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GOVERNMENT OF THE NORTHWEST TERRITORIES
CANADA

Report of Controller on CACFL Affairs
A. G. Gordon, May 31, 1974

Since my appointment by the Commissioner as a government representative to monitor and evaluate certain financial operations and to assess the feasibility of setting up a purchasing - expediting service for the Federation I have the following to report.

The auditors report of December 31, 1973 shows among other things a balance sheet of Assets and Liabilities, Statement of Income and Unallocated Funds and a Statement of Source and Application of Funds. It is interesting to note from this audit the Federation is in very serious trouble financially. To support my claim I must show you that the Debt/Equity ratio of the firm is 92%. This in itself tells us the relationship of long term debt to the total of long term debt and owner's equity. This is used as a measure of risk. Indication of high risk supports the fact that financial institutions will not be in favour of lending money to the Federation. It is also interesting to note that since current receivables are slow in flowing into the corporation the near-term debt retirement and interest requirements constitutes an immediate danger to the corporation's solvency. Management in this case has a balancing problem - to balance short-term, low risk, low yield uses against long-term, high risk, high-yield uses of funds. While it is true that most of the corporation's earnings are the joint product of all of its operating investments as a group an asset structure that is weighted toward short-term uses of funds will ordinarily earn a lower return on total assets. Money in the bank which this corporation has practically nothing - can be put to use at a moments notice. Plant and equipment, i.e., aircraft and spares have very little liquidity. The funds invested here are recovered very slowly as indicated by the loss in the operation of the DC4 and Cessna 180. The sale of such assets of course will result in a loss.

In assessing the inventory turnover of the Northern Images Store the rate of turnover is .89 or less than one; the rate of 1972 was .43. A rising ratio is presumptive evidence of a decline in liquidity high carrying costs and potential future losses from stock that will not sell. Buying costs are high - with slow sales. In fact one reason for this may be starting expense, however, it is noted that consignment was used and the Federation used government grant money to pay salaries. The store broke even during 1973, and, it has agreed to complete with its suppliers an additional purchase price on a deferred basis. The deferred payment for last year was $31,396. This is shown as a current liability when in fact it is a long-term debt. (payment to be made by 1978). This type of deferred payment is actually regarded as a dividend but since the government has given a grant the Federation cannot declare dividends. What is surprising is how a dividend of this type could be given when in fact the audited statement shows zero profit.

In assessing the sales revenue according to total assets employed the audited financial statement of 1973 shows that $1 of assets was required to support $0.43 of sales. Surprisingly the 1972 statement gives the same ratio. In other words there is no indication of growth. Although the corporation has purchased aircraft and spares - expanded its store and started a purchasing agency through CIC they have not moved from its 1972 position. In fact there is indication of overcapitalization of assets which will reflect a decline in the growth or a major loss for such a small corporation.

The log books of the aircraft QIX were reviewed together with an operational report from the pilot. The evidence here reveals the following.

Usage of DC4 - Jan. 15, 1973 to Dec. 4, 1973

User	Hours	Minutes	Total Amt. $
Non-Revenue	42	05	$ 18,900
Holman Island	24	50	11,175
Grise Fiord	8	05	3,640
Igloolik	11	45	5,325
Rankin Inlet	9	50	4,425
Gjoa Haven	7	50	3,375
Spence Bay	8	45	3,975
Grt. Whale & Belchers	29	05	13,090
Coral Harbour	2	20	1,050
Coppermine	28	25	12,663
Repulse Bay	49	0	22,050

User	Hours	Minutes	Total Amt. $
Pelly Bay	605	10	$272,225
Others	5	0	2,700
Total	827	10	$374,593

Of this amount Pelly Bay Co-operative was the biggest user - with 73% of the time and of the 605 hours only 263 hours were used for hauling freight/goods from Yellowknife to Pelly Bay. The amount of goods hauled into Pelly Bay was 463,000 pounds with 74,000 pounds hauled out, i.e., fish, carvings, etc. The cost of hauling goods in and out of Pelly Bay was $118,350 using $450 per hour for the DC4. Therefore the plane was used by Pelly Bay Co-operative for $152,875 on other work - hauling fuel from Resolute and goods from Rowley Island.

