Business Council of Co-operatives and Mutuals

Accounting Standards and Co-operatives: Proposed Solutions to the Problem of AASB 132

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About the Business Council of Co-operatives and Mutuals

The BCCM is the peak cross-sector body for co-operatives, mutuals and member-owned businesses. Its purpose is to promote recognition of the important role of co-operative and mutual businesses in the economy and community development of Australia.

The sector represented by the BCCM is significant to the Australian economy. Including member owned superannuation funds; the contribution of the sector to GDP in 2012/2013 was 7 per cent[A].

The submission was authored by Duncan Wallace on behalf of the BCCM.

[A] "2014 National Mutual Economy Report", Business Council of Co-operatives and Mutuals (2014)

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1. Introduction

Monoculture – the agricultural practice of producing or growing a single variety of crop[1] – has increased dramatically world-wide in the post-WWII period[2]. Monocultures are strongly linked to biodiversity loss, which, in turn, has deleterious effects on security, resiliency, social relations, health, and freedom of choice and actions[3].

Homogenisation has also occurred in the socio-economic realm[4]. Government policy has increasingly encouraged the standardisation of enterprise types[5], with a single organisational form – the investor-owned corporation (ICO) – now overwhelmingly dominant. Joseph Stiglitz, former chief economist at the World Bank, has noted that governments have "focused too long on one particular model, the profit maximizing firm", and that we "need alternative models[6]". Fundamentally, this is owing to the fact that socio-economic ecosystems have numerous actors and stakeholders, including producers, workers, consumers, investors, the wider community and the environment[7]. The current investor-owned model of enterprise works to benefit only one stakeholder – the investor[8]. This is to the detriment of other stakeholders, who, at best, benefit only indirectly and, at worst, end up completely dominated[9].

As an illustration, the ongoing structural problems faced by the Australian economy and economies around the world - which the Global Financial Crisis was only a symptom of - are in large part due to the existing corporate monoculture. Investor owned companies are brittle in the face of – and their dominance often a cause of – financial crises and economic downturns. In contrast, co-operative and mutual forms of business enterprise (CMEs) have proved resilient in the face of crises and excellent mechanisms for smoothing the business cycle and ensuring stable economies[10].

For instance, in the UK, following the GFC in 2008, investor owned companies required substantial state support in the form of bail-outs whilst mutual building societies weathered the crisis unscathed[11].

The necessary implication is that, like the need for biodiversity, we need enterprise-diversity so that all stakeholders can have their needs served[12].

1 Connor, Loomis, and Cassman, Crop Ecology: Productivity and Management in Agricultural Systems (Cambridge University Press, 2nd ed., 2011) 44.

2 Altieri, 'Modern Agriculture: Ecological impacts and the possibilities for truly sustainable farming' Agroecology in Action (2011), viewed 4 April 2016, <http://nature. berkeley. edu/~ agroeco3/index. html>.

3 World Resources Institute, 'Ecosystems and Human Well-being: Biodiversity Synthesis' (2005), viewed 4 April 2016, <http://www.unep.org/maweb/documents/document.354.aspx.pdf> vi.

4 The two are linked. See Michaels, Monoculture: How One Story Is Changing Everything (Red Clover Press, 2011).

5 Henry, Guidelines for cooperative legislation (International Labour Office, 2012) 14.

6 Stiglitz, 'Moving Beyond Market Fundamentalism To A More Balanced Economy' (2009) 80(3) Annals of Public and Cooperative Economics 359.

7 This matches the classic definition of an ecosystem: Smith and Smith, Elements of Ecology (Boston: Benjamin Cummings, 8th ed., 2012) 5.

8 Andrew Haldane, Executive Director for Financial Stability, Bank of England, has stated that "We have arrived at a situation in which the ownership and control of banks is typically vested in agents representing small slivers of the balance sheet, but operating with socially sub-optimal risk-taking incentives. It is clear who the losers have been in the [Global Financial Crisis]." 'The Doom Loop' (2012) 34(4) London Review of Books 22.

9 See, for example, Chomsky, Who Rules the World? (Metropolitan Books, 2016).

10 Birchall Resiliance in a Downturn: The Power of Financial Co-operatives (International Labour Office, 2013); and Birchall and Ketilson, Resilience of the Co-operative Business Model in Times of Crisis (International Labour Office, 2009). See also Novkovic, 'Defining the Co-operative Difference' (2008) 37.6 The Journal of Socio-Economics 2168-2177; and Ernst&Young, 'Sticky Money -Recognising the total value created by Australian Co-operatives and Mutuals' (2014).

11 Mutuo, 'Raising New Capital in Mutuals – Taking action in the UK' (2013), viewed 4 April 2016, <http://www.mutuo.co.uk/wp-content/uploads/2013/11/Raising-New-Capital-in-Mutuals.pdf> 6; and Birchall and Ketilson, above note 10.

12 See International Co-operative Alliance, 'Blue Print for a Co-operative Decade' (2013), viewed 4 April 2016, <http://ica.coop/sites/default/files/media_items/ICA%20Blueprint%20-%20Final%20 version%20issued%207%20Feb%2013.pdf> Chapter Two.

In Australia (though this is not the only jurisdiction where this has occurred[13]), one way that government policy has encouraged the standardisation of enterprise types is through its legislated accounting standards. Adopted in 2005, the current accounting standards discriminate against co-operative enterprises by putting them at a disadvantage compared to IOCs when it comes to seeking external finance. This is due to accounting standard AASB 132 classifying co-operative share capital as debt on the co-operative balance sheet, whereas the share capital of an IOC is treated as an asset.

This paper will provide the first comprehensive overview of the effect of accounting standards on co-operatives in Australia. In the following I shall define what a co-operative is before outlining the legal regime in place for the application of accounting standards to co-operatives. I shall then detail the problem with current accounting standards – particularly AASB 132 - before suggesting six potential solutions. I shall conclude that the most appropriate solution is to develop a separate set of accounting standards purposefully designed for CMEs (Solution Six).

