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March 14, 2012

Chief Glenn Hudson
Chief and Council
Peguis First Nation
P.O. Box 10
Peguis, MB R0C3J0

Dear Chief and Council:

In late 2011, Aboriginal Affairs and Northern Development Canada (AANDC) retained Hallux Consulting Inc. to conduct a review of flood funding for Peguis First Nation (PFN). The purpose of the review was to provide an independent and objective opinion on whether AANDC flood funding was expended in accordance with the terms and conditions of the funding agreements with PFN.

This management letter describes the results of that audit work and future steps.

Background

The review covered various funding agreements and amendments during the 2009-10, 2010-11 and 2011-12 fiscal years. The funding was provided through AANDC's Emergency Management Assistance Program to cover flood-related costs, which include mitigation, preparedness, response and recovery. Eligible costs covered under the funding program are the same as what would be covered under the Province of Manitoba's Disaster Financial Assistance (DFA) program, which is operated by the Manitoba Emergency Measures Organization (EMO).

In most cases, AANDC pays an "accountable advance" (i.e. a payment to cover a future expense that has certain reporting requirements) to the First Nation. EMO assesses the expenditures paid out by the First Nation and makes a determination as to whether or not the expense was appropriate. If the eligible expenses are greater than the amount of the accountable advance, then AANDC will provide additional funding to the First Nation. If the expenses are less than the accountable advance, AANDC will seek a reimbursement of the surplus. AANDC may also seek a reimbursement of ineligible costs.

The exception to the above system in Peguis' case is the labour costs associated with the making of sandbags prior to 2011 as it was assumed that this task was completed with unpaid volunteer labour. In fact, the cost of this labour was covered by AANDC. AANDC also covered specific capital costs (e.g. a steamer for removing ice in culverts).

Where the size of the emergency exceeds certain thresholds, Public Safety Canada will also reimburse EMO for the costs. In these cases EMO will pay a portion of the Public Safety's payment directly to an individual band member for eligible personal costs and a portion to the First Nation government to cover its eligible costs.

During the review period, the audit firm identified that \$10,556,997 had been paid to PFN for flood-related activities. Five events were examined: the floods of spring 2009, spring 2010, July 2010, October 2010 and spring 2011. Public Safety Canada is financially responsible for damage that occurred due to flooding in the spring seasons of 2009 and 2011; and October 2010. AANDC was responsible for the costs associated with the flooding in spring 2010 and July 2010.

Audit Findings

The key findings were the following:

1. Key controls over flood funding were not in place

Peguis had primary responsibility for the controls applied to flood-related expenditures over the review period even though it was placed in co-management in February 2010. Under co-management, the co-manager is expected to assist the First Nation in, at a minimum, fulfilling its obligations under the funding agreement and in remedying the default that gave rise to the requirement for the First Nation to enter in a co-management agreement. MNP-LLP is the co-manager for Peguis.

As co-manager, MNP co-signed all cheques for payment, worked with Peguis to prepare claims to EMO to recover the costs incurred in preparing for and responding to flood events, and worked with Peguis to develop flood-related processes. Peguis Chief and Council removed MNP from its involvement in flood-related activities in November 2011.

Various elements of the control framework were observed by the audit team, which included:

- A range of policies covering topics such as governance and management, finance, and personnel and administration, which are available on the band website.
- An extensive management structure, which included a Project Manager who was responsible for the Peguis Emergency Operations Centre (EOC) and who reported to Chief and Council; a Flood Coordinator who was supported by an Office Manager and area coordinators. The Flood Coordinator, in consultation with his area managers, assessed the damage and determined what response was required; an Office Manager oversaw the reporting of hours and the preparation of claims to EMO; and, the crew chiefs were responsible for preparing daily activity reports for their crew and ensuring that all members of their crew signed in and out each day.
- Extensive record keeping which included activity reports prepared daily by flood workers; sign in/out sheets for all workers; a record of the damage to homes and facilities on the reserve, the required repairs, and the work that was done including the specific materials utilized; and, a record of the number of sandbags produced and moved.

- The names of available electricians, plumbers, carpenters, roofers, etc. were obtained from a list maintained by the band shop.
- Heavy equipment was obtained as necessary from operators located in Fisher River or Fisher Branch, two neighbouring communities.
- Other supplies (e.g. pumps, hoses, connectors, office supplies, etc.) are generally ordered through a local supplier, such as the Peguis Home Hardware which is operated by PFN.

