Risk Assessment and Controls to Enhance Business Development

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Introductions

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Ever Had ..

• A Financial shock?
Ever Had ...

• A venture/contract that went really smooth?
Objectives

• Learn from each other
• Introduce participants to efficient practices
• How to manage risks using a Financial Management System
• Integration of Aboriginal Business Practices and Culture
Our Activity Today

• Define Internal Control & Risk Management
• Present Models to Facilitate Assessment
• Have you complete studies
• Present alternatives
• Alignment with FMB Standards
Risk Management

Risk management is a **process**, effected by a First Nation’s chief and council, management and other personnel, applied in **strategic setting** and **across** the government, designed to **identify potential events** that may affect the government, and **manage risk** to be within its **risk appetite**, to **provide reasonable assurance** regarding the achievement of government **objectives**.

Source: Adapted from COSO Framework
Internal Control Definition

“... a process, effected by a First Nation’s governing body, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

1. Effectiveness and efficiency of operations.
2. Reliability of financial reporting.
3. Compliance with applicable laws and regulations.”

Source: Adapted from COSO Framework
Controls and Risk Assessment Levels

A. Operational ‘Day to Day’ Activities
   • Functional areas – cash, purchases, sales, payroll etc.
   • How we make approvals, reconciliations, etc.

B. Contractual Commitments
   • E.g. service contracts, contribution agreements, leases etc.
   • How we engage with consultants, auditors, etc.

C. Strategic Decisions
   • E.g. Investments, Joint ventures, business proposals
   • How we meet long-term objectives
Controls and Risk Assessment Levels

- Strategic
- Contracts
- Operations
The Challenge

FN Goals & Objectives

Budget/fund & Skill Limitations

Strategic alliances

Opportunities & Risks

Constitution, Treaties, Gov’t & Regulations

Market and Economic Forces

Community

Partners & Suppliers (current & potential)

Traditional values, Culture

Need tools and an approach to achieve goals, assess opportunities and manage risks when making decisions.
Governance Model

Nature:
Direction including for programs, Economic development, cultural

Purpose:
Accountability, Transparency and coordinated approach

Leadership:
Tone from the top

Overseeing Due Diligence

The supports:
Internal Controls, oversight, policies

Consider roles, restraints

Management & Administration:
Finance, Programs, Operations

Corporate Governance
Finance & Audit Committee

Admin
Chief & Council

Political & Governance

Directional Base
Community Plan

Foundation
Community
Cultural, Tradition and Values

Accountable to

Aboriginal Rights and Title

Accountable for

Strategic community based approach

2015-02-18
Framework for Controls and Governance – FMS Standards
Risk Assessment and Internal Controls

CASE STUDIES
Case Studies

#1 – Business Proposal (Strategic Level)
Little Bird First Nation is presented with an opportunity to invest in a wind energy system through a Limited Partnership.

#2 – Service Contract (Contractual level)
Little Bird First Nation needs to upgrade its accounting system. The software developer has prepared a basic contract.

#3 – Fraud Case (Operational Level)
Little Bird First Nation has weak controls over member welfare disbursements
Case 1 - Overview

• Little Bird First Nation located in northern Ontario close to mining activity
• Recently Certified by the FMB
• Seeking investment opportunities
• School and rec centre are overcrowded
• Need new water treatment plant
Case 1 – Overview (Cont’d)

• Little Bird First Nation approached by Sky Windpower Inc. to invest in a new wind energy project
• A new Limited Partnership structure has been proposed
Case Study 1: SKY Windpower Inc. (SKY) proposal to Little Bird First Nation (LBFN) - reviewed by LBFN lawyer, says no legal issues.

