**What does a financial statement tell me?**

Like any other company, Brooklyn Coop has two types of financial statements. An income statement shows income and expenses. It covers a period of time so it has a start date and an end date. During that time, you can see where the organization gets its revenue, what expenses it had, and whether there is anything left over.

A balance sheet shows the fundamentals of an organization: how healthy it is, what are its strengths and its vulnerabilities. You can tell how well this organization will hold up under difficult economic conditions and where it has room to grow. A balance sheet has only one date on it, the end date. The start date is basically the beginning of the organization.

**Here’s our income statement.**

It shows all of Brooklyn Coop’s income and expenses for the first six months of 2019. The operating income and expenses have to do with the day to day operations. Non-operating are more like exceptional items. In our case, non-operating income is our grant money, and in this last six months, a property that had a defaulted mortgage was sold at a loss, so that cost us $22,326.

The end result is that we earned just around $5,285 in six months. It is basically breakeven, no real profit.

**What is on a balance sheet?**

The basic format is Asset - Liabilities = Equity.

Assets are everything the organization owns that can earn revenue, including items we can sell for cash.

Liabilities are everything that can reduce assets, or everything that we owe to others.

Equity is the difference between the two. It is also called Net Assets.

**Brooklyn Coop’s balance sheet for June 30 2019**

The traditional presentation puts Assets on one side and Liabilities and Equity on the other side so that the two sides are equal.

**Equity: Member Deposits**

Let’s start with deposits. Our primary job as a bank is to accept deposits from individuals and businesses and to keep them safe. In a cooperative, our depositors are also owners. That means, on the balance sheet, deposits whether in savings accounts, checking accounts, CDs… are counted as equity because that money belong to Brooklyn Coop’s shareholders.

However, this money doesn’t belong to Brooklyn Coop. It belongs to thousands of individual people who deposit and withdraw and effect thousands of transactions each day. Because deposits can be withdrawn, they don’t actually belong to the organization.

**Equity: Reserves and Undivided Earnings**

Reserves and Undivided Earnings are what Brooklyn Coop owns in its own name. Even if all the member deposits go away, Brooklyn Coop as an organization will still own its Net Worth. This equity is incredibly important. It is our wealth. Over time, for any corporation, its Net Worth is the single biggest indicator of its health. Just like for a household, the more wealth you have, the faster you can grow, the more risks you can take, the better able you are to handle the unexpected.

**Equity: Secondary Capital**

Secondary capital is a type of investment only possible for community credit unions. It is a loan and should be repaid. However, it counts as part of Brooklyn Coop’s Net Worth because, if Brooklyn Coop should ever fail, this secondary capital will instead be used to repay member deposits and the original creditor will not get their money back. Usually these loans last for 5-7 years; Brooklyn Coop’s current secondary capital will mature by 2021.

**Assets: Cash**

Now we move onto Assets. Cash is the simplest, most liquid, most flexible asset. Brooklyn Coop’s cash comes from our members’ deposits. Some we keep in our branches for when members make withdrawals; most of it we keep in our bank account so merchants or VISA can receive payments for bills our members process. We know we should keep about 10% of member deposits in our branches and our bank accounts to handle members’ transactions.

However, cash does not earn revenue. We don’t want to keep all of member deposits as cash. Most companies, including a bank, want to keep cash only for what is necessary. The rest we invest in a way that earns income.

**Assets: Loans**

The loan portfolio is super-critical! You can see that it is the largest asset we have by far. It is the essence of our business model: deposits from members are lent back out to members. Not only does this earn revenue for us, but our loans are the way we have impact for our members: by supporting their small businesses or approving mortgages or processing credit builder loans that increase members’ credit scores.

Our loan portfolio can be broken up by type: mortgages for people buying or refinancing their homes or coop apartments; personal loans; secured loans; business loans under $50,000; larger business loans that are mostly backed by real estate.

**Assets: Allowance for Loan Losses**

Next is the Allowance for Loan Loss. You’ll notice that is negative. This is specifically required because, realistically, not all the Loans create revenue. Some will not get repaid. Because the balance sheet is meant to show the organization’s strengths and its vulnerabilities, we need to acknowledge that some loans are not getting paid back. We do that with by representing potential losses with a negative number: the Allowance.

How do we know how many loans aren’t getting repaid? Right now, the standard way is to estimate losses based on our past experience. You can see our losses in 2017 and 2018 here. If we take the total amount in our Allowance and divide by the current portfolio, you can see that the amount of potential lost loans – which is what our Allowance represents – is pretty close to what historically Brooklyn Coop has experienced in lost loans.

**Assets: Investments**

Out of all the member deposits, whatever we don’t need for member transactions, and whatever we have not lent out, is invested in FDIC-insured CDs with other banks. These are not very high yielding investments, but they are very safe. From our point of view, we take risks in our loan portfolio, not in our investment portfolio.

**Assets: Fixed Assets**

Assets like property and equipment (fixed assets) are still assets, but aren’t as relevant to a bank’s business. This would be very large and very important for, say, Boeing.

**Other Assets:** The remaining Assets are mostly accounting requirements. NCUSIF, for example, represents what our regulator – the NCUA – asks for as a deposit. They use this money, pooled with the NCUSIF deposits of all the other insured credit unions, to ensure that all deposits of members will be repaid if a natural-person credit union ever fails. This required deposit changes each year based on the total member deposits we have.