Despite the control framework outlined above, deficiencies were identified:

- With respect to the record of the number of sandbags produced and moved for 2011, no information is available after April 5. Furthermore, according to the log, only 15 homes were sandbagged between March 28 and April 5, 2011; yet, staff indicated that 125 homes were sandbagged. No information was available for 2010 and none of the staff in the Flood Centre in January 2012 knew what had been done.
- The descriptions of daily activities were frequently not completed. Many of the descriptions reviewed simply repeated the same thing day after day. One individual reported time spent organizing a specific meeting every other day over a two-week period. It is unlikely that the individual actually did what was reported.
- There were deficiencies in the recording of the materials used to complete repairs at a specific location. This information is required to support claims to EMO, and without it, the claimed costs should not be approved by EMO.
- The accounting system was not consistently utilized as a key tool to ensure that all costs were captured and monitored on a timely basis. The following observations were made by the auditors:
 - A listing of journal entries from the 2009 general ledger was found on file with the 2009 claims, suggesting it was used at some point in the process of preparing the claims. A listing of expenses incurred as recorded in the Band accounting system was not used as the starting point for preparing claims for 2010 and 2011. For 2010 and 2011, invoices and payroll details were sent to the Peguis EOC from the Band office after payment was issued.
 - The details were processed by EOC staff in a batch and a claim submitted to EMO. Under this approach, expenses can easily be missed and may only be found months later, if at all. For example, the Peguis Claims Coordinator was advised by EMO in early January 2012 that no claims had been submitted for costs incurred in May 2011 but had been for June and July 2011.
 - Separate accounts were not created in the general ledger to track work done for other First Nations or municipalities, work related to previous fiscal years, or for costs that are not funded under Manitoba's DFA. Any expenditure related to flooding, including long-term remediation is recorded in the same accounts.

As a result, the general ledger as it is currently structured does not facilitate its usage as a starting point for the preparation of claims. It also means that it is more difficult to know if Peguis is covering all costs for off-reserve work or to establish the amount of ineligible costs it is incurring due to the way it has chosen to respond to emergencies.

- A monthly report should have been provided to the Flood Project Manager and/or the Flood Coordinator showing expenses to date against the budget. This task was not performed. The Flood Project Manager relied on the listing of payments to be made along with cheque requisitions to have a sense of expenses incurred to date. As noted in the management letter PFN received from its external auditor in both 2010 and 2011, all journal entries are not reviewed with program managers to ensure accurate reporting of program activities.

Further, budgets were not established in the accounting system for all departments. As noted by the external auditor in their 2011 management letter, "inaccurate or absent budgets can lead to wrong management information on which decisions may have been based and it also increase the risk of uncontrolled expenses or unrecorded revenues".

The 2010 management letter noted the potential that outstanding payables might not be properly recorded. This could also apply to receivables. For example, the Peguis Flood Centre issued its own invoices directly for work done for another First Nation and a municipality in 2011. These receivables for work undertaken between May and October 2011 had not been recorded in the general ledger as of January 10, 2012.

- The supporting documentation for any cost other than payroll was difficult to find. In 2009-10 invoices seemed to be filed by type of expense (e.g. gas, septic or date of a claim to EMO). In 2010 and 2011 there were a series of binders for payroll within a specific time period. Invoices were generally filed based on when they were included in a submission to EMO. To find a specific invoice, the details from several submissions frequently had to be reviewed. Since the general ledger contains the official record of an organization's revenues and expenses, the supporting documentation should be filed in a manner that readily links it to the information in the general ledger. Typical ways of filing documents include the general ledger batch number, date processed as recorded in the general ledger or alphabetically. These methods also facilitate finding source documents when someone calls with questions of any kind.
- An adequate separation of duties did not always exist. The Flood Project Manager who is a contract resource, approved his own invoice on multiple occasions. When asked about why he did this, he did not appear to have any understanding as to why this was inappropriate and why there needed to be a better separation of duties.

Inefficiencies that resulted in increased costs were also noted:

- Hours worked is keyed in multiple times allowing for error. An Excel spreadsheet was created from the sign in sheets. The hours from the Excel spreadsheet were then entered separately into the payroll system. A third Excel spreadsheet was created to support the claims to EMO. There is a software available that would

facilitate entering the required information once. The software would interface with the payroll system, from which reports required to support claims to EMO can be generated. As a minimum, the first spreadsheet created from the sign in sheets should be shared with those preparing the claims to EMO.

