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***Slave River Saw Mill Limited; Historical
Review***

***Type of Study: Operations Management
Forestry, Slave River Area Mills***

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Resident Psrtner
Michael T. Hartley

July 29, 1977.

Division of Policy,
Review and Evaluation,
Department of Planning and
Program Evaluation,
Government of the N. W. T.,
Yellowknife, N.W. T.

Attention: Doug Andress

We have been engaged by the Department of Planning and Program Evaluation to supply stipulated information on Slave River Saw Mill Ltd. for the period from the commencement of activities in July 1974 to the present.

Our report is enclosed based on a format determined by the Department and subject to the terms of our agreement. The information contained therein has been collected during our audit which is principal concerned with the accounting records of the Company. Because the Government played such an active role in the affairs of the Company we undertook a thorough review of their files as well. The reports of C.D. Schultz & Company and John Blackstock were not examined in any depth.

We trust this report will help you complete your review.

Yours very truly,
MACKAY, PEACHEY & CO.



Michael T. Hartley

MTH/hb

encl.

Offices: Vancouver, Whitehorse, Fort St. John, Yellowknife

PRODUCTION HISTORY

Nahanni Lumber was forced to stop operating in the summer of 1973 because the Company was unable to raise much needed working capital (see Investment History). It is apparent that the Company also ran out of logs, as the winter logging had been relatively unsuccessful and an attempt at summer logging was disastrous'. The Company apparently lost a good deal of the logs cut during the summer program in a storm.

While the future of the mill was being determined, the Government of the N.W.T. and the residents of Fort Resolution, realizing that the winter months were crucial for completing the logging necessary to reopen the mill, created Res Logging Co-operative Limited. The purpose of Res Logging was to continue the essential cycle of logging in the winter and milling and planing in the spring, summer and fall. The capacity of milling and planing production is necessarily determined by the number of board feet of logs cut and brought to the mill site during the winter.

Part of the current problem facing the Mill is that during the inter of 1977 an insufficient number of logs were obtained to allow the Mill to continue operating beyond August. As we have been led to understand, the problem arose out of the extraordinary thaw experienced in February during which the winter roads became impassable. Apparently there are still a good number of fallen trees lying in the bush which couldn't be delivered to the Mill site by the termination of the logging season, which is necessarily dictated by the advance of spring and the normal period of thaw.

OPENING INVENTORY

During the winter of 1974 a contract was arranged with Res Logging to cut and deliver 2,500,000 board feet (FBM) for \$112,500. (\$45/1000 FBM). The Mill was opened in July 1975 with apparent inventory of 2,500,000 FBM of logs. However, the logs had been cut and delivered to the Mill site by Res Logging without payment of stumpage fees to the Department of Lands and Forest. Consequently, the Mill had to scale the logs, under supervision by the Department as the scaler was new at his job, after which the stumpage fees were paid by the Mill and not Res Logging.

Immediately the cash- flow projections of the Mill- were jeopardized for the payment of the stumpage fees had not been provided for. -(Other problems surrounding the unreliable cash flow projections will be discussed under Marketing history).

The exercise of scaling the logs prior to milling showed-that there was a dis-repancy in the opening inventory. Instead of 2,500,000 FBM only some 1,759,000 FBM were scaled, a shortage of some 741,000 FBM. Immediately-the cost of the **logs** per thousand rose from the \$45/1000 FBM to \$64/1000 FBM further destroying the initial cash flow projections. The latter were prepared on a very optimistic note to begin with and as such there, was little chance that the Mill's **operating** performance would be reviewed as anything but poor and certainly not up to expectations. For purposes of our audit we are going to back the opening inventory shortage out of operating expenses and present it as an extraordinary cost, which certainly will improve the reliability and meaningfulness of the operating statement. This extraordinary item (741,000 @ \$45/1000 = \$33,345) represents a material amount in determining the Mill's net loss from operations.

JULY 17, 1974 to JULY 31, 1975.

During this period 3,080,000 FBM of lumber was milled and 1,180,159 FBM of lumber was planed. This information was obtained from the Government records. Weekly movements of material were forwarded by the Mill to the Department of Economic Development and Tourism's regional office in Fort Smith. The collection of information is somewhat suspect, certainly from an audit standpoint, as milling and planing production records continue to be completed based on information received from the fork lift driver(s). Essentially everytime a fork lift driver moves lumber which has been milled and stacked by size and grade, called a sling, he marks down a bar on a preprinted form outlining the various sizes (dimensions) of lumber. It is possible that the fork lift operator could either, or both, forget to mark down a sling he moves, or could incorrectly record which type of lumber he moves. The latter would produce a sizable variance if he records a sling as 1" x 4" that was in fact 2" x 12". There is no reconciliation of the production records and physical inventory counts. We have had some difficulty reconciling the physical flows of products; essentially opening inventory less sales should equal physical inventory on hand for any given period. We are going to recommend in our memorandum on improvements to the accounting system that physical inventory counts and reconciliations to production records be under taken on a regular periodic basis.

