

Financial Reporting in Societies: A Survey

by P A Collier and D Hutton

The article by Lord Gallacher in the January 1989 edition of the Journal included a comment that the form of accounts of retail Co-operative societies which he sees nowadays seems 'as much designed to obscure as reveal'. This contention is examined in a chapter on Co-operative societies in "Financial Reporting 1988-9" published by the Institute of Chartered Accountants in England and Wales.

The chapter critically reviews from two aspects the financial reports for the year ended January 1988 of the 22 largest retail Co-operative societies. First, the survey assesses the range of information given and the extent to which an effort is made to communicate financial data to users who, almost without exception, lack financial skills. Second, specific reporting issues that are currently relevant to retail societies are discussed, including the valuation of properties, depreciation policies, and the classification of various costs and revenues as normal, exceptional or extraordinary.

Contents of the Reports

The reports of the societies all contained the financial statements required under statutory regulations and statements of standard accounting practice. There were four main additional sources as follows:

(1) *Value Added Statements.* Since the 1975 Corporate Report, value added statements (showing the wealth created by a business and its distribution) have been seen as a useful alternative for presenting a firm's performance. Nine societies gave results in this form but only the Portsea Island society explained the meaning of the statement. Further there was little consistency in the preparation of the statements by societies with four of them failing to follow the Standing Committee on Co-operative Accounting (SCCA) recommendations that value added should be limited to normal trading and not be boosted by the inclusion of sundry income from asset sales and other sources. If these statements are to be of value, societies must adopt a consistent presentation and educate users into the purpose of the statements.

(2) *Comparative Data.* To enable users to measure performance over time, thirteen of the societies produced figures over five years. The clarity and breadth of information varied widely. The Plymouth and South Devon society

probably confused users by giving detailed revenue and balance sheet data for five years. A better approach was adopted by the CRS which grouped a few related statistics into revenue, asset and capital areas.

(3) *Segmental Information.* Historically Co-operatives were universal providers, and even today they provide food, dairy, non food, motor trades and funerals, each having very different profit margins. No societies give departmental profit figures in their published accounts but eleven analysed turnover across departments.

(4) *Diagramatic Presentation.* Little use was made of diagrams to assist members in understanding the financial statements. Only six societies had any diagrams and only a few topics were covered.

In general, it is difficult not to conclude that there is room for a considerable improvement in financial reporting if members are to be provided with the information necessary to enable them to participate fully in the affairs of the society. In particular there is a need to focus on salient figures rather than overwhelm the reader of the accounts with detail.

Accounting Policies

(i) *Fixed Assets.* Although retail Co-operatives are not property companies, all the societies surveyed had extensive property assets and in such circumstances information on the market value of properties is important if members are to appreciate the true worth of the business. Only two societies fully revalued property assets, two carried non-trade properties at valuation but no trade properties and three provided a note on market value. The remaining fifteen societies provided historic cost data only. The extent of undisclosed assets can be ascertained by the fact that for the seven societies the revaluation was on average three times the net book value.

Major retail companies carry properties in the balance sheets at current valuation and it is hard to understand why the users of Co-operative society accounts should have poorer information.

(ii) *Depreciation.* Given the homogeneous nature of Co-operative societies it might be expected that depreciation rates would be fairly consistent within major fixed asset classes. In fact this was not the case with depreciation rates for fixtures, fittings and plant ranging from 10 to 33.3%, for transport from 10 to 50% and for TV's for rental from 16.6 to 33.3 %.

However the major area of variation between societies was the depreciation of freehold land and buildings. Four societies depreciated freehold land and

buildings—an exceptionally conservative stance and at variance with accounting standards which do not allow land to be depreciated. Three societies did not depreciate either freehold land or buildings. The typical justification is provided by the Leicestershire society note: 'In the opinion of the directors, having regard to the regular refurbishment and maintenance referred to above, the estimated residual values of such buildings at the end of their economic life, based on prices prevailing at the time when the assets were acquired is not significantly different from the historic cost at which they are included in the accounts. Consequently any depreciation charge would not be material.'

Depreciation measures the wearing out, consumption or other loss of value of a fixed asset and therefore the Leicestershire approach is arguably justified. Nevertheless the accounting standard clearly states buildings 'should be depreciated having regard to the same criteria as in the case of other fixed assets.' The variety of approaches adopted to account for the depreciation of assets makes the comparability of performance between societies difficult.

