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Towards an international statement of recommended practice (iSORP) for co-operative accounting and reporting

Centre of Excellence in Accounting and Reporting for Co-operatives (CEARC)
Saint Mary's University, Halifax, Nova Scotia

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1. INTRODUCTION

> "*Although co-operatives have been active for over 150 years and are dominant in many marketplaces … they are not very well understood. More often than not standards and rules which have been developed for public stock companies are applied to co-operatives with no change to recognize the unique characteristics and purposes of co-operatives."*
>
> (Bardswick, K. The Co-operators comment letter to IASB, 2004).

Co-operatives do not always fit well into accounting frameworks designed with others in mind. Generally Accepted Accounting Principles (GAAP) and practice, focus mainly on publicly listed investor owned companies (IOCs). While non-profits, charities, and the public sector are accommodated within specific accounting standards and/or guidance, co-operatives are rarely glimpsed. Yet significant differences are to be found in the co-operative member ownership structure, and co-operative purpose, values and principles (ICA, 1995).

This lack of visibility and recognition in accounting can be problematical. One example is in relation to the search for universally applicable accounting definitions and classifications of financial instruments as equity or liabilities. The co-operative response to the International Accounting Standards Board (IASB) 2003 revision of International Accounting Standard (IAS) 32: *Financial Instruments: Disclosure and Presentation,* and the subsequent introduction of IFRIC 2: *Members shares in co-operative entitities* (IASB, 2004), highlight the difficulties of addressing co-operative difference within an accounting framework designed for IOCs.

Furthermore, the issue refuses to go away. The IASB and the U.S. Financial Accounting Standards Board (FASB) long term project on liabilities and equity is revisiting classification of financial instruments. The FASB has stated a preference for an 'ownership approach' to equity classification, recently modified to include only direct ownership instruments (FASB, 2007) and requiring a direct ownership instrument to have "a proportional claim to a share of the net assets of the reporting entity that is neither limited nor guaranteed" (FASB, 2006). Such a characteristic is not necessarily a feature of co-operative member shares.

While equity is a major issue for co-operatives, we should not make the mistake of thinking that co-operative difference only relates, in accounting, to financial instruments. There are other areas of potential difference arising from member ownership, purpose, values and principles.

A voluntary international Statement of Recommended Practice (iSORP) for accounting and reporting by co-operatives has the potential to make co-operatives more visible in accounting, to encourage wide debate and to draw on the experience and knowledge held within the co-operative sector itself. Providing a co-operative focus and supplementing existing GAAP.

CEARC proposes to develop a draft iSORP on accounting and reporting by co-operatives, with a view to exploring its potential for addressing the points made in the quote at the start of this introduction. This research project aims at both building a practical accounting tool for co-operatives, while also providing a means for researching, discussing and developing a co-operative accounting perspective.

2. WHAT IS A SORP?

A SORP is a form of sector specific guidance on accounting and reporting that operates alongside accounting standards but provides a means for giving expression to characteristics particular to a given sector. Definitions and applications of SORPs do vary from country to country. In Canada for example, there are two public sector SORPs which provide guidance but are not considered part of GAAP: “They are not prescriptive, but offer general guidance to encourage and assist public sector entities in effectively reporting relevant information that is useful in evaluating the entity's financial condition” (CICA, 2004, para 3).

In the UK, SORPs are viewed as supplementing accounting standards; taking account of the “special factors prevailing … in a particular industry or sector” (ASB, 2006, p.1), and they can be prescriptive. There are a wide range of UK SORPs including ones for: banking, charities, educational institutions, insurance, investment trusts, limited liability partnerships, local government, pension schemes, oil and gas and unit trusts. Recognised roles for UK SORPs include: reducing the degree of differing approaches to particular accounting treatments and the promotion of a particular preference where more than one option exists.