- PFN uses private engineering consulting firms to carry out inspections of homes and infrastructure to assess flood damage and to determine what repairs are required. PFN must pay these engineering firms and then seek reimbursement from EMO, adding to its short-term cash flow requirements. For most other First Nations, inspections are undertaken by the Manitoba Association of Native Fire Fighters (MANFF) or EMO inspectors at no cost to the First Nation. In an effort to speed up the process, PFN chose to hire private engineering consulting firms to carry out this work. Required information was missing from the reports prepared by the private consulting engineering firms due to their lack of familiarity with the requirements. The necessary information then had to be collected and added to the reports, which incurred an additional cost.

We understand that inappropriate comments were made by a MANFF inspector which made PFN less willing to use MANFF.

- There has been considerable turnover in key positions in the PFN EOC over the past three years. Staff who are currently responsible for preparing the documentation to support the claims were not always provided with the required forms at the outset. According to staff, with both AANDC and EMO, PFN historically had a reputation for preparing complete claim submissions on time. Staff who had been involved in the process for many years were let go in 2009. Since then, the quality and timeliness of the submissions has suffered. Claims for 2010 and 2011 were submitted with required invoices missing, and summary sheets lacking a total. In other cases, the same expenditure was claimed more than once on separate claims.
- Flood response in many First Nations communities is viewed as a short-term employment opportunity. According to Peguis' Project Manager for its flood response, the Chief wanted to build up PFN's capacity to make it a year round position for at least the key resources. With this objective in mind, priorities for hiring have included:
 - Persons who needed the hours to qualify for Employment Insurance benefits;
 - Persons on social assistance;
 - Young people with large families; and,
 - 17 and 18 year olds who have done well at school.

According to the Flood Coordinator, he regularly received text messages during flood season from Chief and Councillors asking that someone be considered for hiring. In some cases the individuals required reduced duties because of medical issues.

In the opinion of the auditors, the individuals hired may have limited knowledge and experience, which has had a direct impact on the quality of the claims submitted. As of mid-November 2011, only \$1.1 million out of \$3.1 million in claims submitted by Peguis for the July 1-3, 2010 event had been processed and

deemed eligible by EMO. Reasons identified by EMO for not accepting the costs included the following: the expenses were not associated with the July 2010 event; the total claimed was greater than what was documented; the link with the flood event was not adequately established; cost was not eligible under DFA; and, invoices missing.

While these deficiencies are being addressed, Peguis has not received reimbursement on as timely a basis as it might have if complete claims had been prepared at the outset. This affects the First Nation's cash flow. Peguis also spent more on administrative costs to correct the claims.

2. Numerous ineligible costs or inadequately supported costs were identified in reimbursement claims

Documentation supporting PFN's claims to EMO for reimbursement is frequently inadequate or included ineligible costs. This is particularly prevalent in the flood events in 2010 and 2011. In reviewing claims and supporting documentation obtained from both PFN and EMO, the auditors found:

- The level of detail supporting the claim was often such that it was difficult to know what the individual actually did.
- Invoices lacked supporting detail. For example, equipment rentals did not detail what equipment was rented, for how long it was rented, and/or what the hourly rate was. In addition an invoice for \$41,130 for gravel in November 2010 did not indicate how much gravel was provided or to where it was transported.
- Under DFA, only incremental costs for equipment are eligible, but the Peguis Development Corp. charged administration fees (either straight fees or a percentage of purchase price of the goods acquired) for the purchase of equipment. There was no supporting documentation to show what activities were undertaken to justify the administration fee.
- Families were provided with a \$150 credit to purchase whatever they wanted from Peguis Family Foods after the July 2010 flood. In total, \$18,375 was reimbursed. This is not an eligible expenditure under the DFA.
- In May 2011 the same invoice for sand bags in the amount of \$61,681 was included in a claim to both EMO for PFN's flood-related costs and in a claim to Sandy Bay for services provided.
- Maintenance work on water lines and pumps was claimed as flood-related, even though there was no description showing the linkage to flood response (e.g. a water line crack to a pressure pump on March 12, 2011 may have been due to freezing of the water line).
- Problems were also found with the hours claimed. In the opinion of the auditors, it is "quite probable" that hours were not accurately reported. The problems identified included:
 - The handwriting on the individual description of duties undertaken was frequently found to be different from one day to the next. There was no indication on the forms that someone had completed the forms on behalf of another individual for

a legitimate purpose (for example, this might be required if the worker's literary skills were limited). The auditors were advised by some Band members that individuals were hired to write descriptions of duties undertaken some months after the work occurred.

