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Table of Contents

1	Financial Reporting by First Nations A Draft of the CICA Research Report Is Now Ready for Feedback	<i>Nola Buhr</i>
8	Aboriginal Leadership Development: Building the Capacity for Success	<i>Brian Calliou and Dr. Cora J. Voyageur</i>
15	Consensus Decision Making – Fallacies and Fixes	<i>Janice Rose</i>
19	Self Government Negotiations – Miawpukek First Nation Style	<i>Judy White with Tammy Drew and Yvonne John</i>
23	Financial Instruments – Deciphering the New Standards	<i>Sheldon Gunn</i>
26	Introducing a New Series of Aboriginal Management Certificate Courses	
27	Introducing AFOA's Annual Aboriginal Youth Financial Management Conference Awards	
41	Internet Security – Practice Safe Computing	<i>Percy Barnaby</i>
44	Becoming a Certified Aboriginal Financial Manager (CAFM)	
46	Are You Working on Developing Financial Policies, Procedures, By-laws or Other Financial Control Tools? AFOA Has a Unique Tool that Can Help	
48	AFOA's 2008 National Conference	
49	The Aboriginal Finance and Management Capacity Development Series	
51	Build the Skills You Need to Get the Job Done and Get It Done Well!	



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FOR GENERATIONS

Financial Reporting by First Nations

A Draft of the CICA Research Report Is Now Ready for Feedback

Nola Buhr, PhD, CA

If you have been attending the AFOA national conference for the past two years, you would have seen the CICA Research Report, *Financial Reporting by First Nations*, as a workshop topic in 2006 and a plenary session topic in 2007. A great deal of progress has been made on this project over the last year and a draft report will be ready for feedback by the end of August. This article provides some background on the project and then describes the thought process of the Study Group as well as the recommendation and implications found in the draft report. The Study Group is looking for your comments and would like them by early October.

BACKGROUND FOR THE PROJECT

No Accounting Standards for First Nations

Current accounting standards for governments in Canada do not explicitly include First Nations governments. The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) is responsible for setting GAAP (Generally Accepted Accounting Principles) for all levels of government in Canada. Such accounting standards and guidance are spelled out in the *Public Sector Accounting (PSA) Handbook*. The CICA *PSA Handbook* defines “governments” and “public sector” but does not mention First Nations or First Nations governments.

This lack of standards for First Nations is a problem for financial statement users. Credible financial reporting depends on high quality accounting standards to ensure that information is relevant and reliable; comparable over time and with other similar entities; and is understood by users.

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INAC and the Year-End Reporting Handbook

Because of the lack of GAAP for First Nations, INAC has set out its financial reporting expectations of *Indian Act* First Nations in a document known as the *Year-end Reporting Handbook for First Nations, Tribal Councils and First Nation Political Organizations*.¹ The Year-end

¹ Self-governing First Nations are usually required by their self-government legislation to simply follow GAAP for government.

Reporting Handbook instructs First Nations to follow public sector GAAP as provided by the CICA *PSA Handbook* for local governments. However, GAAP for local governments is changing. For fiscal years beginning on or after January 1, 2009 local governments will have the same accounting standards as senior governments (provincial, territorial and federal governments). There will be only one financial reporting model for governments in the CICA *PSA Handbook*. The Study Group refers to that model as the common government reporting model.

Authorization of the Project: Financial Reporting by First Nations

In order to study the gap in GAAP for First Nations, PSAB authorized a research report project to provide recommendations for financial reporting by First Nations.

The Research Report is limited to GAAP-based general purpose financial statements. It can not and does not address the special purpose requirements of INAC or any other user. This means the Research Report does not directly address the reporting burden faced by First Nations. But, if users did accept general purpose GAAP statements instead of a number of special purpose reports, the reporting burden would be reduced.

Getting Feedback

CICA research reports are the work of an author assisted by a study group and represent the positions and opinions of the study group. Research reports are not accounting standards but they can serve as a stepping stone for standard setting projects by a board of the CICA.

Given the need for awareness of this project and to better understand financial reporting issues faced by the First Nations community, public input, especially from First Nations, has been sought.

In the month of March, 2007, the Study Group completed six regional focus group meetings in Moncton, Quebec City, Ottawa, Winnipeg, Edmonton and Vancouver. These meetings were organized by the Aboriginal Financial Officers Association of Canada (AFOA) and the AFOA chapters. Focus group members included AFOA chapter representatives, preparers, auditors and representatives from INAC. These individuals were provided with overview material on the Research Report and asked to discuss the material in a one-day meeting. Feedback received from these regional focus group meetings was reviewed by the Study Group and incorporated into the draft Research Report.

