

Understanding

Co-op Finance

What every co-op leader should understand
about how cooperative finances work.

For boards and staff of rural electric cooperatives.

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ABOUT THIS SERIES

This is the third resource in the Co-op Foundations Series from Co-op Innovation Network. Volume 1 introduced how rural electric cooperatives are structured. Volume 2 explored the relationship between distribution cooperatives and their G&T. Volume 3 turns to finances: what the numbers mean, where the money comes from, and what every co-op leader should understand about how cooperative finances work.

Introduction

Finance can feel like it requires specialized expertise, something best left to a few staff or a small circle of experts. But in a co-op, financial decisions shape what members pay, what programs the co-op can offer, and how much flexibility leadership actually has. To lead effectively, both board members and staff need a working knowledge of co-op finances.

Understanding co-op finances does not mean becoming an accountant. It means knowing which documents matter, what questions they can answer, and how the financial structure of your co-op connects to the decisions it makes.

This resource covers four areas: why cooperative finances work differently than other utilities, the key financial documents you will encounter, where co-ops get their funding, and how capital credits work. Each section points to additional resources for those who want to go further.

WHY THIS MATTERS

Rates

Co-op finances directly determine what members pay each month.

Decisions

Leadership decisions on rates, programs, and capital depend on the co-op's finances.

Accountability

Reviewing the numbers is part of a board's duty of due care.

WHAT THIS VOLUME COVERS

Finances Differ

Nonprofit structure, capital credits, and the 85% rule.

Key Documents

Balance sheet, income statement, and cash flows.

Co-op Funding

RUS, CFC, and CoBank.

Capital Credits

How allocation, equity, and retirement work.

Why Co-op Finances Are Different

Rural electric cooperatives are not-for-profit, member-owned organizations. That distinction is not just philosophical. It shapes how money flows, how the books are kept, and what the numbers mean for your co-op.

Investor-owned utilities exist to generate returns for shareholders. But co-ops exist to provide reliable, affordable power to their member-owners. Surplus revenue does not go to outside investors. It stays in the system, returned to members over time as capital credits or reinvested in infrastructure.

FOUR WAYS CO-OP FINANCES WORK DIFFERENTLY

Not-for-Profit Structure

Co-ops are exempt from federal income tax under 501(c)(12), provided at least 85% of income comes from member-owners. This shapes how surplus is handled and why co-ops track different indicators than investor-owned utilities.

Capital Credits Instead of Dividends

When a co-op has a positive margin, surplus is allocated back to members as capital credits. Members receive payment when the board votes to retire the credits. Until then, the money stays in the co-op as equity.

Long-Term Debt Is the Norm

Co-ops finance infrastructure through long-term loans from RUS, CFC, or CoBank. Debt service is a major driver of rates. Understanding your co-op's debt picture is essential knowledge for board and staff alike.

Member Equity Builds Over Time

Co-ops build equity through retained margins and member investments. A strong equity position provides more financial flexibility and better borrowing terms when capital is needed.



THE 85% RULE

The IRS requires that at least 85% of a co-op's income come from its own member-owners (i.e., the electric bills members pay for the power they use). This keeps cooperatives eligible for tax-exempt status and shapes decisions about selling power to non-members or pursuing outside revenue.

Key Financial Documents

Your co-op produces several financial reports each year, but three are foundational. Each tells a different part of the story, and together they give you a complete picture of your co-op's financial health.

1 Balance Sheet

A snapshot of financial position at a point in time.

- Lists everything the co-op owns (assets), everything it owes (liabilities), and the difference (equity).
- Co-op equity includes member investments, retained earnings, and capital credits held on behalf of members.
- A strong equity-to-assets ratio signals financial stability and stronger borrowing terms.

BOARD QUESTIONS TO ASK

Is our equity growing over time?
How does our debt level compare to our assets?

2 Income Statement

A record of revenues and expenses over the reporting period.

- Shows whether the co-op ran a surplus (positive margin) or deficit for the period.
- Revenue comes primarily from member electric sales. Major expenses include power supply, operations, and debt service.
- A positive margin is the basis for capital credit allocations, not profit in the traditional sense.

BOARD QUESTIONS TO ASK

Are we covering our costs?
What is driving expense increases year over year?

3 Statement of Cash Flows

Shows how cash moved in and out during the reporting period.

- A co-op can show a positive margin on paper but still face cash challenges; margin and cash are not the same.
- Distinguishes between cash from operations, investing activities, and financing activities.
- Shows how capital projects and loan payments affect liquidity.

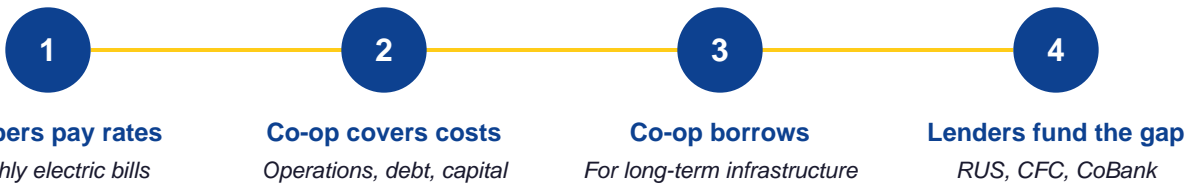
BOARD QUESTIONS TO ASK

Do we have adequate cash reserves on hand?
Are capital projects putting pressure on our liquidity?

For a practical guide to reading these statements, see [Reading Your Co-op's Financial Statements](#) (coming soon).

Where Co-ops Get Their Funding

Rural electric cooperatives rely on specialized lenders that understand the cooperative model. Most co-ops work with one or more of three primary sources. These relationships are not just financial. They come with loan covenants, reporting requirements, and constraints that boards and staff need to understand. A deeper look at these relationships is available in *Who Lends to Co-ops* (coming soon).



