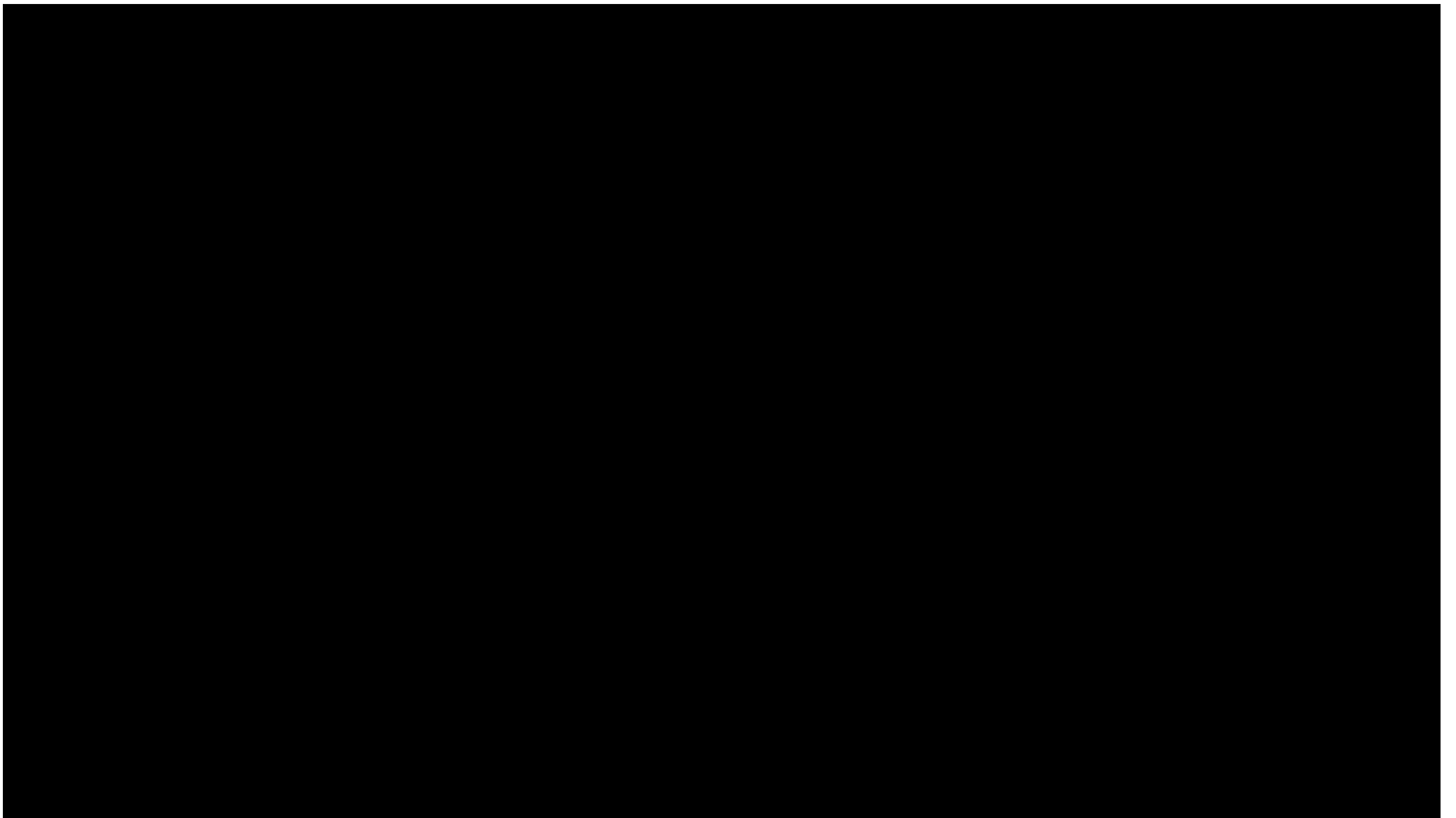
### **3. Recommendation**

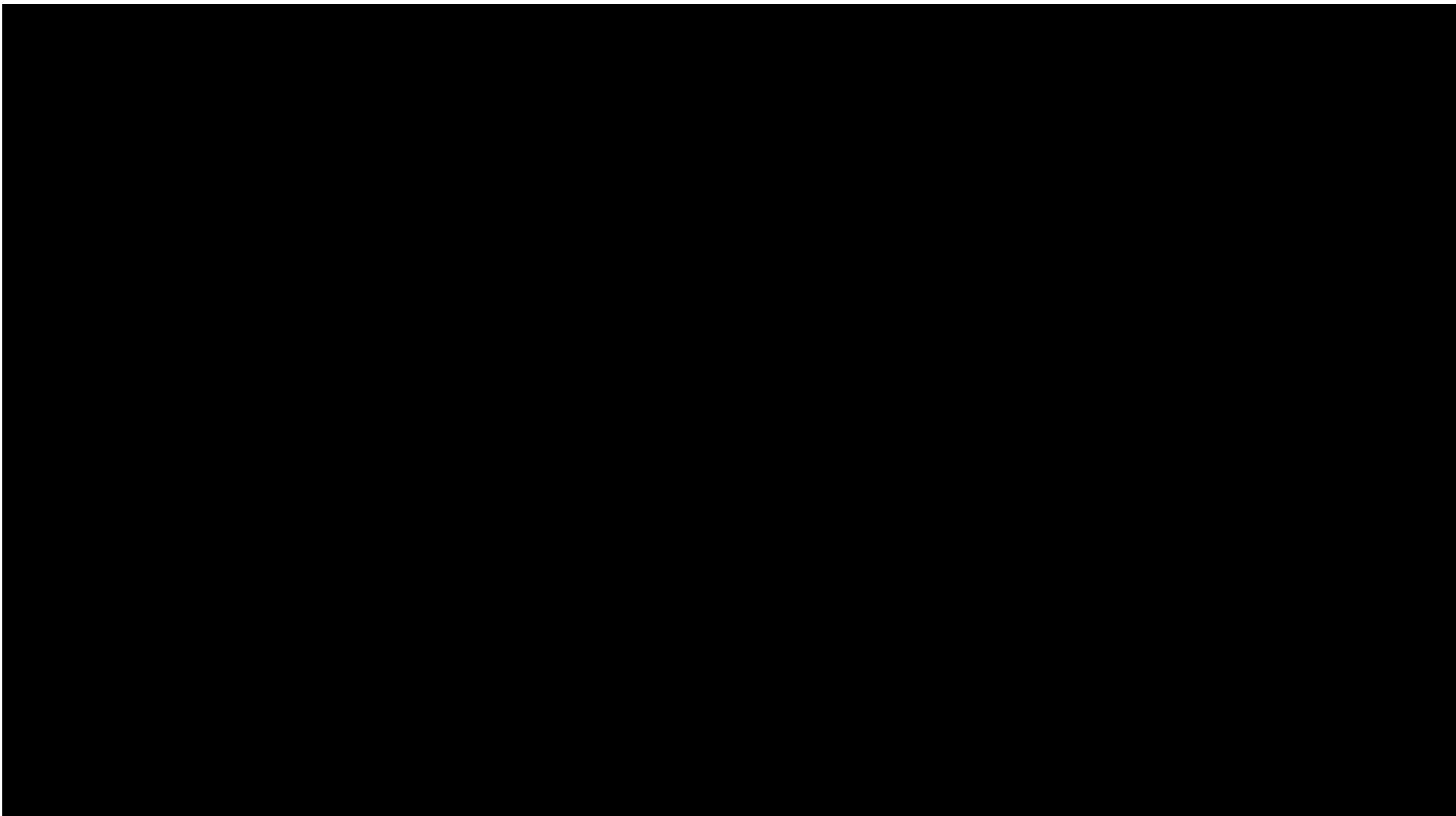
The ARC is asked to consider the paper, and agree next steps with Executive and professional advisors, prior to briefing the full Board.

