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Making a Cooperative (Financial) Statement

An Opinion Piece

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Abstract: This opinion piece is based on a paper presented by Ian Glassford at the 2018 Symposium on Co-operative Accounting and Reporting: Co-operative Socio-economic Transformation. It asks: Is the amount you are spending on your cooperative difference (what the member sees/gets that they would not get if you did not exist as a cooperative) growing or shrinking? Do you know how much it is? Do you know how much you can spend on it without risking the financial viability of your cooperative? It goes on to suggest that if we continue to use unmodified Financial Statement formats designed for entities where there is never enough profit, we are very unlikely to be able to provide our members, Boards and management with those insights. Without those insights, how effective can we be as cooperatives?

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Cooperatives and profit maximizing entities are both in the business of staying in business. With very few exceptions, the financial failure of a cooperative results in damage to members, employees and communities. A cooperative in financial trouble is no longer autonomous and independent – the members risk losing control to creditors and other parties as we have unfortunately seen at times. It is only partly in jest that we can sometimes say that "bankruptcy is not one of the seven cooperative principles". Up to the point of having "enough" to ensure ongoing viability and independence, cooperatives and profit maximizing entities have a great deal in common because of the duty of care managers of a cooperative owe their members.

It is at the point of "enough" that cooperatives materially diverge from profit maximizing entities. Once a cooperative has "enough" to ensure it can continue as an autonomous entity meeting the needs of members, any amount beyond this is available to live the cooperative difference. This may be realized through community or social investments, sharing of excess profits with members, improved pricing for members, or many other ways.

If a cooperative does not know what "enough" is, however, how well can it function as an engine of socio-economic transformation? Without ongoing financial insights into "enough", the cooperative risks either earning too little revenue and profit to continue or holding back on profit that could have been used for the cooperative difference out of concern that they do not have "enough".

It appears that the reason many cooperatives find themselves in this grey area is because of our unquestioning use of standard financial statements. We recognize and are often quite active sharing the message that cooperatives are different than profit maximizing entities when it comes to areas such as regulation, taxation, policy and governance and yet for some reason we rarely question using a template of financial reporting that was designed for those same profit maximizing entities. The structure of modern financial statements was designed for entities where there is no such thing as more than "enough" – they are the numeric equivalent of the old question "how high is up?" Without modification this approach to financial statements will never tell us, our boards or members when we have made "enough".

The point is not that cooperatives should reject standard financial reporting and the structured flow of income statements and balance sheets, nor that we should demand completely different accounting standards. There is value in having consistent statement preparation to allow for comparison and strong controls over financial reporting.

The point is that we as cooperatives do not have to stop there. We can modify internal statements as we see fit for our own internal management accounting and by doing so highlight and enhance our focus on growing the cooperative difference in our entities. We could even advocate for changes to International Accounting Standards to allow for cooperative reporting that better reflects financial performance in this sector.

The ultimate purpose of financial reporting is to tell the stakeholders of an entity the financial information they need to manage the company and to make the most important decisions. If our financial reporting is not telling us whether we are making "enough", or how much more than "enough" we have to invest in our cooperative difference, then we are poorly positioned to manage and maximize one of the most important elements of being a cooperative.

Modifying financial reporting to address the concept of "enough" and funds available (or required) relative to that point involves three steps:

1. Identify what "enough" is in regard to annual income and equity. These figures will be unique to each industry. A credit union, dealing in diverse risks (credit risk, interest rate risk, liquidity risk), will need much more income and equity to ensure long term financial viability than a cooperative where there are fewer events that could cause sudden negative financial swings. Both, however, will need enough income to cover things like inflation, investment in technology/plant/equipment and ongoing operating costs. In addition, within industries each cooperative may choose a different operation model that results in different measures of "enough". The journey to quantify this figure (and it will almost certainly be an estimate in the end) is part of better understanding how your entity functions as a cooperative in its industry.

2. Build a step into your annual income reporting to draw the line of "enough" and, from that, identify whether your annual income is sufficient to ensure ongoing financial viability and, if so, to then quantify how much more than "enough" is available.
3. Build a measure in your balance sheet to identify how much equity is "enough" and from that to quantify how much equity can be applied to the cooperative difference should your cooperative decide to make such investments.

Building this kind of financial reporting requires a great deal of thought about how your cooperative functions, what is financially necessary for it to function simply as a business (regardless of whether it is a coop or not) and then how to separate in your financial reporting that which you spend because you are a cooperative vs what you spend as part of simply operating a business. The insights and journey to gain these insights can have significant value for the cooperative.

The value does not stop there, however. The greatest value is becoming aware of how much or how little you have to invest in your cooperative difference. This may open your eyes to why your coop is not more successful (too little available to invest in your cooperative difference) or to missed opportunities (more available than you realized, so it was not being invested in the cooperative difference). Finally, it may also help to ensure your cooperative always has enough to survive the ups and downs of economic cycles. Without some sense of "enough" it can be like walking along the edge of a cliff in the dark. You won't know how close you are until it is too late.

The figure a cooperative identifies as "enough" is not easy to calculate perfectly. Although it may start as a broad estimate, keep in mind the statement of Charles Babbage (1792 – 1871) who said, "errors using inadequate data are much less than those using no data at all".

Figure 1: Investing in the cooperative difference