

Aug
2008

CEARC
iSORP discussion paper no. 2

Reporting co-operative members' funds

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The Centre of Excellence in
Accounting and Reporting for
Co-operatives (CEARC) is
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Chartered Accountants
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(UK)
- Co-operatives Branch –
Service Nova Scotia and
Municipal Relations
- Co-operative Housing
Federation
- United Farmers of Alberta
- Nova Scotia Co-operative
Council
- Scotsburn Dairy

Published by CEARC
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Sobey School of Business
Saint Mary's University
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Halifax, Nova Scotia B3H 3C3
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1. THE iSORP PROJECT

This discussion paper is the second in a series that is looking at developing content for an international Statement of Recommended Practice (iSORP) for co-operative accounting and reporting. This paper focuses on the presentation of members' funds.

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.

You can find other iSORP discussion papers and CEARC working papers at the CEARC website: 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.

Deadline for comments

In response to feedback received on our first working paper, we have increased the comment period to a minimum of four months following publication. **The deadline for comments on this discussion paper is December 11th, 2008.**

2. INTRODUCTION

The balance sheet, also referred to as the statement of financial position (SOFP), provides a summary of the assets, liabilities and equity of a business. This discussion paper considers the balance sheet from the point of view of information of particular relevance to co-operative members and how this can lead to a differing layout from that adopted by investor owned businesses.

While much of the balance sheet information required by the member is similar to that involved in reporting by investor-owned businesses, the co-operative difference arises in respect of reporting on members' funds. The co-operative members benefit from having a clear picture of the extent and nature of all their financial contributions to the co-operative, irrespective of whether they are currently viewed by accounting standards setters as equity or liabilities. As such, it is essential that members can see their various claims over the assets of the co-operative listed and grouped together, whatever form those claims may take. This may include, for example: member shares, member preferred or investment shares, member loans, member deposits, reserves or retained earnings. Adopting a style of reporting that gives priority to the disclosure of members' claims does not preclude the financial statements having relevance to non-member investors and creditors. It provides decision useful information in regard to the members' equity buffer¹ as well as the extent of other forms of contributions not identified as equity.

This discussion paper takes the view that:

1. The primary reporting responsibility of co-operatives is always to their members.
2. Members' financial contributions and hence claims over assets can take a variety of forms.
3. Members' claims need to be distinguished from liabilities which constitute the claims of non-members.
4. The notes to the accounts can be used to reconcile the limitations of balance sheet presentation required by GAAP with the information needs of members.

What follows is a first draft of proposed iSORP content regarding the reporting of members' funds on the balance sheet and in the notes. This does not include detailed content regarding reporting on particular funds or reporting member patronage returns/dividends as these topics are to be addressed in future discussion papers.

¹ See PAAinE discussion paper on the loss absorption approach (January 2008) for a useful description of the equity buffer and its relevance to users of financial reports. Available at the EFRAG website: http://www.efrag.org/files/ProjectDocuments/PAAinE%20-%20Equity%20-%20Liability/PAAinE_DP%20Equity-Liabilities.pdf

3. PROPOSALS ON THE PRESENTATION OF MEMBERS' FUNDS

1. Co-operatives report to their members. This fact should inform financial report design and the information provided.
2. The financial report should clearly distinguish between funds provided by members and the claims of non-members (liabilities). Where GAAP places substantial constraints on how members' funds are reported on the balance sheet, the co-operative should use the notes to provide full and appropriate disclosure.
3. Members' financial contributions may take various forms, including: member shares, preferred or investment shares, loans, deposits, retained patronage allocations and retained earnings.
4. Members' funds may include some items classed by GAAP² as equity and some classed as liabilities. However, they should be presented in such a way that the reader is provided with a clear understanding of the full range and amount of members' financial commitments. This should include an overall total of all members' funds.
5. Information in the financial report should be presented in a way that is likely to be understandable to the average co-operative member.
6. Balance sheets may be presented in either of two ways: (a) in T-style with assets on one side and liabilities and members' equity on the other, or (b) in vertical style. The T-style is becoming less common and the vertical style is arguably more understandable to non accountants. It places less emphasis on the arithmetical equivalence of the two sides of the balance sheet and can be used to highlight important totals and subtotals as the reader's eye is drawn down the page. This discussion paper favours the use of the vertical style of presentation so that members' funds can be given prominence. Comment is invited on this.
7. A vertical style balance sheet can be presented in either of two ways: (a) in two parts, where the equality of Total Assets and Total Equity & Liabilities is preserved, or (b) where Members' Equity is presented as the difference between Total Assets and Total Liabilities. Following from the explicit primacy of reporting to members, this discussion paper favours the latter form of presentation. Comment is invited on this.
8. Whichever form of presentation a board adopts, or is forced to follow, it is still possible to present members' equity and funds in a way that distinguishes those claims from the liabilities owed to non-members.
9. There are two possible ways of presenting members' equity and members' funds. One option is to make no distinction between equity and funds but present the information under a single heading. The alternative is to provide subtotals for each category as well as a combined total. These alternative presentations are shown in Figures 1 and 2 below.

