

Aboriginal Relations—Systems to Assess First Nations Development Fund Grants

SUMMARY

What we examined

The First Nations Development Fund is a lottery grant program available exclusively to First Nations in Alberta. It is supported by a portion of revenues from government-owned slot machines in Alberta First Nation casinos. Since 2006, the Department of Aboriginal Relations has allocated over \$600 million in FNDF grants to support hundreds of social, economic and community development projects in Alberta's First Nation communities.

In February 2012, the Enoch Cree Nation applied to the department for a FNDF grant of \$317 million over seven years. The grant application stated that ECN intends to use these funds to pay for refinancing and operating costs of the River Cree Resort and Casino. Our objective was to determine whether the department's systems to assess the eligibility of the ECN's application were followed and were consistent with the objectives of the FNDF grant program and the FNDF grant agreement. During the course of the audit, we included other First Nations' projects and concluded on improvements that could be made to the overall systems.

What we found

The department developed additional processes to improve its existing system to review, assess and approve complex grant applications. When followed, the department made informed decisions that funding uses were consistent with the program objectives and grant agreement. When the process was not followed, its analyses were incomplete and insufficient for some approved funding uses.

We also found that the department did not formalize and communicate its interpretation of eligible uses of funds. It also did not consistently monitor for and correct non-compliance with the grant agreement.

What needs to be done

We made the following three recommendations that apply generally to the FNDF grant program:

Formalize and communicate interpretation of eligible uses—We recommend that the Department of Aboriginal Relations formalize and communicate its interpretation of eligible uses of funds.

Improve review process—We recommend that the Department of Aboriginal Relations improve its processes to review and approve grant applications by:

- formalizing the additional review processes it developed for complex grant applications
- consistently obtaining sufficient information to support its assessment of grant applications

Monitor for and correct non-compliance—We recommend that the Department of Aboriginal Relations improve monitoring processes by consistently ensuring First Nations comply with reporting requirements and acting to correct non-compliance with the grant agreement.

Why this is important to Albertans

Albertans, especially First Nations people in Alberta, need to have confidence the FNDF program supports social, economic and community projects that enable First Nation communities to participate in Alberta's economy.

AUDIT OBJECTIVE AND SCOPE

Our objective was to determine whether the department's systems to assess the eligibility of ECN's application were followed and were consistent with the objectives of the FNDF grant program and the FNDF grant agreement.

We focused on the systems the department used to make its funding recommendation for the ECN grant application. We also reviewed other First Nations' projects during our audit. We did not assess whether the proposed uses of FNDF funds were eligible as we would be assuming management's role.

We conducted our field work from March 2012 to April 2013. We substantially completed our audit on May 30, 2013. Our audit was conducted in accordance with the *Auditor General Act* and the standards for assurance engagements set by the Canadian Institute of Chartered Accountants.

BACKGROUND

The department promotes social and economic opportunities to enhance the quality of life of Aboriginal people in Alberta¹ through various programs and initiatives. The FNDF, available exclusively to First Nations, supports this goal by allocating funds to projects that promote social, economic and community development. The FNDF is funded through a portion of slot machine revenues from First Nation casinos in Alberta. Since 2006, the FNDF has allocated over \$600 million to support hundreds of projects ranging from housing and equipment purchases to employment, youth and elder programs.

The department's First Nations and Métis Relations branch is responsible for the FNDF grant program. It administers the program under the *Gaming Grants Regulation*² and grant agreements with First Nations in Alberta. The branch and its program staff are responsible for:

- working with First Nations that are preparing grant applications
- receiving, reviewing and assessing grant applications
- monitoring and auditing projects

First Nations can apply for FNDF grants by submitting an application that complies with the terms of their grant agreement.

