Co-op Directors 101:
Cooperative Finance
Co-op Directors 101 Training Webinar Series
Today’s webinar will run for approximately 60 minutes.

Participant phone lines are muted.

Webinar Format: presentation followed by live answer session.

Submit questions during the presentation via the Question Box.

The webinar is being recorded and will be posted at uwcc.wisc.edu.
Your financial oversight responsibilities

Financial Terms

Financial Reports

Profit Distribution

Financial Analysis and Planning
It is your Responsibility and Duty...

... to acquire and protect the co-op’s assets

... to assess the co-op’s performance

... to protect the interests of both the members and the co-op

What is the financial health of the cooperative? What are its goals?

What financial information do you need? How often do you need to see it?
Annual Cycle of Financial Activities

- Approve a budget
  - In start-up and developing co-ops, a pro forma will be part of a feasibility study and/or business plan
  - Set up Chart of Accounts for easy budgeting and review of financial reports
- Review and approve financial reports at each board meeting
- Make additional financial decisions as needed throughout the year
- At the close of the fiscal year, make decisions about profit
- Annual report for the membership at the annual meeting
- Annual audit – do any changes need to be made?
Financial Terms

**Equity** - money invested in the business without a guarantee of payback or financial return; “at risk” capital that entitles the investor to share in ownership, control, and any business profits or losses; the Articles/Bylaws/Membership Agreements will define the **Membership equity requirement**

**Debt** - money that is borrowed and must be paid back to the lender with additional interest payments; lenders do not have ownership rights

**Profit/Surplus** - total revenue minus total expenses for a given time period, usually one year

**Retained Earnings** - profit/surplus that is retained by the cooperative to be reinvested in the business
Financial Terms

**Patronage allocation** - profit allocated to a member based on their use of the cooperative that year; made up of cash refund and/or **allocated equity**

**Unallocated equity** - a portion of net profits retained and collectively held by the cooperative; often the profit from business conducted with non-members

**Per unit retain** - percentage of each financial transaction with a member held by cooperative and credited to member equity accounts

**Preferred stock** - method of raising equity capital through members and non-members; offers a dividend but does not grant voting rights; dividends are paid out of profits but are not guaranteed
What financial information do you need? How often do you need to see it?

Financial Reports:

• Balance Sheet
• Income Statement (Profit and Loss)
• Statement of Cash Flows
Snapshot at a point in time:

Summarizing activity for the next period of time:

Income Statement

| Sales Revenue |
| Expenses |
| Profit before Taxes |
| Net Profit |

Statement of Cash Flows

| Operating Activities |
| Financing Activities |
| Investing Activities |
| Net Change in Cash |
**ASSETS**

- Cash/Current Assets
- Long-term Assets
- Buildings & Equipment
- Land
- (Depreciation - Buildings & Equipment)

**LIABILITIES**

- Current Liabilities
- Long Term Liabilities

**EQUITY**

- Member Equity Investments
- Retained Patronage Allocations
- Unallocated Retained Profit/Loss

**TOTAL ASSETS**

**TOTAL LIABILITIES**

**TOTAL EQUITIES**

**TOTAL LIABILITIES AND MEMBER EQUITY**

**BALANCE SHEET: At a point in time:**

ASSETS: the co-op **owns**

LIABILITIES: the co-op **owes** - to creditors and lenders

EQUITY: the **members own** – after the assets are used to satisfy obligations

**ASSETS = LIABILITIES + EQUITY**

and

**EQUITY = ASSETS - LIABILITIES**
## INCOME STATEMENT: Summary of activity for a period of time

- Revenue that the co-op business activities produced
- Expenses that were incurred to produce revenue
- Profit that remains

<table>
<thead>
<tr>
<th>Sales Revenue</th>
<th>Cost of Goods</th>
<th>Gross Profit Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expenses</td>
<td>Wages</td>
<td>Operating Expenses</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Depreciation</td>
</tr>
<tr>
<td>Profit Before Taxes</td>
<td></td>
<td>Taxes</td>
</tr>
<tr>
<td>Net Profit</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Unallocated Retained and Member Allocated Patronage Earnings*
### STATEMENT OF CASH FLOWS:
*Summary of activity for a period of time*

