Scoping study
for the assessment of the asset base of the community business sector in the Highlands and Islands

MCM Associates
Woodside Business Centre
4 Woodside Place
Charing Cross
Glasgow
G3 7QF

Tel: 0141 353 5150 Fax: 0141 353 5170
E-mail: enquiries@mcm-associates.co.uk

Contents

Section 1 - Introduction

Preface

1.1 MCM Associates, in association with the Scottish Council of Voluntary Organisations, were appointed by Highlands and Islands Enterprise in December 2003 to undertake a Scoping Study for the Assessment of the Asset Base of the Community Business Sector in the Highlands and Islands of Scotland. The study has involved two distinct elements as follows:

- Development of a framework methodology for the valuation of the asset base of community businesses.
- Undertaking a review of the opportunities and threats which the increased use of the asset base of these organisations might bring.

1.2 It is intended that the framework methodology will be used as a basis for Highlands and Islands Enterprise to undertake an extended assessment of the nature and value of the asset position of community businesses operating in the Highlands and Islands.

1.3 This report presents the main findings that emerged from the study and draws together a number of conclusions and issues for further discussion and investigation. The framework methodology has been prepared as a separate document and is included as an appendix to the main report.

Scope of the Study

1.4 The scope of the study was set out in the consultants brief with the main areas of work to include the following:

a) Specify terminology and set out definitions and assumptions agreed in connection with this study.
b) Define what the sector regards as its asset base.
c) Set out how the wider economy deploys its asset base.
    - How the sector arrives at fair value for its assets.
    - How this value is unlocked to promote its business.

d) An examination of the opportunities and threats relating to the further development of the profit non-distributing business sector through increased deployment of its own asset base.
e) Select appropriate pilot case studies of Highlands and Islands based community businesses.

Approach and Methodology

1.5 The assignment has involved the following elements of work and research.

Induction and Familiarisation

1.6 A range of preliminary work was carried out to ensure that there was a clear understanding of the brief and its end objectives. This included:

- Briefing meetings with Mr Chris Higgins, strengthening communities group, Highlands and Islands Enterprise
- Review and discussions around the consultation process, the set-up of the focus groups and the selection of the organisations for participation in the case studies.
- Agreement of the timetable and reporting deadlines.

Research and Information Gathering

1.7 This stage of the assignment involved the following:

- Review of the relevant policy documents and research papers on the social enterprise sector and the implications for community businesses involved in trading activities.
- A review of the pertinent legal and accounting regulations relating to community businesses and the valuation and disclosure of assets in their accounts. This included a review of the relevant Financial Reporting Standards, Statements of Standard Accounting Practice and the Accounting and Reporting by Charities – Statement of Recommended Practice (2000) ('SORP').

Consultation Programme

1.8 A comprehensive consultation programme was implemented through individual meetings or focus group workshops. The individual meetings were carried out with public sector agencies, high street banks and social banks.

1.9 Two focus groups were organised – one workshop was held with a representative selection of community businesses and the second workshop involved representatives from a selection of High Street commercial lenders, social banks, chartered accountants and lawyers.

Pilot Case Studies

1.10 The final element of the work involved the selection of four organisations as case studies. This gave an opportunity to compare the research findings and valuation methodology against the case study organisations and their financial statements.

1.11 The Local Economic Forums within the Highlands and Islands Enterprise area supplied contact addresses for social economy organisations. The criteria for selection included sector, geographical location, size of organisation and nature of assets.

1.12 Based on this selection process, the following organisations were chosen as case studies:

1.13

Organisation	Sector
Assynt Crofters Trust	Land/environment
Albyn Housing Society	Housing
COPE	Social care
Taigh Chearsabagh	Business/training

Structure of the Report
1.14 The report has been structured as follows:

Section 1 – Introduction	This section sets out the scope of the assignment, the approach and the methodology undertaken.
Section 2 – Development Context	This section provides information on the background to the study, describes the overall policy context and summarises the key relevant policy issues within the social economy sector.
Section 3 – Framework Methodology	This section provides a commentary on framework methodology for the valuation and disclosure of assets in the accounts of community businesses based on prevailing legal and accounting regulations.
Section 4 – Asset Base Development	This section reviews the challenges and issues with regard to the development of the asset base of community businesses and reviews available options and opportunities for this sector.
Section 5 – Conclusion	The final section draws together the main findings from the study and identifies a number of issues for consideration.
Appendix A- Framework Methodology	The framework methodology has been included as a separate document as Appendix 1.
Appendix B – Case Studies	A summary of the case studies undertaken has been included under Appendix2

Acknowledgements
MCM Associates and SCVO would like to express their appreciation to everyone who assisted and contributed to this study.

Section 2 – Development Context

Background

2.1 The scoping study has been commissioned by Highlands and Islands Enterprise as a key element of its work to strengthen communities as set out in its strategy 'A Smart Successful Scotland – the Highlands and Islands dimension'. The study builds on previous work that has been undertaken that focused on providing an assessment of the scale and nature of the social economy within the Highlands and Islands. The scoping study is the first stage of a process in relation to undertaking an assessment of the nature and value of the asset base of the social economy sector within the area, and how the sector is deploying its assets to develop its work.

2.2 The background to the study is based on a number of factors including:

- The recognition and ongoing commitment by Highlands and Islands Enterprise in relation to the importance of developing sustainable communities and the involvement of local people in the process.
- The impact of government policy in terms of the public sector offering fewer services directly within local communities, particularly in rural and remote areas.
- The increasing recognition of the social economy sector as a significant source of employment and provider of local services.
- The changing funding environment and the possibility of significant reduction in available support from sources such as the National Lottery and the European Union.

2.3 Against this backcloth, it is recognised that there is a need to consider the range of work and support that is required to develop the social economy sector and maximise the contribution that this sector can make towards building sustainable local communities. An important part of this process will include consideration of how the social economy can develop and utilise its asset base to expand and sustain local services.

Definitions and Terminology

2.4 It is recognised that there is no generally agreed definition of the social economy. However, for the purpose of this study the definition and terminology used is based on the approach set out in the assignment brief. This approach distinguishes between general community development activity and community business activity. This approach is consistent with the definition and terminology used in the previous studies undertaken to assess the nature and scale of the social economy within the Highlands and Islands. An outline of the definition and terminology is as follows:

Community Development

2.5 Community development is the term used to describe a wide range of organisations, usually with the following common features:

- Groups of local people coming together to identify and tackle community needs and to deliver projects to support community activities and services.
- Some level of economic impact, albeit very modest in some cases; many do not have an intentional economic purpose and have no ambition to develop one.

Community Business

2.6 Community business refers to those organisations that undertake an intentional trading activity to address a particular community need, or to provide a service that is not otherwise available in a local community. Examples include services such as a community shop, an arts centre, a community swimming pool, an auction mart, a harbour association, a building preservation trust, community care facility, and even, via the housing associations, houses. Recent activity also includes the purchase and management of their own land by communities through the community land movement.

2.7 These groups are incorporated and business-like but are values-driven and operate on a 'profit non-distributing' basis; this description is preferred to the more traditional not-for-profit, which can give the impression that generating profit is not necessary and that such community enterprises can be less business-like than their peers in the 'formal' economy.

2.8 The scoping study is focused on those community businesses intentionally undertaking trading activities for social purposes in the Highlands and Islands.

Policy Context

Scottish Executive

2.9 The Scottish Executive published in January 2003 a Review of the Scottish Executive's Policies to Promote the Social Economy. The purpose of the review was to assess the social economy's potential to contribute to the achievement of key Scottish Executive objectives, and identify how the Executive and other public sector and independent agencies may help the sector to realise its potential.

2.10 An outline of the key findings from the review is as follows:

- Social economy organisations can bring added value to the delivery of public services in terms of their capacity to innovate, their closeness and their ability to engage effectively with and meet the needs of their customers/clients; and the communities in which they operate; and their access to resources such as volunteer efforts and charitable donations.
- That there is a case for the Executive to encourage the growth and sustainability of such organisations, so as to increase the range and supply of organisations able to effectively deliver public services;
- That the Executive's strategy should be one of:
    - identifying where there is potential for delivery of executive priorities to enhance by greater involvement of social economy organisations in service delivery markets;
    - Supporting the development of social economy organisations in these areas (both helping existing organisations to grow and supporting the development of new organisations);
    - Removing obstacles that stand in the way of such organisations achieving their full potential;
    - Ensuring that the appropriate support mechanisms are in place; and
    - Developing the intelligence base about the nature of the social economy and its social and economic impact and development needs and priorities.

- That ultimately it should be for individual social economy organisations to demonstrate their worth to those responsible for commissioning public services. Social economy organisations should not be given an inside track in comparison with other potential suppliers but should always have the opportunity to fully demonstrate the capabilities and particular advantages which their service delivery models can offer.
- On funding, the particular requirements are:
  - The need to develop further a wider market of financial products available to and appropriate for social economy organisations so as to allow them to adopt financial arrangements appropriate to their business needs and reduce their dependency on grant.
  - The need to improve existing grant arrangements by simplifying application requirements and improving the efficiency and payment structures;
  - Explore the options for developing funding support mechanisms which encourage social economy organisations to accumulate reserves without undermining the requirements of public accounting;
  - The need to develop the asset base of organisations, particularly to increase their ability to access alternative funding sources such as loans; and
  - The need to allow social economy organisations to include the relevant portion of overhead costs within their bids for service contracts and to identify any further financial obstacles to development.

2.11 The report also made a number of specific recommendations covering extending interest; public commitment; best value/added value; community decision taking; development of a social economy unit/consultant; guidance; procurement and financial management; development of a social economy fund; asset transfer; division of labour between agencies; and charity regulation reform.

2.12 Based on the findings from the review, the Scottish Executive will be publishing a Social Economy Implementation Plan that will set out the arrangements for taking forward activity to support the social economy sector to realise its potential.

2.13 One of the key points highlighted in the report was the fact that while some parts of the social economy, such as housing associations and some environmental organisations are rich in assets, the sector as a whole is asset poor. The report indicates that the lack of a strong asset base acts as a barrier to growth and limits the sectors access to loan finance for development. The report recommends that proposals should be prepared for encouraging local authorities and other public funding bodies to transfer assets to locally based social economy organisations alongside other activity that will improve access to loan finance to support development. It is likely that the issue of asset base development will be a key feature of the Social Economy Implementation Plan when it is published.

2.14

Highlands and Islands Enterprise

2.15 Highlands and Islands Enterprise is the main development agency within the area and has a uniquely wide ranging remit covering social, economic, training and environmental development. HIE operates through a network of local enterprise companies and has a significant track record of work within local communities.

2.16 HIE plays a key role in supporting and developing the social economy sector within the area. This includes work to support community development and in particular actions to develop sustainable community business activity.