*Business plan for LP:
Build SKY prototype based on SKY’s Intellectual Property (IP)
Market, sell and construct SKY windfarms for use on other Aboriginal traditional territory
Production to be financed via letters of intent

Told time is of essence as told other First Nations interested and SKY has spend a lot of time on this with you.
Case 1 Required

• You are a member of the LBFN Finance and Audit Committee ("FAC") that is responsible for evaluating the investment proposal
• The FAC must make a recommendation to Chief and Council
  – Proceed with the proposed investment?
  – Any recommended changes to be negotiated?
• Identify any risks or concerns you may have with the proposed strategic investment
• What is your recommendation?
Case 1 Group Work

• Break into table groups (15 mins)
  – Analyse the case facts
  – Formulate recommendations

• Selected groups asked to share (10 mins)

• Debrief to follow (5 mins)
Case 1

GROUP DEBRIEF
Case 1 – Debrief

1. Where will the desired new revenue source come from?
2. Who actually controls the investment and joint venture?
3. Is the deal as fair as it seems?
4. Are the needs of the Community considered?
5. What other risks exist?
6. Other Considerations?
Case 1 – Applying a Governance Model

- **Proposer**
  - Proposal & $’s to cover cost

- **Negotiator**
  - Negotiations
  - Directions
  - Clarifications

- **Assessment Process, Council &/or Economic Dev Corp**
  - In place
  - Expertise
  - Beyond politics
  - Transcends leadership changes
  - Recommendation

- **Governance Model**
  - Clarifications

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Image 230x0 to 304x49
Image 344x15 to 503x49
Image 111x120 to 535x432
Image 275x276 to 361x335
Image 296x402
Case 1 Assessment Process

**Considerations**
- Business Case
- Financing options, e.g. FMB
- Risks & Managing risks
- Relationship - who
- Tax & structure

**Criteria – community & Business**

**Process with Expertise**

**Community Case**
- Why you?
- What do you offer? 2+2=22?
- + & -’s & distribution $’s & non $’s?: profits, risks, costs, ST &LT, social, health
- Options?

**Output w/ Recommendations**
- Not just yes or no. E.G:
  - How to protect interests, e.g. reports, operational & oversight controls
  - Returns & costs & distribution thereof.

**Business Perspective**
- Trade-offs?
- Congruency with Community plan

2015-02-18
Case 1 Linkage to FMS Standards

• 19.3.1 Investment policy
  – Council establishes and implements a documented policy

• 19.3.2 Investment procedure
  – Council establishes and implements a risk management and approval process

• 19.3.3 Compliance with FAL etc.
  – Council demonstrates that investments are made in accordance with the FAL
Case 2

CONTRACTS WITH SERVICE PROVIDERS
Case 2 - Background

- LBFN has history of qualified audit reports related to accounting for TCA
- COO has been instructed to fix problems
- Solution:
  - Upgrade “Softbooks” (Accounting System)
  - Also develop five new unrelated modules
- Contract awarded to “True North Software”
Case 2 – Software development

<table>
<thead>
<tr>
<th>Purchase Order from LBFN to True North Software Inc.</th>
<th>Development, testing and implementation of a new TCA Accounting Module to meet Public Sector Accounting Standard requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Development of five other Modules</td>
</tr>
<tr>
<td></td>
<td>Certain upgrades to SoftBooks to ensure compatibility</td>
</tr>
<tr>
<td><strong>Hourly rate</strong></td>
<td>$150 (discounted from $200)</td>
</tr>
<tr>
<td><strong>Estimated project fee</strong></td>
<td>$100,000 to $150,000</td>
</tr>
<tr>
<td><strong>Estimated completion</strong></td>
<td>180 days from contract date</td>
</tr>
<tr>
<td><strong>Design rights</strong></td>
<td>True North retains rights to all design</td>
</tr>
<tr>
<td><strong>Deposit required</strong></td>
<td>$25,000 up front</td>
</tr>
<tr>
<td><strong>Payment terms</strong></td>
<td>Time spent will be billed monthly. Invoices are due upon receipt. 15% interest will be applied on any balances that remain unpaid after 30 days.</td>
</tr>
</tbody>
</table>
Case 2 – 12 Months later
February 18, 2015

• Project is six months behind schedule
• Budget estimate exceeded (invoice attached)
• Modules 5 and 6 are work in progress
• New TCA Module has many unresolved bugs
• Chief and Council demanding Explanation
• Uncertainty over completion date & final cost
Case 2 Required

• What went wrong?
• How did LBFN and the COO end up in this situation?
• How could this situation have been prevented?
• What could have been done differently?
Case 2 Group Work

