

REVIEW OF DEPARTMENTAL ACTION PLAN
RESPONDING TO THE REPORT ON THE FINANCIAL
MANAGEMENT REVIEW OF THE MANITOBA REGION
OF THE DEPARTMENT OF INDIAN AFFAIRS AND
NORTHERN DEVELOPMENT

June 27, 1998

E7B.M25
R4B

The
Coopers
& Lybrand
Consulting Group

LIBRARY
INDIAN AND NORTHERN AFFAIRS
CANADA

OCT 19 1988

AFAIRES INDIGENES ET DU NORD
CANADA
BIBLIOTHEQUE

REVIEW OF DEPARTMENTAL ACTION PLAN
RESPONDING TO THE REPORT ON THE FINANCIAL
MANAGEMENT REVIEW OF THE MANITOBA REGION
OF THE DEPARTMENT OF INDIAN AFFAIRS AND
NORTHERN DEVELOPMENT

June 27, 1988

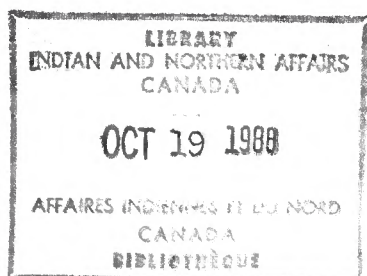
The
Coopers
& Lybrand
Consulting Group

Management Consultants

REVIEW OF DEPARTMENTAL ACTION PLAN RESPONDING TO THE REPORT
ON THE FINANCIAL MANAGEMENT REVIEW OF THE MANITOBA REGION
OF THE DEPARTMENT OF INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

TABLE OF CONTENTS

	<u>Page</u>
<u>SUMMARY</u>	
I. <u>INTRODUCTION</u>	1
II. <u>REVIEW OF RESPONSES TO RECOMMENDATIONS</u>	3
III. <u>REVIEW OF RESPONSES TO MAJOR FINDINGS</u>	18
IV. <u>OTHER OBSERVATIONS</u>	34
V. <u>PROJECT ACTION PLANS</u>	36



SUMMARY

The Departmental Action Plan responding to The Coopers & Lybrand Consulting Group's financial management review of the Manitoba Region of the Department of Indian Affairs and Northern Development is an exhaustive response to the detailed findings contained in the report dated September, 1987.

Our overall conclusion is that the actions proposed, if successfully carried out, are likely to remedy the matters that gave rise to the Review. The key actions will be:

- * accelerating the introduction of Alternative Funding Arrangements which have financial management policies more in keeping with those now practised and with those towards which the Department is moving under devolution and self-government;
- * reducing the overlap in the roles of financial and program managers and thereby contributing substantially to the down-sizing of the Department; and
- * maximizing through target setting and periodic reviews of progress the benefits from the proposed projects to ensure that they produce significant improvements.

The Action Plan questions only in quite minor ways our findings, often endorses our analysis, and generally agrees with the recommendations that we have submitted. This reflects the views expressed at the final meeting with senior management of the Department at which these recommendations were submitted. At that meeting, substantial support was expressed.

In the following detailed analysis, we suggest a number of areas where the Department ought to give further consideration to our recommendations, namely:

- * make less categorical, and apply flexibly, its conditions for entering into AFA agreements so as not to deter bands who would be able to manage the new arrangements, despite their past performance;
- * incorporate various funding arrangements in its Financial Management Manual so as to clarify in one place their applicability;
- * consider, over the longer term, combining the responsibilities of the AFA and Band Support units for negotiating budgets and monitoring budgetary performance;
- * reconsider the Finance involvement in remedial actions, where bands fail to live up to their responsibilities;
- * consider imposing in AFA agreements a requirement for Indian administrations to inform their members of budgets agreed with the department, including amounts to be spent on each activity element as required to be reported in their Annual Reports; and
- * act to remove the audit requirement for band auditors to report to the Department on compliance with contribution agreements.

I. INTRODUCTION

In September 1987, we submitted a report setting forth our findings, our analysis of these findings, and the conclusions and recommendations we arrived at as a result of our review of the financial management systems and practices of the Manitoba Region of the Department of Indian Affairs and Northern Development. We have since been asked to review a draft Departmental Action Plan dated December 1987, which was significantly amended in May 1988, and report whether or not it satisfactorily responds to the issues raised in our Report.

The overall conclusion of our Review, as stated on page vii of the Summary Report, was that "although the region satisfactorily complies with most parliamentary and government policies and requirements where it delivers services directly to Indians, it fails to fully comply with these policies and requirements where administrative responsibilities have been devolved to Indian bands, tribal councils or their representatives". In our opinion the actions proposed by the Department in response to our report, while often directed towards improving compliance with existing policies and practices, also seek to address the causal and more fundamental issues identified in our report by changing those policies and practices that are no longer appropriate in the current environment wherein the Department is encouraging greater devolution to Indian bands and councils.

When we first orally submitted our findings to regional management, they were quite rightly concerned that our report would compound and perpetuate their existing difficulties in financial management through insisting on rigorous compliance with policies and practices that had proven to be unrealistic in the current environment. In responding to this very valid concern, we sought to set forth recommendations that might alleviate the problems that had led to

breakdowns in compliance. While there may be other remedies, we sought to build on initiatives already identified by the Department in suggesting that the Department and the Region might be more aggressive in seeking to change existing contribution agreements, which it was not rigorously enforcing, into Alternative Funding Arrangements which were more in keeping with the financial management practices which it was permitting. This theme runs through most of the recommendations that we submitted, and the reasons for it are embodied in many of the major findings that we highlighted in the Summary to our Report.