² GAAP stands for 'Generally Accepted Accounting Principles' or 'Generally Accepted Accounting Practice' (depending on local accounting framework).

Figure 1

Members' funds grouped under one main heading

FUNDS PROVIDED BY MEMBERS	
Members loans and deposits	000
Members shares ³	000
Non-distributable reserves	000
Distributable reserves	000
Retained earnings	000
TOTAL MEMBERS EQUITY AND FUNDS	<u>000</u>

In figure 1, members' funds are grouped together and listed separately from liabilities in respect of non-members. Non member related liabilities would be listed separately as "liabilities excluding funds provided by members".

Figure 2

Distinguishing between members' equity and members' funds but providing a combined total

MEMBERS EQUITY	
Members shares ³	000
Non-distributable Reserves	000
Distributable Reserves	000
Retained earnings	000
Total members equity	<u>000</u>
MEMBERS FUNDS	
Term	
Members trading deposits	000
Members term loans and deposits	000
Current	
Members short term loans and deposits	000
Total members funds classified as liabilities	<u>000</u>
TOTAL MEMBERS EQUITY AND FUNDS	<u>000</u>

In figure 2, members funds are identified as differing from equity and classed as liabilities but are shown separately from non member related liabilities which would be listed separately as "liabilities excluding funds provided by members".

³ Where several classes of shares have been issued further details would be given.

10. This discussion paper favours the second form of presentation as it makes clearer the difference between those contributions that comprise equity in the form of share capital and associated reserves and retained earnings and those funds which have been contributed on either a short term or long term basis. Comment is invited on this.
11. Departing members. When a member ceases to be an active member of the co-operative and signifies a wish to leave, or when the board determines that such a member has ceased to be active and their funds should be repaid, it is recommended that all equity and funds of such members should be reported as a liability. Comment is invited on this.
12. Figures 3 and 4 (see pages 8 and 9 below) present balance sheets in the style favoured by this discussion document⁴.

⁴ For clarity no comparative data has been included.

Figure 3

Balance sheet of ABC Co-operative Ltd as at dd-mm-yy

MEMBERS EQUITY		
Members shares ⁵	500	
Non-distributable Reserves	600	
Distributable Reserves	350	
Retained earnings	150	
Total members equity		1600
MEMBERS FUNDS		
Term		
Members trading deposits	100	
Members term loans and deposits	300	400
Current		
Members deposits	350	350
Total members funds classified as liabilities		750
TOTAL MEMBERS EQUITY AND FUNDS		2350
Represented by:		
ASSETS		
Cash	100	
Receivables	300	
Inventory	1450	
Property, Plant & Equipment	4500	
TOTAL ASSETS		6350
Less LIABILITIES TO NON-MEMBERS		
Payables	1850	
Loans	2000	
Owing to ex-members	150	
Total liabilities to non-members		4000
ASSETS LESS LIABILITIES TO NON MEMBERS		2350

⁵ Where several classes of shares have been issued further details would be given.

Figure 4

Balance sheet of ABC Co-operative Ltd as at dd-mm-yy

ASSETS		
Cash	100	
Receivables	300	
Inventory	1450	
Property, Plant & Equipment	4500	
TOTAL ASSETS		6350
Less LIABILITIES TO NON-MEMBERS		
Payables	1850	
Loans	2000	
Owing to ex-members	150	
TOTAL LIABILITIES TO NON-MEMBERS		4000
MEMBERS EQUITY AND FUNDS		2350
Comprising:		
Members shares ⁶	500	
Non-distributable Reserves	600	
Distributable Reserves	350	
Retained earnings	150	
Total members equity	1600	
MEMBERS FUNDS		
Term		
Members trading deposits	100	
Members term loans and deposits	300	
Current		
Members deposits	350	
Total members funds classified as liabilities	750	
		2350

⁶ Where several classes of shares have been issued further details would be given.

4. QUESTIONS FOR FEEDBACK

CEARC is keen to receive feedback concerning any aspect of this working 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 view the co-operative member as the primary user of co-operative financial reports?*
2. *Do you think it is more appropriate to use the vertical style of balance sheet?*
3. *If you do favour the vertical style presentation, do you think it is more appropriate to present members equity and funds as the difference between assets and liabilities?*
4. *Do you favour distinguishing between equity and funds but providing a combined total as in Figure 2?*
5. *Do you agree that when membership is terminated all of that member's equity and funds should be reported as a liability?*
6. *If you favour the vertical style of presentation, do you prefer the presentation in Figure 3 or Figure 4?*
7. *Are there any other points to be addressed regarding presenting members funds on the balance sheet 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.

Comments should be received by December 11th, 2008

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