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# Critical Analysis of Cooperative Society

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## ABSTRACT

*The sources of funds of a co-operative society mainly consist of borrowed capital or debt capital and owned capital. Borrowed capital means the total of loaiis, deposits, other borrowings of a co-operative society and current liabilities. Owned capital means the total of paid up share capital and accumulated reserve fund and others created out of profits of a co-operative society or otherwise. The maximum amount which a society may borrow shall be determined annually.at a general meeting of the society and no society shall borrow beyond the maximum amount so determined. The Registrar may, at any time, revise the limit fixed by the general meeting. No society shall incur liabilities from persons who are not members, in excess of a maximum amount fixed time to time in general meeting and approved by the Registrar. A primary agricultural credit society which is a member of a central co-operative bank, shall not borrow by way of loans or deposits from any non-member without the sanction of the central co-operative bank, and where the society is not a member of any central co-operative bank, sanction is to be made from the Registrar.*

***Keyword:*** *Capital Income, Person liabilities, co-operative bank*

## I. INTRODUCTION

No society with limited liability shall, by accepting deposits or loans or in any other way, incur liabilities exceeding twenty-five times the sum of the paid up share capital and the reserve fund for the time being separately invested outside the business of the society except with the permission of the Registrar. [2]The Central Co-operative Land Development Bank, the State Cooperative Bank or a Central Co-operative Bank for the purpose of financing land development*bank, or a land development bank for the purpose of financing its members, may incur liabilities to the extent of thirty times the value of paid up share capital and the reserve fund for the time being separately invested A credit society other than the co-operative banks coming within the purview of the Banking Regulation Act, 1949 shall, if so required by the Registrar, keep minimum liquid cover against deposits held by it. Liquid

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[2] The Central Co-operative Land Development Bank https://www.yourarticlelibrary.com/banking/land-development-banks-in-india-structure-working-and-progress-of-ldbs/26343

 

cover means any assets which can be converted into ready cash at once and which are maintained in one or more of the following forms:

(i) Cash in hand, or with such banks as the Registrar may approve,

(ii) Post-office savings bank account,

(iii) Government securities including post-office cash certificate or national savings certificate or National plan certificate and

(iv) Other investments as may be approved by the Registrar

Under special circumstances the board may, with the approval of the Registrar, decrease the proportion of the liquid cover. A co-operative society may receive loans by issue or reissue of debentures of one more denominations repayable within thirty-five years. The state govt, may grant loans to take share in, or give any other financial assistance to any co-operative society which makes an application in this behalf.

## II. Owned Capital

The owned capital as defined in the Act means "the total of paid up share capital and accumulated reserve fund and other funds created out of profits of a co-operative society or otherwise." paid up share capital consists of fund from [3]the members of a co-operative society. Subject to the rules and the by-laws, the following persons shall be eligible for membership of a co-operative society

[a] an individual competent to contract under Section II of the Indian Contract Act, 1872

[b] any other co-operative society;

[c] the State Government;

[d] subject to the approval of the State Govt, by general or special order, any association or body of persons (whether incorporated or not) or any financial bank.

Share capital from the members comprises "A" class and "B" class share. "A" class shares are only meant for individuals whereas "B" class shares are for others. An individual share holder is allowed to hold share not more than 1/5^^ of the total share capital. Any co-operative society formed under the Act of 1983 must declare its maximum authorized capital.

A co-operative society may deposit its funds :

[a] in a Govt, savings bank; or

[3] the members of a co-operative society

[b] in any security specified in section 20 of the Indian Trust Act, 1882; or

[c] in the share or debenture or security of any other co-operative society with the previous sanction of the Registrar and in the manner prescribed. Provided that no such sanction shall be necessary where a primary co-operative society invests or deposits its fund in the share or debenture of a central society or an apex society or where a central society or apex society invests or deposits its fund in the share or debenture of a primary co-operative society; or

[d] in such other manner as may be prescribed. Every co-operative society shall contribute to the co-operative education fund such portion of its net profit in any co-operative year as may be prescribed.

Every co-operative society shall create a bad debt fund by transfer of not less than fifteen percent of its net profit in a co-operative year and shall utilize it in any business if it has no outside liability in the form of bad debt certified by the audit or in such other manner as may be prescribed.