Accordingly, in assessing the Action Plan, we have focused on the eight recommendations and the twelve major findings that our Report singled out. The Department has chosen to respond to some 142 observations, but we address these specifically only where they relate to the recommendations or major findings.

Our approach in the following sections of this review is to:

- * identify our recommendation or major finding;
- * provide some background on the recommendation or major finding by reference to our Report, or by adding some elaboration;
- * identify what the Department is proposing to do to remedy any shortcoming in policies or practices; and
- * assess whether the proposed action or actions are likely to satisfactorily remedy the situation or whether the Department may expect to find the same deficiencies continuing.

In making this assessment, we have accepted as factual any actions that the Department or Region have stated they have or will take since we have not been asked to conduct the field review that would be necessary to verify this.

II. REVIEW OF RESPONSES TO RECOMMENDATIONS

RECOMMENDATION

1. The Department give the Manitoba region greater freedom to move from existing contribution agreements to Alternative Funding Arrangements on a partial, phased, or individually tailored basis.

Our Report summarizes the difference between the two types of arrangements, and their consequences in terms of the compliance and other practices required, as follows:

- * contribution agreements require the Indian recipients to adhere closely to the program specifications imposed by the managers of each program and program component at headquarters, leaving limited flexibility at the regional level. Under Alternative Funding Arrangements, the Indian communities are allowed to re-design these programs as long as they meet relatively few minimum requirements;
- * funding is advanced on a monthly or less regular basis under contribution agreements, with subsequent funding being advanced only when a satisfactory accounting has been rendered to the Department. Under Alternative Funding Arrangements, accountability is primarily to band members, not to departmental officials;
- * contribution agreements provide funds for narrowly defined purposes even where individual agreements are combined into a comprehensive agreement. Alternative Funding Arrangements allow funds to be allocated according to community priorities, with minimal restrictions;

- * contribution agreements are negotiated annually, whereas Alternative Funding Arrangements are multi-year in nature; and
- * contribution agreements require the recipients' auditors to report to the Department any non-compliance with the detailed requirements of the agreements and any other departmental policies. Alternative Funding Arrangements require an expanded audit, but they limit the auditor's responsibilities to the Department, thereby reducing the conflicting responsibilities now imposed by the Department on the auditors. It also eliminates most follow-up responsibilities of regional management.

The Department states in its Action Plan that it favours increasing the number of Alternative Funding Agreements. It agrees that these agreements have definite advantages over contribution agreements. It also supports the prospect that Alternative Funding Arrangements may be more productive for such services as social assistance.¹

The Department's Action Plan also states that the Department agrees that Alternative Funding Arrangements (AFA) represent a much better transfer instrument and that vigorous action should be taken to accelerate their introduction. In January 1988, the Deputy Minister reconfirmed implementation of AFA as a major priority, having previously assigned the responsibility to a newly appointed Executive Director General, Indian Services and a Director, Alternative Funding Arrangements. Significant achievements since then include:

- * the drafting of a new "model" agreement which is intended to greatly simplify and accelerate the negotiation of agreements, as well as their processing within the Department;

¹ Observations #96 and #106

- * changes are being made to the responsibilities of program managers, i.e., those normally managing the programs under present contribution agreements, to give them the same responsibilities for budget allocation and justification even though day to day administration and AFA policies will continue to reside with separate AFA units; and
- * discussions are underway with Treasury Board with a view to incorporating certain features of AFA arrangements into the funding processes for non-AFA bands.

These are positive steps towards introducing financial requirements more compatible with present practices, but the ultimate test of their efficacy will be the number of bands which as a result come under AFA arrangements.

The Department notes in its response that AFA is no magic solution, and that bands will need to demonstrate that they are willing and able to correct management deficiencies before becoming eligible to enter into AFA arrangements.² The Department has strict eligibility requirements, such as Financial Management Plans proven to be working for at least six months, which may prevent interested bands from converting to Alternative Funding Arrangements. However, the deficits may be occurring due to a conscious management decision, disagreement with departmental priorities and problems normally associated with annual funding - rather than indicate poor managerial capabilities. Under Alternative Funding Arrangements, Indians will be able to establish their own priorities to a greater extent and will be able to plan operations beyond one year. We feel that the Department should not apply its conditions so inflexibly as to discourage Indian bands and councils from applying or to prevent

² Observation #107

the regions from developing more vigorous action plans for implementing Alternative Funding Arrangements.

RECOMMENDATION

2. The Department, with Treasury Board Approval, develop new financial policies and practices to better reflect and distinguish between the financial management practices that are appropriate when:

- * the Department delivers the service;
- * the service is governed by a contribution agreement; and
- * the service is funded under the Alternative Funding Arrangements.

In conducting our review of the Manitoba Region, we found that most of the material in the Financial Management Manual dated back into the late 1970s, when the Department mainly delivered services and before devolution under contribution agreements had become so widespread and Alternative Funding Arrangements had been conceived.

The Department quite correctly contends that it has developed separate financial policies and procedures in the past and it identifies several actions that it is taking to improve these documents:

- * formal statements of the policies and practices that it expects managers to follow when the Department is delivering the service are being reviewed and up-dated and a detailed workplan to complete this was made available to us. The Department states that it intends to conduct several reviews of regions during the current year to confirm that these are being followed;

- * a users guide under AFA is available, training sessions have been provided and all agreements are centrally controlled; and
- * terms and conditions for contribution agreements are spelled out in Treasury Board authorities, the contribution agreements themselves, and in certain departmental directives.

We are pleased to note in the Action Plan that the Department is planning a project to up-date the Manual and new initiatives are underway to up-date transfer payment and cash management policies.

