



Institute On Governance

Policy Brief No.8
– May 2000

Policy Brief

*Getting the Incentives Right:
Improving Financial Management of
Canada's First Nations*

by

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The Institute On Governance (IOG) is a non-profit organization founded in 1990 to promote effective governance. From our perspective, governance comprises the traditions, institutions and processes that determine how power is exercised, how citizens are given a voice, and how decisions are made on issues of public concern.

Our current activities fall within six broad themes: citizen participation, Aboriginal governance, building policy capacity, accountability and performance measurement, governance and the web, and youth and governance.

In pursuing these themes, we work in Canada and internationally. We provide advice to public organizations on governance matters. We bring people together in a variety of settings, events and professional development activities to promote learning and dialogue on governance issues. We undertake policy-relevant research, and publish results in the form of policy briefs and research papers.

You will find additional information on our themes and current activities on our website: www.iog.ca.

The following policy briefs are also available at our website: www.iog.ca:

Policy Brief No. 1: Cabinet Decision-Making in Canada: Lessons and Practices

by Mark Schacter (April 1999)

Policy Brief No. 2: Public Good, Private Gain: Senior Bureaucrats and “Exemplary” Companies in Canada, by Mark Schacter (April 1999)

Policy Brief No. 3: Means... Ends... Indicators: Performance Measurement in the Public Sector, by Mark Schacter (April 1999)

Policy Brief No. 4: Building Trust: Capturing the Promise of Accountability in an Aboriginal Context, by John Graham (May 1999)

Policy Brief No. 5: Youth Involvement in Policy-Making: Lessons from Ontario School Boards, by Elder C. Marques (July 1999)

Policy Brief No. 6: "Capacity Building": A New Way of Doing Business for Developing Assistance Organizations, by Mark Schacter (January 2000)

Policy Brief No. 7: Social Policy Leadership in a Federal State: International Lessons for Canada, by Elder C. Marques (January 2000)

1. Introduction

Feature stories on corruption, lack of accountability, inflated salaries, nepotism, and rising debt among First Nations¹ have been prominent in the national news over the past months.

The evidence suggests there is more here than a few random incidents. For the fiscal year 1998/99, close to a quarter of the First Nations and their organizations funded by Indian and Northern Affairs had independent audits that were either qualified or denied. And, as of January 31, 2000, about the same percentage were under or met the criteria for a government-imposed Remedial Management Plan because of excessive debt. Within this group, the situation facing 58 First Nations (close to 10% of the total number of First Nations in Canada) was so critical as to require either co-management or third party management².

Facing long-standing pressures from the Auditor General and opposition parties, the federal government has predictably "tightened the screws", imposing a self-assessment and improvement regime on all First Nations several years ago. And there have been other, more recent proposals for dealing with the problem. The National Chief of the Assembly of First Nations, Phil Fontaine, has suggested the establishment of a First Nations' Auditor General. Other Aboriginal groups have proposed an Aboriginal ombudsperson and indeed a member of the opposition recently introduced a private member's bill in the Canadian parliament to that effect. (This bill was defeated at second reading.)

But will these approaches prove effective or might there be a better solution? This is the question addressed by this policy brief.

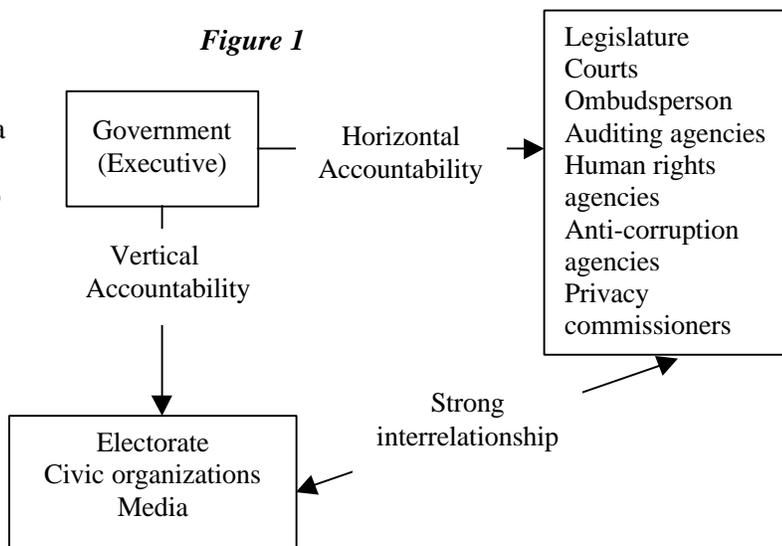
¹ First Nations is the commonly used name for status Indian communities that fall under the *Indian Act*.