2. What is a co-operative?

Investor-owned corporations, state Kraakman et al, are "effectively a special kind of producer co-operative, in which control and profits are tied to supply of a particular type of input, namely capital[14]". Due to the tremendous growth in the size of IOCs, however, there has been a separation of ownership of the corporation from control[15]. Large public corporations have large numbers of shareholders with a small and transient stake in the corporation they own[16], which results in shareholder "rational apathy" with regard to how the corporation is run[17]. It has therefore been left to the courts to interpret what it means for corporate directors – the corporate controllers – to act "in the best interests of the corporation[18]". Their understanding has been that this means the best financial interests of shareholders, and that other interests can be taken into account only so far as this is consistent with shareholders' financial interests[19]. Interests other than financial interests are thus filtered out.

This is an explicit policy of corporate law. Kraakman et al state that through the design of shares, owners are "induced" to have "highly homogenous interests". This means that the 'interests of shareholders' becomes a fiction removed from what shareholders might actually consider to be in their best interests. As stated by Glasbeek, "the best interests of shareholders are assumed to be a positive return on investments made" (emphasis added[21]). A positive return, say Lumsden and Fridman, is what a "powerful majority of shareholders actually want[22]", though they do not cite any evidence.

A capital co-operative, with its sole emphasis on financial gain, is quite distinct from other forms of co-operatives (including mutuals). These other forms I shall call 'true co-operatives', or else just 'co-operatives'.

13 Detilleux and Naett, 'Cooperatives and International Accounting Standards: The Case of IAS 32' (2005) 295 Recma.

14 Hansmann, and Kraakman, 'What is Corporate Law?', in R Kraakman et al (eds), The Anatomy of Corporate Law: A Comparative and Functional Approach (Oxford University Press, 2nd ed., 2009) 15.

15 For the pioneering study on this, see Berle and Means, The Modern Corporation and Private Property (Transaction publishers, 1991).

16 Note that the characterisation of shareholders as owners has consistently been thought wanting. The alternative has either been to deny the existence of a corporation which can be owned at all (Easterbrook and Fischel, The Economic Structure of Corporate Law (Harvard University Press, 1996)) or else to label shares as nothing more than debt instruments (Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public (Berrett-Koehler Publishers, 2012) 39; and Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 62.1 The Modern Law Review 32-57). See also Hansmann, The Ownership of Enterprise (The Belknap Press of Harvard University Press, 1996) ix and 11; and Blair and Stout, 'A Team Production Theory of Corporate Law' (1999) 85(2) Virginia Law Review 269.

17 Velasco, 'Taking Shareholder Rights Seriously' (2007) 41 UC Davis l. rev. 622.

18 Corporations Act 2001 (Cth) s 181(1).

19 See Austin and Ramsay, Ford, Austin and Ramsay's Principles of Corporations Law (LexisNexis Butterworths, 16th ed., 2015) [1.390].

20 Above n 14

21 Glasbeek, 'The Corporate Social Responsibility Movement – The Latest in the Maginot Lines to Save Capitalism' (1988) 11 Dalhousie Law Journal 363.

22 Lumsden and Fridman, 'Corporate Social Responsibility: The Case for a Self-Regulatory Model' (2007) 25 Company and Securities Law Journal 147.

True co-operatives are distinct from capital co-operatives in two key ways. First, members must be "active members[23]", in the sense that, in addition to providing capital, they use, support or maintain a relationship with the co-operative in order that the co-operative can carry on its primary activity[24]. This is in contrast to members of IOCs, who are required only to provide capital and can otherwise be passive, leading to the predominance of investor "absentee-owners[25]". Second, member control rights are detached from capital contributions through the one-member-one-vote rule[26], thereby enshrining democratic member control detached from the financial worth of members[27].

The active member provisions ensure that members have more than a transient stake in the co-operative they are a member of; with democratic member control ensuring that they have an equal voice with other members. Along with provisions which require the majority of directors to be active members[28], these design principles seek to guarantee that the way a co-operative is run is a true reflection of how members want it to be run, rather than its being a reflection of a judge-made legal fiction. Interests other than financial interests, rather than being filtered out, in a co-operative are positively encouraged[29].

A co-operative is therefore a "dual output model producing both financial and social returns to its members[30]", with directors maximising member "value[31]".

This includes the ability of the organisation to service the economic, social and cultural needs of its members, including future members[32]. This is reinforced by the fact that the Co-operative National Law (CNL), unlike the Corporations Act 2001 (Cth) (CA), must be interpreted to promote the seven co-operative principles adopted by the International Co-operative Alliance (ICA)[33]. These include democratic member control, education and training for members, co-operation among co-operatives and concern for the community. The principles are summarised by the ICA when it defines a co-operative as an "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise[34]".

Co-operatives are themselves diverse. There are customer, producer and worker co-operatives, amongst others. There are also distributing co-operatives, which are for-profit and may distribute surplus capital to their members[35], and non-distributing co-operatives, which are not-for-profit and are prohibited from distributing surplus capital to members[36].

23 Co-operative National Law (CNL) s 112. The CNL is a model law adopted by a number of states and territories under the Australian Uniform Co-operatives Laws Agreement (AUCLA). See, for example, Co-operatives (Adoption of National Law) Act 2012 (NSW).

24 CNL s 145.

25 See Veblen, Absentee Ownership and Business Enterprise in Recent Times: The Case of America (B W Huebsch New York, 1923) 3. For a general discussion of the literature see Pillay, The Changing Nature of Corporate Social Responsibility: CSR and Development in Context (Routledge, 2015) Chapter Two.

26 CNL s 228(2). However s 228(3) provides that the rules may provide for a member to have up to 5votes in a general meeting. Section 228(4) allows the rules to provide that the Chairman has a second vote at board or general meetings.

27 See Fajardo, 'Co-operative Finance and Co-operative Identity' (2012) 45 Euricse Working Paper.

28 CNL s 174.

29 See Novkovic, above n 10.

30 Apps, Submission No 28 to the Senate Economics References Committee, Cooperative, mutual and member-owned firms, 30 November 2015, 5.