Our recommendation was designed to encourage the Department to bring these various arrangements together in the Financial Management Manual so that, when the various options for delivery become more widespread, there will be a single reference point to guide financial and program staff who will have to cope with a multiplicity of arrangements. The purpose of this recommendation was to cause the financial staff at headquarters to re-think the guidance or directions imposed on field staff and explicitly distinguish among the three arrangements.

Some examples might help explain what we had in mind:

- * our auditors were astounded by the amount of duplication between program and financial staff. Present practices create much of this duplication by failing to recognize that program managers have moved from delivering programs to mainly funding them. Program managers are capable of exercising independent controls over contribution agreements and their work need not be duplicated by Finance. Finance can exercise a higher level of budgetary control when responsibilities have been devolved than when program managers deliver the programs themselves; and

- * another area where a major change is needed involves the recording of commitments. Traditionally, two types of commitments are recorded: one when the Department has a contractual obligation of some sort and the other when departmental managers reserve funds for anticipated needs. When responsibilities have been devolved and a band has entered in good faith into an arrangement with a third party that the Department would be reasonably expected to fund, it is not sufficient to deny the commitment at the year-end just because no contribution agreement has yet been signed.

We point out in our Report that we found many instances where both program and financial staff bend the rules to achieve legitimate ends. We found ambiguities in Treasury Board terms and conditions and in departmental rules.

All existing policies and guidelines should be reviewed in the light of the Department's fundamental change to new funding arrangements to ensure that no unnecessary requirements are being imposed and internal practices are simplified where responsibilities have been turned over to the Indian people.

The Department has confirmed in a recent letter that the new financial manual will include all departmental financial procedures and internal controls, including those related to contribution agreements, other transfer payments and AFA as well as a cross reference to program information on these subjects.

RECOMMENDATION

3. Responsibility for Alternative Funding Arrangements continue to be consolidated in one organization, with financial responsibility being transferred to this organization as quickly as possible.

This recommendation was designed to bring the Band Support and Alternative Funding groups together, to facilitate the move from one form of funding to another.

We point out in our Report that more rapid introduction of Alternative Funding Arrangements may be being retarded by the self-interest of the program managers who now control most of the funding. As long as they lose from the change, they are unlikely to encourage it. We foresaw a single organization that combines the responsibilities of Band Management, Alternative Funding and many of the grant making and monitoring responsibilities of the various programs. This would combine in one place financial negotiations with the bands and the monitoring of their financial performance. The managers of the individual programs would then be mainly responsible for setting program standards and assessing the effectiveness of program delivery.

The Department' Action Plan states that it has considered a number of organizational arrangements and has reached the following conclusions:

- * special AFA units should continue to be responsible for AFA policy issues and overall implementation;
- * officers dealing with bands should be AFA specialists because AFA agreements involve different working arrangements than contribution agreements;
- * program managers should assume responsibility for resource justification and budgetary management, as well as for program policy, for all bands to ensure consistency and equity; and
- * the AFA units will work closely with the Band Support units to ensure a well coordinated approach.

The Department's Action Plan confirms its intention to retain Alternative Funding Arrangements in a single organization, but ignores the intent of our recommendation that it go further. We accept that this may be necessary in the short-term, when AFA is still being experimented with, but we question whether this is compatible with departmental down-sizing, once AFA practices become more widespread.

The expansion of the role of the program managers into the areas of resource justification and allocation will help gain their support and hopefully, encourage faster introduction of AFA. However, having one group negotiating with and monitoring bands under AFA arrangements and another group responsible for resource allocation is fraught with dangers. The consolidation of all funding functions within a single organization would avoid this as well as make a significant contribution towards the down-sizing of the Department.

RECOMMENDATION

4. The Finance function, in addition to overseeing the various accountability regimes, be responsible for remedial actions if recipients fail to live up to their responsibilities under Alternative Funding Arrangements.

Recognizing that much of Finance's present responsibilities would become redundant under any arrangement whereby resourcing, funding and budgetary management rest with one or more other groups, we considered whether there would be any situations where consolidating all funding responsibilities might be inappropriate. We concluded that indeed there was one - namely, where the funded organization, for whatever reason, has failed. In the private sector, it is common for a trustee, receiver or another independent group to be brought in to work out such problems.

The departmental response contends that such a role would conflict with Finance's advisory and objective role. We disagree. When a band or council becomes insolvent, Finance would provide the added credibility that would be needed to work out a solution. Finance is independent as it does not negotiate or approve funding levels; nor do financial officers approve capital projects or band expenditures. Under Alternative Funding Arrangements the potential for lack of independence of program managers would be more pronounced if they were also responsible for financial rehabilitation. In such situations, the managers in the funding organization would have lost credibility. Moreover, Finance would gain credibility, in offering future advice, from its successes.

We fail to understand Finance's reluctance to take on a new function at the very time that its other responsibilities will be significantly shrinking.

RECOMMENDATION

5. Funding under Alternative Funding Arrangements be reported to Parliament, with both the amounts for each recipient and the intended uses for which they are provided being spelled out, so that recipients will be certain of their allocations and their constituents will know how it was intended to be spent.

We submitted this recommendation, recognizing that it conflicts with the present top-down approach within the government to resource allocation and with the desire of departments to retain maximum flexibility in the manner in which they allocate funds. It is important to remember that it was the alleged underfunding of promises that in part led to our being requested to conduct this Review. Through our recommendation, we sought to add the certainty to the resource allocation process that is in keeping with the underlying premise of the move to Alternative Funding Arrangements-

namely, that the Indian bands and councils, once funded, would decide how their monies might be best spent. Public reporting of intended uses of funds establishes the informational basis on which Indian people can later compare and assess how such funds were actually used. This provides the framework for the accountability of Indian leaders.