- Cash that was received by the business
- Cash that was paid out by the business
- Cash that remains

<table>
<thead>
<tr>
<th>Changes in Operating Activities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Profit Adjustments</td>
<td></td>
</tr>
<tr>
<td>Loan Principal Payments (cash out)</td>
<td></td>
</tr>
<tr>
<td>Depreciation Expenses (no cash out)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Changes in Investing Activities</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Leasehold Improvements, Equipment</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Changes in Financing Activities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Member Equity</td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td></td>
</tr>
</tbody>
</table>

**NET CHANGE IN CASH**
**BALANCE SHEET: At the NEXT point in time:**

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
<th>EQUITY</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash/Current Assets</strong></td>
<td><strong>Current Liabilities</strong></td>
<td><strong>Member Equity Investments</strong></td>
</tr>
<tr>
<td><strong>Long-term Assets</strong></td>
<td><strong>Long Term Liabilities</strong></td>
<td><strong>Retained Patronage Allocations</strong></td>
</tr>
<tr>
<td><strong>Buildings &amp; Equipment</strong></td>
<td></td>
<td><strong>Unallocated Retained Profit/Loss</strong></td>
</tr>
<tr>
<td><strong>Land</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>(Depreciation - Buildings &amp; Equipment)</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td><strong>TOTAL LIABILITIES</strong></td>
<td><strong>TOTAL EQUITIES</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES AND MEMBER EQUITY</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## Comparing Income Statements (Statement of Operations)

<table>
<thead>
<tr>
<th></th>
<th>THIS YEAR</th>
<th>LAST YEAR</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SALES REVENUE</strong></td>
<td>$ 600,000</td>
<td>$ 500,000</td>
</tr>
<tr>
<td>Cost of Goods</td>
<td>$ 350,000</td>
<td>$ 300,000</td>
</tr>
<tr>
<td><strong>TOTAL GROSS MARGIN</strong></td>
<td>$ 250,000</td>
<td>$ 200,000</td>
</tr>
<tr>
<td><strong>EXPENSES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wages and Benefits</td>
<td>$ 160,000</td>
<td>$ 150,000</td>
</tr>
<tr>
<td>Rent, Utilities, &amp; Insurance</td>
<td>$ 60,000</td>
<td>$ 60,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$ 2,000</td>
<td>$ 2,000</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>$ 1,000</td>
<td>$ 1,500</td>
</tr>
<tr>
<td><strong>TOTAL EXPENSES</strong></td>
<td>$ 223,000</td>
<td>$ 213,500</td>
</tr>
<tr>
<td><strong>NET INCOME BEFORE TAXES</strong></td>
<td>$ 27,000</td>
<td>$(13,500)</td>
</tr>
<tr>
<td>Income Taxes</td>
<td>$ 2,025</td>
<td>$ -</td>
</tr>
<tr>
<td><strong>NET INCOME</strong></td>
<td>$ 24,975</td>
<td>$(13,500)</td>
</tr>
</tbody>
</table>
Other Financial Reporting – the Annual Audit

- For the benefit of the decision-makers, not the managers
- The auditor doesn’t prepare the financial statements, but examines for errors and proper recording, internal control, and adherence to accounting standards
- Prepares an audit report based on year-end financial statement
- Includes a Statement of Changes in Member Equity
Some potential financial statement problems include:

- Inadequate reserves for accounts receivable losses
- Obsolete/excessive/estimated inventories
- Lack of internal controls and operating procedures
- Lack of consistent financial statement presentation
- Accounts are not reconciled timely or at all until year-end
- Etc.
Cooperative Operations

Net Profit

Dividends to Preferred Shareholders (member or nonmember)

Allocated Patronage Dividend or Refund (credited to member/patron on the basis of patronage)

Unallocated (not credited to member/patron)

Cash

Minimum 20% qualified allocation required in cash

Qualified Written Notice

Non-Qualified Written Notice

Co-op pays income tax

Both co-op and recipient pay income tax

Member/patron pays any required income tax

Co-op pays income tax. Upon future distribution to member, member/patron pays any required tax, and co-op receives tax credit.
Profits

Dividends to preferred shareholders (member or nonmember)

Allocated Patronage Refunds
based on use by each member
(credited to members)
members pay taxes at personal rate

Unallocated
(not credited to members)
co-op pays taxes at corporate rate
Member 1 - $50,000
Member 2 - $75,000
Member 3 - $100,000
Member 4 - $25,000
Member 5 - $50,000

Total COGS - $300,000
Expenses - $75,000
Total Revenue - $376,000
Net Profit - $1000
YAYA!!!!