31 Mazzarol, Limnios and Raboud, 'Co-operative Enterprise: A Unique Business Model?' (Paper presented at the Future of Work and Organisations, 25th Annual ANZAM Conference, Wellington, 2011) 14.

32 Henry, above n 5 at 38.

33 CNL s 10. These include democratic member control, education and training for members, co-operation among co-operatives and concern for the community.

34 International Co-operative Alliance, 'Co-operative identity, values & principles', viewed 4 April 2016, <http://ica.coop/en/whats-co-op/co-operative-identity-values-principles>.

35 CNL s 18.

36 CNL s 19.

3. The legal regime for the application of accounting standards to co-operatives

The Commonwealth government until recently had limited constitutional powers to legislate with respect to corporations[37]. The power did not extend to a power to legislate with respect to the formation of corporations[38].

The Commonwealth government gained such power by State referral[39], agreed to under the Corporations Agreement 2002[40]. Section 503 of the Agreement extends power to the Commonwealth to legislate with respect to corporations, including financial co-operatives (or mutuals[41]). The agreement does not extend, however, to non-financial co-operatives, amongst others[42].

A corporation is defined under the CA as any artificial person that can sue or be sued or can hold property, including companies and body corporates incorporated in any jurisdiction[43].

The subset of corporations to which the CA applies are called "companies[44]". Section 504 of the Corporations Agreement states that the "Agreement is entered into on the basis that the company is, and is expected to continue to be, the primary vehicle for corporate business enterprises. "The implication is that the co-operative form of business enterprise is not expected to be a primary vehicle for business enterprises. It is also thereby implicit that investors of capital are to be the primary beneficiaries and controllers of business enterprises and that other stakeholders in the socio-economic ecosystem will continue to be subordinate to investors of capital.

Co-operatives can still operate under the CA, though they are not allowed to use the term "co-operative" in their name[45]. Further, co-operative principles must be carried into an act principally designed for IOCs using the co-operative's constitution as the vehicle[46].

Co-operatives therefore principally operate under state and territory laws. There has been significant progress implementing in the various states and territories a nationally uniform law – the CNL[47]. The CNL is a model template adopted by all states and territories except Western Australia, Queensland and the Australian Capital Territory[48]. There are a number of problems inherent to the CNL as a non-federal instrument, but they are not the focus of this paper[49].

The accounting standards which apply to both companies and co-operatives are developed by the Australian Accounting Standards Board (AASB). The AASB is an Australian government agency[50] which must make accounting standards for the purpose of corporations legislation[51]. The AASB accounting standards apply to co-operatives registered under the CNL[52], unless modified or substituted for by the Co-operatives National Regulations[53].

37 The Australian Constitution s 51(xx) ("the corporations power") allows the Commonwealth to legislate with respect to "foreign corporations, and trading or financial corporations formed within the limits of the Commonwealth".

38 New South Wales v Commonwealth (1990) 169 CLR 482.

39 Under the Australian Constitution s 51(xxxvii).

40 A copy of the agreement, viewed 4 April 2016, is available at <http://archive.treasury.gov.au/documents/495/PDF/Corporations_Agreement_2002_as_amended.pdf>.

41 "Building societies, credit unions and friendly societies". Mutuals were converted to companies by legislation passed as part of a financial reform process in 1999. See Ralston and Beale, 'Financial Sector Reforms and Implications for Mutual DTIs in Australia' (2002) 13.2 Journal of Banking and Finance Law and Practice.

42 Others being State or Territory statutory authorities and incorporated associations.

43 Corporations Act 2001 (Cth) s 57A.

44 Corporations Act 2001 (Cth) s 9.

45 Corporations Act Regulations 2001 (Cth) reg 12.9.03, Schedule 6, Part 3, Item 6309.

46 ASIC states that they would then be a "relevant consideration". See Senate Economics References Committee, Parliament of Australia, Cooperative, mutual and member-owned firms (2016) 29.

47 Australian Uniform Co-operatives Laws Agreement (AUCLA). A copy of the agreement, viewed 4 April 2016, is available at <http://www.consumerlaw.gov.au/content/Content.aspx?doc=mcca/aucla.htm>. The CNL has been implemented in NSW, for example, under the Co-operatives (Adoption of National Law) Act 2012 (NSW).

48 The ACT is planning the introduction of its enabling laws in 2017 - Bright Law, 'Co-operatives National Law Update 2016' (2016), viewed 4 April 2016, <http://www.brightlaw.com.au/corporate-governance/co-operatives-national-law-update-2016/>. See also NSW Fair Trading, 'National Co-operatives Law Update Issue # 14' (2015), viewed 4 April 2016, <http://services.enews.fairtrading.nsw.gov.au/online/18262372-4.html> 4.

49 See Apps, Submission No 28 – 28.1 Supplementary Submission to the Senate Economics References Committee, Cooperative, mutual and member-owned firms, 30 November 2015.

50 Australian Securities and Investments Commission Act 2001 (Cth) s 226.

51 Australian Securities and Investments Commission Act 2001 (Cth) s 227(1)(b). The AASB must make standards under the Corporations Act 2001 (Cth) s 334.

52 CNL s 314(1)(a).

53 CNL s 314(3). The Co-operatives National Regulations are made under CNL s 612. A copy of the Co-operatives National Regulations, viewed 4 April 2016, is available at <http://www.legislation.nsw.gov.au/sessionalview/sessional/subordleg/2013-601.pdf>.

4. Problems with the AASB accounting standards with respect to co-operatives

The main problem with the AASB accounting standards for co-operatives is AASB 132 - Financial Instruments: Presentation[54]. This introduces a definition of equity which categorises co-operative share capital as a liability where previously it had been classed as an asset. This has the effect of dramatically altering the balance sheet of co-operatives. For example, when the new AASB standards came into force, the Yenda Producers Cooperative's net assets went from just over $7½ million to just over $900,000 overnight[55].

Under this regime, a co-operative will always show unfavourable debt to equity ratios compared to IOCs, which can make it difficult for co-operatives to secure external debt finance and so compete with IOCs. This encourages the standardisation of enterprise types and contributes to making other stakeholders in the socio-economic ecosystem subordinate to investors of capital.