2.17 The approach is based on the strategic commitment set out in A Smart Successful Scotland – the Highlands and Islands dimension that demonstrates HIE's belief that people of the Highlands and Islands prosper when their communities have a clear sense of identity and they are empowered to take forward their own development. This sense of identity is wider than the geographic boundaries of the community, and encompasses both cultural expression and the natural heritage of the area.

2.18 HIE has four strategic objectives which it seeks to take forward in an integrated way:

- Growing businesses
- Developing skills
- Making global connections
- Strengthening communities

2.19 The review of the Scottish Executive's policies to promote the social economy acknowledged that Highlands and Islands Enterprise has developed a distinctive, effective and recognised role in relation to the social economy in its operating area, and recommended that this role should be continued and developed

2.20 The network's priorities for strengthening communities are to:

- Promote investment in community assets and services
- Develop community strengths, leadership and confidence
- Enhancement of the quality of the environment and culture.

2.21 In practice, the assets and services priority is reflected in:

- Provision since the 1970s of a programme of grants to community groups to undertake activities. This programme has been used extensively to develop village halls, arts and sports facilities, and a wide range of community care and welfare services.
- More recently, HIE in 1997 established a Community Land Unit (CLU). The aim of CLU is to increase the role of communities in the ownership and management of land and land assets, and the sustainable management of these resources for the benefit of the community. Since that date, many community businesses have been established to take forward community land ownership opportunities.
- Following the community buyout of the island of Eigg, (supported by CLU) the community set up a construction company to meet the building needs of the island. The islanders on Gigha have also brought forward plans to establish a construction company on the island. The creation of Profit Non-Distributing (PND) construction companies provide locally based employment opportunities, address building needs, and can save on the developers profits being charged by commercial companies.
- In 2002, HIE also created a community energy team, to help communities take advantage of opportunities for renewable energy. This was resulting in

communities looking to create community businesses to take advantage of wind power, hydro-electric, and wave power.

2.22 Each of these activities contributes to the social economy, and therefore the overall economy of the area. It is also recognised, that the range of community businesses now also manage and deploy a large and growing range of assets. HIE wish to drive this agenda further by looking in detail at how these assets are being used to generate revenue for community benefit.

2.23 It is also acknowledged that the voluntary sector in general has significant assets that can be utilised for community benefit. However, the study focuses only on the community business sector as defined earlier in the report.

Communities Scotland – RSL's

2.24 Communities Scotland was established in November 2001 as an executive agency of the Scottish Executive with responsibility for regeneration and housing. A key area of work includes the management of targeted investment programmes that make additional resources available to tackle poverty, regenerate communities and improve the quality of housing. In addition, Communities Scotland seeks to work with a range of organisations to raise standards in the delivery of services and in the regeneration of disadvantaged neighbourhoods.

2.25 Communities Scotland published guidance to local housing associations (Registered Social Landlords, RSLs) in 2003, on the involvement of RSLs in wider role activity to regenerate local communities. Communities Scotland is also keen to encourage registered social landlords to work together to develop wider role activity. The report recognises that work has already taken place in some parts of the country that shows that there can be real benefits in this approach in relation to economies of scale and to efficiencies in developing relationships with other partners. Communities Scotland will encourage a range of action work based on the Scottish Executive priorities of tackling poverty, building strong safe communities, and helping to support people back into work.

2.26 The Scottish Executive's recent social economy review directed Communities Scotland to support RSLs to 'fulfil their potential as asset owning organisations to regenerate their communities'. The asset base of RSLs and the track record of some in securing private finance make them unique organisations within the social economy sector that can make a significant contribution to the regeneration of the local communities.

Scale of the Social Economy in the Highlands and Islands

2.27 SQW and Simon Clark Associates were commissioned by HIE in 2002 to undertake an assessment of the social economy to provide a better understanding of the size and scope of the sector. The study reported that the social economy had continued to grow in importance since the HIE orginal 1996 audit, and was making a valuable contribution to the development of the Highlands and Islands.

2.28 Social economy organisations in the Highlands and Islands were analysed in terms of their structures and activities, the beneficiaries, wages, employment, income and growth, barriers to future development, and support and linkages with other organisations. The main findings from the study were as follows:

- Social economy comprises *8,142* organisations and generates an annual income of *£360m* per annum.
- Employs *6,250* people on a full time basis and *12,900* part time. The sector provides paid employment for nearly *20,000* individuals, equivalent to *10,700* FTE jobs. In addition to this total, the sector creates *100,000* volunteering opportunities.

- The social economy sector is essentially a small SME sector. Half of the organisation sampled reported an annual income of *£14,000* or less.
- A wide range of activities are conducted within the social economy, relating to arts, culture and music, business and employment support, community development, education, environment, health care, housing, religion, social care, social groups, sport and lifeboat/mountain rescue.
- The areas with the strongest relationships between social economy organisations and the main agencies were Western Isles and Caithness and Sutherland. Relationships with the councils are strongest in Argyll, Caithness and Sutherland and Ross and Cromarty and Western Isles. In Caithness and Sutherland, 82% of social economy organisations reported a strong or average relationship with the LEC.

2.29 The report highlighted the importance of the social economy sector to the local economy. It also indicated, however, that in terms of future growth, the main barrier faced by local community business was in relation to funding.

Section 3 – Framework Methodology – Valuation of Assets

Introduction

3.1 This section provides an overview and commentary of the accounting methodology behind the valuation and disclosure of assets in the accounts of community businesses. This methodology is set out in detail in Appendix A and includes an outline of the legal and accounting framework that underpins the methodology.

3.2 This section also reviews the four social enterprises selected as case studies and considers the extent to which the valuation of the assets as shown in their own accounts reflects the methodology set out in this report.

3.3 The final part of this section considers issues for discussion and further research.

Methodology Overview

Definition of Assets

3.4 Assets are defined as items owned by the community business and which will generate future economic and social benefits.

3.5 Assets are generally categorised as either *fixed or current*. Fixed assets are those items that are not bought or sold as part of the normal trading activities but enable the community business to function and deliver its services. Current assets can be defined as those items that form part of the trading cycle of the community business and will be converted into cash within one year.

3.6 Fixed assets will include such items as property, vehicles, plant and machinery, office furniture, computers, ICT networks etc. Fixed assets may also include land, water resources and historic buildings. Fixed assets may also include intangible items such as goodwill and purchased intellectual property. Current assets usually comprise such items as stock, debtors, (Accounts Receivable), bank balances and pre-payments.

Valuation Principles

3.7 In broad terms the accounting principles applicable to the valuation of assets within the private sector equally apply to community businesses within the social economy sector. The valuation principle can be stated – *assets should be valued at the lower of cost or current valuation.*[1]

3.8 The accounting policies and statutory regulations which underpin this valuation principle are the UK Accounting Standards (Financial Reporting Standards or Statements of Standard Accounting Practice) and the Accounting and Reporting by Charities – Statement of Recommended Practice 2000 ('SORP').

3.9 As regards the valuation and the disclosure of assets, the SORP is consistent with accepted accounting standards except for the requirement that investment in fixed assets are shown in the accounts at current open market value. (There is no option for showing these items at historic cost).

3.10 When assets are purchased they are required to be shown in the Balance Sheet at cost and in the subsequent years they will be depreciated over the useful economic life of the asset.

3.11 The Accounting Standards and the SORP also allow the directors or management committee to revalue fixed assets so that their current market values are shown in the accounts. There is a specific Financial Reporting Standard on the valuation of fixed assets and this is described in some detail in Appendix A.

3.12 It should also be noted that a community business requires too comply with legislation relating to the preparation and publishing of financial accounts, including

[1] Current valuation can be sometimes described as 'net realisable value'.

the valuation of assets. The relevant legislation will depend on the legal structure of the organisation. See Appendix A for details.

Case Studies

3.13 As part of the research for the study, four community businesses were selected as case studies. Visits were made, financial statements were analysed, and discussions were held regarding the valuation and disclosure of the assets in their accounts.

3.14 The results of this research is shown on Appendix B and can be summarised.

Organisation	Sector	Fixed Asset Valuation[2]	Valuation Approach
Assynt Crofters Trust	Environment/Land	£230,000	Cost less depreciation. No depreciation was calculated on the buildings as the value of the buildings is immaterial relative to the value of the overall estate.
Albyn Housing Society	Housing	£69m less grants of £44m	Cost less depreciation. In the case of the housing, the grant is deducted from the cost to show a net value. Housing costs include all attributable costs including legal costs, development costs and development finance. This organisation also arranged for an independent external evaluation of the housing properties and although not shown in the balance sheet, this valuation was disclosed in the notes to the accounts.
COPE	Social Care	£165,000	Cost less depreciation. The Capital Grants received in respect of t he fixed asset purchase are held in the Balance Sheet as deferred Capital Grants and released into the Income and Expenditure Account based on the economic life of the property.

[2] Based on the latest set of audited accounts.

Organisation	Sector	Fixed Asset Valuation	Valuation Approach
Taigh Chearsabagh	Arts and Heritage	£700,000	Cost less depreciation. The accounts have been adjusted in 2003 to provide for the deferred Capital Grants. The main asset is a leasehold property. However, due to restrictions on the lease the organisation would not be able to dispose of the property and could be restricted from using it as a security against any loan finance.

3.15 The findings from the case studies and the underlying research can be summarised:

Valuation Approaches
3.16 All the organisations selected as case studies elected to value and disclose their assets at cost less depreciation or, in the case of debtors and stock, at the lower of cost and net realisable value.
3.17 One of the organisations elected to arrange for a re-valuation of their fixed assets at current market value. This enhanced valuation was not disclosed in the Balance Sheet but it was shown as a note to the accounts.

Adherence to UK Accounting Policies
3.18 A review of the accounts for each of the four case studies showed that generally accepted accounting policies including SORP policies have been adhered to or reasoned arguments have been provided where deviations have occurred.

Development of Asset Base
3.19 Two of the organisations (Albyn Housing Society and COPE) have used their fixed assets as security in order to access bank loans. In the case of COPE, it was a single transaction relating to the purchase of a shop in Lerwick for £33,000 using 80% bank finance. The valuation on the shop together with the projected income was sufficient for the bank in this case. Albyn Building Society has a sophisticated understanding of bank finance products and use their housing properties and their underlying valuations and future rental income streams as a basis for accessing significant loans (currently £18m from a selection of five banks and building societies).

Valuation Issues
3.20 There are a number of issues that emerged from the asset valuation methodology that require to be considered as part of the valuation of assets.

Accounting Concept of Value
3.21 The basic accounting premise that the value of the asset should be the lower of cost or current value is generally widely understood and followed by community businesses, their financial advisers, and auditors. As a broad generalisation, in the case of most assets, cost less depreciation generally provides a fair value of the asset within the accounts and seeks to reflect the decline in value over time because of wear and tear and technical obsolescence. The notable exception to this is property and land where, in a rising market, these assets could be significantly understated in the accounts of a community business unless the organisation arranges for regular re-valuations.

