Mar
2008

CEARC working paper 2

# Towards a conceptual framework for co-operative accounting

By Alan Robb
*Adjunct Professor, Saint Mary's University, Master of Management - Co-operatives and Credit Unions Program*

March 20, 2008

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

**CEARC working paper 2**

**Towards a conceptual framework for co-operative accounting**

**March 20, 2008**

The Centre of Excellence in Accounting and Reporting for Co-operatives (CEARC) is sponsored by:

- Saint Mary's University
- Canadian Institute of Chartered Accountants
- The Co-operators
- Midcounties Co-operative (UK)
- Co-operatives Branch – Service Nova Scotia and Municipal Relations
- Co-operative Housing Federation
- United Farmers of Alberta
- Nova Scotia Co-operative Council
- Scotsburn Dairy

Published by CEARC
Department of Management
Sobey School of Business
Saint Mary's University
Sobey Building, Robie Street
Halifax, Nova Scotia B3H 3C3


Executive Director:
John Maddocks

E-mail: john.maddocks@smu.ca

Website:
www.coopaccounting.coop

## CONTENTS

# 1. BACKGROUND

Comments received on CEARC working paper 1 included the suggestion that a desirable first step in the development of an iSORP for co-operatives is the enunciation of a conceptual framework. This is logical. A conceptual framework which is internally consistent and which defines basic concepts can lead to accounting standards and SORPs which are principles-based and consistent with each other.

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) are developing a common conceptual framework which, it is hoped, will improve upon the existing conceptual frameworks of both boards.

However, the IASB standard setting process is increasingly being criticized for its focus on the information needs of investors in large corporations. The idea that such standards can be 'sector neutral', or equally applicable to all entities, has been seriously challenged by the New Zealand Controller & Auditor General (Brady, 2007).

Brady noted that the reporting issues of most relevance to the public sector, such as the reporting of non-financial performance, were not being addressed; the IASB is unlikely to have considered types of non-commercial arrangements frequently encountered in the public sector, and that there are standards that need to be written just for the public sector that are not applicable to profit-oriented entities.

In each case Brady's comments apply equally appropriately to co-operatives and other entities in what may be described as the association sector (Mintzberg, Molz, Raufflet, Sloan, Abdallah, Bercuvitz & Tzeng, 2005).

Brady noted with approval that the International Public Sector Accounting Standards Board (IPSASB) is in the process of developing a framework for standard setting in the public sector. He believed it likely that the frameworks underpinning the IASB and IPSASB standards would ultimately contain "significant differences".

Again, Brady's comment applies equally appropriately to co-operatives and the association sector.

After careful and extensive discussion, it was decided that this framework would generally follow the structure of the IASB framework but the wording should be written more simply in order that it has the greatest relevance to co-operatives and may better lead to the development of a Statement of Recommended Practice for Co-operatives.

## 2. STRUCTURE OF THE IASB/FASB CONCEPTUAL FRAMEWORK

The IASB Conceptual Framework is being prepared in eight phases:

| Phase | Topic |
|---|---|
| A | Objectives and qualitative characteristics |
| B | Elements and recognition |
| C | Measurement |
| D | Reporting entity |
| E | Presentation and disclosure |
| F | Purpose and status |
| G | Application to not-for-profit entities |
| H | Remaining Issues, if any |

It seems likely that the final format of the Framework may differ in sequence, ‘Purpose and Status’ being the logical opening section of a Framework and ‘Remaining Issues if any’ being incorporated elsewhere in the document.

## 3. A CONCEPTUAL FRAMEWORK FOR CO-OPERATIVES

This conceptual framework is ordered in the following sequence:

- Purpose
- Objectives and qualitative characteristics
- Elements and recognition
- Measurement
- Reporting entity
- Presentation and Disclosure

In the following sections Arial type is used to designate the formal paragraphs of the conceptual framework with italics used for explanatory paragraphs.

### Purpose

1. This framework sets out the concepts that underlie the preparation and presentation of financial reports for members of co-operatives.

*Co-operatives operate on the principles of user-ownership, user-control and proportional distribution. They differ in many significant ways from investor-owned corporations. Consequently there is a need for a specific Conceptual Framework for Co-operatives.*

### Objectives and qualitative characteristics

2. Financial reports of co-operatives are designed to provide retrospective and contemporary financial information that is a guide to future action and to be a report of stewardship to members.

3. Financial reports will be serviceable if the data is representationally faithful and presented in a timely manner. This is the most fundamental principle.

*In order to be representationally faithful, data should correspond with observable evidence and be free from allocations.*

*Non-financial data is also of significance in reports of stewardship and in understanding financial data. The expression 'financial reports' is intended to encompass both financial and non-financial data.*

### Elements and recognition

4. The following elements are integral to the development of standards that are principles-based, internally consistent and lead to financial reporting that provides information of use to members of a co-operative.

**Financial position**: the ability of the entity to engage in indirect exchanges in the market place. It is measured by the monetary value in exchange of the assets and the monetary value in exchange of the liabilities as at a stated date. Financial position changes as a result of transactions, transformations and events.

**Transactions**: exchanges consciously entered into.

*Transactions are the most common cause of changes in financial position in any co-operative (or other entity).*

**Transformations**: changes made to the form of assets held by an entity.

*Transformations are common in manufacturing co-operatives (or other entities which process raw materials). Successful transformations will add value, unsuccessful transformations will destroy it. Regular revaluations to fair value recognize the value added or destroyed.*

**Events**: external occurrences which affect either the form in which assets or liabilities are held or the monetary unit in which they are expressed.