5. How are debt and equity defined under AASB 132?

Paragraph 11 of AASB 132 defines a financial liability (a debt) as a contractual obligation to:

- "deliver cash or another financial asset to another entity"; or
- exchange assets or financial liabilities with another entity "under conditions that are potentially unfavourable to the entity"; or
- deliver a "variable number of the entity's own equity instruments[56]".

An equity instrument is defined as any contract which evidences a residual interest in the net assets of an entity[57]. That is, Equity = Assets – Liabilities.

A share in an IOC entitles the shareholder to certain control rights (such as to attend and vote at meetings), to share in any dividends declared and to share in the net assets of a company after it has been wound up[58]. Since there is no contractual obligation to declare dividends or repay the price of the share, a share in an IOC is not a financial liability[59].

By contrast a share a member holds in a co-operative corporation contains a contractual obligation to repay the member the amount paid up on the share when the member has resigned, been expelled or had their membership cancelled[60]. This must be paid within a year of such an event. This is a part of the co-operative principle that membership is open and voluntary[61], and means that co-operatives have a variable, rather than fixed, capital base[62]. This is what makes co-operative capital a debt under AASB 132 – there is no "unconditional right to refuse redemption of the members' shares[63]".

There are two approaches to accounting: the principles-based approach and the rules-based approach. The principles-based approach looks at the economic substance of an instrument or transaction; whereas the rules-based approach looks to bright-line thresholds and specific criteria[64].

54 Australian Accounting Standards Board, AASB 132 - Financial Instruments: Presentation (September 2011). A copy of the AASB 132 - Financial Instruments: Presentation, viewed 4 April 2016, is available at <http://www.aasb.gov.au/admin/file/content105/c9/AASB132_07-04_COMPsep11_07-12.pdf>.

55 Evidence to Senate Economics References Committee, Parliament of Australia, Sydney, 29 October 2015, 24 (Peter Calabria, Managing Director, Yenda Producers Co-operative); Yenda Producers Co-operative, Tabled Document No 1 to the Senate Economics References Committee, Cooperative, mutual and member-owned firms, 29 October 2015, 19.

56 Australian Accounting Standards Board, AASB 132 - Financial Instruments: Presentation (September 2011), Paragraph 11.

57 Ibid.

58 Austin, above n 19, [5.080], [17.100] and [17.200]. See also Lockhart J, Sydney Futures Exchange 1995 ACSR 166-7.

59 Corporations Act 2001 (Cth) s 254U. There is an anomaly, however, in AASB 132's classification of an instrument as an equitable instrument which, though in other respects like a share, contains a contractual obligation to wind up the company at the option of the instrument-holder (Australian Accounting Standards Board, AASB 132 - Financial Instruments: Presentation (September 2011) Paragraph 16C).

60 CNL ss 128, 163.

61 CNL s 10.

62 CNL s 76.

63 Chartered Accountants, 'FAQs AASB 132 – a number of my clients are co-operatives' (2010), viewed 4 April 2016, <http://www.charteredaccountants.com.au/Industry-Topics/Reporting/Publications-and-tools/FAQs-Reporting/FAQs-on-Analysis-of-AASB-standards/AASB132>.

64 Henderson et al., Issues in Financial Accounting (Pearson Higher Education AU, 15th ed., 2013) 858.

Whilst the AASB has stated its commitment to principles-based standards[65], this approach is not followed for AASB 132. Carlin et al. find that the AASB 132 definitions of debt and equity allow for "deviation from a substance over form approach" with the result that financial statements using the standards "may be seriously misleading[66]".

If the principles-based approach were followed, co-operative membership fees would be classed as equity. This is for the following reasons.

First, members pool their capital together as contributions for the co-operative's use in return for shareholders' rights, and not as advances. Co-operative reserves do not 'belong' in a traditional ownership sense to the members. They are "more like assets currently held by the body of members, almost as trustees for the purposes of the society". This is demonstrated in a number of ways:

- A co-operative may not repurchase shares if the co-operative is insolvent or likely to become insolvent as a result of doing so[68], and it cannot cancel membership if the co-operative is insolvent[69].
- If a member leaves, it does not need to repay the repurchase price for a 10 year period if the board of the co-operative considers that this would adversely affect the financial position of the co-operative[70].
- If the balance sheet of the co-operative last issued before either expulsion or resignation of a member discloses a loss, then there is a proportionate reduction in the repurchase price, though this does not apply to shares which are cancelled[71].
- If a person's membership is cancelled, however, they are still liable to contribute the nominal value of their former shareholding to the property of the co-operative if it is wound up within two years of their membership having been cancelled[72].
- Shares can only be repurchased at, or less than, the nominal value of the share[73]. In real terms, a co-operative will therefore repay less than what it received for the share[74].

As a result, share capital does not fit easily into the definition of debt as an obligation to deliver cash or assets to the member.

Second, the number of members, and so the share capital, of a co-operative is likely to remain steady if not growing while the co-operative remains a going concern. Beaubien has recommended the development of a "Redemption Contingency" which would allow co-operatives to estimate the number of shares that might be redeemed in the year ahead. He states that these shares should not be considered equity, though all others should. The redemption contingency will be small, however: perhaps 2% of total share capital[75]. Therefore, while the share capital will be variable, this is not under conditions likely to be unfavourable to the co-operative, particularly given the restrictions on repurchasing shares outlined above.

Third, members' capital is subordinate to other debts and so acts as a loss absorber[76]. Again, and given the above, shares are therefore not issued under conditions likely to be unfavourable to the co-operative.

65 Ibid 860. See also AASB Statement of Expectations, viewed 4 April 2016, <http://www.aasb.gov.au/admin/file/content102/c3/AASB_Statement_of_Expectations.pdf>.

66 Carlin, T M, Finch, N and G Ford, 'Hybrid Financial Instruments, Cost of Capital and Regulatory Arbitrage –An Empirical Investigation' (2006) 1.1 The Journal Of Applied Research In Accounting And Finance 44.