The Accounting Standards Board (ASB) recognises appropriate sectoral or industry bodies as SORP making bodies, which take on the task of developing their SORP, within set criteria, in conformity with a code of practice and without conflicting with fundamental accounting practice and standards. It is an interesting aspect of the UK approach that the ASB effectively hands over the job of developing a SORP to the particular sector or industry body. So, for example, the Further and Higher Education SORP is overseen by a board made up of representatives from educational bodies, funding bodies, accounting practitioners and the accounting standards board and is supported by the secretariat of Universities UK and a technical advisory group of education finance directors (ASB, 2003). This approach ensures strong sectoral representation and includes opportunities for wider consultation and discussion of issues across the sector membership.

The content of SORPs varies. The two Canadian public sector SORPs are relatively narrowly focused; one providing guidance on financial statement discussion and analysis and the other on public performance reporting. The UK banking SORPS take a similar approach, with separate SORPs providing guidance on: segmental reporting, contingent liabilities, derivatives, securities and advances. But SORPs can also be comprehensive single documents. For example, the U.K. charity SORP (Charity Commission, 2005) runs to 121 pages and has extensive guidance on a range of accounting subjects, including sections devoted to the financial statements layout and classification of income and expenditure.

SORPs can be kept up to date through a review process which includes consultation within the sector and with revisions occurring relatively frequently. For example the first UK charity SORP was produced in 1988 and has since undergone three revisions, with new versions published in 1996, 2000 and 2005. It is worth looking at the UK charity SORP in a little more detail to see how it functions and how it engages with the sector.

The SORP is developed by the Charity Commission and the Office of the Scottish Charity Regulator (OSCAR), working with a SORP committee that currently (Charity Commission, 2007) has a membership made up of:

- Three persons from the Charity Commission and OSCAR
- Six sector finance directors
- Four charity auditors
- Four broader sector/public interest members (currently including a CEO, an independent examiner, a professor and a senior research analyst).

The committee is voluntary and is provided with legal and administrative support by the Charity Commission and OSCAR (these two organizations constitute the joint SORP making body). An annual review is conducted by the joint SORP making body and the committee, which looks at: implications of new and proposed accounting standards, evidence of any widespread failure to adopt any of the guidance, and any developments in the sector that might require new or revised guidance. Proposed revisions go through the following process:

- SORP committee agreement on a consultative draft
- Comment and recommendation from authorized external bodies
- A formal three month consultation period
- Consultation feedback, with amendments agreed by the SORP committee
- A final review and recommendation from the relevant external body and securing of the Accounting Boards Statement to attach to new SORP

In this way, adoption of a SORP can result in a continual, dynamic process of review, consultation and development. Both responding to and effecting change.

Why have an international SORP?

International Financial Reporting Standards (IFRS) are becoming increasingly important, as the process of global accounting harmonization continues. The recent production of the draft *IFRS for Small and Medium Sized Entities* (SMEs) (IASB, 2007) is a significant step in this process; further strengthening the influence of international financial reporting standards beyond listed companies. The IFRS for SMEs aims to provide non-mandatory guidance for unlisted entities, while recognising local variations in its applicability. It provides us with an example of the development and feasibility of accounting guidance for unlisted entities at the international level and it also provides us with another example of the lack of visibility of co-operatives within standards setting. An iSORP for co-operatives has the potential to provide a timely response at the international level; flexible enough to allow for adaption to local laws, regulations and standards, but at the same time providing a shared view on co-operative accounting and promoting understanding of co-operative difference.

3. EXAMPLES OF iSORP TOPICS

The co-operative iSORP would aim to assist those involved in the preparation of co-operative annual reports, including financial and non-financial reporting; the goals being to:

- Improve the relevance, comparability and understandability of information in the report, with recognition of members as one of the main audiences.
- Improve the quality of financial reporting by co-operatives.
- Explain and recommend treatment of co-operative specific transactions.
- Explain and recommend co-operative specific non-financial reporting content, including non-financial measures of co-operative performance.
- Where appropriate, clarify, explain and interpret application of particular accounting standards to the co-operative context.

