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Sipekne'katik First Nation  
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Dear Chief & Council:

We have recently completed the consolidated audited financial statements of the Sipekne'katik First Nation for the year ended March 31, 2015. In addition to issuing an opinion on the audited financial statements, we attempt to identify potential areas of improvement based on our audit procedures. You will notice that some of the issues have been identified in previous management letters. However, 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, 2015**

**Observation**

During the fiscal year April 1, 2014 - March 31, 2015, the First Nation realized a consolidated deficit of \$(414,159) as compared to a consolidated surplus of \$844,544 the previous year, as detailed in the consolidated statement of operations. The primary reason for the change was a decrease in capital funding. The 14/15 results decreased the accumulated surplus from \$9,595,519 at March 31, 2014 to \$9,181,360 at March 31, 2015. 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 page 34 which presents the annual surplus net of these two items. The adjusted surplus for the 14/15 year was \$772,313 as compared to \$1,141,066 during the 13/14 fiscal year.

Financial results were improved in four of the thirteen programs. In particular, the gaming, health and gas bar programs demonstrated significant improvement as compared to the prior year. Education, capital and housing, O&M and employment training programs had much weaker

bottom lines than the previous year with education being by far, the most dramatic change. The community's own source revenue based programs continued to thrive while the funding partner programs struggled to reach break-even levels.

Again, we suggest that any review of the consolidated financial statements include a review of pages 34 and 38. These schedules highlight 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, AANDC provided capital funding (revenue) for a water project during the 13/14 year of \$604,373 so this amount is included in the schedule 5 revenue total. However, the amortization recorded during the 13/14 year applicable to the assets acquired with the funding amounted to only \$60,437. Therefore, this particular funding and related expenditure had a \$543,936 ( $604,373 - 60,437$ ) 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 of \$604,373 was obtained in this example and the money was used for its' intended purpose. So, although there are no funds remaining from this funding, there is still a \$543,936 surplus impact on the consolidated statement of operations during 13/14 that did not apply in 14/15.

We were pleased to see the net debt, defined as the financial assets less liabilities (see consolidated statement of financial position), decrease from \$(10,134,663) at March 31, 2014 to \$(9,252,256) at March 31, 2015. This \$882,407 improvement follows a \$697,049 improvement the previous year. While nearly \$1,600,000 of net debt has been eliminated over the past two years, it remains high at more than \$9,200,000. A significant net debt financial position creates many negative implications including potential intervention requirements necessitated by Aboriginal Affairs and Northern Development Canada (AANDC), 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 \$176,100 while the liabilities including accounts payable in particular, decreased significantly. The consolidated cash position remains weak at \$(347,449), therefore, continued emphasis on an improving cash flow position is required.

### **Recommendation**

Although the net debt position remains high 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 this past fiscal year. The community was removed from co-management in August, 2014 indicating key funding partner AANDC's favorable view as to progress in the community. 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.

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

Aboriginal Affairs and Northern Development 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, AANDC 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, 2015, Sipekne'katik had total financial assets of \$1,192,051 as compared to total current liabilities of \$3,317,786. Therefore, the liquidity ratio had changed modestly to 0.36 at March 31, 2015 from 0.37 at March 31, 2014. This ratio remains well below the benchmark established by AANDC, which is a minimum of 0.9.

Current liabilities were comprised of:

Cheques written in excess of deposits	347,449
Accounts payable, current portion	2,410,536
Deferred revenue	318,546
Current portion of long-term debt (Note 12)	<u>241,255</u>
Total	\$3,317,786

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 2015-2016 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, 2015 was 0.11 (modest regression compared to 0.13 at March 31, 2014) calculated by dividing

financial assets of \$1,192,051 by total liabilities of \$10,444,307 whereas the benchmark established by AANDC is a minimum of 0.5. Excluding the balance owing to Chignecto Central Regional School Board, the ratio would be 0.17, still well below the AANDC 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 31% 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 0.11 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. AANDC have established a threshold of no greater than -8%. Sipekne'katik had a ratio of -6.5% at March 31, 2015 ( -8% at March 31, 2014) calculated as follows:

Current assets \$1,192,051 – Current liabilities \$3,317,786 = - \$2,125,735

$-\$2,125,735 / \$32,477,787$  (total revenues) = -0.065

Two of the three ratios are below the thresholds determined by AANDC, while all three have remained relatively stable compared to the prior year.

### **Recommendation**

The community's financial position, ratios and especially trends are signifying solid progress in band finances. It appears as though financial stability has 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 new measurement criteria established by AANDC. 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 expected to facilitate this important task.