Ownership of Property

3.22 There are some situations where there may be issues in relation to the ownership of a property or there may be restrictions relating to the use of the property that can prevent an organisation being able to use the asset to borrow against. This was a matter of significant discussion in one of the focus group workshops and it does create material difficulties for banks that require ‘clean title’ over assets being offered as collateral. In the case of the Taigh Chearsbagh property in North Uist, the property is shown in the accounts as a Fixed Asset Leasehold Property although the community business is prevented from selling the property and would not be able to use this property as security for a bank loan. Because of the difficulties relating to clean title over this property, it could be argued that showing the property at cost less depreciation in the accounts is overstating the value of that asset to the community business.

Depreciation

3.23 Depreciation in this context is an accounting term whereby the cost of an asset is allocated over its useful life within the Income and Expenditure account. There is often confusion around the depreciation concept in relation to property. The question arises as to why an asset that is appreciating in value should be depreciated. The solution in this particular situation is to arrange for regular re-valuations of the asset with the difference between the cost and re-valuation being shown on the Balance Sheet as a Capital Re-valuation Reserve.

Deferred Capital Grants

3.24 The treatment of capital grants is explained in some detail within the methodology (Appendix A). The accounting principle is that deferred capital grants remain in the balance sheet as a liability over the whole of the useful life of the asset which was grant funded. In accounting terms, this treatment is logical and covers the event of claw-back in the event that the use of the asset changes significantly or is sold. However, as time elapses, the prospect of claw-back becomes increasingly unlikely, especially after say 10 years. A situation may arise where a grant-funded property which is depreciated over 40 years is effectively understated in the accounts.

Section 4 – Asset Base Development

Introduction

4.1 A detailed review has been undertaken of the opportunities and threats which increased use of the Asset Base might bring to the sector. This has involved a review of current activity in relation to asset base development and some of the financial products that are beginning to emerge. It also draws on the feedback from the consultation programme and focus groups. An outline is provided of the main development issues that were identified. Details are also included of some of the models and approaches that could be utilised to assist the social economy sector to develop its Asset Base and how this could be deployed to develop and sustain community based services.

Development Issues

4.2 As a result of the history regarding the funding of community businesses, and the underlying grant culture that exists, there is still significant reticence within the sector towards debt finance or other income that requires ultimate repayment. Based on the feedback obtained during the consultations and focus group meetings, a number barriers and issues were identified that can be summarised as follows:

Investment Readiness

4.3 A strong cultural aversion to borrowing would seem to exist, especially amongst smaller community businesses. At the focus group in Inverness with representatives from community businesses, the taking out of a loan by a community business was unanimously viewed as a 'last resort'. When this was explored further, three fundamental reasons were given:

- Management committees/board of directors, comprising mainly local volunteer residents do not want to put at risk community-owned assets as they see this as creating a burden for future members of these committees.
- A reluctance to borrow 'risk' monies (loans) to finance social services when 'risk-free' monies were available in the form of grants.
- Risk of personal liability

4.4 Clearly, further education and understanding is required to shift this mindset and increase awareness and confidence in relation to the use of the assets of an organisation and the benefits that can be gained by the local community.

Ownership Issues

4.5 If debt finance is to be accessed, the lending bank will generally require a *standard security or charge* over the property. In the event that the organisation defaults in the repayment of the loan, the bank then has the legal right to sell the property in order to discharge the outstanding loan.

4.7 This creates a potential difficulty for some community businesses as they do not own the property to use as collateral or there may be difficulties in using the asset in this way. These difficulties may relate to restrictions on the use of the asset, a deviation from wholly charitable purposes etc.

4.8 In some cases, properties are owned by a local public sector body and the community enterprise has the right of occupation at a minimum rental. There is scope here, in appropriate circumstances, for the ownership of the asset to be transferred to the community business to enable it to develop the asset base and access other forms of finance.

Sustainability of Grant Income

4.9 The study showed that with smaller community businesses, especially those delivering social services, there was a heavy reliance upon annual revenue grants. In such circumstances, the transition from grant funding to debt finance would be challenging. Clearly, grants will continue to be the principal income source for community businesses delivering services in disadvantaged communities. This will be particularly true of start up initiatives where there is no track record in respect of financial performance.

4.10 Other developmental considerations in respect of grant funding for community businesses include:

- Grants are often project based and do not make a contribution to core costs.
- There is also a tendency for grants to gravitate towards the 'latest' programmes and initiatives.
- Grant providers will place restrictions on the use of the grant.
- A high proportion of revenue grants are subject to annual review and this jeopardises the ability of the organisation to make longer-term income forecasts showing sustainable income streams which would be acceptable to a banker.
- Although attitudes are changing, there is still reticence by public sector bodies towards grant funded projects which make a surplus and the issue of claw-back can arise. The difficulty is that the community business is hampered in building up reserves or an asset base which could be utilised to secure future debt finance.

Income from Trading Activities

4.11 The threshold for selecting community businesses for this study was that income from trading activities should be greater than 30%. In a survey carried out by the Bank of England on the financing of social enterprises, it was found that the demand for external finance such as loans was greater among larger social enterprises, especially those with a higher proportion of trading. It also found that community businesses with a turnover of less than £50,000 would generally never seek external finance.[3]

[3] The Financing of Social Enterprises: A Special Report by the Bank of England - Page 10

Attitude of Banks

4.12 A focus group was held involving representatives from three banks together with chartered accountants and lawyers. Further individual consultations were also held with a number of the High Street and social banks. Based on these consultations, the following observations can be made:

- At senior level, trading banks are very aware of the growing social economy sector and the potential for banking businesses. A number of the larger banks have set up social economy specialist departments. However, the impact of this at local branch level is more uncertain.
- With any proposal, the banking fundamentals remain the same – value of security, ability of future income streams to repay the loan, quality of management.
- The banks are very sensitive to reputational risk when lending to a local community based organisation providing social services and delivering social outcomes for disadvantaged residents. In these circumstances, the bank would carefully consider all options before foreclosing in order to avoid bad publicity.
- Some of the banks still use the traditional credit score system that is based on set financial parameters. Others have amended these to also reflect social returns and outcomes.

Business Experience and Business Planning

4.13 Amongst the smaller community businesses, where management committees/boards comprise local volunteers, there is often a lack of knowledge regarding the financial products provided by the banks and a lack of confidence regarding the procedures for accessing these products. At the focus group in Inverness, only one of the five community businesses represented had ever heard of the Charity Bank, the Unity Trust Bank, Social Investment Scotland (Highlands Opportunities), or Triodos Bank.

Business Support

4.14 During the focus groups and other consultations, the quality of advice available to community businesses through the LEC was raised. Some concerns were raised that the quality of advice can vary and sometimes business advisers were limited in their ability to properly play a brokering role between a community business and a banking institution.

4.15 In order to submit a properly researched proposal for financial assistance, banks will require a business plan and underlying financial projections. It is recognised that for a significant number of smaller community businesses, they will require professional assistance with the preparation of these documents.

Development Options

4.16 Having described the barriers and challenges, the second part of this section explores ways in which a community business can develop its asset base. The Scottish Executive policy paper on the social economy promotes the concept of asset-based development and this section seeks to explore how this could be progressed.

4.17 It should be recorded that all the High Street banks consulted appeared to be very aware of the potential within the community business sector of the social economy, and a number have developed specialist community banking departments within their structures. The senior officers consulted were also aware of some of the frustrations which community businesses are encountering when seeking financial assistance and they are looking to rectify these issues. For example, the banks appeared to be aware of the limitations of some parts of the traditional banking credit score system and they are prepared to relax these in order to properly consider a proposal by a community business which appears to be viable but traditionally unbankable.

4.18 For the purposes of this report, the use of a community business asset base has been reviewed under two heads:

- Developing or acquiring an asset base
- Utilising an asset base.

Developing or Acquiring an Asset Base

4.19 Considerable experience now exists within the social economy sector in relation to asset base development. The principle of social economy organisations being able to acquire and own assets is now widely accepted and supported based on a number of factors including:

- Recognition that having a strong asset base can provide a solid financial platform upon which a social economy organisation can build.
- Ownership of an asset such as a building can be more economic for an organisation, improve sustainability, and can reduce dependency on grant funding
- Recognition that social economy organisations have the capacity to add value and secure economic and social benefit from derelict and redundant facilities that is uneconomic for the public and private sectors.

4.20 Community business organisations in the Highlands and Islands have been at the leading edge in relation to asset base development for sometime. The case studies provide a good example of the range of organisations that have developed an asset base as a key part of their work. This covers a range of activities including:

- Housing development, with the asset base of the organisation being used to underpin future housing investment
- The experience that is starting to be gained through community land buyouts
- The development of community facilities such as village halls, arts and cultural facilities, community shops and sport and leisure amenities.
- The development of an asset base to support an organisation to deliver its services and become more sustainable. COPE provides an example of this form of activity within the field of supported employment.

4.21 The review of Scottish Executive policies on the social economy recognises the importance of asset base development within the sector. It is anticipated that the action plan that will be published later this year will set out how asset base development can be supported and encouraged. This is likely to include recommendations on the transfer of assets by public sector agencies to social economy organisations.

4.22 However, in terms of future asset base development, there are a number of issues and approaches that are worth considering. These include:

- *Awareness raising* – In order to encourage community businesses within the area to explore the opportunity in relation to asset base development, a programme of awareness raising activity should be considered. The programme would draw on some of the practical examples that exist within the area and would also provide information on the range of financial products that are available.

  The awareness raising programme would be supported by a range of practical tools and information for community businesses on loan finance and case study examples. The Guide to Borrowing for Social Economy Organisations in Scotland[4] provides a good example of the kind of information that could be utilised.

