National Cooperative Business Association ■ www.ncba.coop

October 3, 2007

Robert Pozen
Chair
SEC Advisory Committee on Improvements to Financial Reporting

Dear Mr. Pozen:

We are writing to urge you to seek input from and consider the financial reporting needs of cooperatives in the work of the Advisory Committee. The National Cooperative Business Association (NCBA) is the nation's only national organization representing cooperatives across all sectors of our economy—including agriculture, childcare, energy, finance, food retailing and distribution, healthcare, housing, insurance, purchasing and shared services, telecommunications and others.

Cooperatives play a major role in the US and global economy. According to the International Cooperative Alliance, **the top 300 co-ops had $963 billion in revenues in 2004**. That is only slightly less that the economy of the world's ninth largest country, Canada.

Of the many financial challenges confronting cooperatives in recent years, few have generated as much concern and uncertainty as accounting issues. How and whether these concerns are resolved will have enormous impact on the balance sheets of cooperatives both here and abroad. Equally important is the impact on the individual members those cooperatives serve, many of whom are small business people themselves—farmers and ranchers, and the independent owners of local hardware stores, pharmacies, hotels, restaurants, office supply stores, newspapers, and many other independents served by purchasing cooperatives.

There are fundamental differences between cooperatives and investor-owned companies. Cooperatives generally adhere to a set of core principles, which include democratic member control and member economic participation. While shareholders of investor-owned businesses seek to maximize returns on their investment, members join a cooperative primarily to receive products or services, not a return on their investment.

The NCBA and cooperatives have spent much time over the past few years monitoring the FASB and its international counterpart, the IASB. We have worked to educate them about the impact of accounting standards on cooperatives and urged them to accommodate the financial reporting needs of cooperatives. We supported the establishment of a committee to address issues affecting private firms, including cooperatives. We hope that the SEC Committee will look at the impact of financial reporting standards on cooperatives and how they may be improved to address the unique economic structure of co-ops.

A Co-op Snapshot

There is no firm estimate of how many co-ops we have in the United States but past estimates have put the number at more than 40,000. This is quite a few more than the estimated 10,000 stock companies. Federally funded research is under way at the University of Wisconsin that will help identify the scope and number of co-ops. Rough estimates are that U.S. co-ops serve 150 million members…or seven in 10 of all adult Americans. Many people are surprised at those numbers. They think of the United States business community as represented by Wall Street, a public, investor-owned market. That's certainly true. But it also has a very strong and vibrant co-op sector.

U.S. cooperatives range in size from small storefronts to Fortune 500 companies. Approximately 30 cooperatives each have annual revenues in excess of $1 billion. The top 100 co-ops have a combined $140 billion in revenues. They serve Americans of all economic levels and walks of life. They are bustling hubs of commerce that operate in virtually every industry. They include some very familiar names, like Land O'Lakes, Ace Hardware, and Nationwide Insurance. Many of our best known franchises are served by purchasing co-ops, including Dunkin' Donuts, Pizza Hut, Kentucky Fried Chicken and Burger King. If your hometown newspaper carries stories from the Associated Press, it's a co-op. If you watch Congress on CSPAN, it's a co-op.

Cooperatives Fall into Four Categories

- Producer-owned cooperatives—These are cooperatives owned by farmers or craftsmen who form a co-op to jointly market, process or produce a like-product. There are 1,600 farmer- or rancher-owned marketing or processing cooperatives in the U.S., most of which are local co-ops. The growth of new generation cooperatives—small co-ops that specialize in value-added agricultural processing—has been spurred by programs and incentives, such as USDA's Value-added Producer Grants program, that have originated in the U.S. Senate. Renewable fuels co-ops—those that process ethanol, biodiesel and wind —are a growing segment of this category.

- Consumer-owned cooperatives—Representing the largest category of co-ops, these cooperatives are owned by the consumers who buy the goods or services of the business. They are largely small and local in nature and include food co-ops, credit unions, rural electric and telecommunications cooperatives, housing co-ops, parent-owned childcare co-ops, and consumer-owned HMOs.