**Liabilities: Accounts Payable**

We don’t have much in liabilities. Accounts Payable are checks we or our members have written that have not yet been cashed. Once they are cashed, they will reduce our cash balance. Notes Payable is part of the secondary capital loan we discussed earlier – that is money we owe to others. Other liabilities include interest accumulated on CDs in member accounts but not yet paid – also money we owe to others.

**Liabilities: Deferred Grants**

BCoop won a major grant in 2018 from the US Treasury Department. It was a total of $1.25 million, of which the Treasury Department has already sent us $1 million. That’s it, right there. The actual $1 million in cash shows up in “Cash” in “Assets”, and to balance it out, is here in “Liabilities”. Eventually it will move to “Reserves”, but not yet because BCoop has to meet some performance goals first. In theory, If we miss our targets badly enough, the Treasury could ask for its grant back and that’s why it is still a Payable. I don’t think that will happen. By Dec 31 2019, we will know if we’ve hit our year 1 target. If we have, which we are on track to do, we can use 1/3 of this Payable.

**Liabilities: Nonmember Deposits**

Nonmembers are other financial institutions that deposit money with us at 0% interest in order to support our lending. This used to be much bigger when we didn’t have as many member deposits.

**Critical Ratios**

That’s our Balance Sheet. We’ve gone through each of those components one by one and you understand what they mean. Still, how do use this information to tell the strengths and vulnerabilities of BCoop, how healthy it is, how much it can grow, etc… ? For that, we use ratios.

There are five ratios in particular that you should know about. I will explain each one, show you the history of these ratios over the past eight years, and also I’ve put down the ratios of other credit unions under $50 million so you can see where Brooklyn Coop stands among its peers.

**Loans/ Deposits**

This goes to the heart of what it means to be a financial institution. The business model of a bank is to be an intermediary. We take deposits from individuals or businesses, and lend those deposits to individuals or businesses. A bank that does not lend is basically just a giant safety deposit box. And maybe that’s fine for some situations. But for us, we aren’t going to survive if we aren’t earning interest income. Furthermore, we will not be helping members build their assets or helping local economic development if we’re just a giant safety deposit box. So, Brooklyn Coop lends actively and steadily. To calculate the deployment ratio, you divide Loans by all Deposits.

**Loan Loss Ratio**

This ratio doesn’t come from the balance sheet. You have to separately add up all lost loans over the past 12 months and then divide that by the current total loans outstanding. The past eight years for Brooklyn Coop are here – you can see how terrible the effects of the financial crisis were for our members and for us. But even in ordinary years, compared to our peers, BCoop has higher losses. Our members have less income, less wealth, less resiliency and so they pose more risk.

**Return on Assets**

The return on assets is a standard calculation for financial firms. It tells you roughly how profitable the company is, how much income we earn off of all the assets we hold. You can see BCoop is less profitable than its peers. The huge number in 2015 was because we took in a large grant that year – you will see our Net Worth also went up that year. Since then, we are mostly right at break-even. It is not a strong performance and that means we do still have to rely on external grants to pay our bills. To get ROA, divide the net income by total assets.

**Operating Income/ Operating Expenses**

There are a number of ways to represent how productive an organization is. Return on Assets is one sort of perspective. It compares our income to our assets in order to get at this idea of our productivity, how good we are at our business model. We could take another perspective by asking the question, ‘Can Brooklyn Coop pay its bills?” So, leaving aside our assets, do we have a deficit right now? This ratio – operating income divided by operating expenses – answers that question. You can see how Brooklyn Coop is never at 100%. We struggle here and have needed grant income to fill in the gap between our expenses and our operating income.

Still, on the very bright side, this has improved dramatically in the last eight years. Finally, after starting from literally zero, we are in a position where a lack of grants will not mean automatic failure. A sustainable business model for a community financial institution is notable.

**Net Worth Ratio**

The Net Worth of an organization is the key to its long-term survival. The more we have, the better off we are. However, there is a minimum we cannot fall below.

All financial institutions are required to have a certain minimum Net Worth. The credit union regulator – the NCUA – mandates a minimum 6% Net Worth Ratio. If any credit union falls below 6%, the NCUA will fire the staff, shut the credit union down, give the depositors back all their money back, and liquidate any other assets that remain. If the Net Worth Ratio falls below 7% then the NCUA can intervene in day to manage the credit union’s finances, so truly we don’t ever want to be below 7%.

To calculate the net worth ratio, you add up Reserves + Undivided Earnings + Secondary Capital (this is the total net worth) and divide it by Assets.

**BCoop Membership and Assets.**  I wanted to put this slide in to give some context regarding our overall growth. In terms of our assets, we have really steady, quite strong growth. Right now Brooklyn Coop is Brooklyn’s third largest credit union despite being its youngest.

The number of members is also very high. Even the second largest credit union in Brooklyn (Consumers FCU) has less than 3,000 members. So this is astounding, honestly. The drop in 2013 was because we purged a lot of dormant accounts that year. Then we were basically steady for a long time until 2017. Since then, growth has been extremely strong, and it the reason our net worth ratio is in such trouble this year.

**Group Exercise**

Evaluate the balance sheet of this small credit union and tell us what its critical ratios are and whether you think there are any particular strengths or vulnerabilities.