67 Pg 14 Mutuo report, citing Mills C, The Funding of Industrial and provident Societies

68 CNL s 107(5).

69 CNL s 160(1)(a).

70 CNL ss 128(1)(b)(i), 163(1)(b)(i) and 165.

71 CNL ss 128(3) and (4).

72 CNL s 450.

73 CNL s 107.

74 Unless the economy experiences deflation.

75 Beaubien, 'Co-operative Accounting: Disclosing Redemption Contingencies for Member Shares' (2011) 44.2 Jounral of Co-operative Studies 40. Contingent liabilities are dealt with under AASB 137 - Provisions, Contingent Liabilities and Contingent Assets.

76 CNL s 444(3), which applies Corporations Act 2001 (Cth) s 515.

Fourth, dividends can only be paid out of the net assets of a co-operative[77], and only 5% of the nominal value of issued share capital can be used to repurchase shares in any given year, unless additional shares have been issued to new or existing members[78], though this does not apply when membership is cancelled or a member resigns or is expelled[79]. The remuneration of members' shares therefore constitutes distributed profit and not a deductible cost as would result from a contractual obligation[80]. Along with the fact that members' capital is subordinate, shares therefore evidence a residual interest in the in the assets of a co-operative after deducting all of its liabilities.

The practical result is that the share capital of a co-operative may be reduced at the discretion of a member, though there are certain restrictions on this discretion which focus on the solvency of the co-operative. The same practical result is in place for IOCs: an IOC's members will, at their discretion, have the corporation reduce its share capital through share buy-backs, though, again, as under the CNL, there are certain restrictions on this discretion which focus on the solvency of the corporation[81].

That the practical result is the same is borne out by the evidence: due to share buy-back programmes, the net percentage of share issues in the total financing of IOCs in the USA between 1970 and 1989 was -8.8%[82]. An approach which looked at the economic substance rather than bright line thresholds – a substance over form approach - would therefore class both co-operative and IOC share capital as equity.

6. Proposed solutions

6.1. Solution One: Co-operatives can change to non-distributing co-operatives without shares but with an entry fee

An entry fee can be required of a member by a co-operative[83]. This fee does not have to be paid back. Recently suggested as a solution by the CEO of the Co-op Bookshop[84], this would allow capital to be raised which would count as an asset and not a debt.

There are two problems with this proposal. The first is dealt with under Solution Two. The second is that all co-operatives would have to function without shares and so as a not-for-profit[85]. In that case, they would not be able to distribute surplus funds to members. Currently, a co-operative's surplus funds can be distributed in proportion to either the economic contribution made to the co-operative by each member or the number of shares held by each member[86]. This acts as a motivator for members to increase the surplus earned by the co-operative. It would put co-operatives at a disadvantage to take this option away.

It should be noted that this solution has not been implemented by the Co-op Bookshop itself. The Co-op Bookshop is a non-distributing co-operative with shares[87].

77 CNL s 357(1).

78 CNL section 107(2). A co-operative may be exempt from this section if the conditions under s 107(3) are met, however

79 CNL ss 128 and 163.

80 See Detilleux, above n 13, 7.

81 Corporations Act 2001 (Cth) ss 256B and 257B.

82 Aglietta and Rebérioux, Corporate Governance Adrift: A Critique of Shareholder Value (Edward Elgar Publishing, 2005) 4. See also 95.

83 CNL s 124.

84 Above n 55, 37 (Peter Knock, Chief Executive Officer, The Co-op).

85 CNL s 19.

86 CNL s 357(1).

87 See the Rules of University Co-operative Bookshop Limited, rule 17. This can either be purchased under s 601 of the CNL or else contact the author for a copy.

6.2. Change the CNL so that co-operatives have an unconditional right to refuse the withdrawal of capital by members

This was the interim solution adopted in most EU countries when the equivalent of AASB 132 was introduced[88]. Since there is no contractual obligation to repay the share capital when the member leaves (though of course the co-operative could still repay if they thought fit) the share capital would be classed as equity and not debt. A reference to requiring the board's authorisation for redemption in sections 128(1) and 163(1) of the CNL would achieve this[89].

This, however – as would occur under Solution One – would involve compromising the principle that co-operative membership is voluntary – a core aspect of the co-operative's distinct legal identity[90] – in order to satisfy standards designed for IOCs (for more on this see below under Solution Four).

It would be problematic if members were not guaranteed a return of their share capital if they were to leave the co-operative. In IOCs, shareholders can sell their equity interest on the secondary market but, as a corollary of the active membership provisions under the CNL, shares in co-operatives are not freely tradeable. Shares can only be sold, with the consent of the board, to a person who will be an active member[91]. This does not often occur and, as such, doubts that co-operatives will continue to return a shareholder's initial capital outlay may, again, disadvantage co-operatives in terms of their ability to attract new members and, hence, capital.

6.3. Solution Three: Change the CNL so that co-operatives have an unconditional right to issue CCUs in place of repayment

Co-operative Capital Units (CCUs) are instruments "conferring an interest in the capital, but not the share capital, of the co-operative[92]". They can be structured as debt or equity and can be issued to both members and non-members[93]. It can be traded on a secondary market with few restrictions[94].

A CCU holder does not have any of the rights or entitlements of a co-operative member[95], thus ensuring democratic rights remain detached from capital contributions.

In order for a CCU to be structured as equity under AASB 132[96], it needs to be:

(1) Perpetual (redeemable at the option of the issuer[97]);

(2) Non-cumulative (any non-payment of dividends in a given year must not give the holder a right to claim the foregone dividends in the future[98]); and

(3) Subordinate (rank behind both secured and unsecured debts owed by the co-operative on a winding up[99]).

If a co-operative had discretion to issue CCUs, whose sum nominal value equalled the nominal value of the shares, in place of repayment when a member leaves then the share capital would be classed as equity. This is because there would be no contractual obligation to deliver a variable number of the co-operative's own equity instruments[100]. For the purposes of the CNL, this could be done by removing the application of sections 128(1)(b) and 163(1)(b) to sections 128(2)(c) and 163(2)(c) respectively, and removing the application of section 165 to the latter two sections. This would be preferable to the first two proposed solutions for two reasons.

