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CEARC  
iSORP discussion paper no. 3

# Reporting payments to members

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February 16, 2009

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## Contents

<b>1. The iSORP project</b>	<b>3</b>
<b>2. Introduction</b>	<b>4</b>
<b>3. Proposals on the presentation of members' funds</b>	<b>7</b>
<b>4. Questions for feedback</b>	<b>11</b>

## **1. THE iSORP PROJECT**

This discussion paper is the third in a series aimed at developing content for an international Statement of Recommended Practice (iSORP) for co-operative accounting and reporting. This paper focuses on reporting payments to members.

You can find other iSORP discussion papers and CEARC working papers at the CEARC website: [www.coopaccounting.coop](http://www.coopaccounting.coop). A draft conceptual framework for co-operative accounting can be downloaded from the website. The conceptual framework provides another component of a co-operative accounting framework and should be considered alongside the iSORP papers.

### **Comments welcome**

We welcome all and any comments regarding any of our iSORP discussion papers and we do feed these in to our review process. A series of questions are included at the end of the paper. Comments will be reported to the CEARC advisory committee and CEARC board and fed into the review and revision of the potential iSORP.

There is no set deadline for comments on this paper although our first review of comments will be completed prior to the production of a first version of the complete iSORP. This is likely to be by the end of 2009.

## 2. INTRODUCTION

The co-operative principles, set out in the International Co-operative Alliance (ICA) statement on the co-operative identity (ICA, 1995), provide guidelines regarding the use of surpluses and state:

“Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; **benefiting members in proportion to their transactions** with the co-operative; and supporting other activities approved by the membership.” (Emphasis added).

Distribution of the surplus to the members in proportion to their transactions was one of the original principles of the Rochdale pioneers which included the following:

- Distribution of surplus in proportion to trade
- Payment of limited interest on capital

The nature of the transacting relationship between co-operative and member, with economic benefit linked to use, and the limitations set on returns to investors are aspects of the co-operative identity that set co-operatives apart from other businesses. This suggests the need to consider whether a distinct co-operative approach to reporting on payments to members is required and what form that might take.

Payments from co-operatives to members take various forms, including:

- a. Payments made to members during the normal course of operational activities and arising from contractual obligations between co-operative and member in relation to trading goods, services or labour.
- b. Additional payments made to members from net operational income at the discretion of the co-operative and in proportion to transactions undertaken with the co-operative.
- c. Payments made to members arising from members' funds held by the co-operative and including: interest paid to members, distributions to members and capital repayments to members.

### **a. Payments made to members during the normal course of operational/trading activities.**

Co-operative members are users of their co-operative and as such undertake transactions with the co-operative in relation to day to day business activities. For example the co-operative member may be:

- a consumer, buying goods or services from the co-operative;
- a supplier, providing goods or services to the co-operative;
- an employee, providing their labour.

Member transactions arising from use of the co-operative form part of operational revenue and expenses and are reported in the income statement. Co-operatives may trade with both members and non-members but may fail to disclose the proportion of trade undertaken with members and non-members or provide an analysis by type of goods or services.

Member decision making could benefit from knowing the proportion of trading activities undertaken with members and non-members. For example, a member employee in a worker co-operative would gain useful information on the extent, increase or decrease in remuneration to members compared to remuneration to non-members. A supplier member would gain useful information on the extent to which the co-operative is focused or dependent on member related business activity.

**b. Payments made to members from net operational income at the discretion of the co-operative and in proportion to transactions undertaken with the co-operative.**

Such patronage payments are not calculated in proportion to the number of shares held by a member but rather in proportion to the level of their transacting with the co-operative as a user of the co-operative. As such, the patronage payment is received in their capacity as a member user (customer/supplier/worker) rather than their capacity as member shareholder.

Patronage payments are typically not an appropriation of equity but rather an expense or a rebate of the initial price charged. Tax law and regulations in many countries identify them as such. Although an expense, patronage payments differ from typical trading discounts because they are:

- Subject to member/board approval
- Paid to members and not to non-members transacting with the co-operative
- Foregone when operating profit is low or where issues of liquidity or expansion require retention of earnings.

Because of these differences it is appropriate to report patronage payments separately from other general operating expenses more closely linked to daily management decision making.

The language used to report patronage payments to members varies from co-operative to co-operative. Examples found in a small sample of Canadian, UK, and New Zealand annual reports include:

- Distributions
- Dividend
- Members dividend
- Members privilege scheme
- Patronage allocation
- Patronage dividends
- Patronage rebates
- Patronage refunds
- Patronage returns
- Payments to and on behalf of members
- Payments to and on behalf of stakeholders
- Rebates to members

Arguably the use of the terms 'dividend' and 'distribution' to describe patronage payments could lead to misunderstanding regarding the nature of the transaction given that such terms are normally associated with a return to the owners in the form of an appropriation as opposed to an expense. The reader of co-operative financial reports would benefit from a standardized language for reporting patronage payments.

