

**ANDREW D. LENEHAN, C.A.**

389 Connell Street Suite 200  
Woodstock, New Brunswick  
E7M 5G5

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Sipekne'katik  
522 Church Street  
Shubenacadie, NS  
B0N 1W0

Dear Chief & Council:

We have recently completed the consolidated audited financial statements of the Sipekne'katik First Nation for the year ended March 31, 2016. In addition to issuing an opinion on the audited financial statements, we attempt to identify potential areas of improvement based on our audit procedures. We are encouraged to note that many of the recommendations have been implemented and are functioning well. As communicated previously, it is advisable to consider assigning the remaining points to a specific person. Therefore, we offer the following observations and recommendations:

**1. Financial position and results for the year ended March 31, 2016**

**Observation**

During the fiscal year April 1, 2015 - March 31, 2016, the First Nation realized a consolidated surplus of \$2,553,393 as compared to a consolidated deficit of \$(414,159) the previous year, as detailed in the consolidated statement of operations. The 15/16 results increased the accumulated surplus from \$9,181,360 at March 31, 2015 to \$11,734,753 at March 31, 2016. The accumulated surplus as presented on the consolidated statement of financial position is comprised of tangible capital assets plus prepaid expenses less net debt.

It is important to note that the surplus/deficit is impacted significantly by both amortization and capital funding received. Amortization expense is a non-cash item, which represents the accounting recognition of tangible capital assets over their respective estimated useful lives. Capital funding is included in the revenue total, however the asset acquired with the capital funding is not included in the expenses but rather is recorded as a tangible capital asset and amortized over its estimated useful life (oftentimes twenty years or more). Given that the impact of these two items is so significant, we suggest referring to Note 15 on page 17 which presents the annual surplus net of these two items. The adjusted surplus for the 15/16 year was \$3,572,439 as compared to \$772,312 during the 14/15 fiscal year.

Financial results were similar or improved in eleven of the thirteen programs. In particular, the band admin, education, gaming and fisheries programs demonstrated significant improvement as compared to the prior year. Capital and housing as well as O&M continue to be work in progresses in terms of financial outcomes. The community's own source revenue based programs continued to thrive while the funding partner programs have reduced their previous large deficits.



Again, we suggest that any review of the consolidated financial statements include a review of page 17 Note 15. This schedule highlights for the reader, the impact of capital related revenues and amortization. Under PSAB, the accounting standards utilized by First Nations, revenue for tangible capital asset acquisitions tend to have a material effect on the financial results. This is because expense recognition for tangible capital assets occurs over the useful lives of the assets, which normally is many years. For example, when INAC provides capital funding (revenue) for a particular project, the amount is included in the revenue total. However, the amortization recorded during the year applicable to the assets acquired with the funding amount to only a modest sum. Therefore, the particular funding and related expenditure can have a significant impact on the overall bottom line result for that year. We feel that it is very important to understand how the bottom line is determined. It also should help to explain why a surplus does not necessarily correlate to a healthy bank balance available to invest in the many community needs. In reality, funding may be provided and the money used for its' intended purpose. So, although there are no funds remaining from this funding, there may still be a surplus impact on the consolidated statement of operations.

We were very pleased to see the net debt, defined as the financial assets less liabilities (see consolidated statement of financial position), decrease from \$(9,252,256) at March 31, 2015 to \$(6,334,500) at March 31, 2016. This \$2,917,756 improvement follows a \$882,404 improvement the previous year. While approximately \$3,800,000 of net debt has been eliminated over the past two years, it remains high at more than \$6,300,000. A significant net debt financial position creates many negative implications including potential intervention requirements necessitated by (INAC), an inability to obtain Ministerial guarantees for new housing loans and considerable cash flow pressure on the day-to-day operations including concerns over issuance of social assistance and payroll each week. As detailed on the consolidated statement of cash flows (pg.4), the cash position improved by \$1,011,107 while the liabilities including accounts payable in particular, decreased significantly. The consolidated cash position continues to strengthen, at \$663,658 for the most recent year end. Continued emphasis on an improving cash flow position is recommended.