88 See Detilleux, above n 13, 10.

89 Ibid.

90 Co-operative principle number 1, CNL s 10.

91 CNL s 99.

92 CNL s 345(1).

93 CNL s 348.

94 CNL s 345(2)(b).

95 CNL s 349(c).

96 Mutuo, 'Raising New Capital in Mutuals – Taking action in the UK' (2013), viewed 4 April 2016, <http://www.mutuo.co.uk/wp-content/uploads/2013/11/Raising-New-Capital-in-Mutuals.pdf> 23.

97 CNL s 350(2)(a).

98 CNL s 350(2)(c).

99 CNL s 350(2)(d).

100 Australian Accounting Standards Board, AASB 132 - Financial Instruments: Presentation (September 2011) Paragraph 11

First, it would make it practically difficult for a co-operative to engage this option rather than simply pay back to the former member the amount owed. This is because of the relatively onerous reporting requirements under CNL[101]. It could also be made more onerous by requiring the board to consult with the former member in person before exercising the option. This would help to ensure that the principle that co-operative membership is voluntary remains a practical reality. And clearly, issuing CCUs in place of cash to members when they leave is preferable under this principle to members being left with nothing.

Second, it would help CCUs gain a profile. Given the strict separation of capital from control in co-operatives, a major issue for them is their ability to raise capital to fund growth, their being heavily reliant on capital got from members and debt from conventional banking sources[102]. CCUs were introduced to increase the flexibility of capital raising options. Uptake, however, has been limited[103].

If co-operatives started issuing CCUs in place of repayment for member shares, a critical mass could be reached that would allow for the existence of a liquid secondary market, raising the profile of CCUs and making them a viable option for capital raising. If CCU and member share dividends were linked, this could provide protection to CCU holders whilst at the same time ensuring that dividend payments continue to be made at the discretion of the co-operative[104].

There is a danger, however, that adopting a hybrid funding model would be a stepping stone to demutualisation[105]. Further, the importance of equity for funding purposes is unclear. A 1996 paper authored by Raghuram Rajan – the current Governor of the Reserve Bank of India – and Zingales, used a cross-jurisdictional analysis to look at the relative importance of debt and equity for funding purposes. It found that the form of finance did not matter[106]. Indeed, it was found that debt financing was more effective than equity financing: a dollar of market capitalisation "has only 40% of the effect on the growth of financially dependent firms" as a dollar of credit.

AASB 132 has negatively impacted co-operatives by rendering their debt to equity ratios unfavourable compared to IOCs, thus harming their ability to access debt finance. Rajan and Zingales' results suggest that pushing co-operatives onto equity instruments to escape this will harm their growth prospects.

A better route may be to establish a Co-operative and Mutual Development Investment Fund controlled by CMEs[107]. Traditional banking institutions have a limited understanding of CME type enterprises, having been exposed primarily to IOCs[108], and the proposed Investment Fund - because controlled by CMEs - would not have such problems. It would also be in accordance with the principle of co-operation among co-operatives[109].

101 CNL Part 3.4, Division 1.

102 Mamouni Limnios, Watson, Mazzarol and Soutar, 'Co-operative Capital Units as a Solution to Co-operative Financing' (2012) DP 1201 CEMI Discussion Paper Series 4; Henry, above n 5, 90.

103 NSW Fair Trading, 'Co-operative Capital Units and Co-operative Principles' (2007), viewed 4 April 2016, <http://www.fairtrading.nsw.gov.au/biz_res/ftweb/pdfs/Cooperatives_and_associations/cooperatives/ccupaper.pdf> 9.

104 See Mamouni Limnios, Watson, Mazzarol, and Soutar, 'Debt or Equity in the Financing of Co-operatives Enterprises' (New Zealand Association for the Study of Cooperatives and Mutuals (NZASCM), Wellington, 2012) 7.

105 MacAulay, 'Restructure will give rise to two groups with conflicting aims', The Weekly Times (online), 21 May 2014, viewed 4 April 2016, <http://www.weeklytimesnow.com.au/news/opinion/restructure-will-give-rise-to-two-groups-with-conflicting-aims/story-fnkerdb0-1226924439178>.

106 Rajan and Zingales, 'Financial dependence and growth' (1996) w5758 National bureau of economic research 19. See also Aglietta, above n 82, 95.

107 Ernst and Young, Submission No 44 to the Senate Economics References Committee, Cooperative, mutual and member-owned firms, 30 November 2015, 21. The ICA also recently recommended "Identifying institutions which can act as aggregators or intermediaries for businesses (large and small) needing capital" – above n 12, 34.

108 Mamouni Limnios et al., above n 103, 2; above n 55, 16 (Simon Lane, Chairman, Almondco Australia Pty Ltd) and 26 (Peter Calabria, Managing Director, Yenda Producers Co-operative).

109 Co-operative principle number 6, CNL section 10.

6.4. Solution Four: Bring co-operative shares under the definition of capital under AASB 132

This was recently recommended by the Senate Economics References Committee in its report on co-operative, mutual and member-owned firms as the course of action the Commonwealth Government ought to pursue[110]. Before considering the propriety of this approach, I will first outline the history of AASB 132.

Following the establishment of the International Accounting Standards Board (IASB) in 2001[111], the AASB adopted a policy to pursue the development of an internationally accepted single set of accounting standards for use in Australia and elsewhere[112]. In 2002 it stated that this was "not likely achievable in the short term[113]". Two months later, however, the Financial Reporting Council[114] (FRC) announced that the international accounting standards issued by the IASB would be adopted in Australia by 1 January 2005. This was apparently determined by the European Union's decision to apply IASB standards to EU-listed companies from that date[115]. Henderson et al. write that,

> "Thus, the FRC had radically accelerated the process of international convergence and harmonisation… without consultation with the AASB about this significant change in policy[116]".

