**UK SORP on financial accounting and reporting project**

**Focus group briefing**

***Introduction***

The purpose of this project is to work towards developing a more systematic approach to accounting and reporting for co-operatives and exploring specific aspects that justify the development of a Statement of Recommended Practice (SORP) in the United Kingdom (UK). SORPs, issued by 'SORP-making bodies', are recommendations on financial reporting, auditing and actuarial practices developed for specific sectors or industries, such as charities, higher education and pension schemes. Currently, there is no SORP or specific accounting standards for the co-operative sector in the UK.

Evidence of co-operative sector support for developing a SORP to address the unique needs of co-operatives was illustrated through the International Cooperative Alliance (ICA) unanimously passing a motion at its October 2019 annual meeting to develop international accounting standards for co-operatives. The motion builds on the work of the Audit and Risk Committee of the ICA and the Centre of Excellence in Accounting and Reporting for Co-operatives (CEARC), at Saint Mary's University in Canada.

A UK SORP Committee has been set up to provide the necessary groundwork and recommendations justifying and promoting co-operative accounting regulation change aiming at meeting the criteria set by the Financial Reporting Council, the UK accounting regulator, for the establishment of an authorised SORP-making body.

For more information on existing projects aiming at building an international co-operative SORP please read: https://www.smu.ca/academics/sobey/cearc-isorp-project.html

***Who is involved with the UK SORP project?***

- Co-operatives UK and its Co-operative Performance Committee (CPC), UK
- Centre of Excellence in Accounting and Reporting for Co-operatives (CEARC), Canada
- Elisavet Mantzari, University of Birmingham, UK
- Maureen McCulloch, Oxford Brookes University, UK
- Daphne Rixon, Saint Mary's University, Canada
- John Sandford, Independent Chair of Co-operatives UK's Co-operative Performance Committee
- Vivian Woodell, Co-operatives UK/Phone Co-op Foundation for Co-operative Innovation
- Ian Adderley, Financial Conduct Authority, UK
- Patrick Morrello, Third Sector Accountancy, UK

***Invitation to participate and comment***

- Please read this paper
- Attend the focus groups to provide input on the proposed areas requiring guidance
- If you are unable to attend the sessions, please email us with your suggestions and comments: Elisavet Mantzari, University of Birmingham E.Mantzari@bham.ac.uk

***What is the issue?***

- The co-operative and mutual model is an alternative to investor-oriented, philanthropic or state models into which we currently classify businesses.
- However, the accounting standards and formats available for financial reporting for co-operatives are currently either for-profit, such as IFRS or variants of these, or philanthropic.
- Most co-operatives use accounting standards created for investor-led businesses focusing on ensuring comparability of metrics which are of use to analysts working for institutional investors. These standards and metrics are developed with the needs of financial capital in mind, not the purpose of a co-operative, or the information needs of co-operative members. As such, they are not the most relevant to co-operatives, and some are at odds with co-operative values and principles.
- Accounting standards for charities and other "purpose driven" organisations, while perhaps offering some advantages, are also not ideally matched to the needs of co-operatives, since their focus is on demonstrating to stakeholders (primarily donors and beneficiaries) how resources were applied in meeting the needs of beneficiaries. They are not primarily designed to meet the reporting requirements of a trading business.
- This means that the co-operative difference is masked by the financial reporting being based on different organisational models which do not reflect the basis of the co-operative model, mutual interest, and co-operative principles and values[1].

***Why does it matter?***

- The co-operative mutual model presents an alternative to the current profit maximisation models for business. If properly understood by co-operative members and the wider public, the co-operative mutual model can lead the way in using market and other mechanisms for social and environmental benefit rather than financial returns.
- Accounting standards and formats for financial reporting designed to provide the right level of pertinent information to members and elected members in co-operatives can better facilitate governance within a co-operative by holding to account and ensuring they fulfil their responsibility of membership.

***What can be done?***

- Co-operatives need accounting standards which derive from a conceptual framework based on co-operative values and principles, reflecting the member-focused purpose of co-operatives.
- It makes sense, therefore, for the co-operative movement to explore and pursue the development of its own set of accounting standards, a "Co-operative SORP", designed to enable co-operatives to report against the key metrics which are relevant to their purpose, within a specifically co-operative conceptual framework that reflects internationally agreed co-operative values and principles. This would allow co-operatives to focus their reporting on the extent to which they are meeting the long-term needs of members, and on the delivery of member value.

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[1] ICA (2018). Cooperative identity, values & principles. International Co-operative Alliance. https://www.ica.coop/en/cooperatives/cooperative-identity

- Non-financial reporting would also be tailored to the specific requirements of a co-operative, in particular requiring co-operatives to describe the extent to which they are meeting member needs, as well as those of other stakeholders, in line with co-operative values and principles, and their strategy and prospects for delivering these things into the future.

***<u>Focus group feedback on particular accounting and financial reporting issues</u>***

The UK SORP committee is working towards developing workable recommendations addressing the key components of a UK SORP for financial accounting and reporting for co-operatives. Particular issues of concern the UK SORP committee have identified and are looking feedback on through focus groups are:

**Section 1 – Objectives, scope and purpose**

**1.1.What are the issues?**

Currently co-operative financial statements are not linked to the seven principles. Co-operative financial reports do not show whether and how a co-operative meets the ICA requirements. More information is required on how co-operative financial accounting and reporting can support the demonstration of how co-operatives meet the minimum ICA requirements of what a co-operative should be, particularly with respect to the seven principles. Another issue relates to identifying the importance for co-operatives to provide appropriate accounting information to third parties other than members, and potential members (please see appendix).

