THE SOVEREIGNTY AUDIT TOOLKIT

Forensic Pre-Investment Checklist, Term-Sheet Stress-Test & Balance-Sheet Equivalence Guide for Cooperatives, Mutuals, and Ethical Funders

When continental cooperatives, mutual insurers, and solidarity funds translate their articles of association, financial statements, or investment term sheets into English for international funders, generalist translation domesticates Civil Law mutualist mechanisms into Anglo-American shareholder categories. This five-page operational manual gives boards, chief risk officers, and investment committees a practical protocol to audit English-language documentation before signature.

How to Read This Toolkit: Modules I, II, IV, and V set out **universal English accounting, prudential, and term-sheet rules** applicable to any cooperative or mutual transaction. Where source-language terms are referenced, they are colour-coded by language (FR French, ES Spanish, IT Italian, PT Portuguese, CA Catalan) – you only need to consult the pill matching your source documents.

Module I: Prudential & Accounting Classification Audit (IFRS, Basel III & Solvency II)

The highest-impact financial risk in cross-border cooperative reporting is **accounting and prudential misclassification** – where an imprecise English translation causes international auditors or rating agencies to reclassify cooperative equity as debt or strip reserves of Tier 1 capital status.

Regulatory Standard	Source Concept by Language	The Domesticating Translation Trap	Sovereign English Rendering & Fix
IFRS / IAS 32 & IFRIC 2 (Member Share Capital)	FR *Parts sociales* ES *Aportaciones al capital social* IT *Azioni / Quote sociali* PT *Títulos de capital* CA *Aportacions al capital social*	Translating member shares as generic 'redeemable preference shares' or 'puttable shares' while omitting the board's statutory right to refuse redemption.	**IFRIC 2 Equity Gate:** Render as **registered member shares** and explicitly translate the Governing Council's unconditional right to refuse or defer redemptions below the capital floor so shares remain **Equity**.
Basel III (CET1) (Cooperative Banks & Credit Unions)	FR *Réserves impartageables* ES *Fondo de reserva obligatorio* IT *Riserve indivisibili* PT *Reservas indivisíveis* CA *Fons de reserva irrepartible*	Translating as 'retained earnings', 'unallocated profits', or 'general reserves' – all of which imply future distributability to shareholders.	**Permanent CET1 Core:** Always render as **indivisible reserves (statutory asset lock)**. Under CRR / Basel III, indivisible reserves form the permanent, non-withdrawable loss-absorbing core of CET1 capital.
Solvency II (SCR) (Mutual Insurers & Guarantee Funds)	FR *Excédent / Ristourne* ES *Excedente / Retorno cooperativo* IT *Avanzo di gestione / Ristorno* PT *Excedente / Retorno (Sobras)* CA *Excedent / Retorn cooperatiu*	Translating mutual surplus as 'net profit' and patronage refunds as 'dividends' (or conversely as an operating discount that depresses EBITDA).	**Tier 1 Own Funds Protection:** Distinguish **net operating surplus** (retained in Tier 1 Own Funds to meet the Solvency Capital Requirement) from post-surplus **patronage refunds** rebated by activity.
CSRD / ESRS & SFDR Art. 9 (Sustainability & Social Auditing)	FR *Bilan sociétal* ES *Fondo de Educación y Promoción* IT *Bilancio sociale / Fondi 3%* PT *Reserva de educação / Balanço social* CA *Balanç social / FEP*	Framing mandatory cooperative education/development funds and democratic governance hours as 'administrative overhead' or 'charity donations'.	**Double Materiality Alignment:** Frame statutory education and mutualist development allocations as non-attachable **inter-cooperative capital formation** and verified **impact materiality** outputs.

Audit Rule 1 (The IAS 32 / IFRIC 2 Trigger): Before sending translated articles of association or financial statements to an international DFI, bank, or auditor, check the clause governing member withdrawal. If the English text fails to state the board's unconditional statutory right to suspend redemptions below the capital floor, an IFRS auditor must reclassify 100% of redeemable member shares from Equity to Debt overnight.