No preferred stock – phew
$500 – unallocated
$500 – allocated → $200 paid in cash dividend, $300 allocated equity

So of $1,000 profit, co-op keeps $800 on its books for investment, reserves, etc.
Member 1 - $50,000 - 16.67%
Member 2 - $75,000 – 25%
Member 3 - $100,000 – 33.33%
Member 4 - $25,000 – 8.33%
Member 5 - $50,000 – 16.67%

Patronage allocation - $500
$200 - cash
$300 – allocated equity

Member 1 - $33 cash, $50 equity
Member 2 - $50 cash, $75 equity
Member 3 - $67 cash, $100 equity
Member 4 - $17 cash, $25 equity
Member 5 - $33 cash, $50 equity
Financial Analysis: Making Better Decisions

Liquidity: Ability to meet short-term obligations

Profitability: Ability to sustain operations that benefit members, and ability to attract and retain financing

Solvency: Ability to meet long-term obligations, generate future revenues
Liquidity

Current or working capital ratio

\[
\text{Current or working capital ratio} = \frac{\text{Total current assets}}{\text{Total current liabilities}}
\]

Net working capital

\[
\text{Net working capital} = \text{Current assets} - \text{current liabilities}
\]
<table>
<thead>
<tr>
<th></th>
<th>THIS YEAR</th>
<th>% of SALES</th>
<th>LAST YEAR</th>
<th>% of SALES</th>
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<td><strong>SALES REVENUE</strong></td>
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<td></td>
<td>$300,000</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL GROSS MARGIN</strong></td>
<td>$250,000</td>
<td>42%</td>
<td>$200,000</td>
<td>40%</td>
</tr>
<tr>
<td><strong>EXPENSES</strong></td>
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<td></td>
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<tr>
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<td>$150,000</td>
<td>30%</td>
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<tr>
<td>Rent, Utilities, &amp; Insurance</td>
<td>$60,000</td>
<td>10%</td>
<td>$60,000</td>
<td>12%</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$2,000</td>
<td></td>
<td>$2,000</td>
<td></td>
</tr>
<tr>
<td>Interest Expense</td>
<td>$1,000</td>
<td></td>
<td>$1,500</td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL EXPENSES</strong></td>
<td>$223,000</td>
<td>37%</td>
<td>$213,500</td>
<td>43%</td>
</tr>
<tr>
<td><strong>NET INCOME BEFORE TAXES</strong></td>
<td>$27,000</td>
<td>5%</td>
<td>$(13,500)</td>
<td>-3%</td>
</tr>
<tr>
<td>Income Taxes</td>
<td>$2,025</td>
<td></td>
<td></td>
<td></td>
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<td><strong>NET INCOME</strong></td>
<td>$24,975</td>
<td>4%</td>
<td>$(13,500)</td>
<td>-3%</td>
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Solvency

Ownership or Equity/ Asset Ratio

= Total member equities/Total assets
Financial Planning...

Importance of cash – a limited resource

- Provides working capital
- Purchase needed assets
- Pay down debt
- Pay annual patronage refunds
- Retire retained patronage equities
Financial Planning...

Purpose of equity

- Cushion to withstand financial volatility
- Reduce dependency on debt

Equity management depends on:

- Profits and working capital needs
- Patronage refunds
- Equity redemptions
Some scenarios and considerations:

- Capitalization strategies for purchase of a new asset or expansion
- Grants and the business proposition
- Unforeseen events…

What do you do if GM is not providing good reports to the board?

How do you communicate the financial situation to your membership?
Questions?

Please use the Q&A Box on the righthand side of your screen to send questions.
Co-op Development Team

Courtney Berner
Contact Courtney about cooperative governance
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Lynn Pitman
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Thank you!