### **Recommendation**

Although the net debt position remains high (18% of total revenues) and the liquidity, net debt and working capital to revenue ratios described below require continued monitoring by Chief, Council and senior management, we applaud the Chief & Council and senior staff for the financial successes achieved again this past fiscal year. An improving financial position should facilitate the creation of employment and economic development opportunities. It is advisable to continue with practices which have been established over the past couple years to continue the positive trending financial direction for the community.

Efforts should continue to be made by Council, senior finance staff and ALL program managers to prepare well understood working budgets for each program. Actual results should be closely compared against Council approved budgets on a timely basis with each manager held responsible for explaining negative variances and participating in determining corrective action where required. Buy in from managers to the First Nation's overall financial objectives is highly recommended given their ability to assist in the ultimate achievement of the goals/objectives. We have observed that these practices are working increasingly well in the community over the last few years.



Lastly, it is important that each program identify a person assigned with the responsibility for the achievement of predetermined financial objectives utilizing timely, accurate financial information with which appropriate decisions may be made by responsible senior staff. Improvements are evident and should be sustained in order to keep the internal financial records updated. We feel strongly that these recommendations should remain a high priority due to the weak, yet improving financial position of the First Nation.

## 2. Key financial ratios

### Observation

Indigenous and Northern Affairs Canada have been employing ratios over the past few years to monitor financial performance and strength of each First Nation. Criteria are applicable to determine whether a First Nation is deemed to require intervention of some level. Specifically, INAC is focusing on three key ratios including a liquidity ratio, a sustainability (or net debt) ratio, and a working capital to revenue ratio.

- a. Firstly, the liquidity ratio measures whether an organization has sufficient financial resources to fund its' current liabilities. In other words, it helps assess how well positioned the First Nation is to continue meeting its' financial commitments over the next twelve months. Current assets are cash, or assets expected to be converted to cash in the next year, such as accounts receivable and inventory of goods for resale. Current liabilities are amounts payable to external creditors including short-term bank debt or suppliers and under normal terms, require payment in the subsequent twelve month period. At March 31, 2016, Sipekne'katik had total financial assets of \$2,539,135 as compared to total current liabilities of \$1,996,473. Therefore, the liquidity ratio had improved dramatically to 1.27 at March 31, 2016 from 0.36 at March 31, 2015. This ratio remains now sits well above the benchmark established by INAC, which is a minimum of 0.9.

Current liabilities were comprised of:

Accounts payable, current (Note 10)	1,427,236
Deferred revenue	39,650
Current portion of long-term debt (Note 12)	<u>529,587</u>
Total	\$1,996,473

Accounts payable excludes a long-term balance carrying forward from previous years due to the Chignecto Central Regional School Board of \$3,282,581 as payments are not expected to be paid in the 2016-2017 fiscal year.

- b. Secondly, the net debt ratio quantifies the First Nation's ability to service both operational and capital obligations over the long term as opposed to the liquidity ratio, which is more of a short-term indicator. Sipekne'katik's net debt ratio at March 31, 2016 was 0.29 (significant improvement compared to 0.11 at March 31, 2015) calculated by dividing financial assets of \$2,539,135 by total liabilities of \$8,873,635 whereas the benchmark established by INAC is a minimum of 0.5. Excluding the balance owing to Chignecto Central Regional School Board, the ratio would be 0.45, only slightly below the INAC minimum level. It should be noted that the majority of liabilities relate to

payments not required over the next few years. Long-term debt, representing 37% of the total liabilities, are payable over a twenty five year time period and involve annual subsidy funding from Canada Mortgage and Housing Corporation not included in the financial assets total. Therefore, the 0.29 net debt ratio can be somewhat misleading without a thorough understanding of when financial commitments are actually due and how they will be funded.

- c. Thirdly, the working capital to revenue ratio measures the financial means available to adequately fund program delivery. The ratio is calculated by dividing current assets less current liabilities by total revenues. INAC have established a threshold of no greater than -8%. Sipekne'katik had a ratio of 1.5% at March 31, 2016 ( -6.5% at March 31, 2015) calculated as follows:

Current assets \$2,539,135 – Current liabilities \$1,996,473 = \$542,662

$\$542,662 / \$35,212,858$  (total revenues) = 1.54%

Only the net debt ratio is below the threshold determined by INAC, while all three have improved significantly compared to the prior year.