Module II: Term-Sheet Covenant & Governance Stress-Test (The Deal Matrix)

When international impact funds, venture philanthropists, or blended-finance vehicles invest in a cooperative or social enterprise, their legal counsel frequently adapt Anglo-American Venture Capital or Private Equity term sheets (designed for Delaware C-Corps or UK PLCs). Left unaudited, six standard clauses will override the General Assembly or force demutualisation at exit:

Term-Sheet Clause	Extractive 'Red-Flag' Wording (Standard VC/PE Template)	Why It Breaks Cooperative Law & Tax Status	Sovereign Redraft (Non-Extractive Cooperative Clause)
1. Exit & Put Options	*Put Option / Drag-Along Right:* Investor may force a trade sale of the enterprise or demand full cash redemption of shares after Year 5 at fair market value.	Violates the **statutory asset lock** by pricing accumulated indivisible reserves into private share valuation and forcing demutualisation upon exit.	**Revenue-Based Redemption Corridor:** Redemption is funded strictly from a capped percentage (e.g. 15–25%) of divisible annual surplus, subject to IFRIC 2 capital floors.
2. Return & Dividend Caps	*Uncapped Participating Preferred Return:* Investor receives a fixed coupon plus an uncapped pro-rata share of enterprise value appreciation.	Breaches statutory caps on capital remuneration in Civil Law cooperative codes, triggering immediate loss of protected cooperative tax status.	**Statutory Return Ceiling:** Remuneration is capped at the statutory limit (e.g. reference bond rate + 200–350 bps) via a non-voting participating security.
3. Voting & Veto Rights	*'Negative Control' / Class Veto:* Investor director holds a unilateral veto over annual budgets, senior appointments, capex, or bylaw amendments.	Subverts democratic member control (*one member, one vote*) and breaches statutory ceilings on external investor voting power.	**Capped Investor College:** Investor sits in a non-controlling Investor Category (capped at ≤20–30% of General Assembly votes) with financial-covenant remedies only.
4. EBITDA & Labour Covenants	*Minimum EBITDA Margin Covenant:* Technical default is triggered if conventional EBITDA falls below X% of annual revenue.	Penalises worker cooperatives that distribute value to worker-members through monthly **membership labour advances** or worker surplus shares.	**Cooperative Surplus Covenant:** Measure Debt Service Coverage Ratio (DSCR) prior to discretionary patronage refunds and member advances above baseline pay.
5. Liquidation Preference	*1x–2x Participating Liquidation Preference:* Investor captures residual net assets upon winding-up, merger, or dissolution.	Directly unlawful under cooperative statutes: upon dissolution, 100% of residual indivisible reserves must pass to designated movement development funds.	**Subordinated Nominal Par Return:** Upon winding-up, investor recovers at most nominal paid-in capital after creditors; 100% of residual reserves remain locked.
6. Reporting & KPIs	*Shareholder-Value Reporting Only:* Quarterly reporting covenant tracks only financial ROI and cost reduction.	Induces institutional **isomorphism** (mission drift) by treating member education, governance participation, and community care as waste.	**Double-Materiality Social Balance Sheet:** Reporting pairs financial solvency metrics with audited social-utility and value-retention indicators.

Audit Rule 2 (The Demutualisation Trigger): Any English-language investment agreement containing a 'Drag-Along', 'Forced Sale', or 'Fair Market Liquidation Preference' clause is structurally incompatible with a cooperative asset lock. Signing such a clause can strip a cooperative of its mutualist tax-exempt status even if the option is never exercised.

