Oneota Community Coop
Minutes for Regular Board Meeting
Tuesday, October 25, 5PM
Luther College Campus, Valders Hall, Room 379

Board Members Present: Johnice Cross, Gary Hensley, Jon Jensen, Lyle Luzum, Steve McCargar, Bill Pardee
GM Present: David Lester
Coop member/owners, staff Present: Larry Neuzil (Finance Manager), Blythe Landsman (Board Administrative Assistant)

1. Call to Order
President Pardee called the meeting to order at 5:11 PM.

2. Board Learning – Patronage Dividends

Summary: One of the benefits of member/ownership in a co-op is the potential for patronage dividends. In the co-op model, patronage dividends are considered to be a return to owners of their proportionate share of net margin (aka, profits). A patronage dividend can only be distributed when there is sufficient net income to justify the costs of distributing the dividend. Because co-ops and the concept of patronage dividends existed long before the US income tax laws, the IRS specifically recognizes them in sub-chapter T of the IRS code. Accordingly dividends returned to owners are not taxable to the recipient or to the co-op.

The law requires that, when a dividend is declared, at least 20% must be distributed to the owners in proportion to their patronage in the previous year. Up to 80% may be retained indefinitely by the co-op as owner-tracked equity. This means that net income that would otherwise have been considered taxable income can be declared as a patronage dividend and up to 80% of that sum may be retained by the co-op tax-free. This both reduces taxes paid by the co-op and increases the co-op's owner-equity standing, thereby improving its financial health.

There are several things that need to be considered before declaring a patronage dividend: Is there a net profit sufficient to more than cover the cost of distributing the dividends? Do the savings from taxes not paid because of the dividend exceed the costs of distributing the required 20%? What % of a dividend should be distributed and what % retained? What is the minimum distribution that should be sent out? (At some point the cost of processing exceeds the benefit if the individual dividend is too small.) What are the bookkeeping requirements to calculate and track distributed and retained dividends over time?

Discounts are commonly given in co-ops, sometimes instead of patronage dividends. Discounts can be seen as giving away the profits before they are made, whereas patronage dividends are given only when profits actually exist. Patronage dividends reward owners for shopping more. So what is the relationship between discounts and patronage dividends? Discounts will not likely disappear just because patronage dividends are declared. Because patronage dividends are a fundamental part of co-op ownership, they are a strategic board-driven tool when determining how to fairly distribute excess net income. Discounts could be considered a tactical management tool to assist with marketing and operations. They both have their place in a successful co-op and a recognition of their respective roles is critical. As we come closer to having real profits we need to consider how to strategically use patronage dividends.

3. Member comments

No members were present.

4. Disposition of Member comments

There were no member comments

5. Agenda Review

President Pardee announced one change: moving item 7.2 discussion to executive session per GM Lester's request.
Motion: Luzum moved and Hensley seconded to **approve the agenda as amended**. Motion **passed** by a vote of 6 aye, 0 nay.

6. Approval of minutes

Motion: Hensley moved and Cross seconded to **approve the minutes.** Motion **passed** by a vote of 6 aye, 0 nay.

7. Reports

7.1 GM report

Financial: September sales were up 2.64% ($7806) compared to 2010. Four-week average is up 3.34% ($71,52) over 2010. Four-week labor as a percent of sales was 19.2% (last year 18.2%), above budgeted goal of 18.07%. Quick Ration is .75. Current balance in Savings (for paying off member loans) is $104,847. Current Assets are $254,533 (up 32.07% from 2010). 180 new members (40 are College Cooperators) since 1/1/11. Local sales for Sep were 23% (last year 24%). Store margin after 3rd Qtr is 39.03%. Current status of taxes paid on the tax reporting schedule was given.

Community/Outreach/Co-op Projects: Excellent turnout at Taste the Local Harvest with 9 producers sampling their products. Meeting was held with 25 people from MN interested in starting a grower co-op like GROWN Locally (giving store perspective of our relationship with growers. We're working with Decorah Schools Food Service about using local foods. Working with other businesses and organizations we will be increasing our donations to local food pantries from our Taste of the Local Holidays event on Nov 3.

Physical Store Update: Energy use mid-Sep – mid-Oct: electricity use down 6% and gas use down 35% from last year. We passed a Safety Audit through a 3rd party auditor, allowing us to become an approved vendor for Sodexo/Luther College Dining Services.

Clarification of L2 Safety Monitoring from last month: Several of the minor injury claims reported were in-store reported only, not requiring external reporting. This means we had four claims that initiated a workers' comp claim. There were no “lost worker days” because the insurance company does not require reporting until the employee has missed three days. This changes item A (total recorded injuries) to barely non-compliant, and item B (lost work days) to compliant. Workers' comp claims have also reduced from last year.