- *Sustainable income streams* – One of the main barriers that exist for community business is the lack of sustainable income sources due to a dependency on annual grants. Consideration should be given to encouraging public sector grant bodies to review the approach to grant funding in order to provide a more secure financial structure for organisations. This would include the development of service level agreements based upon three year contract arrangements. Support could also be provided to community businesses in relation to income generation activity with a view to identifying alternative sources of income to support the work of the organisation. Recognition should also be given to the importance of organisations being able to recover a proportion of their core costs as part of any grant support arrangement.
- *Business support/brokerage* – Access to good quality business support has been highlighted as an important issue. Business advisers should be provided with appropriate training on asset base development and accessing loan finance. An alternative approach could be the establishment of specialist advisors in this area of work. The business advisers could also act as a broker for the organisations with the lending institutions with a view to ensuring that financially competitive deals are secured.
- *Financial products* – A range of activity has been undertaken to develop new financial products to make it easier for community businesses to acquire property and other assets. This includes examples such as the 'rent-to-buy scheme' operated by the Unity Trust Bank. This scheme involves the bank taking an equity stake in the property and a combination of a simple mortgage. The community business equity builds on a monthly basis as the mortgage is repaid. Other examples include the development of 'patient capital' through which private lending institutions would be encouraged to provide equity-type financing. Feedback from representatives of High Street banks during the consultation programme suggested that it is likely that they will begin to move towards this form of support over the next few years.
- *Social angels* - The business angel network is well established in Scotland and a number of the banks consulted referred to an emerging social angel network. An example was provided in Edinburgh where a wealthy individual provided a property to a community business on an interest-free basis over a period of time. The business prospered and was able to repay the loan to the 'social angel'. Activity could be undertaken to promote this form of support.
- *Community investment tax relief* – In 2002, the UK Government introduced Community Investment Tax Relief that encourages investment in start up businesses and social enterprises in deprived areas. The potential exists to combine the promotion of Community Investment Tax Relief with the development of social angels and Patient Capital to provide an attractive package to encourage further private sector investment.
- *Joint venture models* – Work could be undertaken to develop and extend the range of joint venture activity. This could include a joint venture arrangement between a community business and the public sector, or between a community business and a private sector company. Successful examples of public/community joint ventures include the 'leisure trust models' that have been established by a number of local authorities across Scotland. Joint ventures involving the private sector tend to be less common. The work under Public Private Partnerships (PPP) with regards to school re-provisioning does provide a model that could be extended to the social economy sector. A range of major property companies are now interested in exploring opportunities within this framework.
- *Joint working models* – The Taigh Chearsabhagh provides a good example of two organisations coming together, sharing risk, combining expertise, and achieving

[4] 'Taking a Loan of Finance by Social Investment Scotland and SCVO 2003

their goal. The potential exists to encourage and develop other initiatives based upon a joint working approach. In particular, the housing associations could play an important part within this model that would utilise their existing asset base and experience in property management as part of any joint working arrangement.

Utilising an asset base

4.23 Although no specific research has been undertaken on this matter, it is suggested that less experience exists in the social economy sector with regard to the use of an asset base to access finance to expand or sustain activity. The main exception to this is in the field of housing, where borrowing against existing assets to finance future housing investment is an established practice. Experience also exists within larger scale social economy organisations and national charities in relation to the use of their asset base to finance activity.

4.24 Based on the experience that does exist, it is possible to highlight a number of examples in relation to the way that a community business could utilise their asset base. These include:

- *Providing working capital* – A number of examples exist of organisations that have secured working capital to ease cash-flow problems resulting from uneven income flows. This is particularly relevant for organisations that are involved with EU-funded projects and the financial problems that can result from the timescales in relation to grant claims being processed. In such circumstances, some organisations have used their asset as security against an overdraft facility or a term loan to provide working capital.
- *Investment funding* – Some organisations have used their assets to secure loan finance for investment in the development of new services or activities that will improve their income and long term sustainability.
- *Asset base development* – A range of examples exist of organisations that have used their existing asset base as security against acquisition of other property or land. The housing associations and 'Workspace' companies are good examples of this area of activity.

4.25 As outlined above, a limited range of examples do exist of community businesses that have utilised their asset base to support their future development. However, it is suggested that further research is required with regard to the use of assets that are owned by community businesses. The feedback gained during the consultation programme also suggested that there are a number of barriers and issues that require to be addressed to develop this area of activity. These include issues in relation to organisations being risk averse; the lack of sustainable income streams; the lack of awareness of the financial products available; and the requirement for access to good quality business support.

4.26 Actions to address these matters would be similar to those proposed in relation to asset base development, and would form part of a comprehensive programme of support.

4.27 In addition, due to the reduction in funding from the European Union and other sources, consideration could be given to the development of sustainable investment funds that would act as a legacy for the area. Some work has been undertaken in western Scotland and other areas to explore the way that investment funds could be established that would be linked to the asset base development of local organisations that would provide a source of sustainable income.

Section 5 - Conclusion

5.1 The scoping study has focused on the development of a framework methodology that will provide a basis for Highlands and Islands Enterprise to undertake an extended assessment of the nature and value of the asset position of community businesses operating in the area. The study has also examined the opportunities and threats which increased use of the asset base of these organisations might bring.

5.2 The framework methodology sets out the basis for the valuation of the asset position of community businesses. This includes an outline of the legal and accounting fundamentals that underpins the methodology.

5.3 In broad terms, the accounting principles applicable to the valuation of assets within the private sector equally apply to community businesses within the social economy sector. The valuation principle can be stated as – assets should be valued at the lower of cost or current valuation. When assets are purchased, they are required to be shown in the Balance Sheet and in subsequent years they will be depreciated over the useful economic life of the asset.

5.4 As part of the research for the study, four community businesses were selected as case studies. Visits were made, financial statements were examined, and discussions were held regarding the valuation and disclosure of assets in their accounts. The case studies illustrated that the approach to the valuation of assets was consistent with the methodology set out in the framework. However, the case studies also highlighted a number of factors that require to be considered in relation to the valuation of assets. These included:

- *Re-valuation option* – where an asset is likely to appreciate in value over time, such as with property or land, the opportunity exists for a community business to elect to undertake a re-valuation of the asset. The current value can then be reflected in the Balance Sheet. It should be noted that in a rising property market, these assets may be significantly understated in the accounts of a community business unless the organisation has arranged for a regular re-valuation.
- *Ownership of the asset* – the study highlighted the importance of the organisation having an unrestricted title for any of the assets owned. Restrictions on the title can have an impact on the value of an asset and can limit an organisations capacity to use the asset as security against any loan finance.
- *Impact of depreciation* – depreciation of an asset is allocated over its useful economic life. However, the report highlights the fact that the depreciation of an asset can result in an understatement of value if a regular re-valuation is not undertaken.
- *Deferred capital grants* – the treatment of capital grants is explained in detail in the report and highlights the impact that this can have on the valuation of an asset.

5.5 The framework methodology also sets out the basis for the valuation of *Inalienable* and *Historic Assets*; *Investment Assets*; and *Intangible Assets*. It was suggested during the consultation programme that these areas may become increasingly important within the social economy sector as organisations start to develop investment funds and build intellectual property.

5.6 The main conclusions and actions that flow from the framework methodology part of the study are as follows:

Valuation of the Asset Base

The framework methodology sets out the basis for the valuation of the asset base of community businesses. However, the study also highlights that the valuation can be influenced by a range of factors that can have a positive or negative impact on the value of an asset.

> ***Action***
>
> Based on the above, it is suggested that in order to obtain an accurate position in relation to the valuation of assets, the assessment would require to be undertaken on a case by case basis, and could not be based purely on an analysis of financial accounts.

Deferred Capital Grants

The study provides details of the treatment of capital grants and the impact that the release of capital grants can have on the valuation of an asset.

> ***Action***
>
> Consideration should be given by public agencies to the treatment of capital grants that protects public interest but also allows an organisation to maximise the value of an asset at the earliest possible time. This could include the standardisation of claw back periods to an appropriate level of say five, seven, or ten years.

Expanding the Framework

The report sets out the accounting principles in relation to the valuation of Inalienable and Historic Assets; Investment Assets; and Intangible Assets. However, it is also recognised that in general, limited consideration has been given to the treatment of these assets within the social economy sector. As the sector continues to grow and develop, it has been suggested that further consideration requires to be given to these areas in order that appropriate advice, guidance and support can be provided to organisations.

> ***Action***
>
> Consideration should be given to the development of further work on these matters including guidance on how these assets can be maximised and protected by community businesses.

5.7 The second part of the scoping study has focussed on examining the opportunities and threats which the increased use of the asset base of community businesses might bring. The study highlighted the progress that has been made and the experience that now exists within the social economy sector in relation to asset base development. The principle of social economy organisations being able to acquire and own assets in now widely accepted and actively encouraged. Highlands and Islands Enterprise has been at the leading edge of this work and has supported a range of organisations to develop an asset base as part of the process of building sustainable communities.

5.8 The study also illustrated the level of interest that now exists among the High Street banks in relation to the social economy sector. There are also a growing number of social banks and other financial investment organisations that are involved and committed to the sector. New financial products are being developed and new flexible support arrangements are being introduced that can be tailored to the individual requirements of community businesses.

5.9 It is evident from the study that a positive environment now exists that encourages and supports community businesses to develop an asset base using a combination of loan finance and public grants. However, the study also highlights a number of barriers and issues that exist in relation to asset base development. These include:

- Strong cultural aversion to borrowing within the sector;
- Grant dependency culture;
- Lack of information and awareness in relation to financial institutions and products;
- Issues in relation to capacity and opportunity to develop sustainable income streams and surpluses;
- Issues with regard to the quality of business advice and support.

5.10 Maximising the opportunities for community businesses to develop their asset base will require a comprehensive programme of work to be undertaken to address these issues and barriers.

5.11 The final element of the report examined the utilisation of existing assets by community businesses. Limited information is available in relation to this area of activity and it is suggested that further research is required into the way that community businesses deploy their asset base. The main exception that was identified was in relation to the experience of housing associations that have a track record in this field. It should be noted however, that this area of activity is well regulated and is subject to annual inspection by Communities Scotland. Other examples also exist in relation to larger social economy organisations and national charities.

5.12 The impression from the study is that considerable experience would seem to exist with regard to asset base development, but with less progress and experience in relation to the utilisation and deployment of existing assets as part of the growth of community businesses. This impression reflects the majority of the policy rhetoric in this field that talks about the importance of developing community owned assets without going onto illustrate the way that assets can be deployed.

5.13 The main conclusions and actions that flow from this section of the study can be summarised as follows:

Policy Development

It is anticipated that the Implementation Plan on the development of the Social Economy will provide policy guidance based on the Review of the Scottish Executive Policies on the Social Economy. A number of key policy areas require to be addressed including: Developing a framework to facilitate the transfer of publicly owned assets to community ownership; Addressing the problem of annual grant funding; Review of grant support arrangements to allow eligible core costs to be included as part of the grant funding support; Reviewing public procurement arrangements to encourage community owned businesses to secure service contract work; Lifting the restrictions on organisations being able to generate appropriate surpluses without the penalty of grant reduction or claw back.

Action

Continue to develop, in association with other public agencies working in the area, a policy framework to support and encourage the development and utilisation of the asset base of community businesses.

Addressing Barriers

The report highlights a range of barriers and issues that require to be addressed to encourage and support asset base development and the deployment of assets for the long-term benefit of the organisation and the area.

Action

A comprehensive package of support is required covering information and awareness raising; business support and brokerage services; peer group support and demonstration projects; and capacity building.

Promotion of New Approaches

The report highlights some of the new approaches and financial products that are being developed. This includes examples such as the 'rent to buy scheme'; patient capital; social angels; joint venture models; and joint working arrangements.