The draft report has now been approved by the Study Group for the purpose of getting additional feedback. In late August a complete draft of the Research Report will be provided directly to over 100 Project Associates for feedback. Project Associates consist of all individuals who were invited to the regional focus group meetings as well as other interested individuals from a range of stakeholder groups. Comments

received from Project Associates will be reviewed by the Study Group and incorporated into the final version of the Research Report.

In order to make sure that everyone who is interested has a chance to provide feedback, the draft report will also be posted on the AFOA website in late August. It is expected that comments will be due by Friday, October 12th.

Watch the AFOA website

The *Financial Reporting by First Nations* draft report will be posted on the AFOA website in late August for your feedback.

Visit the AFOA website at: <http://www.afoa.ca/>.

Please send your comments by e-mail (in Word format) by the deadline to: ed.psector@cica.ca.

THOUGHT PROCESS OF THE STUDY GROUP

Accountability

The Study Group believes that accountability is the fundamental motivation for financial reporting and that concepts related to accountability must guide the Research Report. The Study Group chose to use the definition of accountability provided by the Office of the Auditor General of Canada.²

Accountability is a relationship based on obligations to demonstrate, review, and take responsibility for performance, both the results achieved in light of agreed expectations and the means used.

This definition of accountability was established for the federal government. However, it also applies to relationships between First Nations and others. These relationships vary. Some of them are a birthright; some of them have been established through centuries of history; and some of them are contractual and legal. Key relationships are:

- relationships between First Nations and their members;
- relationships between First Nations and other levels of government; and
- relationships between First Nations and capital providers.

The Study Group agreed that recommendations for financial reporting had to keep these relationships in mind.

² Office of the Auditor General of Canada, December 2002 Report, Chapter 9, p. 1.

Reporting Alternatives

In making recommendations for financial reporting by First Nations, the Study Group had several reporting alternatives to choose from:

- (1) the common reporting model for government which is GAAP;
- (2) for-profit GAAP;
- (3) not-for-profit GAAP;
- (4) retaining the soon to be outdated local government reporting required by INAC's Year-end Reporting Handbook, although this would not be GAAP;
- (5) a mixture of accounting standards which would not be GAAP;
or
- (6) the development of accounting standards solely for First Nations.

The Study Group felt strongly that First Nations needed well-developed GAAP and began by examining all three types of existing GAAP: for-profit GAAP, not-for-profit GAAP and GAAP for government.

GAAP-Based Alternatives

The Study Group recognized that certain First Nation government organizations have the characteristics of for-profit organizations. This would apply mainly to business enterprises set up to enhance economic development for the First Nation and generate own-source revenue. Indeed, some First Nations have a greater portion of revenue from economic development than they do from federal government transfers. But, many of the characteristics of for-profit accounting are not applicable to the First Nation overall. A First Nation does not exist to maximize profit for shareholders.

As well, the Study Group noted there are other organizations controlled by First Nation governments that have the characteristics of not-for-profit organizations. These would be, for example, organizations focused on social services and health and education programs. However, a First Nation is not a charity. It does not operate with a single charitable objective and does not have revenue from charitable donations.

The Study Group felt strongly that the leadership structure of First Nations should be considered a government. The leadership is selected by the members of the First Nation and operates as a government with the

The Study Group felt strongly that the leadership structure of First Nations should be considered a government. The leadership is selected by the members of the First Nation and operates as a government with the well-being of members as the first and foremost objective. Therefore, the Study Group started by studying whether GAAP for government would serve the purposes of financial reporting by First Nations governments.

well-being of members as the first and foremost objective. Therefore, the Study Group started by studying whether GAAP for government would serve the purposes of financial reporting by First Nations governments.

The common reporting model for government found in the *CICA PSA Handbook* is designed to deal with for-profit and not-for-profit organizations controlled by the government. Other governments have the same issues as First Nations when it comes to dealing with accounting for a variety of government organizations. The *CICA PSA Handbook* currently indicates that each organization within the government reporting entity should use the GAAP that best suits the organization whether that is for-profit, not-for-profit or government GAAP, for the purposes of preparing their own financial statements. Then, GAAP for government is used for the consolidated financial statements of the overall government.

Other Alternatives

Before further exploring GAAP for government and its applicability to First Nations governments, the Study Group considered the other reporting alternatives briefly. The Study Group felt that understandability and comparability were critical qualitative characteristics for all financial reporting. Additionally, unlike the local government model, the common government reporting model provides detailed guidance on the recognition and measurement of tangible capital assets. The Study Group felt that information on tangible capital assets was an important component of First Nations financial statements. Therefore, continuing to use outdated local government accounting standards was not seen as an option.