- o Some of the claimed hours appear to be excessive (e.g. eight hours to clear snow at the old school for one sand bagging machine in early March 2011).
- o Overtime was recorded for which there was no obvious need (e.g., some but not all employees claimed to be working on February 21, 2011, Louis Riel Day which is a statutory holiday in Manitoba):
- o The auditors were advised that most people work from 9:00 a.m. to 5:00 p.m. with a paid break for lunch consistent with the PFN's personnel policy. If working late, employees generally go home from 6:00 to 7:00 p.m. for dinner. The Manitoba DFA is not designed to cover the cost of employee benefits. According to the Manitoba Labour Standards, a paid meal break is considered a benefit. A paid lunch break during a workday from 9:00 a.m. to 5:00 p.m. adds 14.3% to the cost of wages.
- o Some full-time PFN employees were paid as contractors for work they performed on an overtime basis for flood-related activities. The employer's share of source deductions (e.g. employment insurance and Canada Pension Plan) was not remitted on these payments. Since the work was directly related to the individual's full-time employment, payment should have been processed through the payroll and the appropriate source deductions made.

The auditors did not identify any instances where EMO had not allowed an expense that the auditors thought should be eligible. In fact, EMO appears to have provided greater latitude than was required. For example, the auditors noted that PFN had not provided cancelled cheques to EMO as required for expenditures over the required threshold. According to EMO, Peguis advised them that its financial institution does not return cancelled cheques. In increasing numbers, financial institutions no longer return cancelled cheques to their customers. Instead, scanned copies of cheques are provided with bank statements or copies of the scanned cheque can be obtained when required. The information is available and Peguis could obtain it and provide it to EMO to support claims.

3. Complaints to AANDC

A number of complaints were made about how Peguis utilized funding received from AANDC to prepare, respond and recover from flooding. These complaints included:

- Timesheets were falsified to include hours that had not been worked;
- Excessive wages were paid for sandbagging; and,
- Some band staff members, including Chief and Council, may have received extra pay for participating in sandbagging, a funded activity without any adjustment in their regular compensation.

As already noted, problems were identified with the timesheets and expense claims for wages. In addition, unnecessary work may also have been undertaken. For example, 17

individuals were employed during the week for security patrols and only 8 on the weekend in late October/early November 2011. Their role was to check homes that were vacant because the occupants had been evacuated. Homes were checked as often as every two hours during the day and every three hours at night. One crew of two individuals reported a one to one and a half hour gap between each round of checks on homes during their shift. Insurance companies generally only require a home to be checked once every 24 hours when vacant.

Another example noted was the use of gauge readers in April 2011. All of the readers reported working a twelve hour shift or more. The number reported as working ranged from one on April 19 and 20 to 19 persons on April 17. Based on information from Manitoba Water Stewardship, the water level in Lake Winnipeg exceeded the top of the operating range between April 13 and April 20, which is consistent with the peak of Peguis usage of gauge readers. If readings were taken 24 hours a day, we would have expected an even number of readers on duty each day. This was not the case. Eleven readers were employed from April 9 to April 12, in the days leading up to increasingly higher water levels as a result of the spring runoff. Descriptions of the work undertaken ranged from reporting that readings were taken every two hours and brought to the Flood Centre with no details as to where the readings were taken, to a description that readings were taken three times a day at five specific locations. Twelve hour shifts were the norm for gauge readers. The auditors expected to see all readings taken at the same frequency and the location of the readings identified.

In its assessment of the claims, EMO disallowed time where the description did not adequately link the activities to funded activities. Generally, however, EMO accepts the hours as reported. It is very difficult to determine with certainty whether timesheets are falsified or not, especially if there has been collusion. It is the responsibility of supervisory personnel to monitor staff and compare the level of productivity with what was expected. Very low levels of productivity may be an indicator of falsified hours.

The hourly rate paid to sandbaggers appeared to be reasonable. Wages for other staff, in particular those working in administration, were not consistent. Some individuals appeared to be paid more than one would have expected given their responsibilities.

Based on information in the general ledger, payments were made to Chief and Council for flood-related activities. A year-end entry was made in 2009-10, totalling \$142,323 for severance for Chief and Council. A claim made in March 2010 for the 2009 spring flood included payments to Chief and Council. An amount of \$80,289 that included payments to Chief and Council was not allowed by EMO pending receipt of a description of the work done. According to the general ledger for 2010-11, the Chief and each member of Council received a \$5,000 payment in July 2010 for flood-related activities. Based on the information reviewed, it was not possible to determine if these costs were submitted to EMO for reimbursement. Payments to Chief and Council were not identified in the 2011-12 general ledgers which were produced in January 2012.

Most elected officials work more than a standard 35 or 40 hour work week without receiving additional compensation. When there is an emergency in their community, the focus of their activities tends to be on the emergency. It is considered part of the expected activities of an elected official.

