

Treasurer's report from Howard Kaplan, part 1 of 2, For the Karma Board meeting of Monday, 7 June 2010

Report sent Saturday, 29 May 2010

1. Finance Committee status

Four of the five committee members met with Justin McNabb on April 19. We attempted to include Denise Stapleton by phone, but there were technical difficulties. It wasn't until a few days after the meeting that some other issues arose, concerning IOUs and HST, which have not been discussed by the Committee.

2. April financial statements

A summary April 2010 statement is being sent along with this report, and there is good news to report. Now that a bookkeeping error has been corrected, the year is looking about \$12,000 better than it looked previously. Our operating loss will be under \$20,000, or, to put it another way, it will be less than we've spent on extraordinary consulting. Since we haven't spent as much on membership services as we've collected in membership fees, it's possible that our overall loss for the year could be less than \$10,000.

We now know that store operations are doing a little better than breaking even. This does not mean that we can relax about increasing sales (which remain 12% below what they were two years ago), but it does mean we are not in a crisis situation. We still need to make money to compensate for past losses, but doing so now seems quite possible.

I'm not sending another sales graph, because it's uninteresting – it's just a continuation of what we've seen already.

3. Credit policy and practice

A general review of credit policy is still on hold until Arel finishes her investigation of what the Board actually intended to pass last April.

Denise has asked me to inform the Board that we have several members who have not been repaying their IOUs, as well as several who are making appropriate payments. The last time a similar issue came before the Board, I said that it is the Board's responsibility to set a clear policy about IOU collection, before it can do anything about the cases of specific individuals. Therefore, I am not forwarding the names of specific individuals at this time, though I am forwarding some summary information. However, Denise's concern was not to get the Board involved in enforcement; it was to get specific direction about whether we record these IOUs as bad debts or continue to carry them on our books.

We have \$277.04 due to Karma from inactive members, but \$224.66 of that is covered by the \$70 member loans returnable to those individuals (assuming they don't owe Karma anything else). We don't need any new policy to make that deduction from the loans; it's been authorized by our by-laws for many years, and it's also mentioned in our members' handbook. However, I have heard some concerns that we don't have record-keeping systems that ensure our staff properly note such debts before returning loans to departing members. The systems for dealing with loans are currently outside Denise's control, being handled by the general staff and by Marilou; Denise handles only a summary of the loans. Therefore, this motion is addressed to the General Manager. Please note that I have not yet had the time to discuss this motion with Justin, and he may have some important suggestions for modifying it. **Action item:** The Board should consider this motion.

The Board hereby authorizes the General Manager, retroactive to May 29, 2010, to modify our membership and record-keeping procedures to ensure that, whenever a member has become inactive, (1) debts that the member owes to Karma are immediately paid to Karma

from the balance of that member's loan (to the extent possible); (2) the value of the member loan showing on our books reflects the deduction of such debts; (3) no member with debts to Karma at the time of becoming inactive can reactivate membership until all those debts are repaid and, as a consequence, the loan is restored to its full value; and (4) no resigning member's loan can be repaid until the staff check the records to determine the value actually returnable to the member.

I expect that this newly-passed policy, if we pass it, will be reworded but not essentially modified as part of a new general credit policy we need to implement soon.

We also had approximately \$1,000 in debts from currently-active members at the time Denise wrote, but many of those are very recent (including debts related to debit machine malfunctions), and members are making payments towards the others. Therefore, these are not considered bad debts, they will simply be carried forward into the next fiscal year, and no new policy is required to facilitate that.

4. Membership fees – period covered and pro-rating policy

For reasons having to do with the HST (as discussed in Part 2 of my report), we need to clarify the policy on pro-rating the fees. Justin has stated that the current practice is to pro-rate the Member Services fee but not the Building Maintenance fee. This practice is not exactly what is stated in the member handbook, which seems to refer to both fees rather than to just the Member Services fee: "The fees are pro-rated from January to April for all new members joining Karma (as well as any returning previously inactive members). No fees are due if the member is joining in May." Since the general perception is that the November \$18 fee covers the second half of the year, and since in fact we don't try to collect it from someone resigning before November, it is reasonable to charge the full building maintenance fee between November and June, since at least half a year will elapse before it's collected again. In other words, I support the current practice, and I would like the text of the handbook to reflect that. On the assumption that various motions will pass, I've supplied appropriate handbook text to Angela.