² Under co-management, a third party, acceptable to both the First Nation and Indian and Northern Affairs, must approve all expenditures along with the First Nation. Third party management occurs in more serious cases and involves a third party contractor, hired by Indian and Northern Affairs, approving all expenditures.

2. Horizontal vs. Vertical Accountability³

Framers of democratic governments (including the Iroquois Confederacy whose system of government inspired many features of the Constitution of the United States) have known for centuries the importance of checks and balances vis-à-vis the exercise of power. Thus, direct accountability to citizens via the ballot box is not sufficient to ensure a healthy relationship between governors and the governed. There is a requirement for another complimentary set of accountability relationships: the government must *restrain itself* by creating and sustaining independent public institutions empowered to oversee its actions, demand explanations for improper or illegal behaviour and, when circumstances warrant, impose penalties.

These two kinds of accountability are referred to by some as "vertical accountability" (to citizens directly or indirectly via civic organizations or the news media) versus "horizontal accountability" (to public institutions of accountability imposed by the government upon itself, including the legislature, the judiciary, auditing agencies, ombudsperson, human rights commissions). Figure 1 illustrates these two kinds of accountability relationships.



³ I am indebted to my colleague at the Institute, Mark Schacter, for articulating many of the concepts in this section. His paper on Institutions of Accountability will be published shortly on the Institute's web site.

Facing many First Nation communities are weaknesses in both these dimensions of accountability. Civil society and independent media are frail or non-existent on most reserves. And as for public institutions of accountability, the executive and legislative branches are fused in the band government system found in the *Indian Act*; the judicial system is predominantly non-Aboriginal and often not culturally legitimate; and many of the other institutions of accountability either do not exist or have little real impact on reserves.

In fashioning reforms to the accountability system found in First Nations, the fundamental question to be addressed is this: why would political leaders agree to submit themselves to all of the potential problems that a new institution of accountability might pose including nasty questions, potentially embarrassing revelations and possible sanctions? In other words, where are the incentives?

The answer is that horizontal accountability will be effective and sustainable only if political leaders see benefits in such approaches and it is the operation of vertical accountability, particularly the electoral process, which causes leaders to perceive such benefits. *In short, horizontal and vertical accountability are fundamentally interconnected in that the former is not likely to exist in a meaningful way without the latter*⁴.

This conclusion raises questions about the reforms described briefly in the introduction – the self-assessment regime imposed by the federal government, an Auditor General and an Ombudsperson. Originating from outside the community, none is likely to have a firm connection to a First Nations electorate and therefore the incentives for First Nation leaders to take them seriously will not be there. Thus, compulsory plans developed under the government's assessment process will likely be ignored. Should an Ombudsperson or Auditor General be established,

⁴ For an elaboration of this relationship between horizontal and vertical accountability, see Schedler, Andreas, Larry Diamond and Marc F. Plattner, eds. *The Self-Restraining State: Power and Accountability in New Democracies*, Boulder and London: Lynne Rienner Publishers, 1999

these institutions would face difficulties in gathering the information necessary to perform their functions and political leaders would be able to ignore their recommendations with relative impunity.

The Auditor General and Ombudsperson proposals carry additional shortcomings. Both would be expensive to implement, given the number (over 600) of First Nations and their geographic dispersion. Further, response times of both types of organizations are slow—annual reports of ombudspersons, for example, indicate that their offices can take over a year to respond to some complaints⁵. Finally, both types of institutions produce a steady, unbalanced stream of bad news, hardly the environment to encourage Canadians to accept self-government for its Aboriginal peoples.

In conclusion, the close linkage required between vertical and horizontal accountability suggests that Auditors General and Ombudspersons in an Aboriginal context would work much better on a regional rather than national basis, when support for them from the electorates of participating First Nations is clear and unequivocal.