Rural Utilities Service (RUS)

Federal lender

The original source of financing for rural electric infrastructure, RUS provides direct loans and loan guarantees to co-ops serving areas with populations generally under 2,500. Approximately 500 electric co-ops currently hold around \$43 billion in RUS loans. RUS financing often comes with significant reporting requirements and, historically, influenced co-ops to enter long-term all-requirements contracts with their G&Ts.

National Rural Utilities CFC

Member-owned co-op lender

The National Rural Utilities Cooperative Finance Corporation was established in 1969 to provide supplemental financing beyond what RUS could offer. CFC is itself a nonprofit cooperative, owned by its members. It manages over \$37 billion in assets and serves approximately 1,000 rural utility systems. CFC offers long-term loans up to 35 years and short-term credit lines, and it analyzes cooperative financial trends that boards and staff can use as benchmarks.

CoBank

Private co-op lender

CoBank is a member of the Farm Credit System and one of the largest private lenders to rural electric cooperatives. Over 75% of electric co-ops work with CoBank. In 2023, CoBank reported \$32.6 billion in loans, with 33% going to electric distribution and 15% to generation and transmission. CoBank also provides treasury services, strategic planning support, and financial forecasting tools for member co-ops.



WHAT ARE LOAN COVENANTS?

Loan covenants are legally binding conditions attached to co-op borrowing. They may require minimum equity ratios, restrict additional borrowing, or limit how the co-op can use certain assets. Boards and staff should understand what covenants apply to their co-op and how they constrain financial decisions.

Understanding Capital Credits

Capital credits are one of the most distinctly cooperative financial concepts. They are also one of the most commonly misunderstood. A full guide is available in *Capital Credits Explained* (coming soon).

At the end of each year, if a co-op has a positive margin (revenue exceeded expenses), that surplus is allocated to members in proportion to their usage. This is the capital credit allocation. The allocation is recorded on each member's account, but the money is not paid out immediately.

Instead, the co-op holds those funds as equity until it can afford to retire them. The timing depends on the co-op's financial position and lender requirements. The board determines when and how much to retire, balancing member expectations with the co-op's need to maintain adequate equity.

HOW CAPITAL CREDITS WORK

- 1 Co-op earns a positive margin
- 2 Surplus allocated to members by use
- 3 Allocation held as co-op equity
- 4 Board votes to retire credits
- 5 Members receive payment

BOARD QUESTIONS TO ASK

- What is our current capital credit retirement schedule, and when were credits last retired?
- What is our equity-to-assets ratio, and how does it compare to CFC benchmarks for co-ops our size?
- Are there any lender covenant restrictions on capital credit retirement that leadership should know about?

KEY TAKEAWAYS

Co-ops serve members, not shareholders.

Surplus stays in the system, returned as capital credits or reinvested in infrastructure.

Three documents tell the story.

Balance sheet, income statement, and cash flow statement each tell something different. Both boards and staff should work from all three.

Your lenders shape your options.

RUS, CFC, and CoBank are partners, but loan covenants matter. Know what yours say.

Capital credits require a board decision.

The board votes on when and how much to retire, drawing on staff analysis of the co-op's financial position and member expectations.

Common Questions

What financial reports should our board receive regularly?

At a minimum, a monthly income statement, a quarterly balance sheet, and an annual audited financial report. Many co-ops also include a cash flow statement and a budget-to-actual comparison.

What is the difference between a margin and a profit?

A margin is the amount by which revenue exceeds expenses in a given period. Co-ops do not earn profit in the traditional sense. A positive margin is the basis for capital credit allocations and for building equity. A negative margin means the co-op spent more than it took in. When that happens, no capital credits are allocated.

How do we know if our co-op is financially healthy?

A few key indicators:

- Equity-to-assets ratio: a higher ratio generally signals stronger financial health.
- Debt service coverage: can the co-op cover its loan payments from operating income?
- Operating margin trends over time.

CFC publishes benchmarks for distribution cooperatives that can help contextualize your co-op's position.

What is a Form 990, and should we be reviewing it?

Form 990 is the annual tax filing required of nonprofit cooperatives. Publicly available, it includes a financial summary, balance sheet, executive compensation, and key employee information. It is a useful transparency tool and worth reviewing as a leadership team, particularly on compensation and financial position.

Can our co-op lose its tax-exempt status?

Yes, if it fails to meet the 85% rule, meaning less than 85% of its income comes from its own member-owners. This can happen if a co-op sells a significant amount of power to non-members. It is uncommon, but worth knowing.

GOING DEEPER

1

Rates 101

(coming soon)

How rates are set, what drives them, and what boards can influence.

2

Capital Credits Explained

(coming soon)

A full guide to allocation, retirement, and member communication.

3

Reading Your Financial Statements

(coming soon)

A practical, document-in-hand guide for staff and engaged board members.

4

Who Lends to Co-ops

(coming soon)

RUS, CFC, CoBank, loan covenants, and the governance implications.

Sources & Acknowledgements

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- **National Rural Utilities Cooperative Finance Corporation (CFC)**
 Financial reporting, benchmark data, and cooperative lending structure (nfc.org).
- **USDA Rural Utilities Service (RUS)**
 Electric loan program data, borrower information, and rural cooperative financing history (rd.usda.gov).
- **CoBank**
 2023 Annual Report and rural electric lending data (cobank.com).
- **We Own It**
 Research on cooperative governance and financial transparency (weownit.org).
- **University of Wisconsin Cooperative Research**
 Background on cooperative financial structure and member equity.

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