For accounting purposes, we ought to clarify that both halves of the fee actually cover the entire year from June through May. **Action item:** Our motion of a few months ago covers only fee collection policy, not the interpretation of the fee year, so there's no need to amend the previous motion in order to pass this one.

The Board hereby clarifies the interpretation of the membership fee.

The entire membership fee, for legal purposes, consists of both the Member Services fee and the Building Maintenance fee, although it is divided into two parts with different names as an aid to determining its value and to allocating the proceeds in our accounts.

The Membership Services fee, ordinarily collected from continuing members in June of each year, covers the full membership year, retroactive to June 1 and continuing through the following May 31. For any new member who is paying the Membership Services fee in January through April, the fee is retroactive only to the beginning of the month in which the fee is paid, and the fee is pro-rated for the number of months for which it is effective. For any member joining in May, no Membership Services fee is collected, and membership is considered retroactive to the beginning of May. These pro-rating procedures also apply to any returning member who has been inactive since June 1.

The Building Maintenance fee, ordinarily collected from members in November or December of each year, also covers the full membership year, retroactive to June 1 and continuing through the following May 31. This fee is not collectable from any member resigning from Karma before the fee collection begins, but it is collectable from any member resigning afterwards, and it is considered a debt to Karma that may be deducted before returning the member loan. This fee is never pro-rated for a member joining Karma after the beginning of the membership year; for a member joining after the November or December date when the

fee collection began, the fee is due on the same date it would be due from someone who was already a member when the fee became due.

5. Membership fees and fees in lieu of work – policy for inactive members

There is a general, recurring issue we should address: under what circumstances does an inactive member continue to accumulate work and fee obligations? The by-laws say a few things that are relevant:

Article II, Section 7, Membership withdrawal

Upon written notice, a member may withdraw from membership. A member who, without giving notice of an intention to return to active membership, is more than six months delinquent in paying the annual fee of the current fiscal year shall be deemed to have withdrawn from membership. Upon receipt of notice that a member has died, the member will be deemed to have resigned, and any monies ordinarily due to be repaid to a resigning member shall be paid instead to the estate of the deceased member.

Article II, Section 6, Determination of Rights of Members

The rights of members are of two kinds, the democratic right to vote at meetings of the Co-operative and serve on its Board or committees, and the economic right to purchase its goods and services by paying money or performing work. Only those members who are not delinquent in meeting their financial and other obligations to the Co-operative have these rights. These obligations include, but are not limited to, the payment of the annual fee, the payment of the member loan, the payment of any other monetary debts to the co-operative, and the performance of any work required of the member. The Board of Directors shall establish regulations for determining when a member has met these obligations; however, no member shall lose democratic rights unless his or her obligations are overdue by four or more months. Only those members who are eligible to exercise democratic rights or whose eligibility expires four weeks or less before the date of a meeting have the right to be notified of that meeting of the Co-operative.

In other words, if we hold the AGM in October, then a member who has not paid the annual fee is entitled to notice of the meeting but not voting rights; later than October, a member is not even entitled to notice.

However, the by-laws did not anticipate the accumulation of other obligations or fees during the year, such as the work shift compensation fee (for working members missing shifts) or the second component of the annual fee. I think we need to limit the obligations incurred when a member fails to benefit from the co-op, both to clarify what debts may be deducted from the member loan and to not discourage members from re-activating their membership. Please note that I have not yet had the time to discuss this motion with Justin, and he may have some important suggestions for modifying it. **Action item:** I suggest that we adopt the following policy:

The Board hereby clarifies what happens when members cease actively shopping and working without formally resigning.