Action

Consider the opportunity for the use and development of the new approaches to support community businesses within the Highlands and Islands. In particular, consideration should be given to the opportunity to develop joint working arrangements or joint ventures involving Housing Associations based on the significant asset base and experience of these organisations.

Improving Risk Management

Minimising the risk associated with the increased use of the asset base by community businesses will involve organisations in developing their systems, approaches, and techniques in relation to risk management.

Action

Provide assistance to community businesses, including training for board members and staff on risk management.

Sustainable Investment Funding

Given the potential reduction in grant funding from the European Union and other sources over the next few years, the opportunity should be explored as to how some of this funding could be directed towards the creation of a sustainable investment fund that would act as a legacy for the area. This would include linking investment funding to asset base development that would provide a source of sustainable income.

Action

Examine the opportunity to establish a sustainable investment fund based on experience from elsewhere.

Ongoing Research and Analysis

Considerable experience now exists in relation to asset base development with a range of models and approaches being established. However, it is also recognised that further research and analysis is required into this area of activity. This would include undertaking an extended study using the framework methodology to assess the nature and value of the asset base of community businesses operating in the area. Specific attention should also be given to the way that the asset base is being utilised and the identification of barriers and examples of good practice.

Action

Consider commissioning an ongoing programme of research to inform future development and practice within this field.

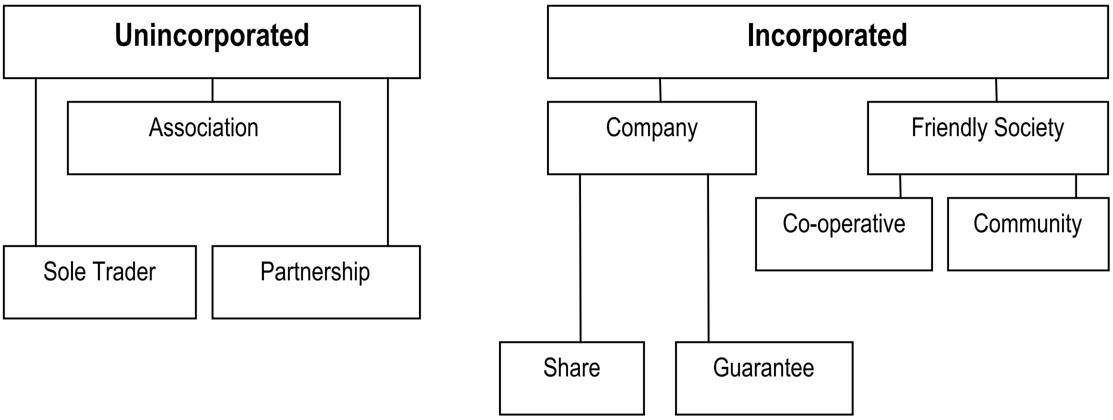
Framework – Methodology for the Valuation of the Assets of a Community Business

Introduction
The document provides an outline of the legal and accounting framework for community businesses and sets out the methodology for the valuation of the assets of such organisations.
The document has two parts:

Part One	-	A legal and accounting framework for a community business
Part Two	-	A methodology of the valuation and disclosure of assets in the accounts of a community business

Part 1 – Legal and Accounting Framework

Legal Structure
There are a variety of unincorporated and incorporated legal structures under which a community business can operate and these are summarised:



Historically in Scotland, social economy organisations have tended to structure their organisation as either an unincorporated association or a charitable trust. However, because of the greater protection afforded under an incorporated company structure which is legally distinct from its members, increasingly community businesses are opting to manage their business within an incorporated structure – usually a company limited by guarantee. The increasing harmonisation of company law within the European Union may increase this tendency towards incorporation within this sector. [5] Community businesses will generally now be owned and managed within one of the following legal structures:

- Unincorporated association
- Industrial and provident society/co-operative
- Company limited by guarantee.
- Trust

Unincorporated association
An unincorporated association essentially binds together the members of an organisation who have agreed to come together for a particular socially beneficial purposes. The governing document for an unincorporated association will be its constitution which will set out the internal management of the organisation. The executive management of the business will rest with a Management Committee – often comprising voluntary unpaid members of the local community.
Industrial and provident society/co-operative
An industrial and provident society is somewhere between an unincorporated association and an incorporated company. It will have rules similar to that of the unincorporated society but it must comply with the Industrial and Provident Society Act 1965 and it does provide the protection of limited liability. In order to qualify for registration as an industrial and provident society, the community business must either be a co-operative society for the benefit of its members or the benefit of the community at large. The industrial and provident society structure is less popular now but it is still used within the housing association sector. Communities Scotland require

[5] SCVO Web Site – 'Law – Organisations'

all housing associations who register with them to be registered as an industrial and provident society and to be registered with the Registrar of Friendly Societies. This structure is also used by the Credit Union movement.
Company Limited by Guarantee
This is now the most common structure for a community business. A company limited by guarantee is a company registered with Companies House and instead of having shareholders it will have members whose liability is usually limited to £1. The governing document for a company limited by guarantee is the Memorandum and Articles of Association which sets out its objectives and addresses the internal management of the company. A company limited by guarantee does not distribute its profits by way of a dividend and the executive management will rest with a board of directors.
Trusts
A Trust structure may be used where assets are held and managed for charitable purposes. It will be governed by the Trusts (Scotland) Acts 1921, 1961 and 1990. Under a trust structure, trustees are appointed to administer the trust and the underlying business in accordance with the Trust Deed which will set out the purpose of the trust and the duties and powers of the trustees. Because the trustees are personally liable for trust losses, a trust structure is less than ideal for a community business where trading activities, with all the risks that go with this, are carried out.
Charitable Status
The above entities are entitled to apply to the Inland Revenue (Charities Division) for recognition as a Scottish Charity.
The administration of charities is the responsibility of the new office of the Scottish Charities Regulator (OSCR)Scottish Charities Office [6] that has the remit to:

- To enhance public confidence in the voluntary sector by making charities more accountable.
- To increase the awareness of the responsibilities in running charities.

It should also be noted that the Scottish Executive intend to publish a draft Charity Bill for consultation in April 2004 that will cover a range of areas including a new definition of Charity, development of a statutory register of all charities, improvements in the regulating of fundraising, and the status and purpose of an independent regulator. This bill will have an impact on the operating and reporting of charities.
The law requires all charities to keep accounting records, prepare annual accounts and prepare an annual report.

Accounting Fundamentals
Financial statements or accounts have two over arching objectives:

- Report on the financial position of the community business
- Show how the community business has performed during the last year.

A set of accounts for a community business will serve a variety of purposes:

- Provide a record of assets owned and amounts owning to creditors, banks etc
- Help the organisation manage its affairs
- Provide a way of measuring an organisation's effectiveness
- Allow stakeholders such as grant bodies to monitor the organisation's activities.
- Enable potential funders to evaluate the organisation in the context of a grant application.

[6] The Office of the Scottish Charities Regulator (OSCR) was established in December 2003 and incorporates the former Scottish Charities Office.

It is important to record other relevant information relating to the effectiveness of a community business will not be disclosed in a set of financial statements. Examples would include:

- The know-how skill and morale of the staff within a community business.
- The commitment and zeal of a local management committee or board of directors who are committed to the success of the business.
- The assets such as property may not be disclosed at their current market value and therefore the Balance Sheet may understate the net worth of the organisation.
- The accounts do not focus on non-monetary social outcomes against objectives.

Within the private sector, accounts are prepared primarily for the shareholders who have invested in the company and who wish to maximise their return. In the case of a community business which has been set up for social benefit, the 'readers' of the accounts will include a wider range of stakeholders such as staff, board/management committee, trustees, suppliers, grant funders, local authorities and the local community who benefit from the provision of services.

Financial Reporting Framework
The obligations of a community business to prepare financial accounts are broadly the same as any other organisation and the relevant legislation will depend on the legal structure.
There are four main pieces of legislation which regulate the preparation of accounts.
1. Law Reform (Miscellaneous Provisions) (Scotland) (Act 1990)

This legislation applies both to unincorporated associations and trusts. It requires the preparation of an Income and Expenditure account.
2. Companies Act 1985

This legislation applies to companies including companies limited by guarantee. The Companies Act requires the preparation of a Profit and Loss account and a Balance Sheet. Over certain specific turnover and asset thresholds, accounts require to be audited by a qualified registered auditor. With effect form January 2004, the audit threshold for turnover has been raised to £5.6m.
However, charitable companies are still required to have an audit where gross income exceeds £250,000 pa. Between £90,000 and £250,000 an independent review and report is required by a qualified reporting accountant and below £90,000 the charity can apply for full audit exemption.
For unincorporated associations and charities, the thresholds are even more stringent. For gross income up to £100,000 an independent examiner is required to review and report; above £100,000 a full audit is required.
3. Accounting and Reporting by Charities – Statement of Recommended Practice (2000)

This document is commonly referred to as the Charities 'SORP' and it comprehensively sets out recommendations 'on the way a charity should report annually on the resources entrusted to it and the activities it has undertaken'[7]
The SORP recommends the preparation of a Statement of Financial Activities, a Balance Sheet, a Cash Flow Statement and notes explaining the accounting policies adopted. (In certain cases, a Summary Income and Expenditure account is also required).

---

[7] SORP Page 1.

4. Accounting Policies

The Accounting Standards Board ('ASB') was set up in 1990 and it governs the disclosure of information in financial statements and it does this by publishing Financial Reporting Standards (FRS).[8] Additionally, sometimes new financial issues emerge quickly and the Accounting Standards Board will publish Urgent Issues Task Force statements ('UITF'). It is effectively a 'fire-fighting' body that will engage with urgent matters that cannot await the publishing of a FRS.

If an organisation does not abide by a particular accounting standard, it is possible that the court may ask the directives to provide an explanation for the deviation. Accounting standards therefore now have semi-statutory status.

In addition to the above broad legislative documents, there are also accounting regulations for specific sectors. For example, a housing association which is a Registered Social Landlord will have regard to Registered Housing Associations (Accounting Requirements) (Scotland) Order 1999. A friendly society will need to ensure that its accounts comply with the Industrial and Provident Societies Act 1965. A broad review of these documents shows that generally these regulations do not engage with approaches to asset valuation and refer to generally accepted accounting principles.

In summary, the above legislation requires the annual preparation of the following financial documents:

Profit and Loss Account or Income and Expenditure Account	A statement setting out the income and the expenditure leaving either a surplus or deficit at the end of the financial year
Balance Sheet	An annual 'snapshot' of the organisation's assets and liabilities
Statement of Financial Activities (SOFA) – required by SORP to be prepared by all charities.	This statement shows all resources received and expended on an activity basis during the year. It differentiates between unrestricted funds, restricted funds and endowment funds. In Scotland, in order to comply with the Law Reform Act 1990, the SOFA usually incorporates the Income and Expenditure Account.