### **Recommendation**

The community's financial position, ratios and especially trends continue to signify solid progress in band financial performance. It appears as though financial stability has certainly been achieved, therefore, the next step is to continue implementing changes that enable the First Nation to improve the financial results even further. It is important to become familiar with the measurement criteria established by INAC. All three of these key ratios should be monitored on a regular basis due to the reasons described above. The most important point is that cash flows need to be extremely well understood and monitored in order to ensure the First Nation's ability in continuing meeting all payment obligations.

### **3. Safeguarding of community assets**

#### **Observation**

In order to remain compliant for PSAB financial reporting, First Nations are required to identify and value each physical asset acquired. Amortization expense is calculated each year on these assets and recorded as part of the First Nation's total expenses. This method of presenting financial information is intended to provide the readers/users of financial statements with appropriate information with which to assess both the financial health and results of the First Nation.

#### **Recommendation**

We encourage Council to identify an individual who would be responsible for the preparation and ongoing monitoring of a detailed tangible capital asset list. Council is responsible for the safeguarding of assets from loss. The safeguarding process will be facilitated by having a complete, accurate list which includes a detailed description and location of each asset. It may be helpful if this list was provided to Council on a quarterly basis to ensure accuracy and



completeness. It should also be helpful to ensure all such assets are adequately insured. It is our understanding that the new Xyntax system's asset management feature is facilitating this important task.

#### 4. Other recommendations

- a. The outstanding payroll advance (including utility assistance) balance at year end was similar to the prior year. If advances are made, they should be documented with specific information including repayment terms, interest rate if applicable, and signed by the borrower as well as the authorized member from Council or senior management. Ideally, these loans would be discontinued as the loans/advances are not available to all Band members of the community, the prepayment of funds creates additional pressure on cash flow and the additional time and bookkeeping requirements are onerous and unnecessary.
- b. We were pleased to observe that cash flow continues to improve. However, a key contributor to a stronger cash flow position of the First Nation is control over the outstanding accounts receivable balance, which was \$2,691,572 before the allowance for doubtful accounts at March 31, 2016 as compared to \$1,929,766 at March 31, 2015 (see Note 8 to the financial statements). Furthermore, we strongly recommend that a detailed cash flow projection continue to be completed annually and that the projection be updated on a monthly basis. Although the band has been successful reducing the accounts payable balance, caution must be exercised to ensure sufficient cash flow is maintained for essential services. On a positive note, the First Nation has been investing heavily in GICs which has helped fund several tangible capital assets as well as provide sufficient positive cash flow to eliminate overdraft interest which is typical in the latter parts of the fiscal year. Also, the \$39,699 total interest and bank charges on band admin, schedule 2 in the audited statements was much lower than recent years.
- c. The new Xyntax system went live during the 15/16 year and it is our understanding that it has created many benefits for senior management and staff including improved access to info for managers, additional features, auto daily computer backups, ability to link in documents, as well as improved integration. We experienced a favorable impact the system has had related to particular aspects of audit execution as well. We commend the band for its proactive approach in implementing a system to improve management information availability.
- d. Expenses for the health program exceeded revenues by \$93,695 during the 2015/2016 year as compared to \$162,960 in 14/15 and \$408,902 in 13/14. The program's bottom line result improved by nearly \$70,000, representing the best result in the past eight years. Whereas the budget for the program was break even, the variance was a negative \$93,695. Though the health program has incurred substantial deficits each of the past eight years, the decreased deficit level confirms that key health staff and band senior management have implemented effective improvements. Consistent monthly financial reporting in the health program should continue to reduce the likelihood of unplanned deficits.
- e. The education program incurred a deficit of \$75,990 as compared to \$749,298 the previous year. In particular, post secondary expenses decreased from \$2,150,927 during



14/15 to \$1,413,809 during 15/16, a difference of \$737,118. It is positive that corrective action was implemented. Although we understand that improvements have now been made, we would encourage senior management to continue to keep a close eye on this program.

