Knowing What You Know:

Shared financial reporting standards

BY KAREN ZIMBELMAN AND STEVE WOLFE

When you review your co-op's quarterly financial statements, how do you know what the numbers represent? It's easy to just accept that they represent a true, accurate, and comparable (to other similar businesses) picture of the co-op's financial status. Because—well, they're numbers! But, in fact, that's only true if the statements are prepared in a consistent fashion.

It's for this reason that the Financial Accounting Standards Board (www.fasb.org) has standards that identify how specific accounting functions are to be performed. These standards are called **GAAP—generally accepted accounting principles**. When a co-op engages a certified public accountant (CPA) to audit or review its financial statements, that CPA is reviewing and testing specific procedures to verify that the co-op's statements are being prepared in conformance with those accounting standards.

NCG feels strongly that these standards represent a critical baseline for financial reporting that contributes to co-ops' shared success and collaboration.

Internal controls

A major focus of these accounting standards is to ensure that the business has good internal controls—in other words, systems that prevent misstatements of financial position, fraud, embezzlement, or theft. For instance, a basic internal control is that the person who approves expenses doesn't sign checks or authorize the actual payment (also known as segregation of duties). This control makes it difficult for an unscrupulous person to authorize payments to him/herself.

Most businesses find great value in having an accounting professional examine their financial systems and statements to verify proper financial reporting. An audit also provides recommendations to improve to internal controls. It's definitely a best practice for the board—the body ultimately accountable for the co-op's overall fiscal health—to engage just such an annual examination, either an audit or a less rigorous (and less expensive) financial "review." Either an annual audit or a review service is performed by an independent certified public accountant. (See sidebar.)

Reporting standards

In our years of working with and for food co-ops, National Co+op Grocers (NCG) has found a wide variety of practices in the ways that financial statements are prepared. For this reason, all NCG member and associate co-ops are now required to adhere to six financial reporting standards:

- **Submit quarterly accounting and labor data** into the CoMetrics financial database within 45 days of the close of the co-op's fiscal quarter. The CoMetrics database offers a secure mechanism for food co-ops to share financial data as well as for co-ops and NCG to identify important trends in our system. This database was developed for U.S. food co-ops and has grown to serve a wide variety of co-op sectors—each with its own segregated and secure "data warehouses."
- **Engage a third party accounting firm to complete a review** of the annual financial statements each year. (Since an audit is a more rigorous financial review and would exceed this standard, co-ops may alternate between a financial review and a full audit as desired.) In this way, all co-ops participating in the NCG system verify that they are preparing their financial statements per GAAP. An audit also ensures that internal controls are verified and enhanced by the review of a third party. Assurance of accurate financial reporting allows the co-op, as well as peers and NCG, to identify and mitigate risk sooner.
- **Prepare separate income statements for each business unit.** This standard only applies to co-ops operating multiple business units (e.g., two stores). For these co-ops, a separate profit/loss statement must be prepared for each store, commissary, or central kitchen/bakery, as well as other units such as a café and an administrative support unit. Separate financial statements enhance management's ability to accurately identify and isolate factors that may be causing the erosion of financial performance.
- **Follow specific accounting procedures for commissary and production** operations, especially product costing, expense tracking, and product transfers, to ensure accurate business unit analysis. As with separate income statements, these procedures ensure that the co-op has the data to accurately measure the performance of commissary and food production units so that problems can be quickly identified and remedied.
- **Conduct a total inventory count at each business unit at the end of each fiscal quarter**, using consistent costing methodology. Without a complete inventory count, management's ability to identify and quickly correct eroding department margins or to identify other operational deficiencies is severely limited.
- **Prepare complete and accurate monthly financial statements** within 30 days following the end of the fiscal period (either a calendar month or a 4/5 week period). This includes reconciliations of all asset accounts; inventory adjustments for departments not counted in the period; and accrual of all expenses, including labor and benefits, depreciation and amortization, long- and short-term debt, and accounts receivable. Monthly statements must include comparisons to budget and prior year figures. Monthly financials are critical to providing managers timely data that can help identify eroding financial performance more quickly and accurately.

While NCG feels strongly that these standards represent a critical baseline for financial reporting that contributes to the shared success and collaboration of NCG co-ops, we do consider and make exceptions to these requirements on a case-by-case basis. For instance, a small number of NCG co-ops are successfully managing a perpetual inventory system with good controls to monitor accuracy. Those co-ops can request an exception to the standard requiring quarterly physical inventory counts.

NCG offers several "preferred practice" resources that provide procedural details to guide compliance with these standards. Another helpful resource for those interested in better understanding financial reporting is *Accounting Best Practices for Food Co-ops: A Primer*, a compilation of four *Cooperative Grocer* magazine articles covering the balance sheet, income statement, internal controls, and cash management, written by Bruce Mayer, Peg Nolan, and Steve Wolfe in 2011-2012. It is available in the CGN Member Only Library as a free PDF download. ☐

Review or Audit?

Businesses that wish to engage a third party to review their financial systems and reports have two primary options:

A review is when the certified public accountant (CPA) performs analytical procedures and inquiries to obtain limited assurance on the financial statements. A review is intended to provide the board with a level of confidence in the accuracy of the business's financial reports. A review does not test and make recommendations on internal controls.

An audit is a more rigorous engagement designed to provide reasonable assurance that the financial statements are free from material misstatement. In an audit, the CPA is required to review and test the business's internal controls to assess soundness of those systems to prevent risk from fraud. Audit reports also provide specific recommendations to improve internal controls.