What follows is an initial look at translating the above into examples of potential iSORP content:

Classification of members' financial instruments

An iSORP could explain and clarify practice regarding the classification of members' shares as equity or debt. This could include recommendations on how to account for and report on shares along with suggested disclosures regarding the reasons for the classification. Examples of good practice could be included, with appropriate cautionary information in regard to their applicability across differing local GAAP.

Reporting member interests/funds on the balance sheet

Following on from the issue of classification of members' financial instruments the iSORP could recommend a balance sheet layout that highlights the amount of member interest in and monetary commitment to the co-operative. This could also extend to recommendations on how to present retained earnings, where members do not have a claim on the residual assets, along with how to disclose and explain this in the notes.

Payments to members and the community

There are a variety of approaches adopted by co-operatives in reporting on patronage returns, refunds, interest, dividends, and donations. The variation is partly related to presentation and the language used to describe particular items on the financial statement and partly the variation in their recognition as distributions or as expenses. Recommended practice could set down favoured approaches to accounting and reporting of each type of payment and could emphasize the importance of clarity of information for the user.

Reserves

Reserve funds can be an important source of capital for co-operatives. Co-operatives are sometimes required by regulation to build and maintain an appropriate reserve; yet co-operatives often do not disclose a reserves policy or indicate their goals, achievements and future plans in this regard (Hicks, Maddocks, Robb and Webb, 2007). An iSORP could recommend items to be disclosed, with a view to improving accountability and stewardship.

Definition of co-operative accounting terms (glossary)

We have already touched on the language of accounting. In the interests of clarity, standardisation and plain language, a list of relevant accounting terms and definitions could be included. There is also a question of how far co-operatives want to go in using language to emphasize co-operative difference. Potential candidates for review could include 'distribution' and 'dividend', and we might also want to consider whether the word 'surplus' or 'profit' best describes the excess of revenues over expenses in a co-operative. Certainly there are variations in the application of these words by co-operatives and it would seem a reasonable goal to seek a standard approach to the use of these and other words.

Annual report, non-financial content

While there are certain items required by statute and regulation to be reported in annual reports, there still remains scope for inclusion of additional material that could expand existing entries to better explain the co-operative's activities. In addition, new sections could be considered, aimed at reporting on non-financial aspects of the co-operatives current performance and future targets. An iSORP could recommend information to be included and could also suggest a minimum standardized, comparable approach to social, ethical and environmental reporting. This might, for instance, include a minimum set of non-financial performance indicators; based on existing good practice found in co-operative reporting, but with a view to making them appropriate to a range of co-operative types and sizes.

Other areas where co-operative specific approaches could be considered

Below is a list of other potential topics for inclusion in a co-operative accounting and reporting iSORP. Some of these may not appear to require a differing co-operative approach, but the suggestion is that we could revisit them with a view to finding ways of reporting more fully on aspects of co-operative identity within current reporting requirements. For example, are there ways in which notes on related parties and economic dependence, could be improved to further explain relationships with other co-operatives and between members and co-operatives?

Areas for consideration include:

- Objectives, scope and purpose of co-operative annual reports and financial statements

- Statement of earnings and retained earnings/revenue account – presentation of information, structure and language
- Income recognition and disclosure
- Expenses/expenditure recognition and disclosure
- Balance sheet – presentation of information, structure and language
- Notes to the financial statements – Nature of co-operative and its activities
- Notes to the financial statements – Basis of preparation
- Notes to the financial statements – Member's interests in the co-operative and movement in member interests
- Notes to the financial statements – Related party transactions
- Notes to the financial statements – Economic dependence
- Notes to the financial statements – Board expenses, remuneration and benefits
- Notes to the financial statements – Education, training and information activities
- Notes to the financial statements – Type and cost of external report (audit or other report)
- Specific issues – Treatment of dormant membership shares and accounts
- Specific issues – Reporting payments to members and the community
- Specific issues – Reporting volunteer board and staff time
- Specific issues – Accounting and reporting worker sweat equity
- Specific issues – Patronage returns
- Specific issues – Housing co-op treatment of land and property
- Specific issues – Analysis of transactions with members
- Specific issues – Business combinations
- Non-financial part of the annual report – administrative information; organizational structure, governance and management; purpose and activities; review and future plans
- Non-financial part of the annual report – co-operative performance re: member, social, environmental, ethical, and sustainability goals.