[8] Prior to the establishment of the Accounting Standards Board in 1990, the earlier body was the Accounting Standards Committee who published Statements of Standard Accounting Practice ('SSAP'). The ASB is slowly replacing the SSAP's with FRS's. At the time of this report, nine SSAP's are still in force.

Part 2 - Valuation of Assets

Introduction
This part of the framework provides an outline of the methodology for the valuation of the assets of a community business and the underlying accounting regulations which underpin such valuations.
The starting point for the review of the assets of a community business is the latest set of accounts which should be obtained. A brief review should be carried out to ascertain whether the accounts were audited. If the accounts were audited, it can be assumed that normal accounting policies were applied when valuing and disclosing the assets in the accounts. (For example, when reviewing the debtors – amounts due to the organisation – the auditor would have ensured that proper provision was made in respect of long outstanding debts now considered irrecoverable.)
The Balance Sheet within the accounts will set out the book value of the assets and liabilities of the community business on a specified date (the 'Balance Date'). The difference between the total assets and the total liabilities is the net assets or net worth of the community business in financial terms (referred to as Charitable Funds).

Example 1:	
The Balance Sheet	
Fixed Assets	
Tangible Assets	235,000
Investments	4,000
	239,000
Current Assets	
Stocks	56,000
Debtors	78,000
Cash at Bank	45,000
	179,000
Creditors: Amounts falling due within one year	82,000
Net Current Assets	97,000
Total Assets less Current Assets	336,000
Creditors: Amounts falling due after more than one	
year	150,000
Net Assets	£186,000

Charitable Funds	
Unrestricted Funds - General	£186,000

Definition of Assets
An asset can be defined as an item which is owned by the community business and which has a value. In this context, value refers to future economic and social benefits which will flow from the asset.
The assets shown in the Balance Sheet are normally categorised under one of two heads:

- Fixed assets
- Current assets

Fixed Assets
Fixed assets can be defined as those items that are not bought or sold as part of the normal trading activities but enable the community business to function and deliver its services.

Fixed assets can be broken down into the following categories:

Fixed Assets

Fixed Tangible Assets	Inalienable and Historic Assets	Investment Assets	Intangible Assets
Property; vehicles; plant and machinery; office furniture; computers; ICT Networks.	Historic buildings or artistic works.	Bank term deposits, shares in listed and unlisted companies and property held for the purpose for producing an income stream.	Goodwill can be described as the sum of the intangible attributes of a business which contribute to its success, such as good reputation or the skill of the management. The valuation of goodwill is difficult because of its vague nature.

Current Assets
Current assets can be defined as those items that form part of the trading cycle of the community business and will be converted into cash within one year. They would include such items as stock, debtors (Accounts Receivable), bank balances and prepayments.
Accounting Principles
In broad terms, the accounting principles applicable to the valuation of assets within the private sector equally apply to community businesses within the social economy sector. The valuation principle can be stated - *assets should be valued at the lower of cost or current valuation.*[9]
The accounting policies and statutory regulations that underpin this valuation principle are:

- UK Accounting Standards – The relevant Financial Reporting Standards (‘FRS’) are:
    - FRS 15 Tangible Fixed Assets
    - FRS 18 Accounting Policies
    - FRS 10 Goodwill and Intangible Assets
    - FRS 11 Impairment of Fixed Assets and Goodwill
- Accounting and Reporting by Charities: Statement of Recommended Practice 2000 (‘SORP’)[10]

Although the SORP is generally in agreement with UK accounting standards, it is important to record the two main differences:

- A requirement for investment fixed assets to be shown in the accounts at current open market value. There is no option for showing these items at historic cost [11]

[9] Current valuation is sometimes described as ‘net realisable value’.
[10] Clause 190 of the SORP states that fixed assets should be valued at cost or valuation and Clause 242 of the SORP states that current assets should be shown at the lower of cost or net realisable value.

- Special treatment of inalienable or historic assets. These are to be shown separately within the Fixed Assets section of the Balance Sheet and there are circumstances where no value is attributable to them.

Valuation Principles – Fixed Tangible Assets
Accounting principles require that initially, when a tangible fixed asset is purchased, it should be disclosed in the accounts at cost. This cost should include all costs attributable to bringing the fixed asset into working condition and this may include such items as legal fees associated with the acquisition, and in the case of a new build, the development finance costs.

Example 2:	
Development of a new community facility	
Land	50,000
Building Costs	300,000
Design Team Fees	25,000
Legal Fees	2,000
Development Finance (Interest during construction)	8,000
Total 'Cost' to be capitalised and shown in the Accounts	£385,000

Accounting principles also require that fixed assets be depreciated. Depreciation is an accounting concept whereby the cost of an asset is allocated over its useful economic life.

Example 3: Depreciation of new office furniture purchased for a	
local home care project	
Cost of furniture	£12,000
Useful Life	6 years
Depreciation Charge (£12,000/6 years)	£2,000

The directors or management committee also need to consider 'impairment' which describes a situation where the net book value of a fixed asset is higher than its current market value. In this situation, the value shown in the accounts would require to be reduced to its current value. This is in keeping with the overarching accounting principle that assets are stated at the lower of their cost or current value as stated above.
Both FRS 15 and the SORP provide for the revaluation of a fixed asset so that if the Board or the Management Committee so decide, the current value of the fixed asset can be reflected in the accounts.

- FRS 15 states that an organisation 'has the option of revaluing its tangible fixed assets…..Where a tangible fixed asset is revalued, its carrying

[11] The only exception here is in the case of investments in unquoted subsidiaries or associated companies

amount (i.e. amount shown on the accounts) should be its current value at the Balance Sheet date'.[12]

- The SORP states that 'all fixed assets should be included in the Balance Sheet at cost or valuation. They may then be periodically revalued. Fixed assets do not need to be revalued unless the charity adopts a policy of revaluation.'[13]

Accounting principles state that where a revaluation policy has been adopted by an organisation, a full valuation should be carried out at least every 5 years and FRS 15 suggests an interim evaluation in year three.[14]

Valuation Principles – Inalienable and Historic Assets

Some community businesses may own or hold in trust fixed assets which are 'inalienable' or 'historic'. The SORP defines an inalienable asset as one which a charity is required by law to retain indefinitely for its own use and benefit and it therefore cannot dispose of the asset. A historic asset is one of 'acknowledged historic, scientific, environmental or artistic importance, whether of former or present times.' Examples of inalienable or historic assets could include historic buildings or artistic works.

The SORP recognises that it may be difficult or costly to determine a cost or value on an inalienable or historic asset and it states that these assets may be excluded from the Balance Sheet if:

- Cost information is unavailable, or
- It would be difficult to value the asset (e.g. lack of comparable sales data), or
- The costs of valuing the asset would outweigh the benefits which the readers of the accounts would enjoy.

If it is decided by the community business not to attribute a cost or value on an inalienable or historic asset and disclose it in the accounts, a note should be included in the accounts explaining the rationale behind this.

[12] FRS 15 page 5

[13] SORP Clauses 190 and 218

[14] 'Interim Evaluation' is not defined but it likely refers to a 'desktop' style valuation, which would not involve a full inspection of the asset.

Valuation Principles – Investment Assets
The SORP requires all investment assets to be shown in the accounts at current open market value. This is one of the few instances where the SORP departs from generally accepted commercial accounting principles.
Investment assets may include bank deposits, shares in listed and unlisted companies and property which is held primarily for the purpose of producing a rental income stream.[15]
Valuation Principles – Intangible assets
The SORP requires intangible fixed assets to be included in the balance sheet in accordance with FRS 10 'Goodwill and Intangible Assets'. These assets, including purchased intellectual property, should be capitalised at fair value (usually cost) and distinguished from purchased goodwill and amortized (written off) over their expected useful economic life. This should not exceed 20 years and should be reviewed at the end of each reporting period and revised if necessary.
Valuation Principles – Current assets
Current assets are shown in the accounts at cost or net realisable value if this is less than the cost.
Debtors will be valued at the total value of accounts receivable after due provision for doubtful or bad debts.
Stock will normally be based on a physical stock take at balance date. The valuation will be based on the lower of cost or net realisable value for each stock item and those items which have not moved for more than a year would be written down appropriately.
Valuation Methods for Fixed Assets
If a fixed asset is to be valued at current market value, FRS 15 and the SORP set out the valuation approaches and methodologies to be adopted and these are summarised as follows:

Asset Type	Valuation Approach
Tangible Fixed Assets	
Property	Property should be valued by a qualified external Valuer (member of the Royal Institute of Chartered Surveyors) or a qualified Internal Valuer but such a valuation is subject to review by an external Valuer. The valuation methods will include estimated cost less depreciation and a review of sales data for comparable properties.
Plant and Machinery/Office Equipment	Replacement cost less depreciation. Often replacement costs can be obtained from new plant/equipment price catalogues. Proper allowance should be made for technical obsolescence.
Motor Vehicles	There is normally an active second hand market for motor vehicles and the Directors/Management committee can estimate the values with reasonable certainty.

[15] Rentals on investment properties should be negotiated at arms length (SORP Clause 18 page 17).

Asset Type	Valuation Approach
Inalienable and historic assets	If it has been decided to assess the value of these assets, the normal valuation approach, in the absence of comparable sales data will be replacement cost less depreciation.
Investment Assets	
Bank term Deposit	Face value plus accrued interest
Shares – Listed Company	The daily-published share prices on the Balance Sheet date will provide a basis for the valuation.
Shares – Unlisted Company	Reference should be to the underlying net assets of the company or the earnings record and future maintainable profit or the dividend record.
Property	Valuation will be carried out by a Chartered Surveyor who will base the valuation on a capitalisation of the annual rental income.
Intangible Fixed Assets	
Goodwill and other intangible assets	Where marketable the goodwill should be shown in the accounts at cost and then amortised (written off) over the life of the goodwill which is normally 20 years.

Capital Grants
Where assets with significant value are purchased by the community business using public sector capital grants the disclosure of the assets financed in this way have to be stated within the accounts.
There are two statutory sources regarding the treatment of capital grants:

- Statement of Standard Accounting Practice ('SSAP') 4 'Accounting for Government Grants'.
- SORP

SSAP 4 states that where a capital grant is made towards the cost of the fixed asset there are two possible treatments.[16]

a) Disclose as a deferred capital grant in the liabilities section of the Balance Sheet. With this treatment a proportion of the grant is released as income into the Profit and Loss account each year based on the useful economic life of the fixed asset which has been funded (the economic life will be based on the depreciation policy for this asset).
b) The amount of the grant is deducted from the cost of the fixed asset and the net amount is shown as a fixed asset in the balance sheet and is depreciated in the normal manner.