There were two perceived benefits of a single set of accounting standards world-wide: first, the reduction of barriers to international capital flows and, second, the reduction in financial reporting costs for multinational companies[117].

Despite the fact that the IASB standards were developed to apply principally to IOCs, the AASB's standards were applied to all reporting entities including public sector, not-for-profit and co-operative entities[118].

Given that AASB 132 was, therefore, developed to apply to IOCs and that this was done to benefit multi-national corporations, reforming AASB 132 would involve attempting to fit co-operative instruments into an IOC framework. The IASB is currently investigating this option[119]. It is partly because of this that the Senate Economics References Committee recommended reforming AASB 132 to bring co-operative shares under the definition of equity rather than an alternative course of action[120].

This is far from ideal, however[121], and, given previous experience, would not be "in the best interests of both the private and public sectors in the Australian economy[122]". A better solution (Solution Six below) would be to design a separate set of accounting standards appropriate for co-operatives operating in Australia with reference to best international practice – an approach close to the Australian approach to standard setting pre-2001[123].

110 Senate Economics References Committee, Parliament of Australia, Cooperative, mutual and member-owned firms (2016) 47.

111 The restructure occurred in order that the international standard setter would more closely resemble the structure of the accounting standard setter in the US. See Henderson et al., above n 64, 849.

112 Henderson et al., above n 64, 854-5. This coincided with the enactment of the Australian Securities and Investments Commission Act 2001 (Cth), which bound the Financial Reporting Council to further "the development of a single set of accounting standards for world-wide use" (s 225(2)(f)).

113 Cited in Henderson et al., above n 64, 855.

114 The FRC is a statutory body under s 261 of the Australian Securities and Investments Commission Act 2001 (Cth). Its role is to oversee, appoint the members, and establish the broad strategic direction of the AASB (s 225).

115 Henderson et al., above n 64, 856.

116 Ibid 855.

117 Ibid 857. Supporting the move to a single set of accounting standards were the Australian President of the International Accounting Standards Committee, the ASX (who hoped for increased business as a result of more foreign companies listing on the exchange) and 'Big Business', represented by the Group of 100 (ibid 113). Henderson et al. find that "On the basis of existing evidence, it is not obvious that the benefits of convergence outweigh its costs" (ibid 858).

118 Ibid 856.

119 Senate Economics References Committee, above n 110.

120 Ibid 47

121 For discussion of the difficulty of existing accounting standards to accommodate co-operatives see Quarter, Mook and Richmond, 'What Counts: Social Accounting for Nonprofits and Cooperatives' (2003) New Jersey: Pearson Education; Ridley-Duff, 'Communitarian Perspectives on Social Enterprise' (2007) 15.2 Corporate Governance: An International Review 382-392; and Unerman, Bebbington, and O'Dwyer (eds), Sustainability, Accounting and Accountability (London: Routledge, 2007).

122 Australian Securities and Investments Commission Act 2001 (Cth) s 225(2)(g).

123 Henderson et al., above n 64, 854.

6.5. Solution Five: Modify the application of AASB accounting standards to co-operatives

AASB accounting standards apply to co-operatives under section 314(1)(a) of the CNL. The Co-operatives National Regulations can, however, modify the AASB accounting standards in their application to co-operatives[124]. The power to make the National Regulations rests with the Governor of NSW acting with the advice of the government of NSW and on the recommendation of the Ministerial Council (on which representatives from each jurisdiction sit[125]).

As suggested recently by Jeremy Fischer[126], the application of the accounting standards could be modified so that AASB 132 did not apply to co-operative share capital. Chapter 3 of the Regulations could have a regulation which stated:

> Classification of co-operative share capital (section 314)
>
> (1) For the purposes of section 314(1)(b) of the Law, the accounting standards made for the purposes of the Corporations Act shall be modified so that:
>
> (a) The share capital of a co-operative under the Law shall not be classified in accordance with the accounting standards made for the purposes of the Corporations Act.
>
> (b) The share capital of a co-operative under the Law shall:
>
> (i) be classified as equity; and
>
> (ii) shall not be classified as a financial liability.

6.6. Solution Six: Implement a separate set of accounting standards appropriate for co-operatives

The Co-operatives National Regulations can also substitute an alternative set of accounting standards[127]. An alternative standard could be drafted in consultation with co-operatives and could be prescribed under Chapter 3 of the Regulations.

As detailed above, IOCs have been designed to focus almost entirely on the financial outcomes of corporate activities. Other considerations are merely ancillary to financial considerations[128]. Thus accounting standards developed for IOCs focus almost exclusively on financial flows – the AASB explicitly states that their standards apply only to financial statements[129]. This is also shown by the recent move by the IASB to replace the expression 'IAS' (International Accounting Standards) with 'IFRS' (International Financial Reporting Standards). Labardin and Nikitin recently stated that "the semantic shift is not necessarily innocent… financial markets have recently taken over international accounting harmonisation, and they just need financial reporting, not accounting[130]."

As we have seen, however, co-operatives do not look just at financial return – they look to member "value", in the sense of the ability of the organisation to service the economic, social and cultural needs of its members, including future members[131]. Co-operatives therefore require accounting standards which look at more than just financial flows[132].

124 CNL s 314(1)(b).

125 CNL s 612(1).

126 Above n 55, 13 (Jeremy Fischer, Private capacity).

127 CNL s 314(1)(c).

128 See discussion of IOCs under the What is a Co-operative? section above.

129 Australian Accounting Standards Board, AASB 1057 - Application of Australian Accounting Standards (at July 2015) 5.

130 Labardin and Nikitin, 'Accounting and the words to tell it: an historical perspective' (2009) 19.2 Accounting, Business & Financial History 149.

131 See discussion of co-operatives under the What is a Co-operative? section above.

132 See above n 118.

One reason that this has been glossed over is that 'money' has been held to be a perfect measure of value. Mainstream economics, for instance, understands money as an illusion due to its supposed perfect synonymy with value and so has not included money in its models[133]. This idea of money, however, has been increasingly found wanting[134]. George Monbiot, for example, has pointed out that the idea of "Natural Capital" – which involves pricing the value of nature[135] – is unworkable since comparing the value of money and the value of nature involves comparing "non-commensurable" things[136]. It is an inappropriate reductionism to attempt to measure value in purely financial terms. Indeed, such attempts have been found to be counterproductive[137].