The alternative of having a mixture of accounting standards was based on the idea that the source and volume of revenue should determine accounting treatment. For example, those First Nations with substantial own-source revenue would use for-profit GAAP. Those First Nations that relied primarily on federal government transfers would use GAAP for government. This alternative was rejected because it would hurt comparability.

Finally, the Study Group did not feel that First Nations governments were different enough from each other or from other governments to warrant different accounting standards for different First Nations or accounting standards different from other levels of government. Accordingly, the Study Group rejected the development of a new set of accounting standards for First Nations.

Testing the Common Government Reporting Model

Having rejected all of the other alternatives, the Study Group concluded that it should test its thinking by exploring GAAP for government in detail to confirm whether it applied to First Nations governments.

The Study Group took a four step approach to the analysis of the common reporting model to determine its applicability to First Nations governments. These four steps were:

- (1) Examine user information needs and general purpose financial statements as found in *CICA PSA Handbook* Section PS I000, “Financial Statement Concepts”;
- (2) Evaluate the characteristics of government as found in *CICA PSA Handbook* Section PS I100.A, “Financial Statement Objectives, Appendix A – Unique Characteristics of Government”;
- (3) Examine *CICA PSA Handbook* Sections PS I100, “Financial Statement Objectives”; and PS I200, “Financial Statement Presentation”; and
- (4) Review *CICA PSA Handbook* Section PS I300, “Government Reporting Entity”.

Some differences were found in the second step which was an examination of the characteristics of government.

- First Nations have a stronger relationship with their land base, most of which is reserve land held by the federal government for the benefit of First Nations.
- Taxation revenue is not a major source of revenue for First Nations. Depending on the First Nation, either federal government transfers or profits from economic enterprises will be the main source of revenue.
- First Nations do not have the same capacity to issue debt even though recent legislative initiatives have the intention of providing First Nations with access to competitive long-term debt financing.
- First Nations differ from other governments in the extent to which they have assets held in trust for them by the federal government. This applies to reserve land and a variety of financial trusts.

Even though there are these differences, the Study Group found that, from an accounting perspective, the characteristics of government in general, applied to First Nations governments. Indeed, overall, the Study Group felt that the *CICA PSA Handbook* applied to First Nations governments.

The Study Group then asked, “What would the financial statements look like if the common reporting model in the *CICA PSA Handbook* was applied to First Nations?”. A set of statements was created and the Study Group agreed that they were meaningful for First Nations. These proposed statements can be found in Appendix B of the draft report.

RECOMMENDATION AND IMPLICATIONS

Recommendation:

The common government reporting model as described in the CICA *Public Sector Accounting Handbook* applies and should be adopted by all First Nations governments.

The Study Group made its recommendation after considering the current social, political and economic circumstances of First Nations as well as the various reporting alternatives available. After reviewing the GAAP requirements that will be common for local and senior governments effective January 1, 2009, the Study Group concluded that the single set of GAAP for government, as spelled out in the CICA *PSA Handbook*, applies and should be adopted by all First Nations governments.

During the regional focus group meetings the Study Group received many comments about the adoption of this recommendation. Although beyond their mandate, the Study Group felt that it was critical to reflect on these comments and the implications of the Study Group's recommendation.

The draft Research Report records these implications. For example, in order for the adoption of the common government reporting model to be successful, capacity building is essential among three key groups: preparers, auditors and users.

NEXT STEPS FOR THE STUDY GROUP

The draft CICA Research Report, *Financial Reporting by First Nations*, will be available for feedback late in August. The Study Group is looking for your comments by early October, 2007. In the fall, the Study Group will review the feedback to determine how acceptable the draft report is and what changes are needed to turn the draft report into a final report. The goal for completion is June 2008.

ABOUT THE AUTHOR:

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Aboriginal Leadership Development:

Building the Capacity for Success

Brian Calliou and Dr. Cora J. Voyageur

Aboriginal leaders in Canada are dealing with an increasingly complex global economy. Through the devolution of powers from central authorities to regional and local governments, Aboriginal communities are assuming increased responsibilities and duties with self-government agreements, service delivery contracts, and the settlement of claims. This growing activity means that Aboriginal leaders must embrace continuing education – especially in leadership and management development so they can carry out their responsibilities effectively.

The Need for Aboriginal Leadership Development

There is a return on investment when one embraces professional development. Human capital theory states that an investment in education now has a return on that investment down the road because the knowledge and skills acquired through the education helps the person to excel at their job. This also has a ripple effect as the increased skills and effectiveness of the leader ripples outward to their team, then outward to their department or organization, and then out to the whole community. Furthermore, many studies illustrate that the socio-economic status of persons with post-secondary education increases substantially.