**c. Payments made to members arising from members' funds held in the co-operative and including: interest paid to members, distributions to members and capital repayments to members.**

Members' funds in a co-operative can take various forms and include:

- Purchase of co-operative shares
- Loans made to the co-operative
- Member patronage returns retained by the co-operative in a members account

The accounting treatment of payments linked to members' funds will depend on whether a particular financial instrument is classed by GAAP as equity or liabilities. For example, where shares are classed as equity any related dividend would be reported in the statement of changes in members' equity. Where shares are classed as liabilities, any related 'dividend' would be reported as an expense in the income statement.

Within these limitations, co-operatives can still seek to develop a co-operative approach to reporting which uses more appropriate language (e.g. using the heading: 'statement of changes in members' equity' as opposed to 'statement of changes in shareholders' equity'). The use of such co-operative language, however, should only be adopted where it furthers the aim of providing clear, understandable and comprehensive information to members on all aspects of their transacting relationship with the co-operative.

This discussion paper takes the view that:

1. The primary reporting responsibility of co-operatives is always to their members.
2. Payments to members take a variety of forms including: daily business transactions, patronage returns and return on member equity.
3. It is useful to distinguish payments to members from payments to non-members, in support of stewardship and accountability and in furtherance of informed decision making.
4. The notes to the accounts can be used to reconcile the limitations of income statement presentation required by GAAP with the information needs of members.

What follows is a first draft of proposed iSORP content regarding the reporting of payments to members on the income statement, on the statement of changes in equity and in the notes.

### **3. PROPOSALS ON THE PRESENTATION OF PAYMENTS TO MEMBERS**

1. The financial report should, where possible, clearly distinguish between payments to members and payments to non-members.
2. Where possible, the use of the word “members” in the financial statements should be preferred over the use of the word “shareholders”.
3. Where GAAP places constraints on how payments to members are reported in the income statement and statement of changes in members’ equity, the co-operative should make use of the notes to provide full and appropriate disclosure.
4. Payments to members take various forms. It is useful to distinguish between payments made to members in their capacity as users of the co-operative (e.g. members as consumers, suppliers, workers) and payments made to members in their capacity as equity funders in the co-operative (e.g. payments linked to member shares, other financial instruments and/or loans provided by members to the co-operative).

#### **Patronage payments**

5. Patronage payments, made to members in proportion to transactions undertaken with the co-operative, are an operational expense but differ from other operational expenses in respect of:
  - a) the requirement for member/board approval
  - b) the restriction of benefit to members, thus excluding non-member transactors
  - c) their discretionary nature and subordination to retention of adequate reserves

These differences support the case for the splitting out of member patronage payments from other operational expenses. Patronage payments should be reported on the income statement, below other operational expenses and under a separate sub-heading.

6. Patronage payments do not meet accounting standards criteria for treatment as dividends. The use of the words ‘dividend/s’ to describe patronage payments can be confusing to the reader of the financial report. To avoid confusion, reporting of patronage payments should avoid the use of the words ‘dividend/s’ and ‘distribution/s’.
7. The notes to the accounts should include further information on patronage payments including:
  - a) Breakdown by type of patronage return (e.g. cash, vouchers, preference shares)
  - b) Frequency of patronage payments (e.g. monthly, quarterly, annually)
  - c) Changes in retained patronage returns
8. Patronage payments may be grouped with various other expense payments under a common heading. Examples include: ‘payments to and on behalf of members’ and ‘distributions to community and members’. Sub-headings may include, for example:
  - a) Patronage payments to members
  - b) Donations to charity and community organizations
  - c) Subscriptions to co-operative movement organizations
  - d) Share interest

9. An alternative to the approach in (8), however, is to make a distinction between payments to members and payments to external parties (e.g. charity, community and co-

operative movement organizations). This discussion paper favours the splitting out of payments to members under a separate heading on the income statement and in the notes. Figures 1 and 2 provide examples (see page 9). Comments are invited.

### **Other payments to members arising from daily user transactions**

10. Other payments made to members arising from day-to-day operational transactions between member and co-operative (e.g. in exchange for goods, services or labour) should be included with other operational expenses.

### **Member/non-member analysis**

11. Where possible, the income statement should include a breakdown showing member and non-member related income and expense. Where inclusion of the breakdown on the face of the income statement is problematical, the co-operative should consider providing this breakdown in the notes.

### **Share dividends**

12. Where member shares are classified as equity, share dividend payments are reported in the statement of changes in members' equity (note that the word "members" is used in place of the word "shareholders"). Where the share is not classified as equity, the payment will be treated as an expense. Where it is an expense the item will be reported on the income statement, and can be grouped with other payments to members. Comment is invited on the appropriateness of describing the payment as a dividend when it is an expense.