*Events, such as storms or fires, can have an adverse impact on financial position because of their effect on assets. Other events, such as a movement in foreign exchange rates or the rezoning of property, may have either a positive or negative effect. Traditionally only adverse events were recognized, on the grounds of conservatism. This view is now passing and it is recognized that financial reporting can be representationally faithful only if all events, whether favourable or unfavourable, are reported as they occur.*

**Assets**: the severable resources in the possession of an entity.

*To be consistent with the fundamental principle of representational faithfulness and to be serviceable in providing information that assists action in markets, assets can only comprise property or property rights recognized by law.*

**Liabilities**: the present obligations of an entity to non-members.

**Equity**: the interest of members in the assets of the entity. It may be either allocated equity (which may be withdrawn when the member leaves the co-operative) or unallocated equity (which remains in the co-operative when the member leaves).

**Income**: revenue and gains accruing to the entity whether from operating activities or elsewhere.

*Income is the gross inflow of resources other than from borrowing or from direct contributions from members. (Note, this is an inflow on an accrual basis, not a cash basis).*

**Expenses**: outflows or depletions of assets whether arising from operating activities or other causes.

*Expenses and losses are diminutions in assets other than those caused by the repayment of liabilities or by distributions to members.*

**Patronage rebate**: a distribution made to a transacting shareholder in relation to that person's transactions with the co-operative over a period. It may be made partly in cash and partly in shares or other financial instruments as part of a capital redemption plan.

**Investor shares**: shares on which dividends are paid as a return on investment and not as a patronage rebate.

**Member shares:** shares which confer membership of a co-operative. In some co-operatives these are held in conjunction with transactor shares.

**Transactor shares**: shares issued which entitle the holder to a patronage rebate.

5. Recognition. Financial position changes as a result of transactions, transformations and events. Financial statements should recognize all changes that can be reliably measured in a cost effective manner.

**Measurement**

6. In order to provide financial information that is both internally consistent and relevant for action all assets should be revalued regularly to fair value. Fair value is the net realizable value in the ordinary course of business.

*Knowledge of the fair value of assets is part of the information which is necessary to establish whether the co-operative is solvent. It may also be relevant for calculating the fair value of shares in the co-operative.*

7. The Income Statement should be all-inclusive. All revaluations should be recognized in the Income Statement as they affect financial position of the co-operative as much as gains or losses from other transactions, transformations or events.

*The constitutions of co-operatives may specify that revaluations be allocated to members when recognized, or retained as unallocated profits, or be distributed only to a designated type of charity on a winding up. This latter provision is designed to safeguard the co-operative against demutualization by individuals seeking windfall gains. The principle of disposal of net assets without profit to members was a constitutional requirement of the Rochdale Pioneers from 1854 and in some countries today, such as France, is currently a legal requirement.*

**Reporting Entity**

8. Where a co-operative has one or more subsidiaries or has a material interest in another entity, group data should be presented in addition to the co-operative's own financial statements. The group data need not be presented in consolidated form unless that form of presentation faithfully presents the obligations of the co-operative.

*Financial statements which consolidate related entities whose liabilities are guaranteed together with related entities whose liabilities are not guaranteed cannot be a representationally faithful presentation of the obligations of the co-operative. Alternative presentations, such as separate supplementary reports, should be used.*

**Presentation and Disclosure**

9. Financial reports should be prepared with due regard for materiality of the figures presented. Notes to the reports should be used to ensure that the information presented is understandable and neutral or free from bias.

10. In order to be useful to members, financial reports should comprise a balance sheet or statement of financial position, an income statement, and a statement of cash flows. Comparative data for the preceding periods should be shown.

*Comparative figures in an annual report would be for the previous financial year(s). In a half-yearly report it would be relevant to show comparative data for the corresponding half-year and for the previous full year.*

*Alternative names of the component parts of the financial report such as Profit & Loss Account and Balance Sheet are equally acceptable.*

11. The reports should clearly disclose the benefits of membership including the basis on which rebates are calculated.

*In some co-operatives the benefits of membership might not be received as rebates. A health co-operative may provide more accessible service; an education co-operative may provide improved teacher/student ratios and an enhanced curriculum.*

12. The reports should disclose the ways in which it has sought to comply with the seven co-operative principles of the International Co-operative Alliance.

*Co-operatives recognize their employees, managers and the community have a legitimate interest in the operations of the co-operative.*

13. The financial reports should be accompanied by non-financial information providing additional reporting on the activities and performance of the co-operative. Both the financial statements and the additional non-financial information should complement and, where appropriate, inform each other.

# 4. REFERENCES


Brady, K. Do NZ IFRS meet the public sector's needs? *Chartered Accountants Journal*, November 2007: 19-20.

Mintzberg, H., Molz, R., Raufflet, E., Sloan, P., Abdallah, C., Bercuvitz, R., and Tzeng, C. The Invisible World of Association, *Leader to Leader*, Spring 2005: 37-45.

## 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. *Does this working paper omit any key concepts which are necessary in a Statement of Concepts?*

2. *Does this working paper include any items which should be introduced in the proposed co-operative international Statement of Recommended Practice (iSORP)?*

3. *What expansion is needed in the items covered in this working paper?*

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


john.maddocks@smu.ca

John Maddocks
Centre of Excellence in Accounting and Reporting for Co-operatives (CEARC)
Management Department
Sobey School of Business
Saint Mary's University
Sobey Building
Halifax
Nova Scotia
B3H 3C3
Canada

Fax: 001 902 4205119


**Please include your name and your organization's name and address and indicate the working paper you are commenting on.**

Comments should be received by **31 July 2008**

Published by CEARC
Management Department
Sobey School of Business
Saint Mary's University
Sobey Building
Robie Street
Halifax
Nova Scotia B3H 3C3
Canada