The Department states that the manner of displaying Alternative Funding Arrangements in the parliamentary Estimates, or in some other way, is currently under consideration. It also states that formula methods add an element of certainty to the resource allocation process, and that steps have been taken to settle budgetary allocations before the commencement of the fiscal year.

The Department states, however, that the primary document for ensuring accountability of band administrations to their members is the "Annual Report to Band Members" as required by the Audit Guide for Alternative Funding Arrangements. The key to making the recipients more accountable is to tell them up front what funding is available for them. With the multi-year nature of Alternative Funding Arrangements, uncertainty about the timing of expenditures would not be the same problem as it is today under contribution agreements. To tell members of Indian bands what is available after the year is over, as suggested in the Action Plan, through the "Annual Report to Band Members"³ will perpetuate present practices, where, as we say in our Report, "they are entitled to believe that additional resources can be provided if enough pressure is exerted on the department."

We pointed out in our Report that the present fragmentation of funding in terms of individual planning elements, all controlled in headquarters instead of the Region, contradicts the essential

³ Observation #118

feature of the Alternative Funding Arrangements - namely, block funding. We also described the failure of present processes to bring together all the financial requirements of individual bands.

The Department states in its Action Plan that it plans to continue to organize its information in the Estimates by the activities and planning elements that it now uses. We understand the Department's difficulty in departing from the present parliamentary presentation and did not suggest it. A display by purpose is appropriate for explaining and justifying the funding of the program to parliamentarians and it is in accordance with the principles underlying Estimates presentation to Parliament. However, we question the use of activity elements for managing funding when the Department is encouraging the Indian bands and councils to take a more holistic approach.

The Department agrees that public display of the amounts available to each recipient may be beneficial, but have not yet decided on a course of action. This decision will have to be reconciled with the approach taken in the new "model" AFA agreement and the Audit Guide, where such information by program is a requirement. We question any accountability regime that does not disclose plans and allows those reporting to adjust plans to actuals when reporting historically.

Nevertheless, we do agree that this type of information is probably better disclosed by the band administration. This could be accomplished through introducing a requirement in the AFA agreement that band administrations must submit a budget to their members before the year commences, using the same headings as are required in their Annual Reports.

RECOMMENDATION

6. Departmental financial and program staff review the classification of accounts and coding documents with a view to ensuring more consistent and complete reporting of expenditures of benefit to individual Indian bands or organizations.

This recommendation was submitted, in keeping with the former one, so that actual expenditures of benefit to individual recipients would be more accurately reported.

The Department's Action Plan states that it is taking the necessary steps to correct present deficiencies. It notes that it will not be allocating regional or corporate costs as part of this exercise. We concur, since we doubt that in such cases the causal or beneficial relationships that are the justification for allocating costs would be valid, or be seen to be valid.

RECOMMENDATION

7. The Office of the Comptroller General review the present policies of the government in respect of:

- * the requirements for Treasury Board approval of total contributions to individual recipients in excess of \$4.5 million; and
- * the interpretation of the Financial Administration Act regarding year-end cut-off when work is performed, goods are received or services are rendered under contribution agreements.

Our concern with the current interpretation of the Treasury Board limitation of \$4.5 million for contribution agreements with each

individual band is that it is being applied globally to all recipients included in this authority. The Department's Action Plan states that the Transfer Payments Directorate ensures that approved funding levels of over \$4.5 million to each recipient are not abused or violated.⁴ The Office of the Comptroller General has responded that it views the \$4.5 million threshold as the upper limit of contracting authority for the Department without Treasury Board authority. Treasury Board is primarily interested in knowing whether appropriate terms and conditions are in place for contribution agreements over this limit. The reallocation of this contractual authority, the OCG contends, is permissible based on the Department's assessment of priorities. This suggests that delegation based on arbitrary amounts might better be replaced by limits based on the terms and conditions to be imposed.

The Department states, with regard to the second part of our recommendation, that it is concerned that the current PAYE criteria prevent it from recording "estimated" amounts, since only "firm" amounts, or amounts actually paid, may be recorded. We understand this difficulty, which particularly applies to payments to other levels of government where final settlement amounts are often not determined until after the cut-off for PAYE transactions has passed. This, however, was not the sole reason for our recommendation. The Department does not record, as PAYE items, expenditures which are incurred by the recipient within the fiscal year, if they are not, at that time, legal liabilities because they have not yet been approved through a contribution agreement for that year. These amounts are charged against contribution agreements of the next year and the following year's budget. While we understand the Department's desire to impose financial discipline by not acknowledging liabilities before they are approved, the intent of the PAYE procedures is to improve the accuracy of a year's

⁴ Observation #140

financial reports, while at the same time charging such items against the subsequent year's budgetary allocation. Since this is achieved under the PAYE procedures, we fail to understand why these items are not recorded. The Office of the Comptroller General has indicated that a project to review PAYE criteria has been initiated to be conducted over the next few months which will consider the matters raised in our report. The government's liability needs to be more clearly defined.

RECOMMENDATION

8. Band auditors' responsibilities be clarified by requiring them to report directly to the department on information required to be audited under conditional contribution agreements, but their responsibility to the department continue to be the same as to other third parties when they report as band auditors on their financial statements under Alternative Funding Arrangements.