The total amount of freight hauled by the DC4 from Yellowknife to all Co-operatives in the West was 674,000 pounds. Pelly Bay had 69% of this business. For example Grise Fiord had 1 trip, Holman Island 4 trips, Coppermine 5 trips, Gjoa Haven 2 trips, Spence Bay 1 trip, Rankin Inlet 2 trips, Igloolik 2 trips, Coral Harbour 1 trip, Belcher and Great Whale 10 trips, Repulse Bay 9 trips and Pelly Bay 126 trips.

The audited statement shows that revenue from the aircraft was $346,720 and the operating expense was $389,760 plus interest of $27,176 for a total of $416,936 or a loss of $70,216. This does not include the operation of the house at Pelly Bay or the operation of the Cessna 180. The Cessna 180 was purchased for $17,500 from Fred Ross & Associates. The aircraft was used for 100 hours @ $90 per hour or $9000 for Pelly Bay Co-operative and there is no indication that Pelly Bay Co-operative paid for the use of the Cessna.

The management of the Federation has overcapitalized the aircrafts plus spares as follows:

DC4		$112,000
Depreciation	30,224	
Estimated cost		81,776
Less repair of two engines		
1 @ 85.4% of 27,000	23,058	
1 @ 69.75% of 27,000	18,832	
	41,890	
Est. present value after shutdown Dec. 4, 1973		$ 39,886
Therefore overcapitalized by		$72,114

The Cessna 180 was purchased for		$ 17,500
Depreciation	$5500	
Value Dec. 31, 1973		12,000
Overcapitalized		$ 5,500

In total the aircraft operation had a loss of

House operation - Pelly Bay	$ 10,000
Undercharged to Co-operatives	70,216
Overcapitalization DC4	72,114
Undercharged Cessna 180	9,000
Overcapitalization Cessna	5,500
Total Loss on Aircraft Operation	$166,830

There is no indication as to what Co-operative received the most benefit but the usage figures would indicate that Pelly Bay Co-operative received the most benefit without paying its full share. There can be no doubt that the Pelly Bay Co-operative requires air transport for resupply. However, the Federation should not subsidize this Co-operative. It would seem that management did not take care to charge at least exact cost of operation. Over and above this there are observations that must be mentioned concerning the operation of the Federation.

1. A gasoline stockpile at Repulse Bay was not mentioned in the auditor's report. This stockpile consisted of some 450 barrels of aviation fuel. This was not listed as an asset. The management has since sold some of this fuel to another firm. In my opinion this is a very haphazard way of doing business.

2. The Federation has sold duffle ($10,000) to CIC for resale to Co-operatives. At the same time the Federation was negotiating a loan from the Federal Government, the management borrowed money from CIC to pay creditors. These creditors were given preference as was CIC for its loans to the Federation. Legal advice to the contrary was not adhered to. In the borrowing of money between CIC and management no promissory notes were signed and the books and records are kept by CIC.

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3. The CIC has a bank account controlling the Federation's receivables. Transfers of money were made between CIC and the Purchasing Division accounts as and when required with no promissory notes. The methods used were forms of payables; the current loan to the Federation would rise and fall. In my opinion a very poor way of doing business.

4. It should be noted that the Cambridge Bay Co-operative has been trying for two years to get an audit from the Federation in order to meet income tax payments. As yet this has not been done. Spence Bay has been trying to get an audit for the last year and has not succeeded.

5. The Grise Fiord Co-operative has not been able to get resupply from the Quebec Federation although Grise Fiord has paid all of its payables. The reason is that CIC purchasing has not paid Grise Fiord's creditors. In my opinion a most distasteful way of treating a client.

6. The travelling expenses for the Federation was moderately high; $21,424. The head office - management alone spent over 10 per cent of its expenditure on travel.

In my opinion the state of present affairs can be attributed to the Federation taking on large projects that it could not handle. It spent money in trying to make money for itself instead of servicing the people it was supposed to serve and that is the Co-operative, be it Paulatuk or Cambridge Bay. If any one Co-operative can be singled out as receiving the most benefit it would have to be Pelly Bay.

The reason for the losses on the aircraft and on the overall operation can be attributed to poor management, poor advice by the Board of Directors to management or a combination of both.

My recommendations to the Board of Directors are as follows:

1. A management review be made immediately by hiring an independent consultant to assess the present management.

2. The DC4 operation under the Federation cease with a recommendation that the aircraft and spares plus the Cessna 180 be sold on the open market.

