Understanding a

Co-op Financial Statement

NORTH DAKOTA
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Understanding a

Co-op Financial Statement

Balance Sheet

THERE ARE BASICALLY TWO LISTS:

- **List 1 =** all property owned
- **List 2 =** claims against the cooperative by suppliers, lenders & owners

*Total Assets = Total Liabilities + Member Equity

Current Assets

Current Assets
cash or items expected to be converted into cash within 12 months (cash, checking, liquid funds)

Accounts Receivable
amounts owned to the co-op from patrons

Inventories
products on hand available for sale (batteries, fertilizer, tires, fuel, etc.)

Other Assets

Investments in Cooperatives

- investments one co-op has in another
- small co-ops buy "from" and "together" creating larger co-ops (EXAMPLE: grain marketing)

Fixed Assets

Land, Buildings & Equipment
accounts that include land, buildings, vehicles and other equipment

- Less Accumulated Depreciation

= Net Fixed Assets

Liabilities & Members' Equity

Current Liabilities

- financial claims against an organization
- what the co-op has to pay within 12 months (short-term)
- payments to suppliers, employees, payments made more frequently then on an annual basis
- accounts payable, accrual taxes, accrual expenses, patronage refunds payable, loans payable

Long-Term Liabilities

- amounts not due in the next 12 months
- mortgage loans on building & equipment are listed in this section
- long-term portion (what a co-op owes)

Members' Equity Accounts

Common Stock

common stock can be purchased or earned through patronage refund (right to vote)

Allocated Equity Credits

- yearly additions of retained patronage refund
- co-op members share that is reinvested minus the amount of dividend paid out

Retained Earnings

- money from business done with non-members

Statement of Operations

- primary revenue sources are listed first
- reports the business results of the current year and the previous year
- after all expenses are deducted from total revenues, net income remains (co-ops also name it net savings/net margins)
- high net income is good
- loss in net income is not good (raises questions)

Sales

$ amount received for products sold

Cost of Sales

$ amount a co-op pays for products it sells
(amount a co-op pays to the supplier for fertilizer)

Sales - Cost of Sales = Gross Margin

Gross Margins on Sales

- represents the difference between "sales" and "cost of sales"
- margins from farm supplies are usually more than grain because farm supplies take more time and are harder to store, handle & sell in large quantities so a large margin is required to cover costs

Other Operating Income

income not from selling products – but from providing a service (grain storage, fertilizer service, grinding, mixing, drying – finance charges)

Total Gross Margins

margins from sales + service income
= total gross margin

Operating Expenses

- represent the cost of goods and services used in a year of operation (salaries, utilities, taxes, fuel, etc.)
- includes labor, depreciation, insurance, truck operating expense, utilities, property taxes, reserve for bad debts, investments, other

- **depreciation -** usually the largest expense, not paid in cash during the year – an accounting charge for use of a building or equipment

  Total Gross Margin - Total Operating Expense
  = Net Income from Operations

Net Income from Operations

Other Income

- **patronage refund -** funds from one co-op to another
- co-ops join together to form co-ops the same way farmers do
- net income of co-ops is often distributed back to its member co-ops based on business volume
- co-ops with other co-ops as members are **federated co-ops**

  Net income from operations + other income
  = net income before taxes

  Net income before income taxes - income tax
  = net income after income tax

Net income

- earnings on member business is usually allocated to the members in a combination of cash and non cash equity allocations
- board of directors, subject to Bylaws and other agreements, decide on the distribution of net income
- based on the year's results, directors decide on patronage refund rates and the program of patronage
- when a co-op has a loss, directors decide how losses will be allocated and make other important regional decisions

Distribution of Net Income

- not part of the operating statement
- not all annual reports present them or prepare them
- distribution of net income is a clear way to show what happens to the income a co-op has earned

Statement of Cash Flows

- statement shows a co-op's ability to meet obligations to lenders, suppliers and members
- only cash payment/receipts are included
- cash & checks received in payment would be included
- credit sales not yet received would be excluded
- on the statement – all cash payments and receipts are divided into three activities

  Operating, Investment, Financing

Operating Activities

includes business activities involved in providing goals and services

- "bring in cash" – sale of grain/supplies
- "send out cash" – payment to suppliers and salaries

Investing Activities

acquiring new production facilities and investments in another cooperative

- sale of land or redeeming investments are examples that generate cash

Financial Activities

obtain or return financial resources from members
(EXAMPLE: repaying a bank loan)

Financial Analysis

- Company sales - between two years will show how the size of the business operations has changed
- Changes between years can be
  - changes in the market, conditions, prices, and weather conditions
  - conditions that affect the members will affect the co-op
- Changes in the individual line item or income expenses may reflect changes in operations

- change the store location
- lower co-op sales of grain
- a new location in an expanded trade area may account for higher farm supply sales
- changes in balance sheet account show how the mix of assets used by a co-op has changed, how assets are being financed
- two years of income is not enough to identify trend

Financial Ratios

Accounts payable

provide an important source of financing - must come from either members' equity or loans from banks or other sources.

Equity-to-asset ratio

shows the proportion of a co-op's assets financed by members' equity.

Ratio = total equity ÷ by total assets

Low Levels

- co-ops with low levels of equity might not have the reserves to weather difficult times
  - low levels of equity are caused by operating losses, low initial equity investment, or financial plans not designed to build equity
  - continued existence of these co-ops depends on favorable interest/continued successful operation

High Levels

have the benefit of low or no interest expense; however, in building their high equity base, they may have delayed expansion or placed heavy burden on their members for financing and may not develop their potential

What do co-ops do with income earned?

- pay larger amounts of cash to members
- build up equity by retaining it in the co-op

Return on Assets

returns-on-assets ratio considers the financial return to both debt and equity

- interest paid is added to net income to measure total return to assets
  - "How much total income has the co-op earned with the assets employed by it?"
- By comparing year-to-year changes, members can follow how effectively their co-op is utilizing its assets

return on assets = (net income) + interest ÷ assets

Return on Equity

this ratio weighs yearly earnings against total equity and takes a slightly different view of performance than the return-on-assets ratio.

return on equity = net income ÷ equity

- if a co-op has a large proportion of its assets financed by member equity, the return of equity and on assets financed by member equity, the return of equity and on assets will be related
- when a co-op is using a high degree of borrowed funds, the return on equity can greatly depend on how the interest rate paid compares to return-on-assets