4. NEXT STEPS

CEARC proposes to begin the process by producing a series of draft papers on specific topics that would make up the components of a draft iSORP. The Centre will circulate the draft papers widely for comment and feedback, with dissemination achieved through the use of e-mail and access to a website. This consultative process will seek to involve interested national and international co-operative organizations, interested co-operative scholars, accountants, accounting bodies and co-operative businesses. A number of national and international co-operative associations have indicated an interest in serving as sources and conduits of feedback, including the Canadian Cooperative Association, the National Cooperative Business Association, the International Co-operative Alliance (ICA), Cooperatives UK and Cooperatives Europe. We would also solicit feedback from accounting bodies and boards including the CICA, FASB, IASB and ASB. The draft iSORP papers will be made publicly available through a website and comments will be welcome from all interested stakeholders.

Once feedback has been assessed, revised papers reflecting additional learning will be issued and added to the draft iSORP. The iSORP content is expected to cover a wide range of topics including matters relating to financial statements presentation, notes and disclosures, the annual report, members' shares and investments, payments to members and the community, reserves policies and co-operative social performance indicators. Initial iSORP draft papers to be produced by CEARC will include:

- the objective and scope of a co-operative iSORP,
- the purpose of co-operative accounts and reports,
- definition of terms (a co-op glossary).

Development of a co-operative iSORP will take time, as the papers, feedback and additional suggestions gradually fill in the gaps. The expectation is that a first version will be ready for dissemination in 2010 and will be made available online and in hard copy.

Preliminary work has already been done under funding available through the Social Economy and Sustainability Research Network (SESRN) directed by Dr. Leslie Brown and funded by the Social Sciences and Humanities Research Council of Canada. SESRN has provided funding to a research team composed of: Elizabeth Hicks, CA, MBA, of Mount Saint Vincent University Department of Business and Tourism; Tom Webb, MA, Program Manager of the Master of Management – Co-operatives and Credit Unions (MMCCU) program, Saint Mary's University; Professor Alan Robb, M Com, Adjunct Professor, Saint Mary's University, Canada and Co-operative Consultant, New Zealand, and John Maddocks, FCCA, BSc (Hons), Executive Director of CEARC and graduate student in the MMCCU Program. The MMCCU program is a partner in the research.

In addition to the work on an iSORP, the Centre is also researching particular co-operative accounting topics. Currently this includes collaboration on international research looking at defining co-operative member shares as equity or debt.

5. QUESTIONS FOR FEEDBACK

CEARC is keen to receive feedback concerning any aspect of this working paper and including the ideas and views presented. In particular we would be interested in your views on all or any of the following:

1. *Do you see current GAAP and the existing accounting framework as adequate in guiding co-operative accounting and reporting?*

2. *Is development of a co-operative iSORP a useful addition?*

3. *What, if any, of the issues covered under iSORP topics are currently of concern to you?*

4. *What other issues would you want an iSORP to provide guidance on?*

5. *To what extent do you think an iSORP can improve accountants understanding of co-operatives?*

6. *Should co-operative identity, purpose, values and principles influence co-operative accounting and reporting?*

7. *Is the proposed process of dissemination and feedback appropriate?*

Please send comments in writing by e-mail, mail or fax to:

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Please include your name and your organization's name and address.

Comments should be received by **28 February 2008**

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