### **4. Appendices**

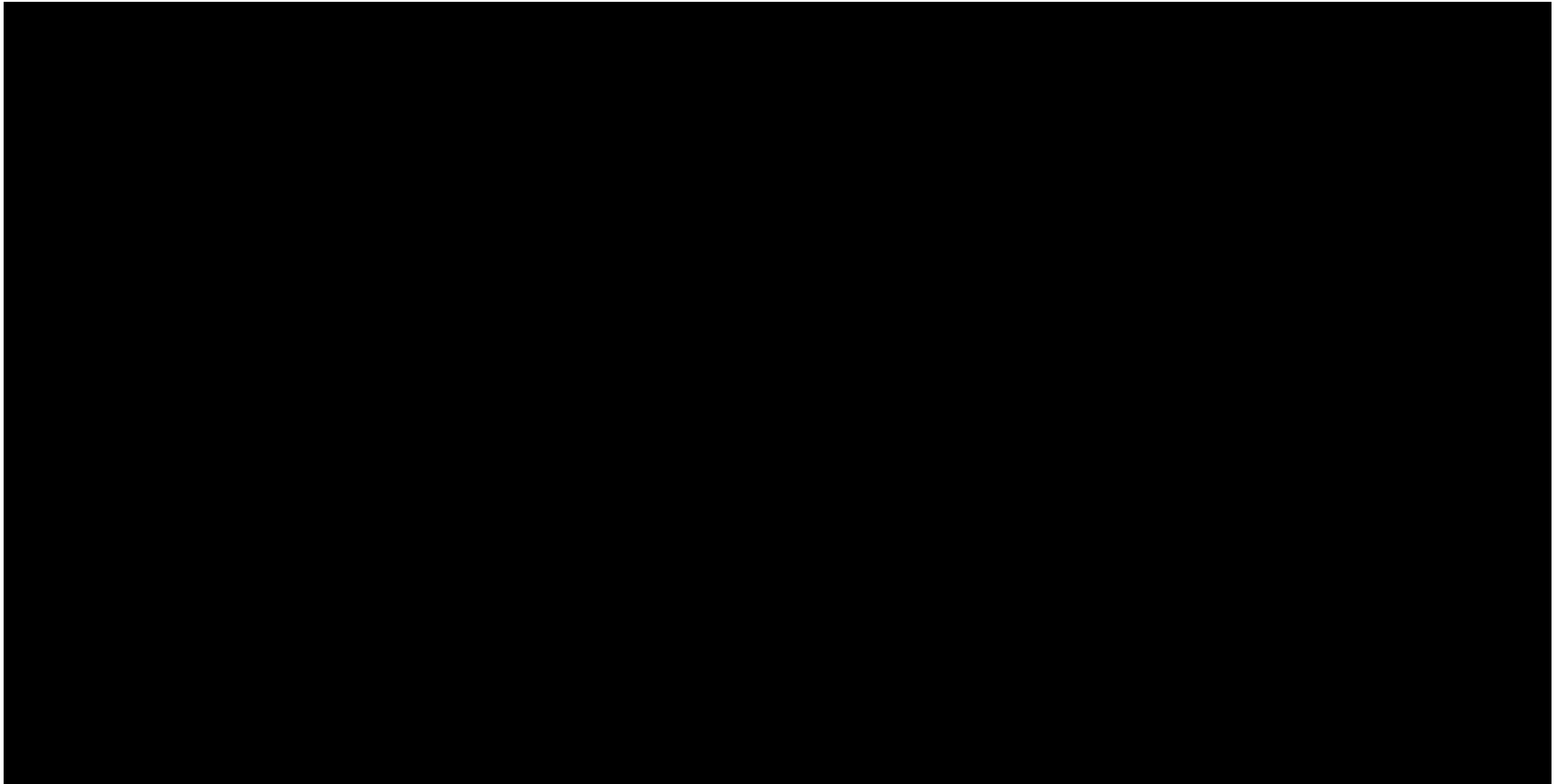
- Revised cashflow – high and low cases
- Assessment of the viability of “Edinburgh” operations standing alone
- Notes of advice from Turcan Connell
- Latest trading charts
- Minutes of last ARC meeting 15<sup>th</sup> Aug 2022
- Notes of ARC briefing 19<sup>th</sup> Sept 2022