Module III: Five-Language Capital & Governance Equivalence Guide

Each Romance jurisdiction has its own statutory instruments for raising patient capital, remunerating worker-members, and auditing governance without surrendering member sovereignty. Consult the row matching your source language to ensure exact English equivalence:

Language & Core Statutes	1. Patient Capital & Investor Voting Caps	2. Worker-Member Pay & Patronage Rebates	3. Asset Lock, Housing & Audit Nuances
FR **French** Law 47-1775; SCIC Law 2001-624; Loi Hamon 2014-856	**Participating Securities (*Titres participatifs*):** Perpetual/long-term (≥7 yr) non-voting quasi-equity; fixed + activity-indexed return. **Investor Members (*Associés non-coopérateurs*):** Capped at **35% of votes** (49% if other co-ops).	**Salaried-Associate Status (*Salarié-associé / CESA*):** Worker-members in SCOPs/CAEs hold employment contracts plus a mandatory ≥25% worker surplus share (*part travail*). *Avance sur ristourne* = **advance on patronage refunds**.	**100% Indivisible Reserves (*Réserves impartageables*):** Never distributable. **Solidarity Land Trusts (*OFS / Bail Réel Solidaire – BRS*):** Severs perpetual non-profit land ownership from price-capped household real property rights.
ES **Spanish** Law 27/1999; Law 20/1990 (Tax); Law 44/2015	**Participating Securities (*Títulos participativos*, Art. 53) & Voluntary Capital (*Aportaciones voluntarias*):** Non-voting risk capital. **Collaborating Members (*Socios colaboradores*, Art. 14):** Capped at **30% of votes** (may be support co-ops or civic bodies).	**Membership Labour Advance (*Anticipo societario / laboral*, Art. 80):** 100% corporate bond (*relación societaria*, not employment salary); monthly advance on account of year-end surplus (avoid false friend 'anticipated').	**Reserve Split:** Mandatory reserve (*FRO*) and Education Fund (*FEP*) are indivisible, but check bylaws to ensure voluntary reserves are locked as *irrepartibles*. **Audit Trap:** *Interventores* are internal member account supervisors, not external auditors!
IT **Italian** Basevi Law 1947; Marcora Law 49/1985; Law 381/1991; Law 59/1992	**Investor Members (*Soci sovventori*, Law 59/1992 Art. 4):** Combined votes capped at **33.3%** (used by CFI in Marcora worker buyouts). **Cooperative Participation Shares (*APC*, Arts. 5–6):** Non-voting preferred shares (+2% yield premium).	**Worker-Member Remuneration Package (*Trattamento economico*, Law 142/2001):** Dual linked contract (associative + employment) pegged to national collective agreements (*CCNL*), plus **patronage refunds (*ristorni*)** capped at 30% of base pay.	**Mutualist Requirements (*Requisiti mutualistici*, Basevi Art. 26):** Never translate as 'health insurance requirements'! **3% Levy (*Fondi mutualistici*):** Mandatory 3% annual surplus levy to federated development funds. **Audit:** *Collegio sindacale* = licensed statutory audit board.
PT **Portuguese** Portugal Law 119/2015 & Law 75/2017; Brazil Law 12,690/2012 & Law 15,068/2024	**Investment Securities (*Títulos de investimento*, PT Law 119/2015 Arts. 29–39):** Non-voting hybrid cooperative securities. **Investor Members (*Membros investidores*):** Plural votes strictly capped at **30% of member votes**.	**Corporate Work Drawings:** Non-employment cooperative work bond. Rendered as **advance on surplus (*adiantamento por conta de excedentes*)** in Portugal and **pro-labore work withdrawal (*retirada pró-labore*)** drawn against *sobras líquidas* in Brazil.	**100% Indivisible Reserves (*Reservas indivisíveis*):** In Portugal, all mandatory and voluntary reserves are insusceptible of division. **Communal Lands (*Baldios*, PT Law 75/2017):** Germanic *Gesamthand* tenure held by **commoners (*compartes*)** via **grants of exploitation**.
CA **Catalan** Cooperatives Act Law 12/2015; Housing Law 19/2015	**Collaborating Members (*Socis col·laboradors*, Law 12/2015 Art. 29):** Capped at **30% of assembly votes** and 45% of share capital; frequently combined with non-voting participating securities in housing and energy co-ops.	**Membership Labour Advance (*Bestreta societària / laboral*, Art. 96):** Co-owner advance drawn on account of cooperative surplus under a corporate-membership bond.	**Grant-of-Use Housing (*Habitatge cooperatiu en cessió d'ús*):** Never translate *dret de superfície* as 'leasehold' or *quota d'ús* as 'rent' (which misclassifies co-owners as commercial tenants). **Oversight:** *Fiscalització* = financial auditing (not taxation).