• Break into table groups (10 mins)
  – Analyse the case facts
  – Formulate responses to questions

• Selected groups asked to share (10 mins)

• Debrief to follow (5 mins)
Case 2

GROUP DEBRIEF
What went wrong

1. Poorly defined project scope.
2. This was a ‘cost plus’ type contract with no cap on spending
3. Lack of any detailed specifications
4. No warranty terms or holdback provisions
5. Lack of expertise – FN Team
What Could Have Been Done Differently

1. Define and negotiate specifications upfront.
2. Have developer signed off on .
3. Agree on a cap price.
4. Clear change order policy to control costs.
5. Negotiate a warranty period and an after-sales support agreement.
Case 2 Understanding Gap

Proposer or Provider understanding & consideration of FN & Community

FN Understanding of needs, costs and technology

Lack of knowledge or failure to proactively address potential risks/issues/opportunities:

“Community needs”
“Show me the I should have known Clause”
“Change order treadmill”
“Unsuited, bug-ridden or non-delivered”
“Undisclosed costs”
“Distribution of benefits & costs”
“I own the IP rights, not you”
Case 2 Linkage to FMS Standards

• 18.6 Procurement
  – Policies and procedures - Procurement, Tendering
• 18.7 Procurement of Suppliers
  – Evaluation procedures, Access to New Suppliers
• 19.7 Information Technology Controls
  – Policies respecting internal controls for information technology
Case 3

FRAUD
Case 3 – Fraud

• LBFN operates a Member Welfare Fund
• Managed by Manager of Member Welfare
• Source of Funds – Bingo & Raffles
• Disbursements – Cheques payable to Manager
• Auditor raises concerns and is unable to complete the audit
• LBFN engages a forensic auditor to assist
Case 3: Forensic Report

- Cheque payments often in whole round numbers
- Minimal documentation to support payments
- $150,000 unsupported payments made directly to Manager
- $50,000 of unaccounted for cash
- Manager had sole access to bingo cash
CASE 3 - required

• How could this fraud have been prevented?
• What were the ‘costs’ of the fraud to the community?
Case 3 Group Work

• Break into table groups (5 mins)
  – Analyse the case facts
  – Formulate responses to questions
• Selected groups asked to share (2 mins)
• Debrief to follow (2 mins)
Case 3

GROUP DEBRIEF
Case 3 Review

• How could the fraud be prevented?
  – Policies and reports
  – Approvals of payments, Dual signatures
  – Controls over receipts, revenue, reconciliations

• Costs to the community?
  – Credibility
  – HR issue
  – Community
  – Other costs
Case 3 Linkage to FMS Standards

• 19.6 Financial Reporting Risks
  – Need to identify risk related to fraud

• 26.1 Reporting Policies
  – Whistleblower policy

...More to come – watch for 2015 Standards!
The Big Picture
Conclusions

• Identify social and economic benefits early
• You hold passport to other Aboriginal groups
• Use governmental powers
  • Control over traditional land/oceans
  • Land use decisions
• Access to FMB Standards and Certification
• Identify non-monetary resources and alliances
• Be proactive and seek advice when necessary
Speakers

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Scott Munro

- Scott Munro, CPA, CA, CAFM works with First Nations in all regions of Canada as they work towards Certification
- Scott leads the development of standards designed to assist First Nations develop effective Financial Management Systems
- Scott participates in AFOA chapter events across the country
John Rankin, CPA, CA, CFE, DIFA, MBA, is the principal of CARET Consulting Inc. Over the past eight years he has worked with First Nations, Metis and Inuit organisations. Assignments include: internal control assessments; forensic investigations; advisor to an arbitrator for a dispute between an Aboriginal Non-Profit and International Corporation; Governance and control training; policies and procedures manuals.

Additionally John has: prepared business plans; completed financial feasibility study of a commercial aircraft; performed risk assessment for Private Public Partnership proposal; provided business insight perspectives for clients to legal counsel. He has been a guest speaker on fraud and internal control at a number of organisations.

A focus of John’s is working together with Aboriginal Organisations and their staff in developing Financial Management Capacity and addressing management, strategic and financial issues on a proactive basis.