### **Examples of presentation of information on income statement and in the notes**

13. Figures 1, 2, 3 and 4 (see page 9 and 10) provide examples of presenting payments to members on the income statement and in the notes<sup>1</sup>. Comment is invited on both the appropriateness and the feasibility of including a member/non-member breakdown of revenue and expense.
14. Figures 3 and 4 (page 10) provides examples of reporting patronage returns by type of rebate and by type of payment. Figure 3 provides the information all in one table by using rows for the type of patronage rebate/return and columns for the type of payment. Figure 4 presents the data in two separate tables. Comment is invited on these two approaches.
15. Whichever form of presentation is adopted, the favoured approach would be to present payments to members in a way that distinguishes them from payments to other parties.

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<sup>1</sup> For clarity no comparative data has been included.

**Figure 1**

**Income statement example with analysis columns and showing payments to members as expenses before tax but below other operating expenses**

	Members	Non-members	Total
<b>Revenues</b>	000	000	000
Less: cost of sales	000	000	000
Gross profit	000	000	000
Other income	000	000	000
<b>Net income</b>	000	000	000
<b>Operating expenses</b>			
Distribution costs	000	000	000
Administrative expenses	000	000	000
Other expenses	000	000	000
Finance costs	000	000	000
<b>Profit before payments to co-op members and community</b>	<b>000</b>	<b>000</b>	<b>000</b>
Payments to co-op members	000	-	000
Payments to community	000	000	000
<b>Profit before tax</b>	<b>000</b>	<b>000</b>	<b>000</b>
Income tax expense	000	000	000
<b>Profit for the year</b>	<b>000</b>	<b>000</b>	<b>000</b>

**Figure 2**

**Example of notes on payments to co-operative members and payments to community**

<b>Payments to co-operative members</b>	
Patronage payments to members	000
Interest paid on member ordinary shares	000
Interest paid on member preference shares	000
Educational grants paid to individual members	000
<b>Total payments to co-operative members</b>	<b>000</b>
<b>Payments to community</b>	
Donations to charity and community organizations	000
Donations to charity and community funds	000
Donations to co-operative development organizations	000
Donations to co-operative development funds	000
Educational grants paid to individual non-members	000
<b>Total payments to community</b>	<b>000</b>

**Figure 3**

**Example note: Patronage returns by type of rebate/return and type of payment**

	Cash	Voucher	Shares	Total
<b>Type of return</b>				
Monthly bulk purchase rebate	000	000	000	000
Monthly standard rebate – own brand	000	000	000	000
Monthly standard rebate – other brands	000	000	000	000
Annual loyalty return	000	000	000	000
<b>Totals</b>	<b><u>000</u></b>	<b><u>000</u></b>	<b><u>000</u></b>	<b><u>000</u></b>

**Figure 4**

**Example note: Patronage returns by type of rebate/return and type of payment displayed in two tables**

	<b>Total</b>
<b>Patronage returns by type of rebate/return</b>	
Monthly bulk purchase rebate	000
Monthly standard rebate – own brand	000
Monthly standard rebate – other brands	000
Annual loyalty return	000
<b>Total patronage returns by type of rebate/return</b>	<b><u>000</u></b>
<b>Patronage returns by type of payment</b>	
Cash	000
Vouchers	000
Retained patronage preference shares	000
<b>Total patronage returns by type of payment</b>	<b><u>000</u></b>

#### 4. QUESTIONS FOR FEEDBACK

CEARC is keen to receive feedback concerning any aspect of this discussion paper and including the ideas and views presented. In particular we would be interested in your views on all or any of the following:

1. *Do you think it is appropriate to split out payments to members under a separate heading on the income statement, showing it separately from payments to community?*
2. *Do you consider an analysis of revenue and expenses by member/non-member:*
  - a) *useful*
  - b) *feasible*
  - c) *appropriate*
3. *To what extent would you support the development of a standardized co-operative accounting language which seeks to reflect co-operative difference in respect of purpose and identity (e.g. members' equity v shareholders' equity, profit v surplus)?*
4. *Do you consider the use of the words 'dividend' and 'distribution' problematical when describing operational expenses?*
5. *What other word could be used in place of 'dividend' to describe a payment to members which is classified as an expense?*
6. *What is your opinion with regard to the use of tables to provide a more detailed breakdown of information in the notes? Do you have a particular preference in regard to the examples given in this paper?*
7. *Are there any other points to be addressed regarding the presentation of payments to members on the income statement, on the statement of changes in members' equity and in the notes?*

Please send comments in writing by e-mail or mail to:

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**Please include your name and your organization's name and address and indicate the paper you are commenting on.**

**There is no deadline for comments although a first review will be completed and reported on by the end of 2009.**

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