Module IV: The Sovereignty Dashboard & Quantitative Audit Metrics

Synthesising the analytical models in *The Sovereignty Audit*, *The Wealth of Networks*, and *The Resilience Stack*, Root & Branch replaces extractive shareholder metrics (EBITDA, ROE, IRR) with four structural equations that measure whether a cooperative or financing deal retains or extracts collective force (*force collective* / Luis Razeto's *Factor C*).

1. The Value Retention Ratio (VRR) vs. Extraction Ratio (ER)

Conventional accounting treats wages and member advances as costs to be minimised and external dividends/interest as returns to be maximised. The **Value Retention Ratio (VRR)** measures the proportion of total Net Value Added (NVA) that remains permanently locked in the commons or circulated to worker/user members:

```
VRR = (Δ Indivisible Reserves + Statutory Development Levies + Member Labour Advances + Patronage Refunds) / Total Net Value Added (NVA)
```

```
Extraction Ratio (ER) = (External Debt Interest + External Investor Dividends + Management Fees) / Total Net Value Added (NVA)
```

Sovereignty Threshold: A healthy mutualist capital structure maintains **VRR ≥ 0.85 (85%)** and caps the external **Extraction Ratio ≤ 0.15 (15%)** across the life of any external financing facility.

2. The IFRIC 2 Equity Cushion Ratio (ECR)

To prevent a sudden wave of member withdrawals from triggering a liquidity crisis or an IAS 32 balance-sheet debt reclassification, cooperatives must track the ratio of **Permanently Locked Capital** to **Total Balance-Sheet Equity**:

```
ECR = (Indivisible Reserves + Statutory Development Funds + Unconditionally Capped Member Shares) / Total Balance-Sheet Equity
```

Sovereignty Threshold: ECR ≥ 0.70 (70%). If ECR falls below 70%, the cooperative should amend its bylaws to introduce an unconditional Governing Council redemption refusal gate at 75–80% of peak paid-in share capital.

3. Social Reproduction & Governance Care Allocation (The C-Factor Buffer)

If democratic participation (assembly preparation, committee work, member education) is unremunerated, governance degenerates into a managerial oligarchy. Conversely, if governance hours are booked inside operational cost of goods sold (COGS), commercial pressures optimise them away. We audit the **Care & Reproduction Ratio (CRR)**:

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CRR = (Remunerated Governance Hours + Mandatory Education & Care Funds) / Total Working Hours & Operating Surplus
```

4. Counter-Cyclical Mutual Credit Liquidity Buffer (Resilience Stack Metric)

In periods of commercial credit contraction or supply-chain disruption, cooperatives participating in B2B mutual-credit clearing rings (e.g. *WIR*, *Sardex*, *Monnaie Léman*, or federated inter-cooperative clearing) track their **Internal Clearing Velocity (ICV)**:

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ICV = Total B2B Inputs Cleared via Mutual Credit & Inter-Cooperative Supply Chains / Total Annual Operating Expenditure (OPEX)
```

Worked Audit Case Study (Worker Cooperative Raising €1.5m Expansion Capital):
• **Extractive Venture Debt Proposal:** €1.5m loan at 11% interest + 15% equity warrant + investor veto over Governing Council capex. *Audit Verdict:* **FAIL** – Extraction Ratio jumps to 28%; the equity warrant breaches the statutory indivisible reserve lock and revokes protected cooperative tax status.
• **Sovereign Audit Redraft:** €1.0m issued as non-voting *Participating Securities* (capped at Euribor + 300 bps, redeemed from a 20% corridor of divisible surplus) + €500k via a cooperative bank credit line. *Audit Verdict:* **PASS** – VRR stays at 91%, ECR = 88%, and 100% of governance and tax protections remain intact.