Staff Updates: Our 3rd all-staff meeting held Oct 23, doing more Zingerman's customer service training and discussing the benefits and challenges of moving towards “open book management”.

Marketing/Special Projects: Classes, local artist spotlights, and Taste of the Holidays events are scheduled.

7.2 Member/Work Labor Law

Moved to executive session.

7.3 Board Treasurer Report

Board Treasurer McCargar presented a report of the current board budget status. We are currently under budget and expect end the year within budget.

***7*.4 Board Development Report**

No formal report was available.

8. Action Items

8.1 GM Monitoring Report – L5: Financial Condition

Summary: Policy L5 Financial Conditions Policy states that "With respect to the actual, ongoing financial conditions and activities, the GM shall not allow the development of fiscal jeopardy or material deviation of actual expenditures from board priorities established in Ends policies". This policy is considered in compliance when all sub-policies are in compliance. GM Lester reported compliance.

In order to clarify some things about several individual sub-policies and discuss their actual data and interpretation, President Pardee requested that the L5 Financial Conditions Monitoring Report be dealt with through 4 separate motions. (Result: Finding of compliance for L5.2 only was reversed.)

Motion: McCargar moved and Jensen seconded to **approve compliance finding for L5.1**. Motion **passed** by a vote of 6 aye, 0 nay.

Summary: Sub-policy L5.1 states that the GM will not "Allow sales to decline or be stagnant". What does this mean? OCC's 2011 budget was based on sales growth of 8.75%. Current Qtr growth rate was 5.57% with YTD growth of 6.21%. However, the NCGA benchmark growth rate is 3%. So, is a growth rate below a goal, but above a benchmark count as compliant or not?

Pro: It appears that the sales growth goal was optimistic for the year. However, the actual growth rate (qtr and ytd) are still both above the NCGA benchmark. A goal set almost a year ago is something to aim for, but cannot necessarily accommodate larger economic conditions. The NCGA benchmark is a more serious, nationwide, number used by all NCGA members. We are still above that so that should be the comparison used when determining compliance. Nationally, co-ops are reporting about 5% growth with a downward trendline. While below our goal, our trendline is still upward.

Con: What is the point of a goal if there are no consequences if it is not achieved? If we set a goal, that is what we should judge ourselves against.

Motion: McCargar moved and Luzum seconded to **approve compliance finding for L5.2**. Motion **failed** by a vote of 0 aye, 6 nay.

Summary: Sub-policy L5.2 states that the GM will not "Allow operations to generate an inadequate net income". What does "adequate" mean? OCC's 2011 budget called for a net income of 1.01% by the end of the 4th quarter. The NCGA benchmark is set at .5% by the end of the 4th quarter. According to the financial report our current quarter net income was .33% and the YTD net income was .30%. However, it should be noted that the net income reported included income not-from-operations, such as an NCGA dividend. Current quarter net income from operations was about $90, substantially below the quarter total net income of $3106. There is 1 quarter left. The Board found this sub-policy not in compliance.

Pro: The year is not over and the 4th quarter is typically the strongest. There is still a chance that the NCGA benchmark can be met, but not likely the budgeted goal. For consistency, we should stick with the NCGA benchmark as the criterion for compliance. Given the chance that the benchmark will be hit, we should not find non-compliance until all the information is in. In addition, there have been several big project expenses this year, with the RTU replacements and additional unanticipated maintenance costs coming from cash. No new major expenses of that kind are anticipated.

Con: Even if we do achieve the NCGA benchmark net income, is that a reasonable interpretation of “adequate”, or just the minimal needed to not considered in jeopardy? We need to strive for the budgeted goal and adjust expenses accordingly. By the time we get the final results for the year, it is too late to take needed action. The longer budgeted operational expenses continue in the face of under-performing sales the harder it is to reverse. Further, the policy states that the GM will not allow operations to generate an inadequate net income. Since the net income reported (itself below both the benchmark and the budget goal) included non-operational income, the operational net income was only ~$90. Under any definition, this is not even near the benchmark and is inadequate.

Motion: McCargar moved and Luzum seconded to **approve compliance finding for L5.3**. Motion **passed** by a vote of 6 aye, 0 nay.

Summary: Sub-policy L5.3 states that the DM will not “Allow liquidity, or the ability to meet cash needs in a timely and efficient manner to be insufficient”. What does “insufficient” mean? Two measures are used to gauge liquidity and bill-paying capability: Current Ratio (Current Assets divided by Current Liabilities) and Quick Ratio (Cash + Accounts Receivable divided by Current Liabilities). NCGA's Current Ratio jeopardy benchmark is 1.25. Their Quick Ratio benchmark is .70. While very close to the benchmark, our Current Ratio is still above, as is the Quick Ratio. The major contributors to these ratios falling (the trend has been positive for several quarters) is slightly lower sales and the fact that our RTU replacements came from cash. This is being carefully monitored. Since our ratios above the benchmarks, this is compliant.