However, for registered charities, the SORP recommends option a) above and prohibits the netting off of the grant.
It is pertinent to note that with both approaches, the net asset position of the community business is effectively reduced to the extent that the deferred capital grant remains in the liability section of the Balance Sheet. In the early years of the life of the asset, this treatment provides a 'true and fair' statement of the organisation's financial position as if the fixed asset which was the subject of the grant was sold, with the public sector capital grants used to finance it could potentially be clawed back. However, after a longer period of time (say ten years) the probability of the grant being clawed back would become increasingly unlikely.

[16] Refer Clause 15 of SSAP 4

Appendix B1
Case Study – Assynt Crofters Trust

Summary

Sector	Community Land Ownership
Turnover	Circa £20,000
No of Staff	1 Part Time Administrator
Asset Value	Circa £230,000

History and Background
Over ten years ago, the North Assynt Estate in Sutherland was sold to Scandinavian Property Services Ltd, a Swedish owner. Due to financial difficulties, this company proposed to divide the Estate into lots and start selling them off. In order to prevent the fragmentation of the Estate, and to bring it back into local ownership the Assynt Crofters Trust was formed in 1992. The Trust successfully mounted a bid for the purchase of the Estate. Although the original asking price was in excess of £1m, the Trust negotiated a purchase price of £300,000. This was funded from public appeals, pledges and grant aid from public agencies.
Objectives
The Assynt Crofters Trust ('the trust') seeks to achieve the betterment of the area through three overarching objectives:

- Improve the social, educational and cultural environment of the crofting community.
- Improve the natural environment of Assynt in Sutherland.
- Help fund viable developments in order to secure land renewal and environmental projects for the Assynt Crofting Community.

Legal and Management Structure
The trust is a company limited by guarantee. It has a board of 14 members – 12 members representing each of the 12 townships in the area together with two co-opted Directors who have specialist experience in fishing and shooting. The trust does not have charitable status. There are currently approximately 150 members and croft ownership is a condition of membership.
Description of Operations
The land area comprises 21,500 acres and includes 182 crofts. Approximately 300 people live in the North Assynt area.
The trust has been involved in the following activities and initiatives:
- Advice and guidance on crofting agriculture including the development of new crofts
- Development of trout fishing and shooting
- Management of woodlands and forestry
- Developing tourism in the area (the buyout received significant media and public interest which initially brought significant numbers of visitors into the area).
- Research into housing needs and assistance with the development of new housing.
- Research into the development of renewable energy and the commissioning of a hydro scheme.

In 1992, the trust commissioned a study which consulted with the Assynt community regarding the development of the estate – entitled 'Whole Estate Plan'. When consulted about the trust, respondents commented that the trust was:
- Supporting development
- Accessible and local
- Owns the land

The study also pointed to challenges for the trust including a perceived lack of communication and apparent lack of vision and direction once the buyout was achieved.
Approximately four years ago, the trust formed a subsidiary company, Assynt Hydro Ltd and this company has developed a hydro-electric scheme at Loch Poll at a cost of approximately £575,000. Public sector grants were accessed to finance this development. Unfortunately, this company has been incurring losses because of recent dry winters and summers. During last summer the river dried up completely.
The trust employs one part-time admin. assistant for two days each week.

Income Sources

The trust has an annual turnover of approximately £20,000 and the accounts for the year ended 31 March 2002 show:

Income	£21,251
Expenditure	£18,405
Net surplus	£ 2,846

The income sources can be analysed as follows:

Wayleaves - Received from Energy Bodies	4,698	22%
Fishing Permits	4,127	19%
Rent - Land	4,013	19%
Gazing and Croft Rentals	3,215	15%
Grant Funding	2,728	13%
Venison sales	1,262	6%
Land Sales	835	4%
Salmon Netting rentals	200	1%
Sundry	173	1%
	£21,251	100%

Valuation of Assets

The assets owned by the trust comprise the estate itself, the old telephone exchange at Stoer (used as the trust's office), a fishing bothy and drying green, both at Clachtoll, ten boats for hire to fisherman, and the old Highland Council shed at Strathcroy. The trust also has an investment of £25,000 in the Hydro Electric subsidiary.
Fixed assets have been shown at cost and all assets have been depreciated over their useful lives apart from the land and buildings. The directors took the view that the value of the estate will not be depleted by the passage of time and the value of the buildings was immaterial relative to the total value of the estate. In this same context, the government grants of approximately £230,000 received at the time of the buyout have been shown in the accounts as a capital reserve instead of being shown as a deferred capital grant and released into profit and loss account over the useful life of the asset. Although this is a deviation from accepted accounting principles, the directors believe that this treatment is necessary for the accounts to show a 'true and fair' view of the net assets of the trust.
The investment in the Hydro Electric subsidiary is shown at cost. However, having regard to the losses currently being incurred, it is likely that some downwards adjustment to this figure is required.
No recent market valuation of the estate has been carried out.

Relevant Issues and Challenges

Based on the current annual income of circa £20,000 and the approximate breakeven position, the trust is not in the position to access debt finance in order to develop its asset base and trading activities. Discussions with one of the directors suggested that accessing capital monies to achieve the buyout was easier than the year-by-year financial management of the trust and its estate in order to achieve viability.

There is an ongoing dialogue between the trust, its members and the wider community regarding the composition of the membership and whether membership should be opened to those, who live in the area but do not own a croft. This approach might make it eligible for charitable status, as well as widening the activities of the trust and its future potential for generating income.

Appendix B2

Case Study – Albyn Housing Society Ltd

Summary

Sector	Housing and Care
Turnover	£5.4m
No of Staff	Circa 44
Asset Value	Circa £20m

History and Background

Albyn Housing Society ('AHS') was established in 1973 to provide housing for incoming workers in Invergordon who were employed at the smelter or the oilrig construction site. In the mid 1980s 'right-to-buy' was introduced and local authorities stopped building new homes and AHS began to develop new housing within the wider Highland area in conjunction with local housing authorities.

Objective

The AHS develops, manages and maintains housing in the Highlands for people in housing need.

Legal and Management Structure

AHS is a registered Friendly Society and is a Registered Social Landlord with Communities Scotland. It is also recognised by the Inland Revenue as a registered charity. Under the Friendly Society structure, it has 200 members and 75% of these are tenants.

It has a board of 15 and around half of the board members are also tenants.

Description of Operations

The principal activities comprise:

- Management and maintenance of existing housing properties
- Purchase of new sites for new housing developments
- Development of new housing (£3.7m was spent on new housing in 2003).

AHS has also been working collaboratively with local authorities in respect of the Local Lettings Initiatives. This is an initiative which brings investment into local communities in order to ensure their viability and sustainability. For example, AHS worked with the Assynt Crofters Trust in developing in the Assynt Estate four new tenanted houses. This provided new accommodation for young married couples and increased the roll and sustainability of the local school. In the late 1980s AHS moved into providing social care in conjunction with social care providers.

Income Sources

In the year ended 31 March 2003, AHS generated a total income of £5.4m and the deficit for the year was £193,000. (It made a surplus in the previous year of £570,000).

73% of the income comes from housing rental and the balance comes from special needs accommodation and shared ownership accommodation.

Valuation of Assets

AHS values its fixed assets as follows:

Housing Properties

The housing stock is valued at cost less the grant and less the accumulated depreciation. For depreciation purposes, the houses have an expected useful economic life of 75 years.

In 2001, external valuers, DTZ Pieda Consulting were instructed to value the housing stock on the basis of 'existing use value – social housing'. This valuation approach is laid down in the Royal Institute of Chartered Surveyors Appraisal and Valuation manual and uses discounted cash flow methodology. The calculation is based on assumptions regarding future rental incomes, rates of tenant turnover, the level of future right-to-buy transactions and the level of likely future shared ownership equity sales. The assumed discount rate used in the DTZ calculation was 7%.

Since 2001, this valuation model has been updated on a 'desktop' basis.
This appraisal approach based on existing use value, valued the housing stock at £28m and this compares to the net book value of the housing stock as stated in the accounts of £20m. The uplift of £8m was not shown in the balance sheet but the above approach was described as a note to the accounts.

Relevant Issues and Challenges

The management, development and financing of social housing is complex and this organisation appears to have developed comprehensive systems to merge their business. AHS have a loan portfolio of £18m and this funding has been provided by a total of five banks or building societies.

The issues that this organisation faces in the future include:

- The supply of land and the price of land (Often AHS will be competing with private developers for plots of land and this creates difficulties having regard to the economics involved).
- Significant costs involved in modernising and refurbishing the housing stock on a rolling basis.
- The possibility of a housing stock transfer and a way in which AHS can position itself for this. Perhaps consideration could be given to showing the existing use valuation of its assets in the balance sheet in order to increase the net worth of the organisation in the accounts.
- Scope for assisting other initiatives by drawing on AHS's considerable project management skills and experience.

Appendix B3

Case Study – COPE

Summary

Sector	Social Firm – Social Care and Support (Adults with learning difficulties)
Turnover	£439,000 (March 2003)
No of Staff	18
Asset Value	£165,000 (March 2003)

History and Background

Community Opportunities for Participation in Enterprise ('COPE') started in 1997. It provides learning opportunities and work experience for adults living in Shetland who have learning difficulties. The organisation operates a number of retail trading activities.

Objectives

COPE seeks to support and assist adults with learning difficulties in Shetland by providing learning and employment opportunities.

Legal and Management Structure

COPE is a company limited by guarantee and is recognised as a charity by the Inland Revenue. Membership of COPE comprises Shetland residents who have expressed an interest in the company's activities and objectives.

Description of Activities

COPE has developed the following retail trading activities:

Horticultural Nursery	A variety of shrubs and trees are propagated and these products are available to a number of retail outlets in Shetland. There are now plans to double the size of the nursery and effectively create a garden centre in Shetland.
Sandwich Bar	This catering unit produces an extensive range of sandwiches, baguettes, ciabiattas etc and these are sold through some 14 retail outlets on the Island.
Karibuni Café	This café specialises in meals and takeaway foods and also produces a variety of specialised coffee blends.
Soaps and Cosmetics	This production unit produces a range of hand crafted soaps and cosmetics. This particular business unit has received interest outwith the islands because of its success and is now being franchised elsewhere within the Social Firms network.

In addition to the above existing business activities, COPE is currently preparing a feasibility study for the manufacture and distribution of bottled mineral water and lemonade.

The company has a total of 18 staff (4 of these have learning difficulties) and a further 26 volunteers with learning difficulties are provided with training and employment experience by the company.

Income Sources

COPE currently has a turnover of approximately £450,000 and of this, some £320,000 (71%) is generated from the above business units. The balance is sourced from the following public sector grants:

- Shetland and Islands Council Charitable Trust – A grant of approximately £100,000
- Community Fund – Funding for a dedicated post.
- Shetland Islands Council – Funding from the Carers Support Fund.

There are uncertainties around the continuation of the grant from the Shetland and Islands Charitable Trust and COPE is currently negotiating a service contract with the

social work department for the delivery of support services for local people with learning difficulties. It is expected that the amount of this contract will be approximately £100,000.
The audited accounts for the year ended 31 March 2003 show a total turnover of £439,000 and a net surplus for the year of £12,886.