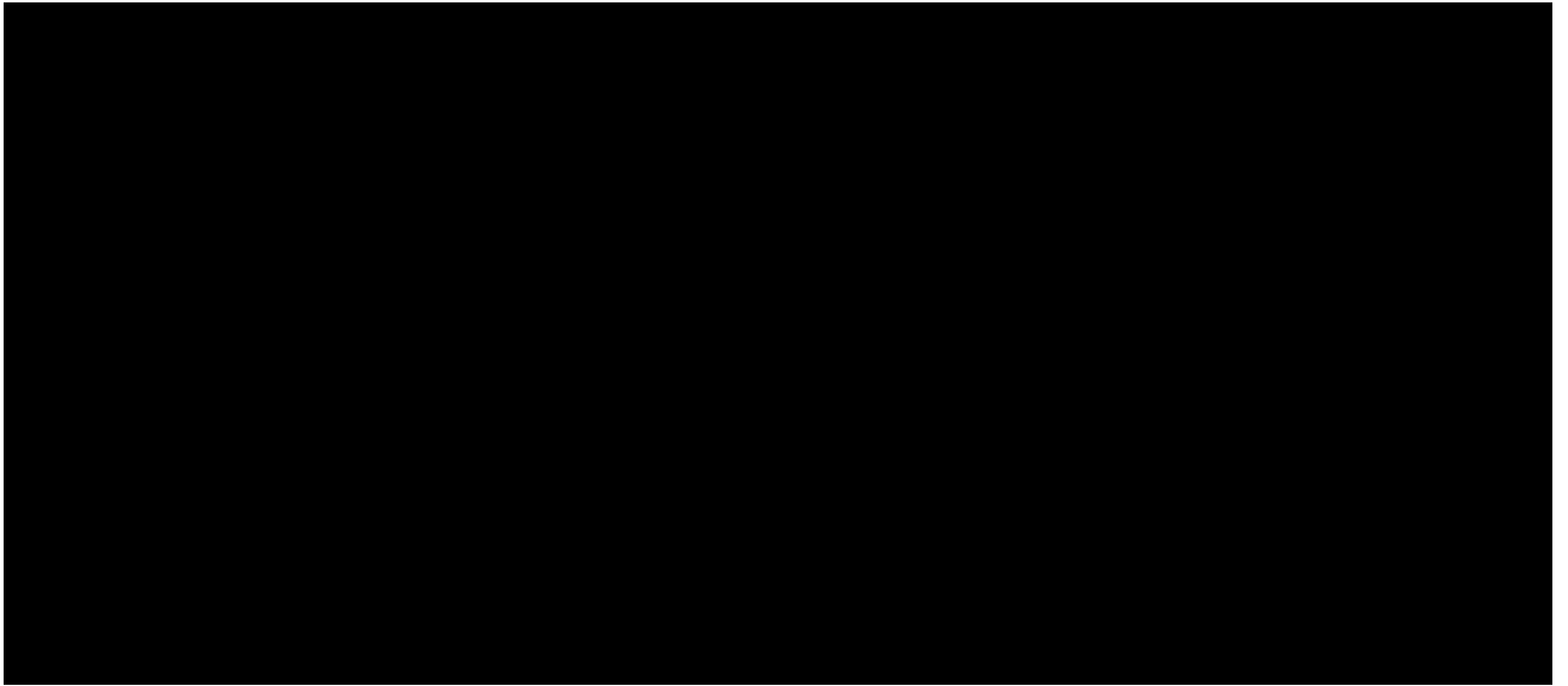


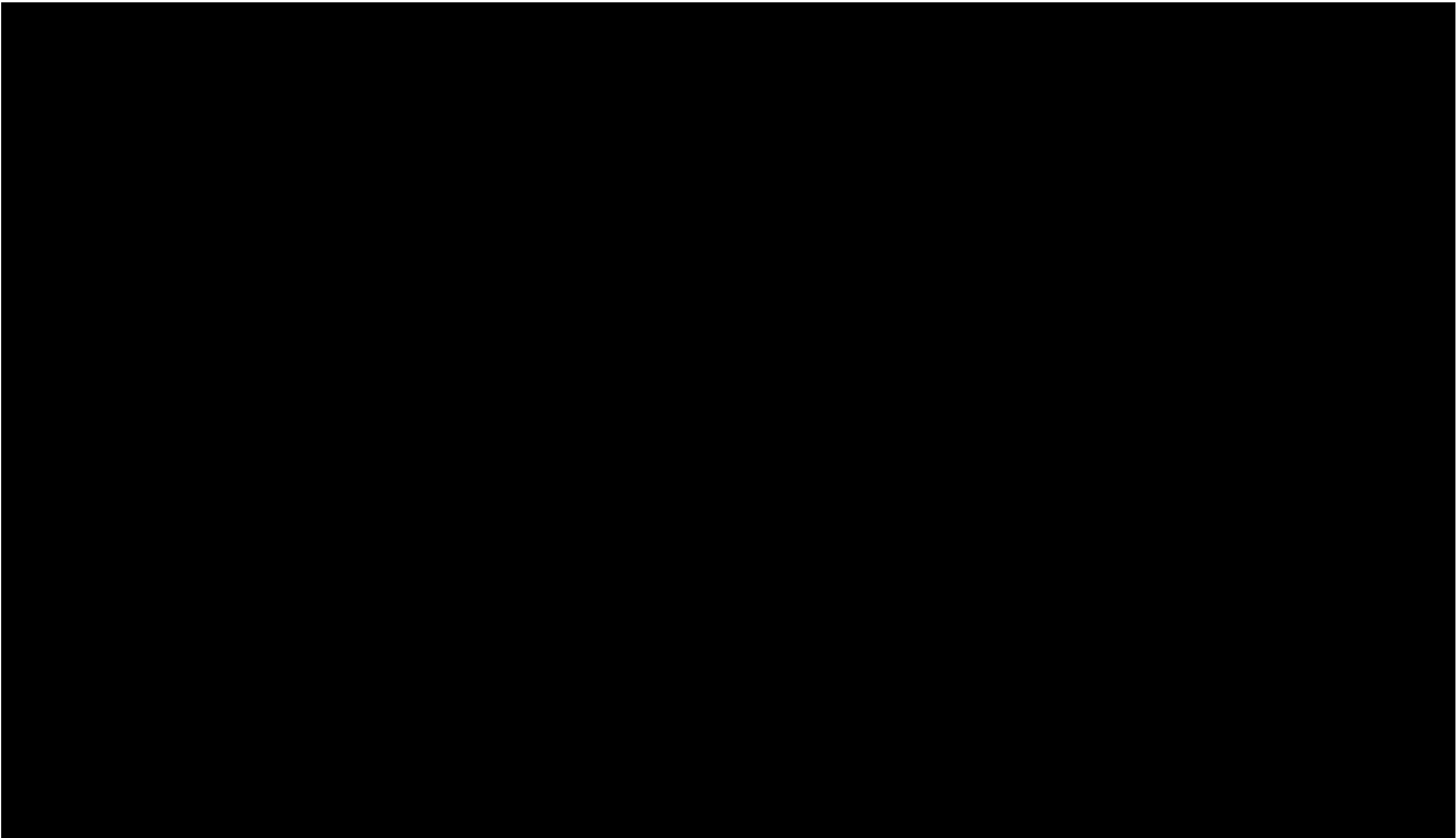


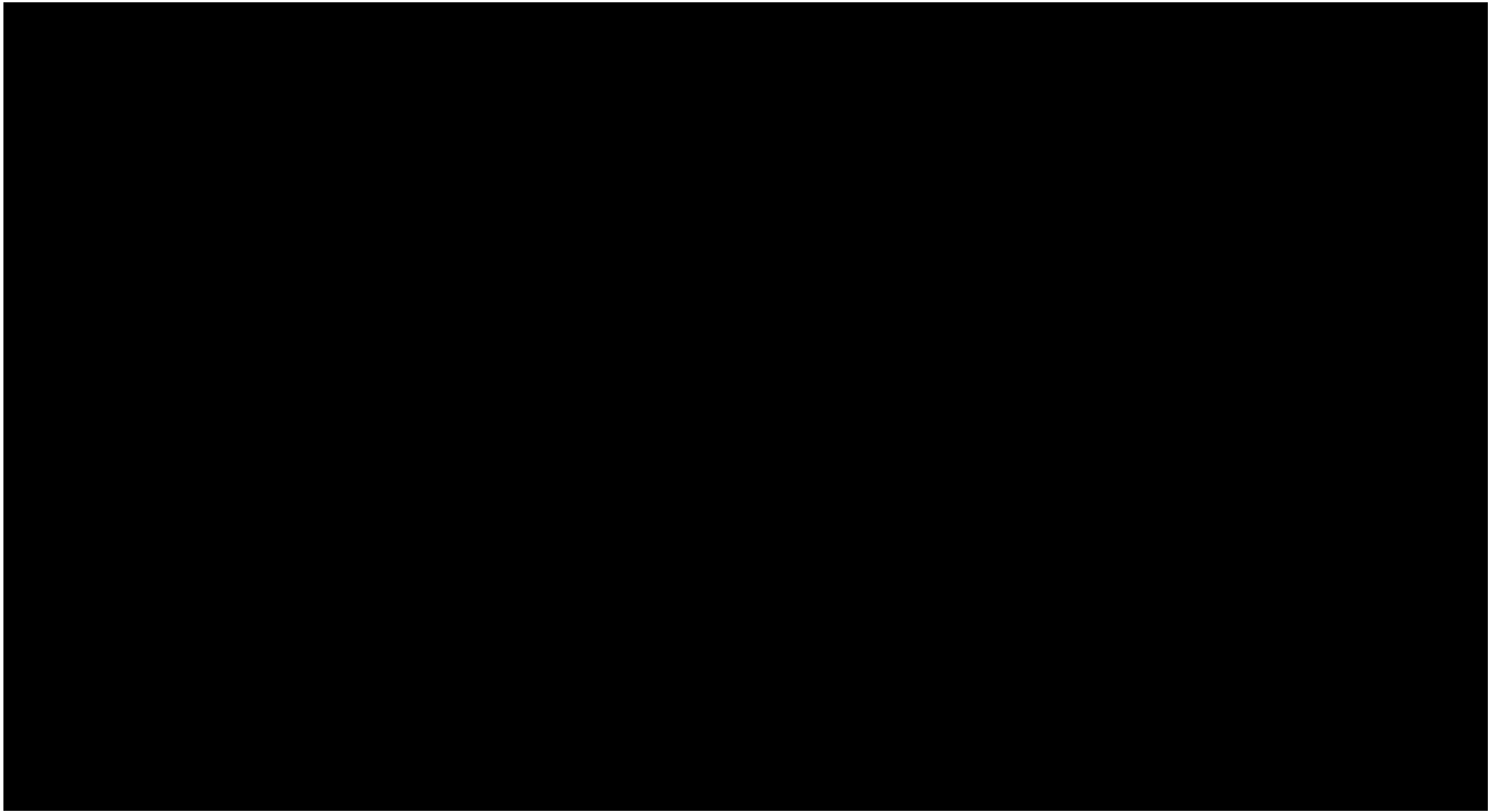


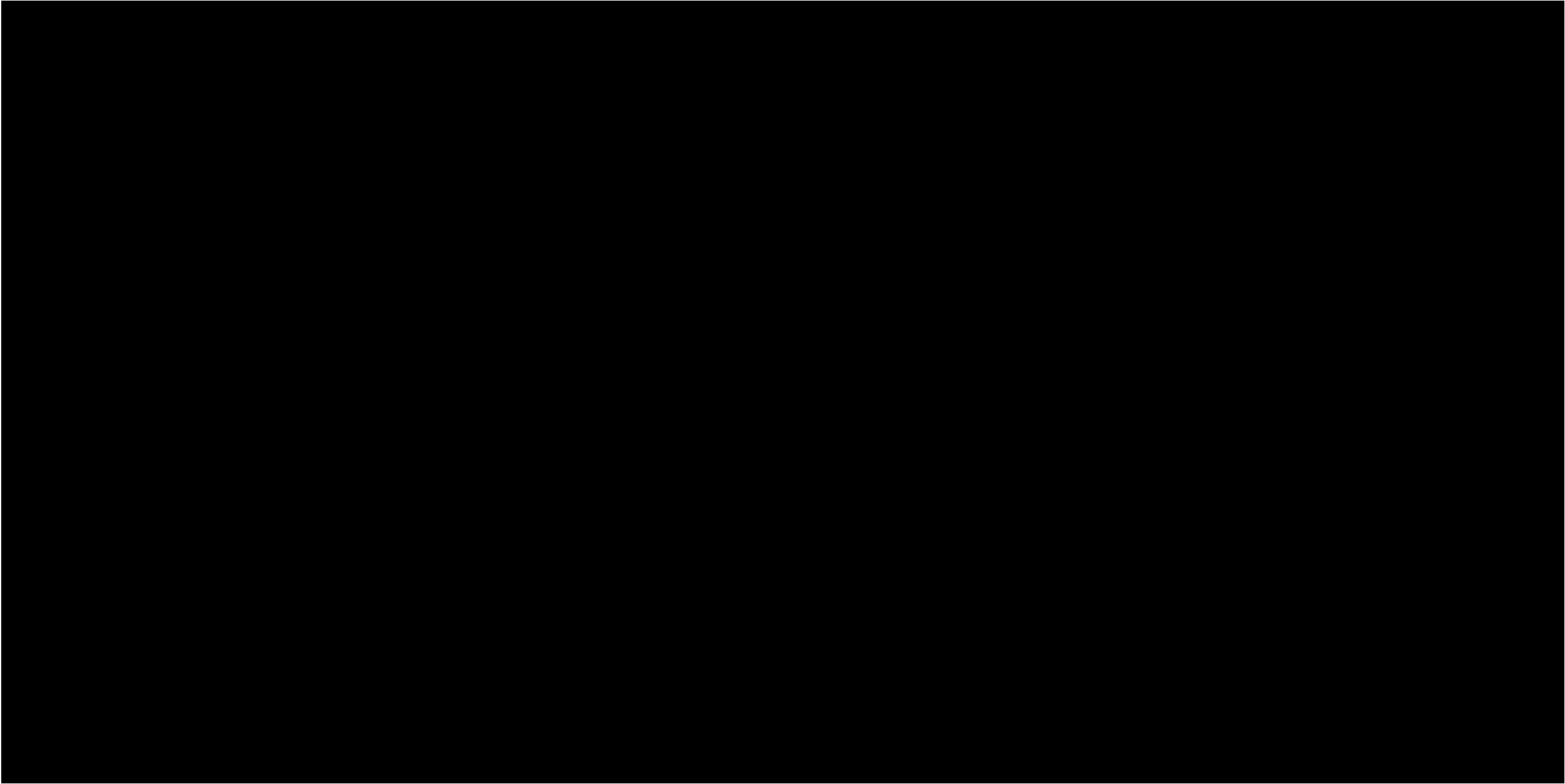


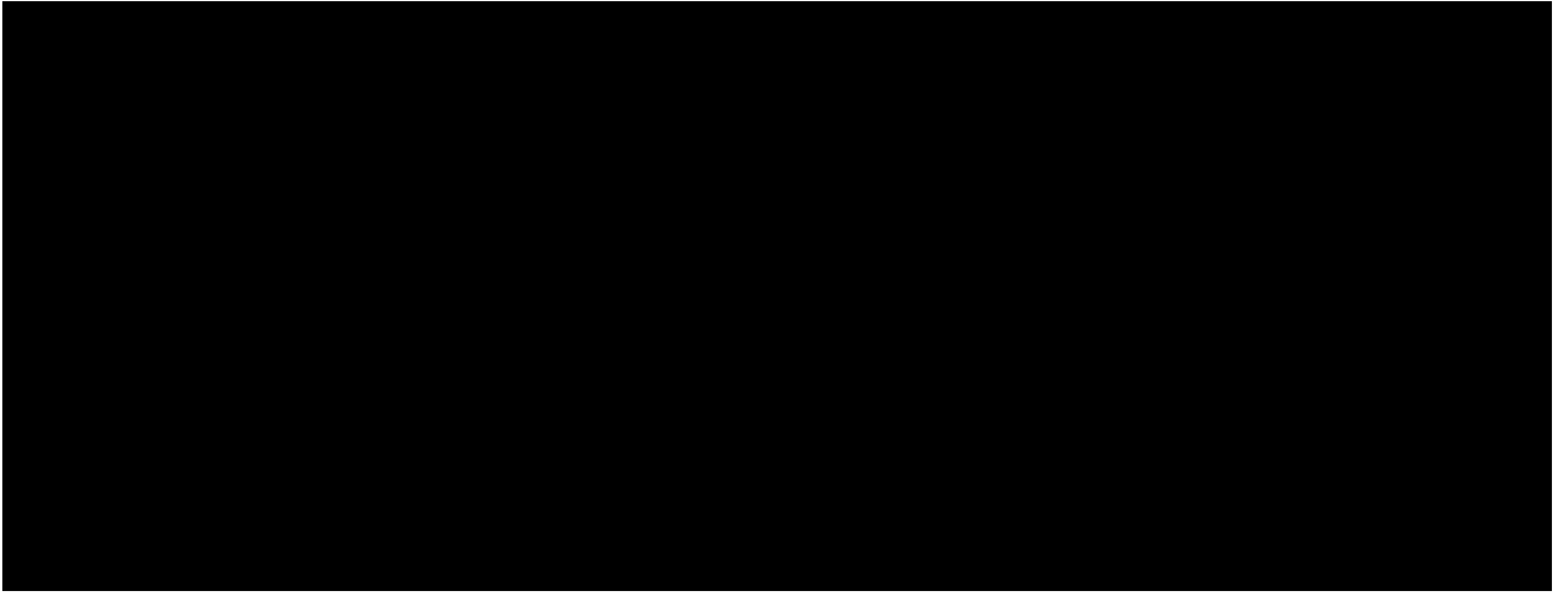












## Note of Advice

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Centre for the Moving Image

F03109.0001

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### **Charity trustees' responsibilities in the event of impending administration or liquidation**

#### *Introduction*

The purpose of this short note is to provide guidance to the charity trustees (company directors) of CMI and of the companies which form part of the CMI group. The context is the precarious financial position of CMI and the risk of imminent administration or liquidation of CMI.

#### *Background*

The detailed background has been provided to us by Ken Hay and [REDACTED], and we have been able to sit in on initial meetings with representatives of FRP Advisory [REDACTED]

[REDACTED]

[REDACTED]

#### *Charity trustee duties*

A charity trustee's primary and overarching duty is to act in the interests of the charity. In the normal course of events that includes ensuring that a charity is controlled and managed properly, having regard to governance, financial, operational and general strategic affairs.

Where there is pressure on a charity financially, it is the responsibility of the charity trustees to seek to find a solution to the problems which exist. This can extend from the most basic efforts to re-budget expenditure, to seek to generate further income, whether from donations or otherwise, or to conduct a more serious overhaul of the charity's business and financial structure.