PFN employees were also paid for flood-related work; however, as part of its verification, EMO ensured that only pay for work reported as having been completed after regular work hours by regular employees was reimbursed.

During the audit, the Chief identified a concern with PFN's claims for reimbursement for the cost of gravel used in response to the 2009 spring flood. A claim submitted to EMO for gravel relating to the spring 2009 flood was examined as part of the review. EMO disallowed costs because more gravel was placed than identified as being required in the assessment reports; there was no assessment report for the location where the gravel was placed; Peguis had already been compensated on a prior claim for the gravel identified as being required in the assessment report; and, the site where the gravel was placed was inadequately identified in the supporting documents.

Before gravel is placed at any location, an assessment must be completed to determine the quantities required. A justification must be provided if more material is used. Without an acceptable reason, Peguis is responsible for the cost associated with placing more gravel than is deemed required.

4. Work for Other Clients

In May 2011 Peguis provided its sandbagging machine along with machine operators to another First Nation. The invoice for the work was dated September 30, 2011, four months after the work was completed. As of January 12, 2012, it had not been paid.

Work was also undertaken between late June and early October 2011 in another municipality. Based on the information provided to the audit team in January 2012, bills had not been sent out for a significant portion of the work undertaken. Because the accounting system was not used to accumulate the revenues and costs, it was difficult to determine what invoices were submitted to the recipients of the service or exactly how much Peguis incurred in expenses to provide the services. Bills were prepared for over \$500,000, including a 15 percent administration fee, and many were awaiting final review before being sent as of January 12, 2012. It appeared that the employer's share of source deductions was not specifically billed and was absorbed as part of the administration charge added to each invoice.

The invoices indicated that payments were to be directed to the Project Manager at the Peguis EOC. A stronger control would have directed the payments to accounts receivable. Payments should not be received and processed by the same individuals involved in generating the invoices.

PFN has had to redirect cash resources intended for other purposes to cover payroll and other expenses incurred in providing services off reserve because invoices were not issued and payment collected promptly after the services were provided. The auditors were told that because of Peguis resulting cash flow pressures, on reserve site inspections to determine what repairs were necessary were not done. Without the inspections, the repairs could not be made and reimbursement of the costs sought from EMO.

Conclusion

There are numerous significant control weaknesses over the funding provided to PFN in response to flood events, such that it is not possible to provide assurance that all of the funds were spent for the intended purposes.

It is quite possible that individuals were paid for time that was never worked. The work that was undertaken was not consistently performed in a cost-effective manner.

EMO acts as a key control by performing a desk audit on all claims to verify that costs are eligible. In the auditors' opinion, they are much more likely to give a claimant the benefit of the doubt and allow costs that should not have been allowed as opposed to disallowing costs that should have been deemed eligible.

Recommendations

We recommend that you improve the controls around the management of the flood program. This could include:

- Ensuring that key resources have the skills necessary to properly guide more junior staff and to ensure that required information is captured at the outset;
- Using the accounting system to capture and track the revenues and costs for specific initiatives (e.g. events) and external clients either through specific account codes or a project tracking capability;
- Using a journal listing of the costs for a specific event or client as the starting point for preparing claims to EMO or invoices for external clients;
- Using software that will interface with the payroll system so that hours worked are only keyed in once;
- Filing invoices in a manner that better links them to information recorded in the general ledger so that invoices can more easily be found;
- Using a time sheet template that requires workers to show time spent on meal breaks;
- Ensuring that the reason for working overtime is documented and approved in advance of the overtime being worked;
- Providing the Flood Coordinator with a monthly report showing expenses to date against budget for each flood event or client for which work is still ongoing so that costs can be regularly reviewed and monitored;
- Ensuring that payment for all work undertaken by PFN employees is processed through the payroll system so that the necessary source deductions can be determined;
- Ensuring that no contractor undertaking services on behalf of PFN is approving his/her own invoice for payment;
- Ensuring that there is a clear justification for any overtime worked.

Possible recoveries have been identified in the audit work. While no recoveries are anticipated at this time, AANDC may consider such recoveries appropriate in the future.

The Way Forward

AANDC is in the process of conducting an evaluation of the Emergency Management Assistance Program, with a specific focus on the emergency management activities that were undertaken related to the mitigation of, preparedness for, response to and recovery from the 2011-12 floods in Manitoba. Further simple requirements may be placed on First Nations when they are undertaking work. This could include for example, a log of what was accomplished related to the material that was produced, what homes had dike work done and, where the sandbags were stacked.

If you have any questions, please do not hesitate to contact me.

Yours sincerely,

Sylvie Lecompte

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