Valuation of Assets

The company owns the property in which the Karibuni shop is located in Lerwick and also owns various items of equipment and motor vehicles. It has also carried out some leasehold improvements to some of the property leases and these costs have been capitalised in the balance sheet.
Fixed assets are shown in the accounts at cost less depreciation which is based on the estimated useful life of the asset.
In some cases, capital grants have been received in respect of fixed asset purchases and these are held in the balance sheet as a deferred capital grant and released into the income and expenditure account based on their economic lives to calculate the depreciation.
The property at Lerwick was purchased for £33,000 and the company negotiated a loan with the Bank of Scotland for 80% of the purchase price. The loan was repayable over 5 years. A business plan together with underlying financial projections was prepared in support of this loan application. It is estimated that this property now has a value of approximately £40,000.

Relevant Issues and Challenges.

This organisation has significantly expanded its activities over recent years and has been successful in discovering niche markets in which it has been able to carryout its operation.
The next significant development is the mineral water and lemonade project and it has been estimated that the start up costs for this will be approximately £80,000. Initial discussions have already been carried out with the Bank of Scotland regarding a loan for 75% of this cost.

Appendix B4

Case Study – Taigh Chearsabhagh

Summary

Sector	Arts and Heritage
Turnover	Circa £190,000
No of Staff	4 Full Time and 4 Part Time
Asset Value	Circa £700,000

History and Background

Taigh Chearsabhagh was established in 1993 as a joint venture between two existing organisations – North Uist Historical Society and Uist Art Association. The organisation's joined forces with the aim of establishing a new arts and heritage centre within the area.

A derelict building in Lochmaddy was identified that was owned by North Uist Estates Trust. The building was in a poor state of repair and required extensive upgrading. The 'B-listed' building was leased (75 years) from North Uist Estates Trust at a rent of £500 per year. Capital funding for the refurbishment was provided by Western Isles Enterprise, Leader 1; Foundation for Sport and Arts; and Western Isles Council. The total cost of refurbishment was £270,000. A small loan for the work was also provided by the Architectural Heritage Restoration Fund.

The new centre was formally opened in 1995 and was extended in 2000 with grant support through Scottish Arts Council; National Lottery Fund; Western Isles Enterprise and Western Isles Council.

Objectives

Taigh Chearsabhagh operates the arts and culture centre based on the following objectives:

- To generate employment, interest and activity in the arts and heritage
- To strive for quality and innovation
- To provide a meeting place for people and ideas

Legal and Management Structure

Taigh Chearsabhagh operates as a company limited by guarantee and is recognised as a charity by the Inland Revenue. The two organisations North Uist Historical Society and Uist Art Association have retained their own independent status and identity. The company manages the building and employs the staff. The two groups are responsible for the programming of the centre.

The centre manager is responsible for day-to-day management.

Description of Operations
The museum and arts centre is located close to the harbour in Lochmaddy and attracts over 30,000 visitors each year. The centre provides a range of facilities including:

- Museum
- Gallery space
- Studio space
- Meeting area
- Café
- Shop
- Toilets

Since the inception of the centre, the café has been operated on a franchise basis. This approach was designed to minimise the risk for the company during the start up phase. The centre manager was funded through the Workers' Educational Association (WEA) Graduate Placement Scheme. This post is now funded from generated income through the shop, café income, entrance fees etc.
Grant funding was secured through the Scottish Arts Council in 1997 to enable the organisation to employ an arts development worker. This post is now funded as part of the mainstream grants programme from the Scottish Arts Council. Revenue support was also secured through Arts Council Lottery Fund to cover the cost of employing an arts education worker. This post terminates in June 2004 and the organisation is now looking towards ongoing support for this activity.
The organisation has been extremely successful in its work and has secured a number of awards including the Dynamic Place award 2001 and the BURA award in 2001.
Income Sources
The organisation has an annual turnover of £191,000 with approximately 85% through grant sources. An outline of the main income sources for 2003 is as follows:

Donations and Grants		
Capital Grants	13,257	
Revenue Grants	138,671	
SAC Grant	11,000	
In Kind support	810	
	163,738	*85%*
Income from Operating Activities		
Art Sales commission	1,789	
Admissions	2,700	
Rental – Café	2,600	
Rental – Premises	9,480	
Workshop Income	1,449	
Western Isles Enterprise IIP contribution	656	
	18,674	*10%*
Other Income		
Interest	1,163	
Post Office income	7,758	
Increase in carrying value of investment	341	
	9,262	*5%*
Grand Total	£191,674	*100%*

The accounts indicate that the organisation generated a surplus for the period of approximately £15,000.

Valuation of Assets

The assets of the organisation comprise of the leasehold property along with various items of equipment and artefacts. Fixed assets have been shown at cost and all assets have been depreciated over their useful lives. The accounts have been adjusted in 2003 to include provision for the deferred capital grant that was used for the refurbishment and extension of the building.

Relevant Issues and Challenges

The main issue faced by the organisation in terms of its asset base, is the position that the property has been secured on a leasehold basis with restrictions in relation to the use and disposal of the building. This position limits the scope of the organisation to generate loan funding on the basis that the property cannot be used as security.

On a positive note, the experience of Taigh Chearsabhagh also highlights the value of joint working at a local level. It was suggested that the particular benefits of the approach included:

- Combining the work of the two organisations has enabled them to achieve their respective objective of establishing a facility within the area.
- The approach provided a vehicle for sharing the risk between the two organisations
- The approach has resulted in significant synergy between the arts and heritage activity.

Appendix C
Focus Groups and Consultations

1. Focus Group – Community Businesses

Name	*Organisation*
Hassel, Harry	Coigach Community Hall
Hendry, Frances	Nairn Little Theatre
Jones, John	Kyle and Lochlash Social Firm Development Group (Touchwood)
MacKenzie, Kenny	Assynt Crofters Trust Ltd
Mclean, Karen	Social Firm Scotland
Morrison, Fergus	Golspie Recycling and Environmental Action Network

2. *Focus Group – Banks and Professionals*

Name	*Organisation*
Forgie, Peter	French Duncan, Chartered Accountants Clydesdale Bank Plc
Franksen, Stuart	Lloyds TSB Bank Plc
Fulford, Andrew	French Duncan, Chartered Accountants
Gray, Alistair	Wylie Bisset, Chartered Accountants
McErlane, Vince	Unity Trust Bank
Phillips, Stephen	Burness, Solicitors

3. *Consultations and Interviews*

Name	*Organisation*
Anderson, Andrew	Highlands and Islands Enterprise – Community Land Unit
Anderson, Scott	Social Investment Scotland
Causland, David	Tridos Bank
Critchley, Cathy	Social Firms Scotland
Edwards, Aileen	EQUAL Programme – Dunbartonshire LEC
Grimes, Alistair	CEiS
Gronbach, Shona	EQUAL Programme – Communities Scotland
Higgins, Chris	Highlands and Islands Enterprise
Hope, Jeff	VIU
McKay, Neville	Scottish Executive – Voluntary Services Unit
Munro, Eric	Royal Bank of Scotland (Community Finance and Social Enterprise)
Paton, Sandy	Charity Bank (previously head of commercial banking with Bank of Scotland).
Pope, Geoff	Scottish Executive – Voluntary Issues Unit
Robb, Stuart	Scottish Executive – Voluntary Issues Unit
Sloan, Duncan	Royal Bank of Scotland (Community Finance and Social Enterprise)
Wood, David	Research Officer with the Institute of Chartered Accountants in Scotland

Appendix D

Summary of Banks [17]

Charity Bank	
Specialist Community Banking Section?	N/A – This is a social bank
History	Established in 2002 by Charities Aid Foundation. A not-for-profit bank set up to assist organisations delivering social, community and charitable products
Types of finance assistance available?	Provides loans and bridging finance to assist with the time lag in grant payments. Will lend up to £250,000. Do not provide current account facilities
Types of security required?	Will secure over property if possible but may lend on an unsecured basis. Do not have a policy of taking personal guarantees
Social Investment Scotland	
Specialist Community Banking Section?	N/A – This is a social bank
History	Public/private /voluntary sector joint venture. Provides financial assistance to social enterprises operating in Scotland
Types of finance assistance available?	Provides loans, bridging finance to assist with the time lag in grant payments and finance for working capital. Will lend up to £200,000.
Types of security required?	Will secure over property if possible but may lend on an unsecured basis. Do not have a policy of taking personal guarantees
Unity Trust Bank	
Specialist Community Banking Section?	N/A – This is a social bank
History	Established in 1946 by the trade union movement. Provides financial assistance for trade unions and organisations within the social economy
Types of finance assistance available?	Short and long-term loans available
Types of security required?	Assessed on the merits of each proposal
Triodos	
Specialist Community Banking Section?	N/A – This is a social bank
History	A larger European ethical bank. Lends to organisations which create environmental, social

[17] This data was obtained from research undertaken by MCM Associates, SCVO and the publication 'Taking Out a Loan – A Guide to borrowing for social economy organisations in Scotland' published by Social Investment Scotland. It should be made clear that the above details are subject to change at any time

	or cultural benefit.
Types of finance assistance available?	Will lend up to £10m
Types of security required?	Normally all loans will be secured and would be willing to take personal guarantees based on a community of guarantors where each guarantee was limited to a specified amount (usually £2,000)

Highland Opportunity Ltd	
Specialist Community Banking Section?	N/A – This is a loan fund
History	The Enterprise Trust for the Highlands. Its Community Enterprise Loan Fund was launched in 2003. Will provide financial assistance to non-profit making community-based organisations in the Highlands.
Types of finance assistance available?	Will make loans up to £50,000
Types of security required?	Not known
Royal Bank of Scotland	
Specialist Community Banking Section?	Yes – ‘Community Development Finance’
History	Has established 11 community finance funds to support community businesses which are viable but not bankable. Initiative must show financial and social benefits
Types of finance assistance available?	Flexible loan sizes depending on proposal
Types of security required?	Flexible depending on proposal
Bank of Scotland	
Specialist Community Banking Section?	Yes – ‘Community Banking’
History	The Community Banking department was set up to provide assistance to the voluntary sector and social economy organisations
Types of finance assistance available?	Loans, bridging finance etc
Types of security required?	Security is normally required
Activity levels in Highlands and Islands?	
Lloyds TSB plc	
Specialist Community Banking Section?	No
History	The bank will consider loan applications from social economy organisations
Types of finance assistance available?	Flexible loan sizes depending on the proposal
Types of security required?	Flexible depending on proposal
Clydesdale Bank plc	
Specialist Community Banking Section?	No
History	Some experience in lending to organisations within the social economy
Types of finance assistance available?	Loan and overdraft finance
Types of security required?	Flexible depending on proposal