In the circumstances which CMI finds itself in, there has already been an effort by the CMI board over an extended period to seek to monitor expenditure and to focus on income generation. Discussions with funders take place regularly and relationships with key stakeholders and donors are already in place. It seems to us that the charity trustees have therefore sought to ensure that the charity is as financially resilient as possible. The impacts on the charity which are affecting its current financial position are largely driven externally. It appears that the charity trustees have therefore sought to fulfil their responsibilities up to this point.

While the charity trustees would not wish absolutely to rule out accepting a financial rescue package should one come to light, they must also be realistic about what is achievable in the immediate term. In the circumstances on which FRP Advisory have set out, it appears necessary for the charity trustees to switch their focus now to accounting for liabilities and protecting the interests of CMI group's creditors to ensure that they are not prejudiced.

The winding up of a charity is not what a board of charity trustees would consider in most normal situations as being in the charity's best interests, but where there are distressed financial circumstances, the charity regulators in the UK expect charity trustees to be willing to take the ultimate decision to arrange an orderly wind down of affairs if the charity cannot otherwise continue. Accordingly, once all other options are exhausted, the primary responsibility of the charity trustees is to protect the interests of the charity's creditors. That is treated as acting in the charity's best interests in such a financial situation. This means that the charity trustees need to be willing to act swiftly to ensure that the charity's creditors are not prejudiced beyond their current position, especially if it clear that no other financial solution will be available.

In the event that administrators or liquidators are appointed, the charity trustees have ongoing duties to cooperate with them and to report to OSCR that the appointment has been made.

### *Summary*

█ [REDACTED]

- In the absence of a rescue funding package, the advice from FRP Advisory suggests that the charity trustees may need to act fairly immediately in appointing administrators or liquidators;
- In such circumstances, the charity trustees' primary duty of acting in the charity's best interests becomes a duty to protect the charity by protecting the interests of its creditors so that those creditors are not prejudiced.



- It is likely that the charity trustees will have to act almost immediately if they are to fulfil their duties if the financial position is as grave as the projections and FRP's advice suggests, and on the assumption that there is no immediate alternative financial solution.

**Turcan Connell**

**21<sup>st</sup> September 2022**

## Note of Advice

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Centre for the Moving Image

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### Introduction

As a result of various factors, we understand that CMI is in a vulnerable position financially. While CMI is not presently insolvent, the risk of administration (or possibly insolvency) is now a real risk. We have been asked to provide a Note of Advice in relation to the potential administration or insolvency of the Centre for the Moving Image (“CMI”). This Note of Advice will set out the key considerations for the directors of CMI when making a decision in relation to administration or insolvency.

There is no statutory definition of ‘insolvent’ although the Insolvency Act 1986, when referring to a state of insolvency, uses the phrase ‘unable to pay its debts’. In practice there are 2 separate tests for insolvency and failure of either might be an indication of insolvency:

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

Provided CMI can pay its debts, then it does not meet the insolvency test. Administration may still be necessary and before making a decision, the directors must consider all information that is available to them and assess whether there are other options for CMI. This falls in line with the directors’ duties.

### Considerations for Directors

As directors of a charitable company limited by guarantee, the directors are required to comply with the Charity Trustees duties that are set out in the Charities and Trustee Investment (Scotland) Act 2005 (“the 2005 Act”) and the duties of directors contained in the Companies Act 2006 (“the 2006 Act”).

Therefore, when considering any decision the directors of CMI must:-

- Act in the best interests of CMI;
- Protect and safeguard the assets of CMI;
- Take necessary professional advice;
- Make a collective decision;
- Have a full understanding of all the facts; and
- Notify the regulator at the appropriate time.

The ultimate decision for any director to make is in relation to winding up a charity. The directors of CMI have a collective responsibility to act in the best interests of CMI and in doing so, they must be fully aware of all the information that is available to them. Therefore, it is important for the executive team to fully brief the directors as soon as they are able to.

[REDACTED]

[REDACTED]

Directors are under a duty to take formal advice where it is required. The purpose of this note is to clearly set out the directors' responsibilities when making a decision in relation to administration or insolvency. We are aware that professional advice has been sought from FRP in relation to administration or insolvency and it is important for the directors to consider this advice before making any formal decision.

### **Liability for Directors in the Event of Insolvency**

Although we understand that CMI is not insolvent, we thought it would be helpful to highlight the directors' potential personal liability so that the board fully understand the issues. The normal position for any company established under the Companies Acts is that its directors will be protected from financial liabilities flowing from the operations of the company, unless they act in a manner which is fraudulent, negligent or reckless. However, where there is a risk of insolvency, directors may be exposed to additional risk.

A company which trades while insolvent, but in the honest belief that the insolvency is temporary and that the company can trade out of insolvency, is trading lawfully.

Where, however, a company trades while insolvent and the directors of the company know that the company is insolvent and there are no realistic plans as to how the creditors of the company will be paid, this will amount to wrongful trading. Wrongful trading is a serious criminal offence and can expose the directors of the company to unlimited personal liability for the debts of the company. It also opens directors to the risk of other criminal penalties including imprisonment. Where a company's directors allow their company's level of creditors to increase during a period of wrongful trading, then the exposure of the directors will generally be treated even more seriously.

Where there is a risk of wrongful trading, directors must ask themselves:-

- Do the liabilities of our company exceed the company's assets?
- Can our company afford to pay its debts as and when they fall due?

- Is there a reasonable prospect of our company avoiding insolvent liquidation?
- Has our company traded beyond the point of no return?

While the answer to these questions in the case of CMI may not all presently point to wrongful trading, the precarious financial position which CMI finds itself in is one which the directors must treat with the utmost seriousness, especially if the financial position of CMI continues to worsen.

While the liability of the individual directors is likely to be nil, on the basis that they are protected by limited liability, this is only the case for so long as CMI is not engaged in wrongful trading. If CMI were to begin trading while insolvent, the risk of wrongful trading also begins to increase. Insolvent trading by itself is serious but is not unlawful, but it can lead to a position where the company begins to trade wrongfully. If the line between insolvent trading and wrongful trading is crossed, then the directors can be personally liable for the debts of the company and would be at risk of criminal prosecution.