Motion: McCargar moved and Cross seconded to **approve compliance findings for L5.4 through L5.10**. Motion **passed** by a vote of 6 aye, 0 nay.

Summary: Data and interpretations to support compliance findings for the remaining L5 sub-policies were supported. Accordingly, OCC's debt to equity ratio is below the benchmark and declining as we pay off debts; debts that were incurred were normal in the ordinary course of doing business; the GM did not encumber or dispose of real estate without the Board's approval; tax payments and other required filings were made as required; payments of contracts, payroll and other financial obligations were made as on time and as required; no restricted funds were used improperly; and the financial records are being kept in accordance with GAAP (according to a financial review conducted Jan 31, 2011).

8.2 Use of EBDIT (changed to EBDITAP)

Motion: Pardee moved and McCargar seconded motion to **explore monitoring using EBITDAP for one year.** Motion **passed** by a vote of 6 aye, 0 nay.

Summary: President Pardee proposed that one of the financial metrics worth tracking in financial reports is EBITDAP (Earnings Before Interest, Taxes, Depreciation, Amortization, and Patronage). The original proposal was to use EBDIT (Earnings Before Depreciation, Interest, and Taxes), but EBITDAP is a standard tool that has been tracked for several years in the co-op world, has an NCGA benchmark, and we have a substantial history of this information in our system. The motion would initiate reporting on this metric for a year to see if it is useful for monitoring purposes. It was noted that this is a lagging indicator, typically available the month following a quarterly report.

8.3 Board Monitoring Report – G6 Governance Investment

Motion: Jensen moved and Luzum seconded motion to **approve the G6 Monitoring Report.** Motion **passed** by a vote of 6 aye, 0 nay.

Summary: Board Policy G6 says that, "The Board shall invest in its governing capacity". This policy is considered in compliance if the each sub-policy is in compliance. Accordingly, the Board uses both formal and informal means of building board skills, including new member orientation, an annual retreat with CBLD consultants, and board learning activities prior to the business portion of the regular monthly meetings; the Board used administrative support personnel, including a new-this-year Administrative Assistant; outside monitoring assistance is used when appropriate (i.e., auditors); the Board attempts, through various means, to understand member viewpoints and values via activities planned by the Member Linkage Committee; the Board has a budget and tracks its expenditures; the Board budget is stays within the limits proscribed by the policy (½ of 1% of the Co-op annual budget); and the Board's budget is developed in a manner consistent with financial planning for the Co-op's budget. It was noted that the Member Linkage Committee did not give a report this quarter, but they will do so by the end of the year.

8.4 Board Budget

Motion: McCargar moved and Hensley seconded motion to **approve the Board budget for next year.** Motion **passed** by a vote of 6 aye, 0 nay.

Summary: The 2010 Board budget includes the following planned line items: CBLD membership - $5850, Board clerical assistance - $1200, Election expenses - $1725, BOD insurance - $1800, Misc CDS expenses - $1100, Misc Other expenses - $750, Board training - $2000, Non-cash volunteer discount expenses - $3700. Total = $18,125, which falls below the policy required limit of ½ of 1% of the Co-op budget.

8.5 Auditor Selection Recommendation

Motion: The audit committee moved to **select Hacker Nelson to perform our audit and authorize up to $10,000 for the audit, with final negotiations to clarify some ambiguous language and accommodate an assessment of financial controls**. Motion **passed** by a vote of 6 aye, 0 nay.

Summary: Three auditing firms responded to our RFP. For a variety of reasons, the committee selected Hacker Nelson.

9. Next monitoring

Board policy D4 – Monitoring GM Performance

GM policy L6 – Asset Protection

10. December meeting: Tuesday December 20^{th}.

11. Executive Session

Motion: Luzum moved and McCargar seconded to **enter executive session**. Motion **passed** by a vote of 6 aye, 0 nay.

Time entered: 7:21. Time returned: 8:14

12. Adjourn

Motion: Luzum moved and Cross seconded to **adjourn**. Motion **passed** by a vote of 6 aye, 0 nay.

Meeting adjourned at 8:14.

Documents Reviewed:

Agenda
Patronage Dividends for Food Co-ops – A Primer (board learning)
Minuted from September 29, 2011 Board meeting
GM Report
2011 Tax Reporting Report
Board Treasurer's Report
L5 Financial Conditions Monitoring Report
3^{rd} Qtr Balance Sheet Previous Year Comparison
3^{rd} Qtr Profit & Loss Budget vs Actual
3^{rd} Qtr Profit & Loss Previous Year Comparison
Verification of no new real estate purchases
Motion to Explore Monitoring EBDIT
G6 Governance Investment Monitoring Report
Proposed Board Budget for 2012