We submitted this recommendation because the Department is placing excessive reliance on band auditors to report instances of non-compliance. This requirement is inconsistent with their role as auditors appointed by, and accountable, to the bands. Our findings also showed that the Department was receiving false comfort from this requirement since, not only were a majority of the auditors qualifying or denying an opinion, but the Region was doing little to respond to any matters so reported. We concluded that the present relationships between the auditor and the Department are neither effective nor tenable and ought to be clarified by making them more consistent with the method of funding chosen and the responsibilities of their clients, the Indian bands and councils.

The Department states that our recommendation is based on the false assumption that the Department relies on audit reports to confirm compliance. The Action Plan states that compliance is confirmed

through program monitoring, periodic visits and operating reports from the bands. If this is true, we would suggest that the present requirement for auditors to certify compliance with contribution agreement terms and conditions in their "audit complement" be withdrawn. That is one of the reasons they qualify their reports.

The Department also states that changes in policies to give the bands more flexibility in administering program services, the use of grants which do not require the same degree of accountability, and the move to AFA arrangements will lessen the need for both the auditors and the Department to monitor compliance. We agree. This is consistent with the whole intent of our recommendations. Nevertheless, we agree also with the Department's statement that, where this approach is not applicable, "the Department will need to improve its procedures for monitoring and for ensuring compliance with program requirements." Indian bands and their auditors, as well as departmental employees who now have responsibilities that they cannot discharge, would welcome removal of policy requirements that are not enforceable.

* * * * *

In summary, the Department's Action Plan promises corrective action on most of the eight recommendations. There are a number of areas where we suggest the Department should reconsider its position in view of the additional information we have presented. We now look at the Department's response to the major findings set forth in Part 1 of our Report, as well as to selected observations that we believe are of significance if its proposed actions are to succeed.

III. REVIEW OF RESPONSES TO MAJOR FINDINGS

The Department's Action Plan has addressed 12 of the major findings summarized in Part I of our Report; the remaining one was referred to the Office of the Comptroller General. The Plan further identified 142 pertinent observations which were grouped according to the major finding to which they related, except for those included in a miscellaneous category.

MAJOR FINDING

A. The financial organization is appropriately organized and adequately staffed.

The Department has underway an Organizational Review of the Regional Financial Organizations which is being conducted by an outside firm of consultants. The study is primarily of the regional finance organizations, including the functions they perform, their organizational structures and person-year allocations, their workload and means of measuring it, and the impact of down-sizing on them. Most importantly, the consultants are required to examine the relationships between the roles of financial and program managers. This relates directly to our much greater concern, which is covered under Finding H below - namely, the extensive degree of duplication between program and financial processes. With the transformation of the Department from a delivery to a funding organization, the role of the financial staff needs to change to complement, rather than duplicate, the much greater financial responsibilities being assumed by program managers. The study could make a significant contribution to the down-sizing of the Department.

MAJOR FINDING

- B. Financial policies and practices do not anticipate, communicate, and integrate the different financial accountability responsibilities that are appropriate where delivery of services has been fully or partially devolved to the Indians under either contribution agreements or Alternative Funding Arrangements.

The Department's Action Plan responds that sufficient financial policies and practices exist for services delivered by the Department and lists the various sources where other guidance on contribution agreements and Alternative Funding Arrangements can be found.⁵ This multiplicity of sources indicates the need for integration and some reasons for the managers' confusion.

With respect to contribution agreements, our auditors found, particularly in capital management, that program managers were unclear as to their responsibilities in verifying performance under a contribution arrangement when signing under Section 27. No differentiation is made for signing authorities under various funding arrangements. While the Financial Management Manual covers normal financial processes, the other documents do not. Furthermore, we were advised that distribution of Financial Management Manuals is limited to financial officers. Given the financial responsibilities of program managers, consideration should be given to wider distribution.

The Department's Action Plan reports it is planning to review the capacity of Band Support to implement new guidelines, effective April 1, 1988, on the audit review process, a major control under contribution agreements.⁶

5 Observation #136

6 Observations #47 and #79

The Department feels the Alternative Funding Arrangements Users Guide adequately describes the financial policies and accountabilities of the Department and its clientele. However, since no managers mentioned Alternative Funding Arrangements as even a partial solution to some of their administrative problems, it is highly likely that communications would need to be improved if such Arrangements become more widespread.

The Department has committed itself to developing a departmental transfer payments manual to improve and document the transfer payments management processes.⁷ The project addresses two observations: the need for operational guidelines over contribution agreements and non-compliance in capital projects contribution agreements. The terms of reference for this review has recently been extended to include "other transfer payments" other than Alternative Funding Arrangements. As well, the Department is reviewing a new Treasury Board circular on contribution agreements which will result in new financial and operational policies on compliance.⁸

A second project action plan proposed by the Department addresses the adequacy of the testing of Section 27 procedures by Finance and the possibility of applying statistical sampling.⁹ This is one area where regional Finance did not have a policy and ought to. However, we anticipate that this will lead to more questions regarding the extent and nature of departmental monitoring and control of band expenditures, and accordingly runs the risk of adding to the rules that already are not being enforced.

7 Observations #78 and #100

8 Observation #21

9 Observation #122

A third project action plan provides for completion of updates to the Financial Management Manuals for items missing since its introduction.¹⁰ A schedule of items is provided. They appear to be normal types of revisions and the project is ongoing in nature. The Department subsequently confirmed its intention to develop a comprehensive financial procedures and controls manual with cross references to program directives contained in the departmental directives manual.

The major thrust for some fundamental rethinking of the Department's roles and responsibilities as suggested in our Report is likely to come from the Organizational Review being conducted by outside consultants. They have been asked to review the Minister's fiduciary accountability. This will not be an easy task in view of the fact that the present Indian Act was written in a different time and environment. The Action Plan states that, depending on the findings of this study, "it may be necessary for the Department to develop or revise financial policies to better reflect and distinguish between the financial management practices required under the various delivery mechanisms."