First Nations gaming policy

In January 2001, the Government of Alberta announced its First Nations Gaming Policy. The policy permits construction of casinos in First Nation communities and includes a gaming revenue model for First Nation casinos. Host First Nations³ in Alberta currently operate five casinos, in Alexis Nakota Sioux, Enoch Cree, Cold Lake, Stoney Nakoda⁴ and Tsuu T'ina First Nations. First Nation casinos operate under the same general terms as other casinos in Alberta, with two key differences: the charity that

¹ <http://www.aboriginal.alberta.ca/index.cfm>

² AR 29/2004

³ The grant agreement defines "Host First Nations" as an Alberta First Nation that is a signatory to the grant agreement and that has an Alberta First Nation casino located on its land.

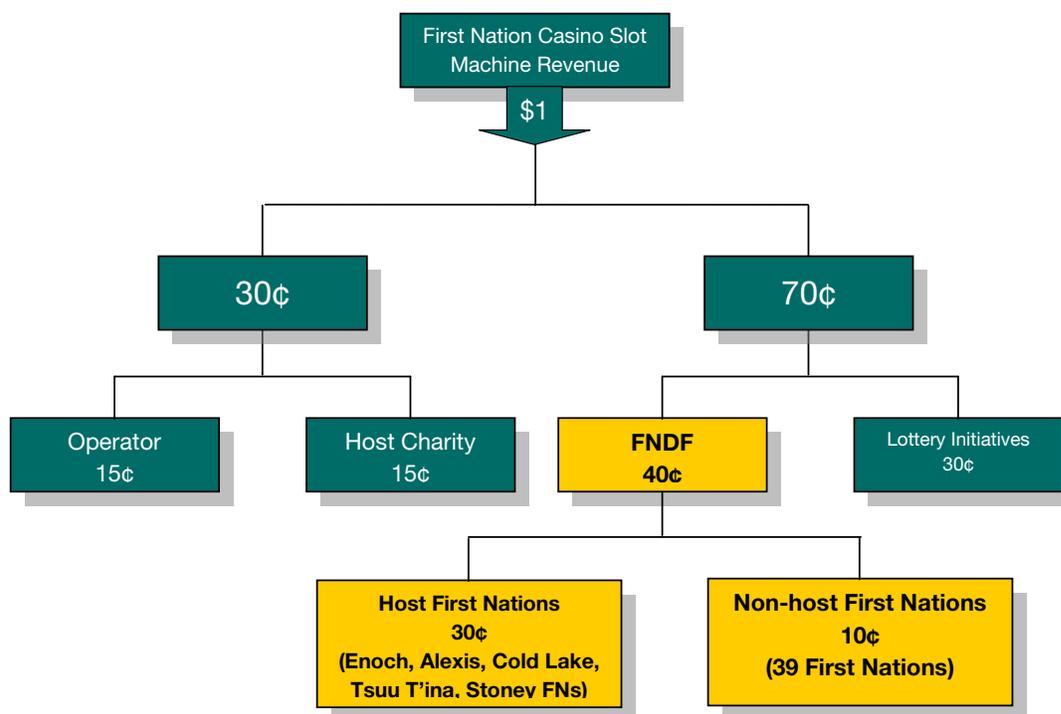
⁴ The three Stoney Nakoda tribes – Bearspaw, Chiniki and Wesley – are considered one host First Nation for the purposes of the FNDF program.

benefits from slot machine revenue is the host First Nation and a portion of slot machine revenue is allocated to the FNDF program.

The host First Nation is itself designated as the host charity. As it is both the casino licensee and the charity that receives casino revenue, the host First Nation must keep its casino and charity operations as separate and distinct entities.

For non-First Nation casinos, the Government of Alberta allocates 70 per cent of net slot machine revenue to the Alberta Lottery Fund. The Alberta Lottery Fund uses gaming revenue from slot machines, VLTs, lottery tickets and electronic bingo to fund Alberta community initiatives such as skating rinks and playgrounds. For the five First Nation casinos, the government allocates 70 per cent of net slot machine revenue to the Alberta Lottery Fund, with 40 per cent to First Nation communities through the FNDF program and 30 per cent to Alberta Lottery Fund initiatives.

Of the amount allocated to the FNDF, 75 per cent is available to host First Nations and 25 per cent is available to non-host First Nations. The allocation for every \$1 of net slot machine revenue is illustrated in the chart that follows.