3. A better solution – an Aboriginal run accreditation system

A more promising reform might be an accreditation system, akin to the existing ISO series of standards for organizations, whereby First Nations would seek to be certified in the financial management area by an independent agency. Principal elements of such a system would be:

- A group of prominent First Nation individuals or their organizations would establish a non-profit financial management institute to run the

⁵ The former Ontario Ombudsperson, Roberta Jamieson, for example, in her 1998/99 annual report, noted that complaints that could not be resolved by “informal inquiries from Ombudsperson staff” were placed in a managed backlog registry where they remained for an average of over 3 months. Once assigned to an investigator, complaints were assigned a service standard of three, six or nine months, depending on their complexity. See www.ombudsman.on.ca.

certification system. The institute would be independent of any First Nation or political advocacy organization and, while Aboriginally controlled, might have on its board individuals linked to existing financial management organizations such as the Aboriginal Financial Officers Association and the Canadian Institute of Chartered Accountants;

- The institute would establish a financial management standard consisting of a number of elements as outlined in Box 1:

Box 1
Possible Elements of a Financial Management Standard⁶

- 1. Financial management policy or by-law;**
- 2. Budget and control system;**
- 3. Purchase and payments system;**
- 4. System for cash management & investment**
- 5. Receipt and deposit of revenues system;**
- 6. System for controlling assets and equipment;**
- 7. Auditing of financial performance;**
- 8. Procedures for communicating financial plans and results to members as well as other key information such as salary levels;**
- 9. Conflict of interest guidelines;**
- 10. Appeal and redress mechanisms; and**
- 11. Competent, qualified financial management staff.**

- The standard might have several 'levels' of complexity to take into account the wide variation in the size of First Nations;
- First Nations would *voluntarily* apply to be certified by the institute; indeed, they would pay a fee to cover some of the costs of certification (remaining costs would have to be

covered by a grant from the federal government or from the private sector);

- To gain certification, First Nations would have to demonstrate that all of the elements of the standard not only existed in their community but were operating effectively;
- Certification would be for a certain period of time (say three years) but could be withdrawn at any time for well defined reasons (say a qualified audit or a significant deficit);
- Market forces would produce firms adept at providing First Nations with the assistance necessary to develop the elements of the standard or improve those that needed upgrading in their communities. CESO Aboriginal Services⁷ might also be asked by the institute to take a proactive role in providing high value for money assistance in getting prospective First Nations up to speed.

What would be the incentives for leaders in First Nation communities to voluntarily request certification and be willing to pay part of the costs? The answer is that their electorates, given more exposure to financial management problems faced in many communities from such groups as the First Nations National Accountability Coalition, might increasingly demand it as a concrete, practical means for ensuring the financial integrity of their governments. Alternatively, candidates or even groups of candidates might run in elections on a platform of seeking certification. Further, once certified, there might be significant incentive from an election standpoint to stay certified. In sum, because of the voluntary aspect of this proposed approach, it would be driven only by First Nation electorates, thus ensuring the interconnection between horizontal and vertical accountability that is so fundamental to any successful reform.

There might be other incentives for First Nation leaders to seek certification. Government departments, for example, might reduce reporting

⁶ Most of these proposed elements are drawn from a model by-law produced by the Indian Taxation Advisory Board and the Native Law Centre of the University of Saskatchewan. See *First Nations Gazette*, Volume 1 No. 1 (Ottawa, 1997)

⁷ CESO is a Canadian not-for-profit organization which provides volunteers with senior level experience to serve as advisors to, among others, Aboriginal communities and organizations.

requirements for certified First Nations, thus allowing them to recoup the costs of certification over a reasonable time period. And private sector firms, such as financial institutions or resource companies, might be more inclined to work with certified First Nations. Again possible savings in lower borrowing rates or enhanced employment or business benefits might result.

4. Conclusions

Because of the voluntary nature of the certification system, this proposal requires no national consensus for implementation to begin. The key step is for a small group of respected First Nation individuals (perhaps former political leaders) to establish the financial management institute to underpin the system, seek the required development funding to establish the standard and publicize the certification process among First Nation communities. The electoral dynamics at the First Nation level should do the rest.

A number of partnerships would also make this certification system run smoothly. Several have already been mentioned: gaining the assistance of the Aboriginal Financial Officers Association and a respected accounting association to help develop the standard; having government departments reduce reporting requirements for certified First Nations; persuading financial institutions to offer support and possibly incentives; and having an organization like CESO Aboriginal Services engaged in providing assistance tailored to certification.

The proposed certification system would not be a panacea for every problem that ails First Nation communities. That said, it represents a concrete, practical and relatively low cost step to strengthening a key dimension of governance, one where the incentives are pointing in the right direction.