Aboriginal leaders are facing increasing opportunities, especially in the area of economic development. These opportunities manifest themselves in different ways. For example, when large industrial projects are proposed on their traditional lands or when companies want to enter partnership agreements with them. But, some Aboriginal communities do not have the human resource capacity to take advantage of these opportunities. This lack of skill and knowledge can begin with the elected community leaders.

Community leaders must take their own leadership development seriously. It is their duty to help rebuild their communities and help get them out of the dependency trap that resulted from the imposition of external institutions and legislation. Most Aboriginal leaders, and many managers and directors of boards, have little or no formal management or administrative training. However, the exception is Aboriginal women leaders who have often worked their way up through administrative roles and are now taking on leadership roles.

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When Aboriginal leaders and their communities lack the capacity to run their governments, boards, and economic development business ventures effectively and efficiently, they often rely on outside experts. These outside experts often do not mentor, or coach, or build capacity of community members. Thus, the community leadership remains dependent upon the experts' skills and knowledge. This maneuver ensures future employment for the expert but does little for community capacity. Sometimes business ventures have Aboriginal partners as mere silent partners. As such, little knowledge, skill, or expertise is transferred to the community. Investing in human resource development within the community both increases human capital and financially benefits community members but also decreases the communities' reliance on the outside experts.

The Difference between Leadership and Management

The distinction between leadership and management is an important one. Leaders must clarify their roles and responsibilities as leaders and recognize how they differ from those of the management staff. Micromanagement of the everyday business is part of the old leadership style and is counter-productive. We live in an age where leaders are hiring people who are more skilled than themselves. Leaders cannot use the old command and control style of leadership or these skilled employees will just go to work somewhere else where there is a more meaningful working environment. Bennis and Nanus discuss the distinction between leaders and managers and argue that whereas managers do things right, leadership does the right thing. What that means, is that managers are skilled at implementation of strategies, controls, and processes to reach the overall objectives or vision. They do these things right. The leadership, on the other hand, has to set the vision, mission and values of the community or organization, and therefore have to make the work meaningful and valuable. They have to do the right thing. For example, a leader of a business venture that makes a profit at the expense of harming the environment or burning out employees does not do the right thing, because it is not a sustainable model and is not reflecting the value of the community or the environment.

Despite the leader-manager distinction that helps in clarifying roles and responsibilities, it is important to keep in mind that all managers are leaders too. They are leaders of departments or teams, and must display the new leadership style of stewardship and servant leadership. There is a vast literature on the study of leadership and on management. Leadership is defined as, “to guide; show the way; direct activity or performance.” Sociologist Keith Grint of the U.K. carried out an overview of the study of leadership and categorized four areas into which the literature fall into: (i) the trait approach; (ii) the situational approach; (iii) the contingency approach; and (iv) the constitutive approach. The trait approach is the great man approach where researchers try to isolate the great characteristics or traits that made this person a great leader, who it was thought could lead in all circumstances. The situational approach viewed the circumstances or situations the leader faced as being a more important factor; meaning that unless the right situation arises, a leader of great potential may not have the opportunity to excel. The contingency approach takes both the essence of the leader and the situation into account and identifies the alignment of the two, that is, the emergence of a great leader can only occur if the right situation arises and the right type of leader is matched to that challenge. The constitutive approach is seen as a proactive approach where the leader actively shapes the group’s interpretation of the situation or context. Thus, leaders must interpret each situation they face and try to persuade others that their vision of dealing with the situation is the correct one.

It is this last approach that falls within the new leadership realm. This new leadership paradigm reflects the shift away from direct management, or what was known as the command and control type of leadership, to a stewardship and servant form of leadership. At one time, under the old command and control type of leadership, the leader simply barked orders to subordinates. They also expected that they be made aware of, and approve of, every detail. They pounded the tables and screamed at anyone who did not follow specific orders. In essence, these old direct managers created a climate of fear. Creativity was stifled since people would not or could not think for themselves. The office stopped functioning whenever the leader was away because employees would not make a decision. They feared the wrath of the leader. Such work environments are not productive. New leadership, on the other hand, is about stewardship and servant leadership. Max DePree argues that leadership is an art, rather than a science. He argues that good leadership sets out a clear vision, clarifies the roles and responsibilities, allows employees to grow, and allows for creativity and innovation to flourish. DePree argues that a good leader asks employees what he can do for them – how can he help them to achieve their workplace goals, whether it be finding more resources, changing structures, or improving systems and processes. Transformative leadership also reflects the new leadership, where the leaders excite their followers with a bold vision, organize resources on key strategies, and motivate others to take action as leaders in their own right for the common good of the community.

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