- Worker-owned cooperatives—These are cooperatives that are owned and controlled by their employees. They are similar to companies with Employee Stock Ownership Plans (or ESOPs) in that the workers own the company. However, in a worker cooperative, the employees benefit from the profitability of the company earlier than ESOP employees. Members of worker-owned co-ops receive annual taxable dividends on the company's earnings, rather than waiting for retirement to cash in their stock.

- Purchasing and shared services—These are cooperatives that are owned by individuals or small businesses that band together to jointly buy goods or services as a group, thereby lowering their input costs. Unlike buying clubs, the members of purchasing cooperatives actually own the company, ensuring that it is acting only in their best interests in procuring inputs and services. This is a growing segment of the co-op sector, as more and more small businesses see purchasing co-ops as the key to their survival. We estimate that, nationwide, more than 50,000 independent businesses are members of purchasing co-ops. The nation's 1,600 local farm supply and service co-ops fall into this category, since they are effectively purchasing co-ops for farmers and ranchers.

Major Trends by Sector

- Credit union membership is growing steadily, to more than 87 million, while the number of credit unions has declined approximately 30 percent in recent years, primarily from mergers. Today there are approximately 9,000 U.S. credit unions.
- Membership in rural electric cooperatives has been growing steadily as well. It now totals 40 million in 47 states, while the number of utilities is holding steady at approximately 900.
- The number of agricultural cooperatives has declined approximately 25 percent over the last decade, again primarily from mergers. At the same time, net business volume of all agricultural co-ops is up approximately 25 percent over the same period.
- While rural telecommunications cooperatives have held steady at approximately 270, the services these co-ops provide in 31 states have grown considerably, especially Internet and wireless services.
- Food co-ops are flourishing, even in the face of stiff competition from investor-owned supermarkets. They generated more than $33 billion in revenues in 2005. While some smaller stores have gone out of business, many larger food co-ops have opened second or third stores and a steady stream of new co-ops are being launched.
- Small business purchasing co-ops have doubled in the last decade, to approximately 300, and include some well-known names in American business, such as Ace Hardware and Carpet One.
- Cooperative housing units are increasing and now house more than 1.2 million families in 7,500 co-ops. Most of the growth has been in affordable, limited-equity co-ops, which make up approximately a third of the total.

Though many cooperatives are indeed quite large and well-known businesses, the majority of cooperatives are small, community-based businesses. These cooperatives and their members generate millions in economic activity, creating jobs, wealth, and opportunity. They also do not have the resources to monitor and keep up with many of the changes in accounting standards.

The Cooperative Structure – Presenting Challenges for Standard Setters

Cooperatives have a different financial structure than publicly traded, investor-owned firms. Cooperatives typically do not engage in the publicly traded market. Co-ops, by design, are capitalized at lower levels and are book value entities that rely on equity primarily from their members and debt financing from lenders to support both start-up and growth activities. Many co-ops operate on an at-cost basis to provide lower cost products and services to their members.

Unlike publicly held investor-owned entities, an individual may only join a cooperative after meeting the requirements for membership and after approval of the Board of Directors, or in some cases, the membership. The member's interest in the cooperative typically is not transferable.

In co-ops, the interests of the members or users of the products and services are aligned with the owners of the co-op. Therefore, a decision to raise the price on a product or service would be viewed from the perspective of the person paying for the product and would not be viewed favorably unless justified based on a number of factors. In an investor owned company, the shareholder's interest – not typically aligned with the consumer's -- may be to increase the price of the product or service to gain more return on the investment.

We understand the need for relevant and useful financial information but that may vary depending on the structure of the entity. For example, rapidly fluctuating market values and arbitrage concerns are of little relevance to the typical co-op member or user or preparer of co-op financial statements. But complex issues involving the impact of both public and private debt on the bottom line may be of great significance to co-op lenders.

Differences in GAAP should be based on the needs of private company constituents. Included within this concept should be consideration of differences in the financial structures of certain types of private companies, such as cooperatives, where it can be shown that proposals may have a different and measurable impact on such entities.

We would welcome the opportunity to provide more information to the Committee about cooperatives and the challenges they face with regard to financial reporting. If you have any questions or would like more information, please contact Mary Griffin at 202-383-5450 or mgriffin@ncba.coop.

Sincerely,

Paul Hazen

Paul Hazen, CEO