Where there is a risk of a company going into liquidation, the directors' obligations include a duty to minimise losses to creditors. Failure to perform that duty can leave a director open to liability for wrongful trading. As a result, resignation as a director does not provide a solution, since it does not fulfil the duty of minimising the creditors' losses. Specialist advice from a corporate recovery expert will be required, and we understand that this has already been sought.

We must stress that in the event of a solvent winding up the above risks do not arise.

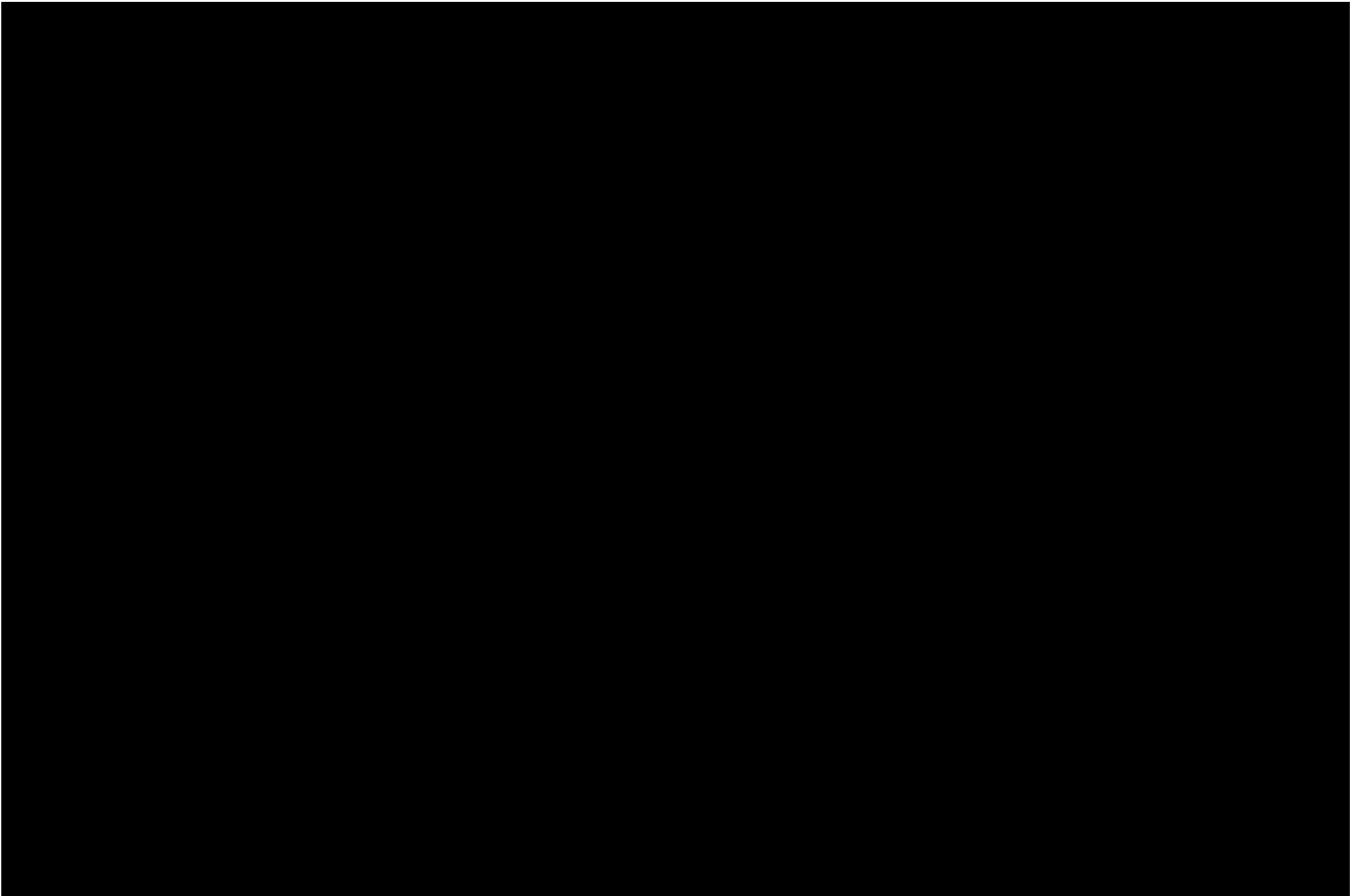
### **Notification to OSCR**

While the potential administration or insolvency of a charity does not amount to a notifiable event with OSCR, if the directors take the decision to put CMI into administration or insolvency then the directors must inform OSCR of that decision having been made. OSCR must be notified within three months of the decision, although an early disclosure is to be encouraged so that OSCR has prompt visibility of the directors' decision.

### **Conclusion**

In summary, the directors of CMI have a collective responsibility to act in the best interests of CMI. When making a decision, the directors must consider all of their legal duties and ensure that they are protecting the assets of the charity. From the evidence that has been provided to us, a decision in relation to administration or insolvency appears to be close and the directors must be aware when it is time for FRP to be appointed to carry out the administration or insolvency process. In addition, if the line has not been crossed then the board has to ensure that they are not trading while insolvent.

We believe that the directors are currently complying with their legal duties by taking the necessary advice and they should be guided by their professional advisers as to when the time is right for them to formally enter into the administration or insolvency process.



## CMI Board | Minutes of Audit & Risk Committee Meeting

Monday 15 August 2022, 4pm

Filmhouse, 88 Lothian Road, Edinburgh

Present: [REDACTED]

### In Attendance:

Ken Hay (CEO), [REDACTED]  
[REDACTED]

## 1. Introductions and Apologies

- 1.1. [REDACTED] welcomed [REDACTED].
- 1.2. Minutes of CMI Audit and Risk Committee Meeting 31 January 2022 had been approved previously.