Taking into account our overall concern about the degree of duplication between financial and program staff, we would expect that the consultants chosen to do this study will examine the contribution of both to discharging the Minister's fiduciary accountability.

¹⁰ Observation #135

MAJOR FINDING

- C. Resources are increasingly being allocated to the recipients on a formula basis, in response to complaints about the inequitable distribution of funds.

Our primary concern here is that present processes unfairly raise the expectations of the Indian bands and councils. Managers spend considerable amounts of time explaining amounts to be distributed under the contribution arrangements where input variables to formulae are applied. The Department continues to exercise discretion over the use of other funds - for example, as is contemplated by the revised capital projects regime.¹¹ It will therefore continue to be subject to pressure and criticism from Indian bands for more equitable distribution of funds.

Efforts to improve the formulae or data bases will be useless unless it is made more clear how funds are distributed. This will not eliminate charges of underfunding, but unless Indian bands and councils know how funds are allocated they will continue to press for more funding, rather than shift their attention to making better use of available funding.

MAJOR FINDING

- D. Formal resource allocation processes of the department do not seek to justify or document the resources to be provided to individual Indian bands or tribal councils, or the allocation between and among the department and individual recipients of grants or contributions, this being accomplished through meetings and discussions with Indian bands that may leave both

¹¹ Observations #54 and 56

departmental employees and the bands uncertain as to their total entitlement.

The Department has made some progress in increasing the level of certainty of funding - for example, band support and tribal council funding will now be finalized by July 31 rather than March 31.¹²

The Department's Action Plan states that bands are normally aware of amounts being sought for them or base their expectations on previous year's funding. It also states that resource requirements, which are submitted to Treasury Board, are built up from underlying band and individual Indian data.¹³ This may be true, but nowhere in the formal reporting processes are total resource requirements documented or aggregated by the band. It is not surprising therefore that the recipients may have false expectations when the formal processes ignore their individual requirements.

MAJOR FINDING

- E. Parliamentary appropriations that are designed to limit each of operating, capital, and grants and contributions expenditures are, in effect, managed within the region on a total basis for most of the year, relying on transfers among regions to remedy any potential over-expenditures by individual votes. However, this could result in over-spending a parliamentary vote.

The Department's Action Plan correctly describes the budgetary control process wherein budgets are managed decentrally during three-quarters of the year, subject to headquarters concurrence for any transfers between program components, and managed centrally during the last quarter. While it would be rare for parliamentary

¹² Observation #101

¹³ Observation #69

appropriations to be overspent at the end of December, this means, as stated in its response, that Supplementary Estimates may be required to align cash and budgetary requirements.¹⁴

Our concern is that the Department's instructions to its managers maintain close control over program components, a control that Parliament delegates to the Department, but do not maintain the same quality of control over individual votes, something over which Parliament has sought to retain control.

Traditionally, departments maintain commitment systems that rigorously record expenditures and commitments throughout the year to guard against over-expenditures. Commitment accounting requirements have been somewhat relaxed by recent amendments to the Financial Administration Act and there is much logic in the Department's response. However, without Supplementary Estimates or moving funds between regions, over-expenditures could occur since there is no guarantee that expenditure trends in the first three quarters can be corrected in the last quarter in the light of firm commitments that may then exist.

The Department has reviewed its procedures with the Office of the Comptroller General who have validated the Department's approach. This is based on the fact that present practices warn the Department of any need for Supplementary Estimates. We suggest this approach, however, preempts Parliament's right to deny such additional authority.

¹⁴ Observation #117

MAJOR FINDING

- F. The focus in allocating resources is on individual planning elements which are first organizationally assigned to headquarters branches, and from them to their counterparts in the region. This fragments resource allocation decisions and controls.

The Department's Action Plan does not challenge the accuracy of this finding. As stated by the Department, data are accumulated from individual bands to determine their needs and unit costs are applied to these to justify total resource requirements. The Department also states that individual bands may have some idea of their likely funding, based on the previous year's funding, but they rarely know with any certainty until contribution agreements are signed and often live in hope of new funding being made available.

None of this denies the main purport of our finding - namely, that the whole process, data base, allocations and contribution agreements are based on individual planning elements wherein each program and program component divides up "its" money to individual regions and individual recipients without even the Regional Director General being able to re-allocate funds among these elements, without reference to headquarters. Thus, no one looks at the totality of an Indian band's needs, or any desire on their part to reassign spending priorities.

As well, present arrangements allocate resources provided for Alternative Funding Arrangements in this same way, thus perpetuating bureaucratic control over pockets of funding provided by Parliament.

MAJOR FINDING

- G. The central accounting system fully satisfies the region's needs for financial control, but inadequately analyzes expenditures of benefit to individual bands or tribal councils so that total amounts are known.

The Department's Action Plan addresses the coding aspect of this finding and states that a recently established Internal Control unit now reviews program coding. The Department has also listed, as a project, a revision to the Service Code directory.¹⁵ This is essentially a housekeeping activity.

A special report developed in June 1987 facilitates the reconciliation of planning elements to recipients as reported by contribution agreement.¹⁶ The financial information is taken from the BCS/EAS and contribution agreement files. A further improvement to departmental dictionaries has also been implemented subsequent to our review - namely, to process all expenditures according to band or tribal council.

The Department's Action Plan also indicates some progress has been made at the regional level in the review of program reporting needs which has culminated in a special Finance report covering all services to their clients. As well, the Department is reviewing the system's capacity for client-oriented financial reports.¹⁷ An update to the BCS is expected to be operational in October 1988.