Source: First Nations Development Fund Grant Program Annual Results 2010–2011

The department allocates funds to First Nations for approved projects after each fiscal quarter, based on Alberta Gaming and Liquor Commission’s verification of slot machine revenues. The department determines the exact annual allocation following the end of the fiscal year, after actual slot machine revenue has accumulated. The FNDF has allocated over \$600 million since its inception (see table on next page).

| | First Nations Development Fund Paid Amounts (\$ millions) | | | | | | | Total* |
|----------------|---|-------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | 2006-2007 | 2007-2008 | 2008-2009 | 2009-2010 | 2010-2011 | 2011-2012 | 2012-2013 | |
| Treaty 6 FNs | 11.8 | 38.8 | 54.5 | 56.0 | 55.7 | 63.0 | 66.7 | 346.5 |
| Treaty 7 FNs | 0.5 | 10.9 | 35.2 | 36.4 | 34.8 | 36.3 | 38.1 | 192.2 |
| Treaty 8 FNs | 1.3 | 6.7 | 11.8 | 12.4 | 12.3 | 13.5 | 14.2 | 72.2 |
| Total * | 13.6 | 56.4 | 101.5 | 104.8 | 102.8 | 112.8 | 119.0 | 610.9 |

*Differences are due to rounding

Source: Provided by the department (unaudited)

FNDF grant agreement

The Government of Alberta and Alberta First Nations⁵ (see Appendix A: Treaty 6, 7 and 8) approved the FNDF grant agreement in 2004. To access the funds, each First Nation must sign a grant agreement. Key to the grant agreement is the definition of eligible and ineligible uses of FNDF funds. Eligible uses support economic, social and community development projects, such as addictions programs, education, health and infrastructure. Ineligible uses include funds to operate or finance a casino, for per capita distributions or for security against loans or debt.

Enoch Cree Nation's 2005 grant application

In 2005, the ECN proposed to build a destination casino, hotel and entertainment complex at a projected cost of over \$400 million. At the time, they submitted a \$212 million FNDF grant application for funding over seven years⁶ to assist with non-gaming costs to develop and operate the River Cree Resort and Casino complex. The project was, and continues to be, owned and operated by Enoch/Paragon Limited Partnership.⁷ Paragon Gaming EC Company, a corporation based in Las Vegas, Nevada, holds a 45 per cent interest and is the general partner. The ECN, through the Enoch Cree Nation Business Trust, owns a 55 per cent interest and is the limited partner. The Enoch Community Development Corporation is the operating parent company of a group of companies that provide oversight, due diligence and management of the ECN's interest in the complex.

⁵ Alberta First Nations are members of three treaty organizations: Confederacy of Treaty 6 First Nations, Treaty 7 Management Corporation, Treaty 8 First Nations of Alberta.

⁶ The grant application requested funding for fiscal years 2006–2007 to 2011–2012.

⁷ A limited partnership is a business organization with one or more general partners who manage the business and assume legal debts and obligations, and one or more limited partners who are liable only to the extent of their investments. Sourced from <http://www.investorwords.com>.

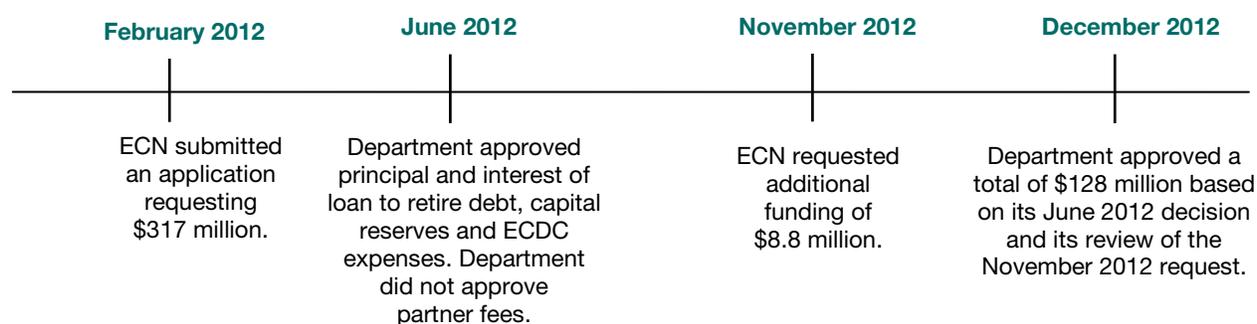
The Ministry of Gaming, responsible for the FNDF program at the time, approved funding for four items related to the non-gaming parts of the complex:

- principal and interest on long-term debt to finance the development of the complex
- operating and overhead costs
- capital reserves for future improvements/expansion
- project and/or management fees to the ECN’s business partners

By December 2012, the department, through the FNDF, had disbursed the entire \$212 million to ECN relating to the 2005 application. This amount represents 35 per cent of total FNDF funds allocated from 2006–2007 to 2012–2013.

Enoch Cree Nation’s 2012 grant application

The timeline below provides a chronology of key events related to the ECN’s 2012 grant application.



ECN’s submitted application

In February 2012, the ECN applied to the department for \$317 million over seven years, to pay for costs associated with refinancing and operating the complex. The ECN proposed to use the funds as follows:

| Funding Use | Requested Funding (\$ millions) |
|---|---------------------------------|
| Principal and interest on a loan to retire the debt of the complex, pay a mezzanine debt ⁸ to Paragon, pay for debt transaction costs, pay past general partner fees and an advance of future limited partner fees | 130.6 |
| Principal and interest loan for current general partner fees | 8.9 |
| Capital reserve for improvements such as restaurant renovations, paint and ventilation upgrades | 18.0 |
| Enoch Community Development Corporation expenses such as salaries, professional fees, training and other operating expenses | 10.5 |
| General and limited partner fees to Enoch Cree Business Trust and Paragon for their initial investment in the complex | 149.0 |
| Total | 317.0 |

⁸ Mezzanine debt is a hybrid debt and equity financing with high interest rates and no borrower collateral. The lender has the right to convert their stake to an ownership or equity interest in the company in the event of default.

Department’s initial review and approval

In June 2012, the department decided to review the application in two parts. The department approved funding for all of the capital reserves and 90 per cent, the non-gaming portion, of Enoch Community Development Corporation’s expenses. It also approved 79 per cent, the non-gaming portion, of the principal and interest of the loan to retire the debt of the complex, the mezzanine debt and debt transaction costs. At the time, the department did not have the exact principal and interest to approve because the amount could vary depending on the terms of the loan. The approval was subject to the ECN submitting the financing documents.

The department then assessed all past, current and future general and limited partner fees separately. The department did not approve any of the partner fees. It determined that partner fees are capital returns or profits to investors and, as a result, are not an eligible use of funds.

ECN’s additional funding request

In November 2012, the ECN submitted the financing documents and requested additional funding to be included in the loan to retire the debt of the complex as follows:

- \$6.8 million to reimburse partner fees related to the ECN’s 2005 application, which the bank applied toward the ECN’s outstanding debt to finance the complex
- \$2 million for additional legal expenses, of which a significant portion is related to legal disputes

Department’s final review and approval

In December 2012, the department reviewed the additional funding requests and banking information. It approved the legal fees but did not approve the reimbursement of partner fees. As a result of this and the June 2012 decision, the department approved a total of \$128 million for the principal and interest related to the non-gaming portion of the debt,⁹ the non-gaming portion of the Enoch Community Development Corporation expenses and all of the capital improvements. It did not approve any of the partner fees. The following table shows the final approved funding.

| Funding Use | Approved Funding (\$ millions) |
|--|--------------------------------|
| Principal and interest on various long term debts | 100.5 |
| Principal and interest loan for current general partner fees | - |
| Capital reserves for improvements | 18.0 |
| Enoch Community Development Corporation expenses | 9.5 |
| General and limited partner fees | - |
| Total | 128.0 |

FINDINGS AND RECOMMENDATIONS

Clear objectives and terms and conditions

Background

In its business plans and annual reports, one of the department’s goals is “Aboriginal communities and people fully participating in Alberta’s economy and society.” On its website, the department states that the FNDF program contributes to promoting healthy and vibrant First Nation communities, fully participating in the opportunities of a prosperous and diverse Alberta.¹⁰

⁹ The department approved principal and interest for the four-year term of the loan rather than the seven years as submitted in the grant application. The loan includes an amount to retire the debt of the complex, the mezzanine debt and debt transaction costs. The debt transaction costs include the additional legal costs requested in November 2012. It did not approve loan amounts related to the general and limited partner fees.