There are already moves to address this issue. For example, corporate social responsibility accounting – reporting on a corporation's impact on societal welfare – is gaining traction among IOCs[138]. The Global Reporting Initiative has developed "Sustainability Reporting", which involves communication "of a range of qualitative, quantitative and financial information about a company's economic, environmental and social performance to key stakeholder groups[139]". Companies must "identify key stakeholder groups and communicate about areas of performance that are significant to those groups[140]". Integrated Reporting has also emerged[141]. This "potentially offers [co-operatives] a reporting framework capable of capturing the total value they create[142]". Ernst and Young too recently created the Total Value Framework which helps organisations "understand how they create value, measure the broader value created and use these insights to improve performance[143]".

It has been found that corporate disclosure through a corporation reporting on its environmental impact is effective at integrating sustainability into the thinking and practices of the company.

Reporting was found to be a "useful tool to convince the company that environment is important[144]" and as a "motivator for progress[145]". In other words, reporting helped to keep firms accountable for their environmental impact – indeed the etymological roots of 'accounting' are in 'accountability[146]'.

An accounting standard which requires co-operatives to report on their performance regarding the seven co-operative principles contained in section 10 of the CNL, for example, would help ensure continued adherence to those principles. A co-operative's performance regarding democratic member control, co-operation among co-operatives and impact on the sustainable development of its community are important to member value and must be reported on together with financial performance. As stated above, it is an inappropriate reductionism to attempt to measure value in purely financial terms.

133 Keen, Debunking Economics – Revised and Expanded Edition: The Naked Emperor Dethroned? (Zed Books, 2011) 243,405.

134 See, for example, Wray, Modern Money Theory: A Primer on Macroeconomics for Sovereign Monetary Systems (Palgrave Macmillan, 2015). For a short introduction see Pierce, 'What is Modern Monetary Theory, or "MMT"?', Naked Capitalism (online), 12 March 2013, viewed on 4 April 2016, <http://www.nakedcapitalism.com/2013/03/what-is-modern-monetary-theory-or-mmt.html>.

135 Costanza et al., 'The value of the world's ecosystem services and natural capital' (1997) 387 Nature 259. The authors valued total planetary ecosystem services annually at US$16–54 trillion, with an estimated average of US$33 trillion. They say "The real value is almost certainly much larger", however.

136 Monbiot, 'Put a price on nature? We must stop this neoliberal road to ruin', The Guardian (online), 24 July 2014, viewed on 4 April 2016, <http://www.theguardian.com/environment/georgemonbiot/2014/jul/24/price-nature-neoliberal-capital-road-ruin>.

137 Gibson, 'The Problem with Reporting Pollution Allowances: Reporting is not the Problem' (1996) 7.6 Critical Perspective on Accounting 655-65.

138 Henderson et al., above n 64, Chapter 28.

139 Ibid 931.

140 Ibid 932.

141 See http://integratedreporting.org/.

142 Ernst and Young, above n 106, 16.

143 Ibid. See also the UK based Social Audit Network (http://www.socialauditnetwork.org.uk/) and above n 12, 18.

144 Bubna-Litic, 'Climate Change and Corporate Social Responsibility: The Intersection of Corporate and Environmental Law' (2007) 24.4 Environmental and Planning Law Journal 270.

145 Ibid 271. See also Pokharel, Aiyar and Samji, 'Social Audits: from ignorance to awareness. The AP experience' (2008) World Bank, Intellecap and SPIU (AP govt); and Aiyar and Samji, 'Transparency and Accountability in NREGA – A Case Study of Andhra Pradesh' (2009) Accountability Initiative.

146 Labardin and Nikitin, 'Accounting and the words to tell it: an historical perspective' (2009) 19.2 Accounting, Business & Financial History 149.

Under the CNL, a large co-operative must deliver an annual report every year consisting of a financial report made in accordance with AASB accounting standards, a directors' report, and an auditor's report on the financial report. As established above, a co-operative maximises member value and not financial profit. As part of its annual report, a co-operative ought, therefore, to deliver a 'total value report' in accordance with an appropriate accounting standard in place of its delivering a 'financial report' in accordance with an accounting standard developed for IOCs. "Financial report" would simply be replaced with "total value report" under section 284(1)(a)(i).

Together with such benefits, an accounting standard developed to be appropriate for co-operatives would mean that problems created by attempting to fit co-operatives into an accounting framework designed for IOCs would no longer be an issue. Co-operative share capital could be classified appropriately, for example.

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Together with such benefits, an accounting standard developed to be appropriate for co-operatives would mean that problems created by attempting to fit co-operatives into an accounting framework designed for IOCs would no longer be an issue. Co-operative share capital could be classified appropriately, for example.

7. Conclusion

Government policy discriminates against co-operatives by focusing on catering to the needs of investor-owned corporations. Organisations such as co-operatives, which have different design principles and values, are forced to operate within a framework designed for IOCs and so one not appropriate for them. This forces organisations onto an IOC model thus encouraging the standardisation and homogenisation of enterprise types.

I have examined six solutions which would mitigate or avoid legislated accounting standards having this effect in Australia. The first three solutions look at the possibilities available for co-operatives to adjust themselves in order to fit into an IOC framework. I find that this would involve compromising co-operative principles and would continue the practice of disadvantaging co-operatives relative to IOCs.

Solution Four involves adjusting accounting standards developed for IOCs in order that co-operatives fit as they are into an IOC framework. I find that this is ultimately futile.

The appropriate solution would be to implement accounting standards specifically designed for co-operatives. A simpler, interim solution is proposed (Solution Five), as well as a long-term solution which matches co-operative design and values with accounting standards (Solution Six). The latter solution is preferable since it would be fair to co-operatives and beneficial to the health of society by properly accommodating for the existence of diverse enterprise-types.

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