15 Observation #119

16 Observation #9

17 Observation #39

These improvements indicate the Department recognizes the need for this information and is working towards achieving better reporting. However, in its response the Department has associated "analysts" with the monitoring and controlling of specific claims and audits, rather than discerning trends and unusual relationships. Analytical review techniques should be employed on a timely basis to determine the reasonableness and comparability of expenditures.

The lack of analysis of information being reported to the Department was evident, for example, in our observation on level "C" costs, wherein we suggested the Department review the actual costs incurred by the band to adjust unit factors. The Department's response ignored this experience-rating aspect of unit costs.¹⁸

MAJOR FINDING

H. Program managers have their own system for managing contributions. They have copies of all agreements, records of amounts approved, committed, spent, and free balances remaining, and procedures for reviewing and approving transactions. As a result they have all the information they need to effectively control outlays to Indian bands and organizations and overlap most of the functions performed by financial staff.

The Department has addressed to some extent our concerns regarding the degree of duplication between program and financial staff and has proposed a project to:

- * study the impact of PY reductions on the ability of regions to perform their financial functions;
- * identify organizational issues to ensure the viability of regional financial organizations; and

- * review the relationship of the finance role to the program role.¹⁹

This Organizational Review of the Regional Finance Organizations, as previously mentioned, will be completed in July 1988 and should adequately address this finding.

MAJOR FINDING

- I. Compliance audits conducted by the auditors, chosen by the recipients of the funding, are ineffective as control devices since the records and other information available to them are usually not adequate to enable them to confirm compliance or the accuracy of financial information reported, and many either qualify or deny an opinion.

The Department has misinterpreted the meaning of compliance used in this context. The Department states that compliance is obtained through an ongoing analysis of financial and operational reports rather than "compliance audits". However, the audits of Indian bands have been converted from opinion audits to compliance audits by the way they are imposed as a condition of contribution agreements. As well, auditors are required to complete a questionnaire, called an audit complement, as part of their engagement. Question 9 of this report specifically requires the auditor to confirm that any transfers of the funds for purposes, other than intended, were approved by the Department or were consistent with the contribution agreement. As well, the Department states that audited financial statements may be substituted for receipts and detailed statements of expenditures.²⁰ Program Directive 20-1, paragraph 25(b) requires Program managers to review

¹⁹ Observations #130 to #132

²⁰ Observation #128

portions of audit reports that belong to their programs to ensure compliance.

The performance of audits is a condition that Treasury Board imposes for contribution agreements and therefore an accountability and reporting relationship to the Department exists. The Department's response does not respect that condition. The Department's Action Plan acknowledges that these reporting relationships may require amendment as a result of a court inquiry/decision, but it does not elaborate.²¹

The Department has introduced improvements to the audit review process subsequent to our review which it contends will address the deficiencies in the Region's follow-up of audits cited in our Report. The Department reports it is planning to review the capacity of Band Support to implement the new policy and procedures for the audit review process. However, no terms of reference and anticipated results are provided.²² The Region has also instituted a new requirement for the Director of Indian Services to issue an annual management letter to the chief and council on the quality of management, the adequacy of financial position, and departmental requirements for improvement.²³ This is a very positive step forward which we strongly commend. However we do not know how these improvements will help departmental personnel trying to assess performance in accordance with the contribution agreement when there has been a denial or qualification of opinion. This fundamental shortcoming of present audit processes was not specifically addressed in the Department's Action Plan.²⁴

21 Observation #85

22 Observation #80

23 Observation #66

24 Observation #81

The Department states that it has issued new guidelines for Indian band accounting which require the auditors to reconcile funding provided by the Department with revenue recognized by the Indian band. Our concern, however, was that the Department did not reconcile the expenditures recorded by the Indian band with the intended purposes of the funding.²⁵

MAJOR FINDING

- J. The region has difficulty in estimating and controlling those essential social development services that are administered by the bands because the Indians, not the department, decide on individual entitlements.

The Department's Action Plan includes a project to improve the mechanisms for resourcing and managing the social development regime. This project addresses our criticisms of the historical data bases, the lack of comparison with outside data and the shortcomings of the audits of bands. The project activities include a review of regional operations, an interim management regime, and a data base review to be completed by December 1988.²⁶

The Department's Action Plan indicates appropriate measures have been taken at the regional level to share information with other government bodies and other departmental programs to reduce program slippage.²⁷ It has also increased its contribution agreement reporting requirements to meet national standards.²⁸ These measures are designed to increase the surveillance of social assistance

²⁵ Observations #47, #50 and #84

²⁶ Observations #90 to #95 inclusive

²⁷ Observation #42

²⁸ Observation #40

claims assuming the continuance of the contribution agreement regime. Interesting enough though, Headquarters also acknowledges the flexibility and increased productivity that Alternative Funding Agreements would likely achieve over direct social assistance payments.²⁹ We are pleased to note this positive response to the overall purport of our recommendations.

MAJOR FINDING

K. Program managers circumvent financial controls to maximize the utilization of funding. At times, they use separate recipients rather than request authority to increase contributions to an individual Indian band; they have sometimes refrained from recording commitments that are uncertain or for which payment can be delayed (thus increasing the likelihood of overexpenditures or carrying over into the subsequent year expenditures more properly charged to the current year) and they have, on occasion, retroactively provided financing for expenditures that have already been incurred.

Our Report was primarily concerned with the fact that present rules do not fit the situation where an Indian band disburses the funds. This inevitably causes program managers to apply the rules so that they ratify the results already obtained. It also cited a number of cases where the use of commitment certificates and administration of contribution agreements and specific service agreements were found to be inadequate.