¹⁰ <http://www.aboriginal.alberta.ca/895.cfm>

The grant agreement's terms and conditions contain provisions for payment and release of funds, banking arrangements, reporting, repayment, change in use and dispute resolution. The grant agreement also specifies the department's responsibility for reviewing and approving grant applications and defines eligible and ineligible uses of the grant funds. FNDF grants can only be used for economic, social and community development projects, and cannot be used for operating or financing costs of a casino or other gaming facility/equipment, for per capita distributions, or as security against loans or debts.

RECOMMENDATION 1: FORMALIZE AND COMMUNICATE INTERPRETATION OF ELIGIBLE USES

We recommend that the Department of Aboriginal Relations formalize and communicate its interpretation of eligible uses of funds.

Criteria: the standards for our audit

The department should have clearly stated grant program objectives and terms and conditions, which includes eligible and ineligible uses of FNDF funds.

Our audit findings

KEY FINDING

The department has not formalized and did not fully communicate its interpretation of eligible use of funds to all First Nations.

The department stated the program objectives in its business plans, annual reports and website. It also has standard terms and conditions, including eligible and ineligible uses, in its grant agreement. However, when the department exercised discretion to determine whether certain uses, applicable to all First Nations, are eligible, it did not formalize and fully communicate its interpretation to all First Nations.

The eligible use of FNDF for economic, community and social development is broad. Therefore, the department exercised discretion to interpret whether certain uses fit under these purposes. The department determined that the non-gaming operating costs of a business are not eligible, as they do not contribute to development or growth in the community. It further clarified that uses promoting development and growth, such as feasibility studies, market research, initial seed funding or business expansions, are eligible. However, program staff told us they did not communicate this decision to all First Nations.

Implications and risks if recommendation not implemented

Without clarity on the eligibility of uses, First Nations may unnecessarily submit grant applications that are not eligible. The department may also inconsistently award projects or inadvertently approve projects that do not align with program objectives.

Review and approval

Background

The department assesses grant applications according to its grant application approval procedure, which identifies staff responsible for receipt, review and approval of grant applications. The liaison officer at the department reviews each grant application to ensure that it complies with the grant agreement and, more specifically, to verify that the application has:

- a valid band council resolution
- identified eligible uses of the funds
- been signed by an authorized person
- a clear project description including start and end dates
- identified project revenues and expenditures

Each grant application is reviewed by the director and executive director. An approval package is sent to the assistant deputy minister and deputy minister who recommend approval to the minister.

RECOMMENDATION 2: IMPROVE REVIEW PROCESS

We recommend that the Department of Aboriginal Relations improve its processes to review and approve grant applications by:

- formalizing the additional review processes it developed for complex grant applications
- consistently obtaining sufficient information to support its assessment of grant applications

Criteria: the standards for our audit

The department should have systems and processes to review and approve the grant application.

Our audit findings

KEY FINDINGS

- The department developed and implemented additional processes to review and approve complex grant applications. However, these processes have not been formalized.
- The department did not have complete and sufficient analysis for some approved funding uses.

Formalizing review procedures

As the ECN grant is complex, the department developed additional procedures and processes. However, these have not been formalized for future grant applications.

In response to the complexity of the ECN grant application, the department asked Alberta Justice to provide legal advice on the review process for the ECN grant application. The department developed a form its staff used to assess whether the:

- application is complete
- project is consistent with the grant program—specifically, whether the use of funds is eligible or ineligible
- project is properly described
- First Nation provides project revenues and expenditures
- First Nation provides a rationale for costs in excess of costs of a similar project
- First Nation obtained adequate professional advice

The department, through the form, supported its rationale for most of the significant funding uses. Following consultation with its specialists, it assessed that payments towards partner fees would constitute a share of profit or a reduction of capital or equity of an already profitable enterprise, which is not consistent with the objectives of FNDF.