Every co-operative society shall transfer in every co-operative year not less than ten per cent of its net profit to a reserve fund; provided that the reserve fund shall be invested in a government saving bank including nationalized bank and regional rural banks or in any security specified in [4]section 20 of the Indian Trusts Act, 1882 or in the business of the co-operative society in the prescribed manner. A co-operative society may establish a provident fund for the benefit of its whole time employees with the contributions of such employees and may make contribution to the fund at the prescribed rate and the fund shall be administered in the prescribed manner.

A co-operative society may establish a gratuity fund in accordance with the provisions of the payment of Gratuity Act 1972 for the benefit of its employees.

The net profit of a co-operative society in a co-operative year shall be distributed among its members by way of bonus or dividend. The balance of the net profit in a co-operative year with the undistributed net profit, if any, of the previous year may, to such extent and under such conditions as may be prescribed, be utilized for all or any of the following purposes :

[a] Payment of dividend to members on their paid up share capital at a rate not exceeding twelve per cent;

[b] Contribution to such special fund as may be prescribed or as may be provided in the by-laws;

[4] section 20 of the Indian Trusts Act, 1882

[c] Contribution of any amount not exceeding ten percent of the net profit in a co-operative year for any charitable purpose or any other purposes as may be prescribed.

## III. Analysis of financial performance through liquidity, solvency, profitability and capital structure

The purposes of the conventional revenue statement and balance sheet are to show, firstly, the result of operations for the period under review, and secondly, the assets and liabilities of the firm as on the relevant date. But it is difficult to deduce any inference from the mass of figures included in the usual annual financial statements. So, in order to gauge accurately the financial health of the firm it is generally necessary to regroup and analyse the figures as disclosed by these conventional statements. The use of accounting ratios enables conclusion to be drawn from the redrafted figures as to the earning capacity and financial condition of a concern.

A ratio is an expression relating to one number to another. The ratio should be between different relevant or related accounting variables; ratios of unrelated variables are meaningless. Analysis of financial statements constitutes the last step in accounting, the earlier steps being recording, summarizing and reporting. It is through interpretative or analytical function of accounting that the accountant aids the management in financial planning and control.[5] Analysis of financial statements is also required for external parties (e.g. investors, creditors, etc.) for sound decision making. Thus, financial statement analysis is mainly intended for the following two groups:

Ratios may be used as measures of efficiency. This may be so for a single firm when comparing changes through time or for a number of similar fums. It may be mentioned that inter-firm comparision through ratios may enlighten the constituents about the position of the industry. This again is helpful in determining prices and in judging the optimum size of the unit under the circumstances. Now we shall judge the liquidity, solvency, profitability and capital structure of the different co-operative societies individually and as a whole on the basis of different relevant accounting ratios.

### LIQUIDITY

The liquidity position of a firm is largely affected by the composition of current assets in as much as any considerable shifts from the relatively more current assets to the relatively less current assets, or vice versa, will materially affect a firm’s ability to pay its current debts

[5] Analysis of financial statements

promptly. Therefore, it is desirable to study the distribution of current assets to determine the liquidity position exactly, The liquidity position may be judged through the following ratios: Liquidity position may be judged through comprehensive test of the above ratios. Ranking or weighting is used to arrive at a more comprehensive measure of liquidity. A high working capital to current assets ratio as well as high liquid resources to current assets ratio shows relatively favourable position and ranking should be done in that order. On the other hand, a low stock to current assets ratio indicates a more favourable position and hence ranking is done in that order. High cash to current assets indicates more favourable liquid position. Since the current liabilities are not expected to exceed one- half of the current assets, the cash percentage should run not under 10 to 12 percent of the same

**SOLVENCY**

Solvency is the debt paying ability of the firm over a long period of time. Long-time creditors, lenders, and shareholders are interested in measuring solvency of a firm for their credit and financing decisions. It, therefore, involves in measuring financial risk of the firm. Through debt to total assets ratio and debtequity ratio we can measure solvency position of a society. Debt to total assets ratio measures the percentage of total assets provided by the creditors. Debt normally refer to long-term debts. But current liabilities are also suggested to be included to have a complete picture of financing of total assets by creditors- long term as well as short-term. From the creditors' point of view, a low ratio is desirable. However, the adequacy of this ratio is often judged in the light of the earnings of the society. Society with stable earnings may go for higher proportion of debt to finance total assets than those with relatively less stable earnings. Debt to equity / owned fund ratio is the variation of debt to total assets ratio. It measures the relation between debt and equity and signals the extent of financial risks involved. From the creditors’ point of view a low ratio is desirable. From the shareholders’ point of view, the higher the ratio the greater is the possibility of increasing the rate of return to the equity so long as the cost of debt is lower than the rate of return from investment. Using debt capital to increase the rate of return on shareholders’ equity is known as “trading on equity”. There are costs and benefits to shareholder for adopting trading on equity. The costs are interest payments and increased risk, and the benefits are the higher rate of return as long as there is sufficient net income. Financing from debt increases the risk of shareholders. This is known as financial risk.