3. The Purchasing Division as operated by CIC cease to operate and that the signing authority given to J. Casey be rescinded with all records of accounts taken over by the Federation.

4. That the Federation consult with individual Co-operatives for the purposes of levying a percentage fee on gross sales, so that the Federation can receive monies for its services to the Co-operatives.

5. That the Federation undertake a new expediting-purchasing service as outlined in Alternative #3 attached. The government would be willing to help on resupply and would be willing to give one man for one year at no expense to the Federation in setting up a feasible system.

6. The Federation should seriously consider an alliance with the Federated Co-ops from southern Canada. With the expertise the southern co-operated can muster many of the purchasing and expediting problems would be solved.

For your information and consideration.

Alex G. Gordon.

Yellowknife, N.W.T.
June 3, 1974.

Alternative #2

Purchasing Division - as part of CACFL in Head Office Yellowknife.

Volume of Sales		$2,000,000
Aircraft Operation		400,000
Cost of Goods Delivered		$2,400,000
7% fee to Co-ops		140,000
Cost to Co-ops		$2,540,000
Gross Margin		$ 140,000
Expenses:		
Warehouse Rentals	24,000	
O & M trucks, bldgs.	2,000	
Salaries: Buyers	15,000	
Expediters (2)	20,000	
Typist	7,000	
Travel	5,000	
Telephone, telex	4,000	
Office Supplies	1,000	
Office Space	2,000	
Misc.	2,000	
Depreciation Trucks	1,500	
Operating Capital $283,500		
Cost of OC @ 13%	36,885	
Total Expenses		130,355
Net Return to Federation: Profit:		$ 9,645

Alternative #3

(First Year Operation)

Setting Up Expediting Service -			
Volume of Sales			$2,000,000
Commercial Aircraft Expense			400,000
(Should be less because use only when required so costs are prorated)			
Cost of Goods Delivered			$2,400,000
3% purchasing fee			60,000
Total Cost to Co-ops			$2,460,000
Gross Margin			$ 60,000
Expenses:			
Salaries:	1 Purchasing Agent Expediter	20,000	
	1 Clerk Typist	7,000	
	O & M Truck	500	
	Travel	2,000	
	Telephone, telex	1,500	
	Office supplies	500	
	Misc.	500	
	Depreciation truck	500	
		32,500	
Operating Capital 30,000			
Cost of O.C. @ 13%		3,900	
		36,400	
Net Return to Federation			$ 23,600
Savings to Co-ops			$ 80,000
Sale of DC4, Spares, & Cessna 180		60,000	
Sale of 2 Trucks		3,000	
		63,000	

Net Return to Federation (1st year) $ 86,600

Second and subsequent years operation (20,000 plus) - as volume of purchases increase - profit increases.

With this method of operation the CACFL would just be a clearing house for purchases. Most purchases would be made through Federated Co-ops and the orders would be made in the individual Co-operatives' names thereby, no receivables by the Federation. The Federation then charges a fee for purchasing service plus expediting. If the Co-ops do not pay the supplier we know immediately when to cut off poor paying or slow paying Co-operatives. This also gives the Federation a gauge to judge field operations and a reason to investigate.

Through this method the cost of freight shipment goes direct to each Co-operative - the onus must be placed on the business requiring the goods - if you can't pay you don't receive goods or services - it is just good business sense. The Federation should not have to suffer the losses because certain Co-operatives have poor management or no working capital.

Under this alternative the Federation does not have administrative headaches of running an airplane plus suffering unforeseen expenses on this type of operation.

Alternative #1

By Using Present Agency (CIC) & Expediting at Churchill

Charging a 7% purchase fee with 2% going to the Federation.

1.	Volume of Sales 1974	$2,000,000
2.	Federation Aircraft Expense	400,000
3.	Cost of Goods delivered	$2,400,000
4.	7% fee to Co-ops on Cost of Goods Bought	140,000
5.	Total Cost to Co-ops	$2,540,000
6.	Return to Federation (140,000-100,000)	$ 40,000
	Working Capital Required (Aircraft)	$ 200,000
	Cost of Working Capital (13%)	$ 26,000
	Net return to Federaticn	$ 14,000

The only thing I do not like about this alternative is that CIC would control records, a bank account and incidentally they or Mr. Casey also owns Grosser Parts, a supplier - any orders placed with his own firm gives extra profits - and we must also look at his past record of preferring himself to other creditors on payment of accounts.