(iii) Exceptional and Extraordinary Items. There was a lack of consistency in the treatment of surpluses on the sale of assets, usually properties, and redundancy costs in the accounts of the societies surveyed.

Three options exist: the items may be deemed 'normal' and accounted for in arriving at the surplus for the year; the items may be described as 'exceptional', which leads to them being disclosed separately and accounted for after the surplus for the year; and the items may be classified as 'extraordinary' and be dealt with after the surplus for the year after taxation and distributions have been calculated. The problem of classifying items in this way is not unique to Co-operatives. The decision hinges, first, on whether the items are sufficiently large to warrant separate disclosure and, second, on whether the transactions fall within or outside the ordinary activities of the business. Ordinary activities for this purpose include not only trading but also activities which are frequently or usually undertaken. For the decision taken to be appreciated by users of the accounts, it might be expected that a note to the accounts would detail the rationale behind any classification. Only two of the societies gave a policy note and in both cases it was to justify income and charges from rationalisation as being extraordinary.

Often the amounts involved are extremely significant. In the year ended January 1988 approximately a third of the surplus before distributions in the societies surveyed arose from the sale of assets with approximately equal amounts being treated as exceptional and extraordinary. In the accounts surveyed, ten societies classified the asset sales as exceptional, five as extraordinary and two classified the sale of trade properties as exceptional and

non-trade properties as extraordinary. The extent of the dilemma is best illustrated by the Central Midlands society which treated the property surplus in their 1985/6 accounts as part of the surplus in their revenue accounts but in the comparative figures in the 1986/7 accounts choose to reverse this decision and classify the items as extraordinary. No attention was drawn to this change in accounting treatment. Similarly closure and reorganisation costs showed inconsistencies in classification. Ten societies did not separately disclose the amounts, eight treated the costs as exceptional items and the remaining four classified the costs as extraordinary items.

For the accounts of societies to be readily comparable with each other it is important that the basis of classification as exceptional or extraordinary is explained to readers of the accounts and that the decisions made in particular circumstances are consistent.

(iv) Other Policies. As well as the accounting policy areas discussed other areas of inconsistency were identified including the disclosure of dividends as either an expense or distribution, the basis of calculation of the liability for dividend stamps and the capitalisation of interest and other costs on development projects. The lack of a common approach amongst societies makes it difficult to compare the accounts of societies.

Conclusions –

It is hard to avoid the conclusion that many Co-operative retail society accounts do not provide information in a manner which enables members to assess the success of the society over the past year and compare the performance of their society against other societies. Such shortcomings prevent members from pressurising boards into corrective action which may avoid more shop closures and job losses than would otherwise be necessary. Although members do not suffer any direct financial loss, it does run counter to the social goals of societies which include the protection of employees and the extension of the Co-operative sector of the economy.

The major problems identified are: (1) a lack of any real will by many societies to make accounts intelligible to members through reporting in a simplified form using diagrammatic presentations rather than swamping users in the overwhelming detail of full accounts; and (2) a failure of the societies to integrate their accounting policies so that the surplus and balance sheet values of each society have been calculated in the same way.

The rectification of these problems is not easy as accounts are essentially technical documents. However, there is no reason why Co-operative retail societies should not be in the vanguard of a movement to make the financial

performance of a body readily understood by users not versed in a thorough knowledge of accountancy. Without this information it is difficult to see how directors or members can participate meaningfully in the affairs of the society.

– And Recommendations

Steps to achieve this could involve:

- (i) Research into a simplified financial statement which highlights key performance indicators which can be sent to all members prior to the annual meeting.
- (ii) Monitoring by the Standing Committee on Co-operative Accounting of compliance with its recommendations and the encouragement by this body of a more unified accounting practice. In especially contentious areas like the classification of property sales as either exceptional or extraordinary, the SCCA might issue specific guidance on the criteria to be applied in deciding upon the correct accounting treatment.
- (iii) The SCCA should consider bringing the Accounting Standards Committee (ASC) into the picture. This could be achieved by seeking the ASC's endorsement of practice recommended by the SCCA – a process referred to as the “franked SORP” (Statement of Recommended Practice) mechanism. This would add additional authority to the SCCA's pronouncements.

The Authors

P.A. COLLIER is Lecturer in Accountancy in the Department of Economics, University of Exeter and a member of the Co-operative Studies Centre at the University.

DAVID HUTTON is a professional statistician who was a director of London Society 1976-1980 and of CRS 1981-2.