The by-laws already specify that a member who is six months behind in paying an annual fee is deemed to have resigned from membership, whether or not the member has participated in any other co-op activities.

A member who was last active during the previous membership year but does not shop at all during a membership year incurs no new obligation to pay any membership fee or to meet any work commitment. According to the by-laws, such a member remains a member of Karma Co-operative for six months and is entitled to receive a notice of the Annual General Meeting but is not a member in good standing and may not vote at the meeting. If the member subsequently reactivates membership during the year, the Member Services fee

will be pro-rated by the same amount as for a new member joining at the same time, and the full Building Maintenance fee will be due as of its usual date.

A member who shops at all during the membership year incurs the obligation to pay the same Member Services Fee that would be payable for someone joining in the first month of the member's shopping, even if for any reason the membership fee was not collected at that time. The value of this fee, if unpaid, will be deducted from the member's loan upon resignation.

A working member ordinarily incurs the obligation to work or to pay a fee in lieu of working even if the member does not shop that month. However, once a working member has not shopped for two consecutive months, no further work obligation is incurred for any further months of non-shopping. Any unpaid work obligations will be deducted from the member's loan upon resignation.

Any member who does not shop in the two months before the Building Maintenance fee becomes due is not obliged to pay that fee unless resuming active shopping. Instead, if and when the member formally resigns, the resignation will be treated as being effective as of the end of the second consecutive month of not shopping.

There are some additional issues related to how long we carry an inactive member's loans on our books, but I have no proposals for that at the moment.

6. Report on a brief meeting with our auditor

The fiscal year is about to end, and I took the occasion to talk to Jerry Berman, whom we treat as our auditor although technically it is the firm of Berman, Lofchik, & Lum, LLP, that is our auditor. Here are a few results from that discussion, other than a preliminary discussion of HST issues, which I will report in Part 2.

All business transacted on Monday, May 31, will be recorded in our books as if it occurred on Tuesday, June 1, instead. This has the effect of ending the fiscal year on Saturday, May 29, which is what the by-laws actually specify, though we haven't paid attention to that detail of the by-laws for as long as I can remember.

Jerry will be out of the country at the time of our AGM, and therefore Winston Lum will attend in his stead.

Jerry considers it important that we have a written document from Brian Iler, authorizing our policy of removing member loans from the books after eight years of non-contact. (According to Reg's conversation with Brian, Brian's previous advice was oral only, though Jerry thinks there may once have been a written document.) Before we proceed with getting any such document, we should consider whether to adopt policies that would require a different document, shortening the time frame and getting members to sign a document acknowledging that shorter time.

7. Cash registers

We are getting close to putting the new cash registers into service. I was hoping to do it for June 1, but it seems unwise to do it two days before I take a long weekend off, so we'll do it in the second week of June. We have not been able to program around a minor deficiency of the new cash registers, one which duplicates a deficiency of the old one, so at least we're not moving backwards on that front while we move ahead on many others. At the time we first install the registers, they will not scan barcodes, but turning on that feature should be much easier than programming many other features.

8. Budget proposals

The Finance Committee discussed the budget proposals that appear below. For simplicity in presentation, the budget resolutions below do not include most of my explanations to the Committee of how I got the numbers, nor do they include the current year's totals or projections for comparison. There were no disagreements with any of the projected numbers, though there were some disagreements with the language of the resolutions implementing the proposals. I will explain those disagreements after presenting each budget. **Action items:** The Board should discuss, amend if necessary, and approve the budgets.

Membership budget, Fiscal Year 2010-2011

(1) The Board hereby adopts the following FY 2010-2011 membership budget, as submitted by the Treasurer after consultation with the General Manager, the Finance Committee, and those other committees that made the requested submissions for the budget:

MEMBERSHIP BUDGET	
Income*	16200
Expenses	
Audit fee	600
Membership secretary	2000
Membership administration	1000
Board of directors	1500
Chronicle	1500
Member meetings	1500
Finance Committee	100
Community Development Committee	150
Food Issues Committee	100
Building Committee	50
Orientation Committee	25
Web Committee	300
Opportunity Fund	<u>7375</u>
Total expenses	16200

* This is calculated as 900 members, paying \$18 each. Note that, if members receive \$18 shopping credits for recruiting new members, the \$18 credits will be paid from the membership account, but compensating \$18 fees from the new members will contribute to that account. Therefore, there is no need to budget for lost revenue or increased expenses as a result of the shopping credits.