- f. Payroll remittances to Canada Revenue Agency have been addressed during the past two years such that there was no arrears balance owing to CRA at March 31, 2016. Efforts should continue to be made to keep this account paid on a timely basis in order to avoid unnecessary interest and penalty charges. Annual T4 preparation was much smoother and cost effective given the implementation of the Xyntax software. Historically, the simply accounting software utilized to process payroll and therefore pay deductions was not always current causing insufficient deductions being taken from employees resulting in the band having to contribute additional funds to CRA. Although we observed that the proper payroll deduction tables are now being used, we encourage continued monitoring.

It is important that the Sunlife health plan is managed carefully. Someone in Human Resources should be responsible for ensuring that relevant information is communicated to Finance on a timely basis and a process should be created and maintained facilitating a timely exchange of this info. In recent years, there have been instances where the deductions withheld from employees were insufficient, causing the band to pay the difference unnecessarily.

- g. We were pleased to see the First Nation continuing to apply for and recover GST/HST on eligible travel expenses incurred by the First Nation using a GST189E form, general application for rebate of GST/HST. We encourage the finance staff to continue ensuring one of these rebate applications is filed each year.
- h. We noted continued improvement in the accuracy of accounts payable balances as compared to supplier statements/invoices. Proper cutoff of accounts payable is important in order to produce accurate financial information. Therefore, we would encourage a process where this type of reconciliation is done on a regular basis by obtaining supplier statements and reconciling to internal records. This may prevent unintentional overpayment of account balances and potentially reduce interest charges by ensuring accounts are paid by the due date.
- i. Whereas the auditor's reports of the past several years included qualifications attributable to internal control deficiencies related to completeness of revenue concerns in both the fisheries and tobacco programs, it is very positive that this year's audit opinion was a clean or unqualified opinion for the third consecutive year. Notable improvements and processes continue to facilitate timely completion of the audit. In fisheries, all deposit slips, supporting documentation and license lease agreements should continue to be maintained in an organized manner with a detailed description of funds being deposited including copies of cheque stubs, ideally filed by month. We encourage continuation of these processes.
- j. Despite notable improvements in the Tobacco Shop, we suggest you refer to the detailed recommendations we provided four years ago and consider implementing any of the remaining points.



- k. We were pleased to learn that on a monthly basis, Chief, Council and senior staff are committed to a process whereby actual financial results continue to be compared to budget with issues identified as required. It has been our experience that Council are very engaged during audit reviews with quality questions and a genuine interest in understanding the Community's finances. Therefore, it would seem that the regular updates present a great opportunity for collectively determining appropriate solutions.
- l. Sipekne'katik continues to implement and refine various policies. We would encourage continued commitment to this endeavor in light of the history of legal claims the band has been a party to. Effective, properly planned policies should reduce the risk of legal claims. Furthermore, priority should continue to be given to execution of appropriately prepared contracts with both employees and independent contractors.
- m. Timeliness of completion of bank reconciliations has improved. These recs represent an important control, therefore, all bank accounts should continue to be reconciled on a timely basis with any identified adjustments recorded in the accounting system monthly.
- n. Previously, it was determined that there was potential that social assistance recipients could defraud the program by claiming employment insurance benefits while they are on social assistance. However, during 13/14, client release of information forms were completed enabling social staff to do verifications. Social expenses excluding the assisted living program increased during 15/16 by \$209,784, a 4% change. As always, we encourage consistent application of the guidelines in social.
- o. Regular backups of the computer system should continue to be performed. Additionally, the backups should be stored off-site or in a fire-proof vault to protect against the loss of data. Also, the backups should be tested regularly to ensure the process is working as planned.
- p. The timing of audit field work and completion was very good for the fourth consecutive year. Information required for the audit was available in a timely manner.

We were able to have the detailed review of the draft financial statements with Chief & Council on July 27<sup>th</sup> which means important financial information required by the decision makers is now available on a timely basis. We commend the finance staff for their efforts in achieving this goal. We encourage finance staff to begin preparing for the March 31, 2017 audit in order to facilitate completion of the audit work by July 29, 2017.