The department also obtained the services of skilled specialists to evaluate the complex legal and financial transactions within the ECN grant application. It brought in legal, accounting, finance and audit specialists. For example, the department obtained advice to determine the eligible non-gaming allocation to apply to ECN's loan to retire the debt of the complex, the mezzanine debt and debt transaction costs. The consultant used construction costs for the non-gaming areas of the complex (for example, restaurant, ice rink) to arrive at a 79 per cent non-gaming allocation that the department applied to the debt.

The department developed and adopted additional processes and procedures to systematically review and approve the grant application. As it may continue to receive complex grant applications that will require similarly rigorous reviews, the department should formalize these processes to deal with such

applications, where appropriate. In its implementation, the department should consider which projects merit the additional review.

Supporting analysis

The department had supporting analysis to deny the request for partner fees and approve the request for principal and interest on the loan to retire debt. However, it did not have sufficient analysis to support its funding decisions for the other uses it approved.

The department did not obtain complete information to support its approval of \$18 million for capital reserves. The ECN requested capital reserves for improvements (for example, re-carpeting, ventilation systems, restaurant renovations, general maintenance); however, it did not provide estimated costs or timing for the capital improvements. The department did not request this information yet it determined that all of the capital reserves were properly described, reasonable and eligible for FNDF.

Similarly, the department approved 90 per cent, the non-gaming portion that ECN requested, of Enoch Community Development Corporation's annual expenses of \$1.5 million. The corporation's responsibilities include:

- overseeing and managing the ECN's interest in the development and operation of the complex
- promoting the development and growth of economic opportunities
- providing training and development to its members

The department's assessment supports that the corporation's annual expenses are an eligible funding use. However, the department did not have analysis to support the non-gaming allocation of 90 per cent. The department also did not analyze whether the directors' salaries, which make up over 50 per cent of the annual expenses, are reasonable.

The ECN requested an additional \$2 million for legal fees that were mainly related to its legal disputes. The department initially determined that these legal fees were not an eligible use. The ECN explained that the legal costs were related to the refinancing of the debt and the legal disputes. Without further analysis, the department accepted the ECN's rationale and approved the legal fees.

The department's additional processes and procedures are designed to bring more rigour when reviewing complex grant applications. Management explained that some of these funding uses are immaterial relative to the ECN's total funding request. However, we observed that these funding uses are material relative to funds allocated to other First Nations.

Implications and risks if recommendation not implemented

Without sufficient analysis to support its granting decisions and formalized procedures, the department cannot demonstrate how it approved certain uses transparently and equitably. Thus, it may award grants for uses that are inconsistent with the objective of the grant program.

Monitor and audit

Background

Monitoring and auditing helps the department identify and take action where there is a gap between planned and actual performance and non-compliance with the grant agreement.

The department monitors all First Nations to ensure compliance with reporting requirements. The grant agreement requires all First Nations to submit an approved financial report annually on June 30 and within 90 days of completion of each project. Each First Nation must report:

- revenues from all sources, including interest income
- costs and any donated labour, services, material and equipment received
- explanations for significant variances or delays

The department is required to review the eligibility of expenses and compare actual expenses to the approved application. If the First Nation does not comply with the requirements of the grant agreement, the department may withhold future payment or suspend the First Nation's grant agreement.

The department audits each First Nation to ensure compliance with the grant agreement and to specifically determine whether the grants funds are used for approved purposes. The department performs a risk assessment of all approved FNDF projects. It assesses each project based on the funding amount, type of project (for example, purchase or construction of an asset versus purchase of services) and the adequacy of controls. Based on its risk assessment, the department prepares a three-year audit plan that ensures all First Nations are audited during this period.¹¹ It audits all First Nations at least once every four years and host First Nations every two years.