## 2. Audit Process 2021/22 – Update from Auditors

- 2.1. [REDACTED] thanked [REDACTED] and [REDACTED] for all their help in completing the audit process, which had gone well. A standard risk assessment had been undertaken and they were satisfied that mitigations were in place. Control recommendations had been made and there were management responses for each. The main area for discussion was around the going concern statement.
  - 2.2. [REDACTED] commented that the new system for conducting the audit worked well.
  - 2.3. [REDACTED] commented that now that EIFF is later in the calendar, an earlier closing would make more sense.
  - 2.4. [REDACTED] thanked [REDACTED] and stated that the process had gone well.
  - 2.5. [REDACTED] asked about the recommendations for improving internal controls. Both [REDACTED] and [REDACTED] said that the issues were being addressed.
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

- 2.9. [REDACTED] reminded the trustees of their responsibilities and that there is a need to demonstrate that the trustees have considered/are considering these issues and what mitigations are required. [REDACTED] stated that the charity has until end December 2022 to lodge signed accounts with Companies House and OSCR, noting that the going concern statement would need to

be updated if the board decided to delay signing off the accounts from the intended 5 September 2022 date.

- 2.10. ARC agreed unanimously that taking the opportunity to delay the sign-off of the accounts would allow the Board to understand the final settlement of some of the uncertainties and make more informative going concern disclosures in the accounts.
- 2.11. ■■■ asked about the draft Letter of Representation. ■■■ stated that this would remain draft until the going concern statement had been confirmed, and any relevant paragraph(s) would be updated.

### **3. Audit Process 2021/22 – Update from Audit and Risk Committee to Auditors**

- 3.1. It was noted that some additional amends would be made to the trustees' report in the CMI Statutory Accounts.
- 3.2. ■■■ explained that the Audit and Risk Committee had been asked by the chair to consider how the organisation could address long term sustainability and this work was underway. The outcomes of this work will be crucial in providing

### **4. Audit Process 2021/22 – Agree Process and Recommendation from A&R Committee to Full Board**

- 4.1. It was agreed that the Audit and Risk Committee would discuss the material uncertainties within the going concern statement with the full board.
- 4.2. ■■■ confirmed that if it was useful she would be able to attend the full board meeting.

■■■ left the meeting

### **5. Shaping the Future Workplan Review**

- 5.1. ■■■ provided a brief introduction to ■■■ about the Shaping the Future Workplan and the need to press on with this work as promptly as possible. ■■■ to provide ■■■ with a more thorough briefing.
- 5.2. KH confirmed that the workplan provided key dates for work to be done and decisions to be taken.
- 5.3. It was noted that other business priorities had diverted KH and ■■■ in the previous three weeks.
- 5.4. It was recognised that there was a complex communications process attached to any decisions taken and change process initiated – both internal and external. It was noted the importance of maintaining confidentiality at all times – for staff and stakeholders. One element of the workplan was determining the optimum timing and sequencing of any change process.
- 5.5. It was agreed that there was a need to bring the full board up to speed as soon as possible.
- 5.6. It was agreed that ■■■ would speak to the chair ahead of a scheduled meeting between the chair, ■■■, KH and ■■■ on 24 August 2022.

### **6. Dates of Next Meetings**

- a. TBC, September 2022
- b. TBC, Monday 31 October 2022
- c. 4pm, Monday 21 November 2022

## CMI Board | Notes of Audit & Risk Committee Briefing

Monday 19 September 2022, 9am, via Zoom

Present: [REDACTED] [REDACTED]

### In Attendance:

Ken Hay (CEO), [REDACTED]  
[REDACTED]

## 1. Introductions and Apologies

- 1.1. Apologies from [REDACTED]
- 1.2. [REDACTED] explained that the meeting was to brief members of the Audit and Risk Committee on the current situation with professional advice from FRP Advisory and Turcan Connell.

## 2. Briefing and Questions

- 2.1. [REDACTED] had circulated a paper prior to the meeting.
- 2.2. [REDACTED] highlighted that the cashflow presented assumed receipt of contracted public funding. A receipt from Creative Scotland RFO relevant to funding EIFF22 is due on 7th October. If this was not received, following consultation with Creative Scotland, the outlook would materially worsen.

[REDACTED]

- 2.5. [REDACTED] asked about obligations to funders and any restrictions, [REDACTED] stated that the RFO funding from Creative Scotland was unrestricted. The annual RFO grant of £1.067m is released in 4 equal quarterly payments, and while based on an annual activity plan is not technically "restricted".

[REDACTED]

- 2.7. [REDACTED] asked about timings.
- 2.8. [REDACTED] stated that more work would need to be done on understanding the detail of the winding up costs, and how that would impact cashflow and balance sheet solvency. The primary responsibility for the trustees is protecting the interests of creditors, including Lothian Pension Fund and Royal Bank of Scotland, and ensuring that any decisions and actions do not prejudice creditors.
- 2.9. Therefore, the formal Audit and Risk Committee should be arranged as soon as practicable this week, with both the chair of the board, Alastair Morrison, and all members of the ARC attending, along with the professional advisers. A formal board meeting should then be arranged as soon as practicable after that to make formal decisions.



- 2.10. There was a discussion about the process beyond taking any decisions, with it being noted that at the point of appointment of administrators, the business would cease trading and that control of the business would pass to the administrators. The trustees and senior executives would still be required to assist the administrators.

- 2.12. [REDACTED] invited [REDACTED] to comment, adding to Turcan Connell's note of advice included in the papers.

- 2.13. [REDACTED] stated that charity law requires that trustees act in the interests of the charity and in a situation like this are able to demonstrate that they have considered and explored all options. [REDACTED] stated that the trustees have fulfilled their responsibilities up to now. Once all options have been exhausted, the trustees' primary responsibility is protecting the interests of creditors. This needs to be the focus of the board. OSCR would expect this.

- 2.14. There was a discussion about whether to go public in seeking help. [REDACTED] stated that the scale of the projected deficit is so great that a public appeal would be unlikely to succeed. KH noted that the conversations with public funders will ascertain whether any additional financial support will be possible from those routes. He noted the political fallout that would happen if there isn't support.

### 3. Conclusions and Next Steps

- 3.1. [REDACTED] stated that he and [REDACTED] would update the paper ahead of the formal ARC later in the week with additional information on the impact of winding up costs crystallising.
- 3.2. [REDACTED] stated that he would update the note of advice from Turcan Connell in light of today's discussion and make it more explicit about what the responsibilities of trustees.
- 3.3. It was agreed that KH and [REDACTED] should continue with their scheduled meeting with Creative/Screen Scotland on Tuesday 20 September to brief them fully of the financial situation and the scale of the projected deficit.
- 3.4. A full Audit and Risk Committee would be arranged as soon as practicable.
- 3.5. A full Board meeting would be arranged as soon as practicable after that.