Module V: The 15-Point Pre-Signature Executive Verification Checklist

Complete this verification checklist prior to executing any English-language investment term sheet, cross-border loan agreement, grant covenant, or audited financial statement translation:

A. Financial Statements & Prudential Reporting (Items 1–5)

- ☐ **1. IFRIC 2 Share-Redemption Refusal Gate:** Do the English articles of association and financial statement notes explicitly state the Governing Council's unconditional statutory power to refuse or suspend share redemptions below the capital floor?
- ☐ **2. Indivisible Reserve (Asset Lock) Clarity:** Are locked reserves consistently rendered as **indivisible reserves (statutory asset lock)** rather than 'retained earnings' – and where voluntary reserves exist, do the bylaws explicitly lock them as non-distributable?
- ☐ **3. Surplus & Patronage Refund Separation:** Is cooperative **net operating surplus** clearly distinguished from commercial 'net profit', and are activity-based **patronage refunds** separated from shareholder dividends?
- ☐ **4. Worker-Member Remuneration Accuracy:** Does the translation respect the exact national legal regime – distinguishing non-employment **membership labour advances** (ES PT CA) from salaried or dual-contract worker-member packages (FR IT)?
- ☐ **5. Non-Attachable Education & Development Funds:** Are mandatory cooperative education funds and federated mutualist levies (e.g. 3% development funds) disclosed as non-attachable statutory allocations rather than discretionary CSR expenses?

B. Investment Term Sheets & Debt Covenants (Items 6–10)

- ☐ **6. Excision of Demutualisation Triggers:** Have all Drag-Along, Forced-Sale, IPO, Trade-Sale, and Fair-Market Put Option clauses been completely removed from the investment agreement?
- ☐ **7. Statutory Return Cap Compliance:** Is remuneration on external investor shares or quasi-equity notes strictly capped within national statutory limits so the cooperative's protected tax status is never jeopardised?
- ☐ **8. Investor Voting Ceiling & Veto Removal:** Are cumulative external investor votes capped below the statutory ceiling (≤30–35%), and have unilateral investor vetoes over board elections, mission, and budgets been removed?
- ☐ **9. Native Quasi-Equity Instrument Selection:** Where non-voting patient capital is required, does the deal use native statutory instruments (e.g. *Participating Securities* or capped *Investor Member Shares*) redeemed from divisible surplus?
- ☐ **10. Quantitative Sovereignty Thresholds:** Does the pro-forma financial model maintain a **Value Retention Ratio (VRR) ≥ 85%**, an **Extraction Ratio (ER) ≤ 15%**, and an **IFRIC 2 Equity Cushion (ECR) ≥ 70%**?

C. Governance, Property & Bilingual Contract Clauses (Items 11–15)

- ☐ **11. Dissolution & Residual Asset Lock:** Does the winding-up clause stipulate that external investors recover at most nominal paid-in capital after creditors, with 100% of residual reserves transferring to a designated movement fund?
- ☐ **12. Governing & Audit Organ Precision:** Are cooperative boards rendered as **Governing Council / Board of Directors** (never the UK insolvency false friend 'Administrators'), and are internal member account supervisors (ES CA *Interventores*) distinguished from licensed statutory auditors?
- ☐ **13. Non-Speculative Property & Commons Tenure:** In housing and land-commons contracts, are grant-of-use occupancy fees, surface rights, real solidarity leases (FR *BRS*), and communal land concessions never mistranslated as 'commercial rent' or 'freehold sale'?
- ☐ **14. Public–Social Co-Design Protection:** In welfare and community tenders, are statutory co-design and public–popular partnerships framed as collaborative public governance rather than lowest-price commercial outsourcing?
- ☐ **15. Governing Civil Law Text Clause:** Does the bilingual contract explicitly specify that the source-language cooperative statute governs the legal interpretation of all mutualist, capital, and governance terms?

> **Commission a Bespoke Sovereignty Audit:** Root & Branch Translation provides flat-fee pre-investment term-sheet audits, statutory translation, and bilingual terminology engineering across French, Spanish, Italian, Portuguese, and Catalan into UK English. Contact: shaun@rootandbranch.online | rootandbranch.online/services