(2) The Board intends the Opportunity Fund mentioned in the budget to be allocated to specific projects during the year, on the basis of applications from itself, the General Manager, the Membership Secretary, and the committees.

(3) The Board hereby authorizes those committees whose expenses are listed in the approved budget to spend the listed amounts, without limiting their right to request additional amounts from the Opportunity Fund.

(4) The Board hereby directs all Committees who wish to spend money from the Opportunity Fund to address their requests to the Committee Secretary, who shall approve or decline to approve expenditures of up to \$200, reporting both the approved and declined requests to the Board, and who will convey any larger requests to the Board in a form suitable for the Board's consideration.

The budget resolution is based on the originally-approved \$18 membership fee. If the Board approves any adjustment to that fee as a result of the HST introduction, the income and the Opportunity Fund will be adjusted accordingly.

All committee expenses are based on specific requests from the committees, to cover their ordinary, ongoing expenses. (Finance and Building have minimal expenses as committees, and they did not request specific administrative budgets, so only small amounts are included above.) It is understood that the allocations for large, special projects will need to occur as separate decisions later this year.

Clause (4) empowers the Committee Secretary to take some of the routine decision-making load off the Board and to ensure that only coherent requests reach the Board. This clause is rephrased from the version the Finance Committee considered.

Some members of the Finance Committee specifically requested that, when this budget is publicized, the Board be very clear about the kinds of projects that might be approved under the Opportunity Fund, since an unallocated fund equal to nearly half of the budget can be abused if not handled carefully.

Operating budget, Fiscal Year 2010-2011

(1) The Board agrees with the General Manager, Treasurer, and Finance Committee that the FY 2010-2011 operating budget, as submitted by the Treasurer and shown below, is a realistic projection of what the co-operative will achieve in the fiscal year (a loss of approximately \$7,500) if no significant changes are made and no catastrophic events occur.

OPERATING BUDGET	
Sales	
Total sales before staff and work credit discounts	1436442
Total Cost of Goods Sold	<u>-1149154</u>
Gross margin, \$, before discounts	287288
Gross margin, % of total sales	20.0%
Staff discounts	<u>-14400</u>
Gross margin, \$, after discounts	272888
<i>continued on the next page</i>	
Expenses	
Total wages and benefits paid out	222586
Work credit discounts	7900
Non-working offsets	<u>-35368</u>
Wages & benefits net of offsets	195119
Depreciation	26118
Other expenses excl. consulting	<u>71413</u>
Total expenses excl. consulting	292650
Total expenses excl. consulting, % of sales	20.4%
Operating Income	-19762
Miscellaneous store income (excl. building fees)	1002
Building fees	16200
Contract negotiations and other consulting	<u>-5000</u>
Net Store Income	-7560

(2) The Board does not interpret this budget as granting or limiting the General Manager's authority to commit the co-operative to any specific operating expenses; instead, the Board directs the General Manager to make decisions about such expenses in a way that will reduce the currently projected loss, within the terms of his general authority.

(3) The Board directs the Treasurer to use both this budget and the results for past years as references when presenting financial statements, providing a context for this year's results, and to present summary statements in a format as similar to the budget format as is practical.

(4) The Board does not yet authorize any new capital expenses over \$1500 each, except in the case of emergencies. The Board intends to authorize additional capital items in a separate capital budget later this year.