**PROFITABLITY**

Profitability of a concern may be judged through different ratios like, gross profit ratio, P/V ratio, operating ratio. Here, we shall measure it on the basis of return on capital employed ratio. This ratio reveals the overall efficiency or otherwise with which the society is operated. Higher the ratio higher is the profitability of the society.

**CAPITAL STRUCTURE / LEVERAGE RATIOS**

It relates to the study of proportions of various types of capital in the capital structure of the society. The composition of capital structure or the leverage can be measured in two ways. One approach is to examine the balance sheet ratios (i.e. "stock" terms) and determine the extent to which debt capital has been used to finance the firm. The other approach measures the risks of debt by income statement ratios (i.e. in flow terms) designed to determine the number of times fixed charges are covered by operating profits. If we follow the former approach, we can use (a) capital gearing or debt / equity ratio, (b) debt to total capital ratio etc. while from the latter approach the (a) ratio of earnings before interest and taxes to interest payments or (c) the ratio of net cash flows for interest payments can be used. However, the "stock" and "flow" ratios are complementary to each other and may be examined together. In general, the lower the flow ratios and the higher the stock ratios, the greater is the risk and vice-versa. Here, we shall discuss the capital structure through balance sheet ratios. Debt /equity ratio of a cooperative society measures the relation between debt and equity in the capital structure of the society. Generally, the higher the ratio the greater is the possibility of increasing the rate of return to the equity so long as the cost of debt is lower than the rate of return from the investment. But financing from debt also increases the risk of shareholders. This is known as the financial risk and is measured by the variability in the earnings per share or rate of return to equity. Normally, cost of debt capital is lower than that of equity. Thus under favourable conditions (say rising sales), a high debt / equity ratio may be adopted, to take advantage of cheaper debt capital. On the other hand, when sales are faUing, it is desirable to use a low debt / equity ratio. Debt / total capital ratio is a variant of D/E ratio and expresses outside liabilities (both long-term and short-term) in relation to total capitalization of the society. Generally, creditors will prefer low debt ratios, since the lower the ratio, the greater the cushion against creditors' losses in the event of liquidation. Conversely, the owners may prefer high debt ratios (i.e. higher leverage) either (i) to magnify earning or, (ii) because issuing new share means giving up some degree of control. But a high debt ratio may create problems with respect to future financing because creditors may be reluctant to lend the firm more money unless the equity base is increased. Proprietory ratio or capital employed to total assets ratio is the relation between share capital (owners' equity) and total assets. The proprietory ratio is a test of long-term financial position and also a test of capitalization. The higher the ratio, the stonger is the long-term financial position. Again, a high ratio indicates that insufficient use is being made of external equities to finance the business. Normally, the proprietor's fund should be sufficient to cover at least the fixed assets. This ratio is also a test of credit strength, it follows that proprietory ratio is really that of proprietors' equity to total liabilities, so that if the amount of proprietor's equity decreases relative to the amount of debt capital, a business becomes more dependent upon creditors to supply its working capital.

## IV. Liquidity, Solvency, Profitability and Capital Structure of Sample Cooperative Societies

The liquidity position of a firm is largely affected by the composition of current assets. The high working capital to current assets ratio and a high cash and Bank to current assets ratio shows relatively better liquidity position. The higher the liquidity position of the firm the higher is the short-term debt paying ability of the firm. The low stock to current assets ratio indicates a more favourable position. The higher the liquidity position of the co-operative society, the larger the amount of rupees available to meet its short-term maturing obligations[6]. From the liquidity ratios it is observed that the amount of stock is on an average 1% of the current assets over the years which is very negligible. Cash and bank balance is on an average 35.3% of the current assets. Cash and bank balance are the most liquid component of the current assets. The larger the amount of cash and bank balance, the higher is the liquidity position of the society. The amount of working capital is on an average 65.1% of the current assets.

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[6] short-term maturing obligations