**1.2. How could the above issues be addressed in a UK Co-operative SORP on financial accounting and reporting?**

[Discuss]

**Section 2 – Co-operative Capital: reporting on co-operative members' funds and payments to members**

**2.1. What are the issues?**

2.1.1. Members' funds
The qualification of co-operative member shares as equity or liability has been an enduring accounting issue at an international level. The definition of equity under IFRS is the residual interest in the entity after the deduction of liabilities. A liability is understood as an obligation to another party. If equity is withdrawable, it is classified as a liability for the co-operative. These definitions separate the member from the co-operative by classifying the member as "another party", thus ignoring and obscuring the importance of social relations through member participation. The treatment of withdrawable equity reduces the co-operative's financial capital base which makes the co-operative appear weak within an investor-oriented analysis framework.

2.1.2. Payments to members

Under IFRS, patronage dividends/co-operative dividends/patronage refunds have to be shown as a reduction from revenue rather than being shown separately as a distribution because in the view of the standard-setters, the only valid distribution is one made by reference to capital ownership. As above, this accounting treatment of members' funds undermines the co-operatives' ownership base, distorts the financial position and separates the co-operative as an entity from part of its membership. This separation makes it harder to understand the basic principle of participation.

**2.2. What are your current practices/approaches related to reporting on co-operative capital and patronage payments?**

[Discuss]

**2.3. What are the issues/challenges you encounter in relation to reporting on co-operative capital and payments to members?**

[Discuss]

**2.4. How could the above issues be addressed in a UK Co-operative SORP on financial accounting and reporting?**

[Discuss]

**Section 3 – Reporting on expenditure**

**3.1. What are the issues?**

Expenditure can be seen as an application of financial resources or as a reduction in financial return. Classifying expenditure is deciding what costs are to be used in the calculation of profit and what are to be classed as returns to members for participating in the co-operative. As noted below, trade with members is not considered as generating a profit for tax purposes.

**3.2. What are your current practices/approaches related to reporting on expenditure?**

[Discuss]

**3.3. What are the issues/challenges you encounter in relation to reporting on expenditure?**

[Discuss]

**3.4. How could the above issues be addressed in a UK Co-operative SORP on financial accounting and reporting?**

[Discuss]

Section 4 – Tax considerations

4.1 What are the issues?

Identifying what is member trade and not member trade can have tax implications. From a tax perspective in the UK, the law has long recognised that 'a person cannot trade with themselves' and there is no liability to pay tax on any profits arising from mutual trade with members. This is reflected in mutual trading and member clubs tax treatment by Her Majesty's Revenue and Customs (HMRC, 2021). While only a subset of co-operatives will benefit from this tax treatment, the constitution of the co-operative and the way in which funds are generated and used is significant. Similarly, dividends in a co-operative have specific treatment under the Corporation Tax Act 2009.

**4.2. What are the potential tax implications for co-operatives based on the sections above?**

[Discuss]

**Section 5 – Reporting on non-financial participation and membership contributions**

**5.1. What are the issues?**

As noted in the overview above, co-operative financial reporting is not linked to the seven co-operative principles. Some co-operatives address this issue by reporting against the principles in their non-financial reporting – through key performance measures. The attached document in the appendix suggests a very basic framework for this sort of reporting.

Another issue which arises, chiefly for smaller and start up co-operatives, is that of volunteer time or "sweat equity".

**5.2. What are the current practices/approaches related to reporting on non-financial information?**

[Discuss]

**5.3. What are the issues/challenges you encounter in relation to reporting on non-financial information?**
[Discuss]

**5.4. How could the above issues be addressed in a UK Co-operative SORP on financial accounting and reporting?**
[Discuss]

## Appendix

**MINI CO-OP SORP ROPOSAL**

**Aim**

Co-operative accounts should show how the co-operative adheres to the co-operative principles. Some co-ops are co-ops in name only, which is unfair on co-ops that are actual co-ops.

**Scope**

Entities recognised by Co-operatives UK as co-operatives, on a voluntary basis.

| Co-operative principle | Narrative | Notes |
|---|---|---|
| Voluntary and open membership | Describe the qualifications for membership and the member recruitment process. | Disclose the number of members of the co-operative. |
| Democratic member control | Describe how members are able to participate in management. | Disclose the numbers of members attending meetings. |
| Member economic participation - worker co-operatives | Describe how members become workers, and how workers become members; what are the benefits of membership. | Number of workers who are members, compared to the total number of workers; total wages payments to members compared to total wages cost. |
| Member economic participation - consumer co-operatives | Describe how consumers become members and what the benefits of membership are. | Sales to members compared to total sales. |
| Member economic participation - members funds | Describe how members fund the business and what the economic return is on the funding. | Summary of funding from debt, reserves, and equity, and return paid to members under these headings. |
| Education, training and information | Describe training available to members | Disclose cost of member training. |
| Co-operation among co-operatives | Policy in relation to trading with other co-operatives. | Total sales to other co-ops, % of sales to other co-ops; total purchases from other co-ops and % purchased from other co-ops. |
| Concern for community | Describe how core activity benefits the community; describe any non-core activity that benefits the community. | Disclose cost of any non-core activity to benefit the community (e.g., charitable donations). |