- q. At March 31, 2016, the First Nation owed \$786,758 (2015 - \$822,758) to minor band members related to previous years' annual community bonuses. The First Nation continued the process of funding this liability, with \$150,000 in a GIC as at March 31, 2016, a \$100,000 increase from the previous year end. Plans are in place to set money aside to ultimately pay the entire balance as it becomes payable.
- r. As described in Note 20 to the consolidated financial statements, as a result of financial concerns and irregularities, Chief and Council of Sipekne'katik engaged a firm to carry out a forensic audit, which commenced May, 2012. To date, none of the amounts specified have been recovered. However, the First Nation has commenced a claim with its' insurer for a potential recovery. The likelihood and amount of recovery are both



unknown at this time.

- s. According to the First Nation's agreement with Canada Mortgage and Housing Corporation (CMHC), it is required to maintain a replacement reserve fund. The amount of the annual contributions is determined on a per unit basis and is reduced when qualifying repairs have been incurred. During the 15/16 year, the First Nation continued funding the reserve by transferring another \$100,000 to a GIC specifically for the replacement reserve fund (balance sits at \$300,000 at March 31/16). Additionally, band finance reps have negotiated an agreement with CMHC describing how the remaining balance will be funded. We commend management for implementation of this important plan.

The housing and capital program staff are now tracking repairs and maintenance expenditures made to CMHC units, which facilitates a more accurate representation of the CMHC project financial results, potentially decreasing amounts repayable to CMHC. Staff should continue recording the repairs and maintenance invoices in the accounting system to determine whether or not they qualify to be funded from the replacement reserve fund. Correspondence with CMHC will be required prior to the incurring of such expenses if they are to be applied against the reserve account.

Previously, neither the repairs and maintenance nor the utilities expenses were identified by unit. As a result, they could not be attributed to either a particular project or a particular program. This means that these expenses were not recognized in the CMHC project expenses. This led to a non-representative surplus in the audited statements sent to CMHC, which resulted in amounts potentially payable to CMHC. Again, Xyntax is now facilitating recording and retention of this important data.

- t. We make note of the salt shed expense incurred on the O&M schedule that ended up being a loss failure for the First Nation as it collapsed multiple times and in the end, did not get completed. We would like to stress the importance of hiring qualified people and/or companies, having proper contracts in place, ensuring vendors have their own WCB, using proper inspectors, and ensuring that proper oversight from management is in place until project completion.
- u. We encourage Council to consider developing a strategy to resolve the annual deficits in the operating and maintenance program as expenses continue to be significantly higher than revenues, resulting routinely in large deficits. This could be partially attributable to the age and/or condition of the systems. In any event, it will be challenging for the First Nation to continue paying such significant sums for O&M type costs on an annual basis. O&M results as detailed on schedule #5 reflect a two million dollar deficit over the past two years alone.
- v. As a result of INAC funding becoming repayable in certain programs in previous years, we continue to recommend that all contribution funding be monitored closely so that all funding terms including completion of activities by the respective due dates are achieved. Otherwise, there is a risk the funding could become repayable to INAC. We have definitely noted a marked improvement relative to this issue during the past three years. Therefore, we simply recommend continuous monitoring.



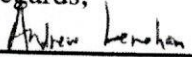
- w. During the 13/14 year, Council proceeded with developing a property in the Hammonds Plains region through Wallace Hill Development Inc. to create economic development opportunities. The 15/16 year represented the second full year of operations and helped the gaming program realize a healthy surplus.
- x. For the second consecutive year, we have included an education schedule (page 39) pursuant to MK's requirements. Council and senior management should continue ensuring that all MK related reporting requirements are understood and prepared.

As noted in the opening paragraph, these observations and related recommendations are intended to help Chief & Council and staff to improve on procedures and policies already in place.

In closing, we would like to express our appreciation to Nathan (Director of Operations), Matthew (Executive Financial Officer) and the rest of the staff for the assistance extended to us during the audit.

If there are any questions or comments relating to our observations and recommendations, we would be pleased to discuss them with you. Finally, we would like to take this opportunity to thank you for engaging us to provide audit services for Sipekne'katik and congratulate you on the successes of the past year.

Regards,

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Andrew D. Lenehan, C.A.