The department conducts audits according to the audit manual, which outlines procedures to assess:

- eligibility of the use of FNDF grants
- compliance with reporting requirements
- change in use of FNDF grants

The department also tracks findings and recommendations of prior audits, and uses this information to plan future audits.

RECOMMENDATION 3: MONITOR FOR AND CORRECT NON-COMPLIANCE

We recommend that the Department of Aboriginal Relations improve monitoring processes by consistently ensuring First Nations comply with reporting requirements and acting to correct non-compliance with the grant agreement.

Criteria: the standards for our audit

The department should monitor and audit the approved grant application to ensure compliance with the agreement.

Our audit findings

KEY FINDINGS

- The department did not consistently monitor First Nations for or take action to correct non-compliance with the grant agreement.
- The department did not document its analyses to compare actual to budget project costs or obtain explanations for variances.

We found that the department had good systems for auditing the First Nations. The department prepared a three-year audit plan using this risk assessment and audited the First Nations according to the required frequency. Specific to the ECN, the department audited its 2005 grant application in December 2009 and February 2011.

¹¹ The department prepared three-year audit plans for 2010–2012 and 2013–2015.

We found that the department did not consistently monitor First Nations to ensure they are complying with reporting requirements, and it did not take action to correct non-compliance. We reviewed the department's summary of reporting status for First Nations¹² and found that a significant number of First Nations have not submitted the required reporting. The annual number of overdue reports increased significantly over this time. Specifically, the ECN submitted its 2009 report a year late. The department rejected this report because it did not meet reporting requirements. The department also rejected the ECN's 2010 report several times because the report was not in the required reporting template and was submitted by Paragon, who is not party to the grant agreement. In April 2013, the department received the ECN's 2012 report, which was due in January 2013. Despite the late and unacceptable submissions, the ECN continued to receive funding with no consequence for not complying with the grant agreement.

The department developed a process to withhold payments for those First Nations that do not comply with reporting requirements. Under the process, the department will send notifications to First Nations to follow up on overdue reports. If the First Nation does not comply, the department will withhold future payments. It has been applying this process and the number of outstanding reports has decreased.

For those reports that were submitted, including the ECN's, the department did not document its analysis to compare actual to budget project costs and obtain explanations for variances, as required. Therefore, it is difficult to determine whether any analysis was performed. We also found that the department's reporting template does not include the budgeted amounts for the project expense categories and explanations for variances. This further exacerbates the problem, as department staff do not have the necessary information to analyze project costs and follow up on variances.

Implications and risks if recommendation not implemented

Without ongoing monitoring to ensure grant recipients are complying with the grant agreements, the department may not be able to determine whether:

- funds are used for the intended purposes
- projects are managed effectively

¹² In July 2012 and February 2013, the department provided the summary of reporting status from 2007–2008 to 2011–2012.

TREATY 6, 7 AND 8—FIRST NATIONS

This is a list of Alberta First Nations that participate in the FNDF program.

| Treaty | Member First Nations |
|----------|--|
| Treaty 6 | Alexander, Alexis, Beaver Lake, Cold Lake, Enoch Cree, Ermineskin, Frog Lake, Heart Lake, Kehewin, Louis Bull, Montana, O'Chiese, Paul, Saddle Lake, Samson Cree, Sunchild, Whitefish (Goodfish) |
| Treaty 7 | Blood, Chiniki (Stoney), Piikani, Siksika, Tsuu T'ina, Wesley (Stoney), Bearspaw (Stoney) |
| Treaty 8 | Athabasca Chipewyan, Beaver, Bigstone Cree, Chipewyan Prairie, Dene Tha', Driftpile, Duncan's, Fort MacKay, Fort McMurray #468, Horse Lake, Kapawen'o, Little Red River, Loon River, Mikisew Cree, Sawridge, Smith's Landing, Sturgeon Lake, Sucker Creek, Swan River, Tallcree, Whitefish Lake, Woodland Cree |

Source: http://www.aboriginal.alberta.ca/documents/2012_AboriginalOrganizationGuide.pdf