Clearly, we cannot project anything to the nearest-dollar precision appearing in the budget, but it seemed more straightforward to leave the figures like that than to start fiddling with roundoff error. If the Board wants to make changes at the meeting, I'll have a live spreadsheet with me to redo the computations. For the record, the budget takes into account the projected raises for unionized staff and management, a 5% allowance for inflation in general expenses, no sales increase over the current year, and no surprising shrinkage increases being discovered after the year-end inventory. Also, compared to the budget presentation approved by the Committee, I've moved the work credit discounts from the sales section into the expenses section, consistent with the way Denise and Jerry want to account for them, without changing the bottom line.

Clause (1) can be interpreted as a vote of confidence in the accuracy, not the desirability, of the financial projections provided in the budget. It doesn't allow, require, or forbid any specific future action by the GM, Board, or Treasurer, but it does say that the Board, as well as those on whom it relies for advice, takes responsibility for using this budget as a starting point for managerial decisions and financial reporting. Note also that the resolution doesn't say that the projected loss is acceptable, but I'm not sure how to indicate that it is unacceptable. For example, I do not think it would be appropriate to say something equivalent to "The GM is hereby directed to reduce the loss to \$0, on pain of losing his job otherwise", when we do not know whether there are any decisions any GM could make which would have that effect, nor do we know how to share responsibility for the projected loss between the GM and the Board.

Clause (2) clarifies that the GM is authorized to make the best decisions, as circumstances require, rather than to follow the budget when it's inappropriate. That is presumably a large part of why the General Manager was hired. There does need to be a clear statement about the General Manager's authority, but the place for that statement should be elsewhere, primarily in the job description, rather than here. Nothing in this point prevents the GM and the Board from discussing proposed deviations from the budget's predictions before the GM implements changes that are under his power. Donald Altman disagrees with the phrasing of this clause, stating that we should explicitly say that the General Manager's authority is to manage to the bottom line; Donald would like us to specify a specific target which the General Manager should achieve.

Clause (3) is a specific directive that the budget figures be used as a standard of comparison for understanding actual performance. If the co-operative has a bad year, losing \$20,000, then the year would be equally bad regardless of what budget were approved at the beginning of the year. However, if the budget is unrealistic, then the Board and GM will have difficulty understanding how and why such a loss occurred. On the other hand, starting with a realistic budget enables the Board and GM to better understand the problem and prevent it in the future. Also, starting with a realistic budget should contribute to monitoring the situation effectively and making decisions that reduce that loss. Note that clause (3) also requires that financial statements be presented in a way that makes it straightforward for the Board to compare actual

results with the approved budget. Donald quibbles with my language here, saying that a comparison of actual against budgeted performance is a variance report rather than a financial statement, but I'm assuming that the Board wants to see only one document and to call it a financial statement.

Clause (4) clarifies, for the benefit of future meetings and future Boards, that the budgeting and planning work for the year is not yet complete. The figure \$1500 is my guess about where the Board wants to draw the line between the GM's authority and its own authority; for example, that figure should allow for the replacement of office equipment or scales but not the replacement of large freezers. Donald and Justin believe that the G.M. has the authority to spend \$5000 without specific Board authorization, but I do not know where such a figure has been documented. I have no objection to the Board's deciding to use a figure other than \$1500 in this resolution.

To put some perspective on these numbers, here is a what-if calculation. If we assume that we can raise sales by at least 5% before we start needing to increase staff hours, then such an increase in sales will change the projection from a loss of \$7,600 to a surplus of \$6,800. So, at a bare minimum, we should be trying to raise sales by 5% without raising operating expenses. Since we're planning to consider most of the costs of a membership drive to be membership expenses, this seems like an achievable target. Note, however, that the required average sales increase is 5% for the whole year. If the growth is steady from month to month, then that means we need to raise sales by 10%, month-over-month, by the end of the year. After an increase of that size, we might start needing a few more staff hours next spring – the budget isn't subtle enough to track that consequence. A 10% increase by the end of the year would put our sales very close to what they were in the spring of 2008, the end of our best year.

Capital expenses, such as major renovations, are not yet included in these budgets. I will try to bring a capital budget next month.