## 4. Other recommendations

- a. We observed that the volume of loans/advances continues to decrease. The outstanding payroll advance balance at year end was less than 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. It was apparent during our audit work that while cash flow is improving, it continues to be an issue. A contributor to the weak cash flow position of the First Nation was the outstanding accounts receivable balance, which was \$1,929,766 before the allowance for doubtful accounts at March 31, 2015 (\$2,224,001 at March 31, 2014). 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 paying down the accounts payable balance, caution must be exercised to ensure sufficient cash flow is maintained for essential services. The improving financial position experienced by Sipekne'katik should provide an opportunity to secure a line of credit that can be used to help manage cash flow. The community has confirmed amounts of funding partner contributions that should prove helpful in placing an appropriate credit line. The credit line would also be expected to result in a reduction of interest charges levied by the bank and suppliers. The \$105,000 total on band admin, schedule 2 in the audited statements was much higher than anticipated.
- c. Though the Xyntax system was not live prior to March 31/15, it is our understanding that it is expected to create 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 look forward to the favorable impact the system is expected to have in the aspects of audit prep as well. We commend the band for its proactive approach in implementing a system expected to improve management information availability.
- d. Expenses for the health program exceeded revenues by \$162,960 during the 2014/2015 year as compared to \$408,902 in 13/14 and \$555,651 in 12/13. Although the program's bottom line result improved by nearly \$246,000, there continues to be a significant

negative impact to the band's overall finances. Whereas the budget for the program was break even, the variance was a negative \$162,960. Previously, Health Canada program reviews have described several concerns to be reviewed by Chief, Council and senior management so that corrective measures can be identified and implemented. The health program has incurred substantial deficits each of the past seven years, however, the decreased deficit level confirms that key health staff and band senior management have implemented effective changes. 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 \$749,298, primarily attributable to increased post secondary expenses of \$2,150,927 during 14/15 vs. \$1,083,262 during 13/14. As the deficit was higher than budgeted, it appears as though corrective action was not identified soon enough. Although we understand that changes have now been made, we would encourage senior management to keep a close eye on this program.
- f. Payroll remittances to Canada Revenue Agency were addressed during 13/14 such that there was no arrears balance owing to CRA at March 31, 2015. 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 is expected to be 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.

Additionally, our audit procedures revealed that the Sunlife health plan deductions withheld from employee pays were insufficient by approximately \$2,000 per month meaning the First Nation was having to pay that differential unnecessarily. It is our understanding that Human Resources is responsible for ensuring that information is communicated to Finance on a timely basis, therefore it is advisable that a process be created and maintained allowing for a timely exchange of this information.

- 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 confirmations. 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 second 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 three 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. Although social expenses decreased in 13/14, they (basic, special, rent) increased by \$207,000 or 4.2% during 14/15. 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 third consecutive year. Information required for the audit was available in a timely manner. Furthermore, changes were made to the internal accounting files (chart of accounts, etc.) that facilitated both the audit and monthly financial reporting processes.

We were able to have the detailed review of the draft financial statements with Chief & Council on July 24<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, 2016 audit in order to facilitate completion of the audit work by July 29, 2016.

- q. At March 31, 2015, the First Nation owed \$822,758 (2014 - \$884,258) to minor band members related to previous years' annual community bonuses. The First Nation has begun the process of funding this liability by maintaining \$50,000 in a GIC. Plans are in place to set money aside to ultimately pay the entire balance as it becomes payable.
- r. As described in Note 19 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 14/15 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 \$200,000 at March 31/15). 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 expected to facilitate recording and retention of this important data.

- t. It was encouraging to see the improved financial results for the gas bar. Operational changes caused a 23% reduction in expenses. Despite sales volumes decreasing modestly, the gas bar program reduced its deficit from \$147,759 to \$28,275. This is a great example of decision makers using relevant information to identify corrective action steps. Weak overall band cash flow issues continue to cause the gas bar to be closed at various times throughout the year, leading to lost sales. Whereas the gas bar has been required to prepay for fuel purchases, it is advisable to secure credit terms with the fuel supplier or use a line of credit to be secured from a lender. Another alternative could be to obtain a letter of credit from the First Nation's lender to enable establishment of a

credit account. Additionally, there is no adjustment made at each month end in the accounting records for inventory on hand. Such an adjustment would enable senior management and Council to monitor the financial results more appropriately including gross profit percentages. This monitoring would allow for timely recognition of any financial issues at the gas bar. Council's decision to make all the gaming activities band owned includes an initiative that has enabled the gas bar to begin generating additional gaming and tobacco income which helps offset the historical losses created in part by important employment opportunities at the gas bar. We also have been advised that Council feel the gas bar serves an additional community service in that it allows band members to acquire fuel conveniently.

- 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. Excluding the impact of capital transfers in 13/14, O&M deficit results on schedule #5 would have been approximately two million dollars in the past two years alone.
- v. As a result of AANDC 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 AANDC. We did note a marked improvement relative to this issue during the past two 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 14/15 year represented the first full year of operations and helped the gaming program realize a healthy surplus.
- x. We have added an education schedule this year 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 the finance 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.