The Department has responded by stating that utilization of these methods may lead to beneficial results. We agree. However, we see little or no need for rules that are not appropriate for the Department's clientele, and that the Department has no intention of

²⁹ Observation #96

enforcing. This is why we suggest Alternative Funding Arrangements - to get the Department out of the business of enforcing compliance with a set of rules established for its own accountability, but one with which the Indian people do not believe they should comply. Alternative Funding Arrangements would remove the necessity for unilaterally decommitting funds and establishing alternative departmental priorities to prevent lapsing of funds.³⁰ The region is supportive of developing a set of rules that are more appropriate to compliance for their client recipients.³¹

MAJOR FINDING

- L. Some Indian bands incur deficits by spending beyond the resources available to them which the department cannot prevent and often has to retroactively redress by providing the bands with funding intended for other purposes to pay off their debts.

The Department's Action Plan does not adequately address our concerns about the need to formally recognize and report actions taken to remedy band deficit financing; rather it contends that no additional funding is provided, a fact which we acknowledge in our Report. This manner of recording such assistance, while literally accurate, hides the true purpose of the funding and may also distort the historical data bases on which future funding is provided. As a result of present practices, for example, unapproved capital projects or excess costs of approved projects are not recognized in the Department's records unless they are subsequently ratified by special actions taken to eliminate the deficit. If resources to pay off deficits are drawn from band administration budgets, the underlying cause of the deficit will never be recognized. Until such costs are recognized, the unit costs and cost estimates will

30 Observation #121

31 Observation #38

continue to be understated, as will the capital asset base. After they are recorded, they may increase the base for future funding. The Department also states that there are authorities which permit them to retroactively approve capital project funding.³² The Indian people are therefore justified in believing in the possibility of obtaining more funding if they spend beyond their current resources. The risk they run in doing so is deficit financing. The incurrence of deficits may therefore be a deliberate risk-taking decision by Indian bands rather than poor managerial skills as suggested by the Department.

By making the Indian bands and councils accountable to their people through Alternative Funding Arrangements, the effectiveness of their financial management of resources can be more truly measured over time. As the level of funding will be determined up front under these agreements, the occurrence of unwieldy deficits can only be addressed through normal debt restructuring processes.

³² Observations #26 and #56

IV. OTHER OBSERVATIONS

Variance Reporting

We reported three instances where variances were not reported on the monthly management reports. The Department's Action Plan acknowledges one of these, involving an interdepartmental Special Service Agreement, as an area where confusion could exist. The Department is currently re-examining the variance reporting system with the objective of clarifying and standardizing the input from all regions. This will hopefully address the inherent weakness in the present variance reporting system, wherein it reports only legal liabilities, rather than the most likely course of events.

The Department states that the BCS/EAS is not the primary mechanism used to provide accurate forecasts. Rather "work plans and knowledge of progress achieved" is the basis for forecasting their financial requirements.³³ Nevertheless, we found these BCS/EAS variance reports to be the primary evidence supporting financial reports of variances forwarded to headquarters. As well, we were advised during our debriefings with regional managers that work plans were used for individual or unit performance appraisal, not as a resource allocation or management tool.

The Department's Action Plan recognizes the need to link variances to work plans and program results. As well, Regional Finance now requests narrative explanations and action plans on variances for the preparation of a monthly report for the Regional Director General.³⁴ We are encouraged by these actions to improve reporting.

³³ Observation #5

³⁴ Observations #3 and #2

Land and Membership Data

The Department's Action Plan recognizes there is a backlog in both of these areas, in part due to system implementation problems and volume of work.³⁵ Higher priority undoubtedly will be attached to these projects once the current review by the Office of the Comptroller General is complete.

Education

The Department's response indicates that two action plans have been developed as a result of our Report to review the nominal roll and some problematic service codes.³⁶ These are minor criticisms; we were generally satisfied with the data bases in Education.

35 Observations #44 and #45

36 Observations #87 and #88

V. PROJECT ACTION PLANS

The Department's Action Plan includes the following project action plans:

1. Material Management Review;
2. Transfer Payments Process Review;
3. Renovation Guidelines;
4. Social Development Management Regime;
5. E/S Education Nominal Roll;
6. Education Service Codes;
7. Regional Financial Review;
8. Sampling Section 27 Verification;
9. Service Codes/Chart of Accounts; and
10. Financial Manuals Update.

While all of these projects are worth doing, most deal with matters that are not of a fundamental nature. Many of them, such as the Renovation Guidelines and the Material Management Review, are primarily program, not financial management matters.

Several projects will address financial management matters raised in our Report, but only Project 2, Transfer Payments Process Review, Project 7, Regional Financial Management Review, and Project 10, Financial Manuals Update, have very broad scope.

The Transfer Payment Management Process Review is a very positive response to our concerns about the need to adapt the Department's financial management procedures to the environment that now exists with extensive devolution to Indian bands.

The Regional Financial Review is the second project with broad scope. We particularly welcome the fact that this study will "review the relationship of the finance role to the Program role".

Our investigators were particularly struck by the extensive duplication between the two and the missed opportunities to contribute to down-sizing by some greater rationalization.

Finally, we note that the Financial Manuals Update is mainly designed to make more current and complete the existing manual. The Department has subsequently confirmed that its main intention is to include all financial procedures and controls for contributions, other transfer payments and AFA, and will cross reference these manuals with program directives.

In summary, while we believe that the Department has embarked on an extensive program of action to implement many of the recommendations that we have advanced, the Office of the Comptroller General must monitor further before it can be assured that these projects will remedy the deficiencies contained in our Report.