It should be noted that a lease agreement between Nahanni Lumber Ltd. and the Commissioner of the N.W.T. was undertaken whereby a lease payment of \$5/1000 FBM of lumber milled would be paid for the use of the Nahanni assets by Slave River Saw Mill. Although the contract was initially stated to be for the period terminating March 31, 1975, it was apparently extended on a defacto basis until the end of the first fiscal period, July 31, 1975. This apparent liability for lumber milled was included in determining the purchase price of the shares of Nahanni Lumber Ltd. held by the MacCalders (70%). (See Investment History).

WINTER 1975 "

The Company entered in-to a logging contract with Res Logging Co-operative Limited which in turn sub-contracted with Deines Brothers. The price established was to be the cost of logging which includes delivery. A total of 3,021,085 FBM was delivered to the Mill at an initial cost of \$50/1000 FBM. As the contract was at cost another \$4/1000 FBM had to be paid to Deines Brothers. As will be discussed under Investment History, a good portion of the liability incurred by Slave River Saw Mill Ltd. with Res Logging for the cutting season 1974 and 1975 was never paid off. Res Logging is now in the position of being liquidated.

1975-- 1976

During this period 3,003,298 FBM were milled and 1,566,824 FBM were planed. The production reco'rds were recorded essentially in the same manner as in the previous year, except that after January 1, 1976 the information was forwarded directly to Economic Development in Yellowknife and Hinchey & Co. who entered into a contract to process the accounting data on their computer facilities. In the course of our audit we tried to reconcile the physical flows of lumber with opening and closing inventory balances and we came up with a net unreconcilable variance of some **475,000** FBM. The Mill undertook its own logging operations during the winter in which **2,270,300** FBM were scaled

1976 - 1977

Logs scaled January-March 1977	1,355,045 FBM
	<hr/>
Lumber milled	2,266,673 FBM
	<hr/>

Lumber planed

1,760,928 FBMEMPLOYMENT HISTORY

Enclosed as Appendix A are the employment records of Slave River Saw Mill Ltd. as forwarded to Workmen's Compensation. This represents only the people employed directly by the mill. It has been stated many times by the Government that the employees of Res Logging Co-operative Limited and the saw mill were essentially the same, particularly during the winter logging season of 1974. During the 1975 season the logging operations were undertaken by Deines Brothers, an independent contractor from Calgary, and it is uncertain how many local residents were employed. The statistics for Res Logging have not been included. We believe they can be obtained through the records held by Froment & Co. or by enquiring directly to Workman's Compensation. Due to time constraints we have been unable to obtain the information, particularly since we are not examining the records of Res Logging Co-operative Limited.

residents say all local employment except for

Logging operations were undertaken by Slave River Saw Mill Ltd. itself during the winter of 1976 and 1977. From that point on all the operations surrounding the production of lumber were now being handled directly by the Mill.

All employees have been native except for four non-natives. Due to the seasonal activities of the Mill, the number of employess has varied considerably. From the commencement of operations the Mill employed three non-natives on a permanent basis, except for one who was fired for a period of time because of his drinking habits. They included Ray Orbell, the Mill Manager, Allan West, the Millwright, and Tim Acey, Office Manager. Ray Orbell was recruited by John Blackstock of C.D. Shultz & Co. who had known him for many years during his involvement in lumber operations in B.C. Allan West had worked for Ray Orbell for many years in B.C. Tim Acey was recruited from the ranks of the Hudson Bay "Company and had spent several years with the Bay in Snowdrift and Fort Resolution. In 1976 Frank Broadhead was hired as a mechanic. He had previously managed the local water delivery firm in Fort Resolution for several years. It is understood that at the end of June 1977 Allan West

terminated his employment and returned to B.C. Ray Orbell tendered his resignation in April 1977 to the Board of Directors of the Company and it was rejected. Ray has stated **that** the past three years have been very hard on him and he wants to leave. He has been asked by the Board and by the Government of the N.W.T. to stay.[?] He will decide his course of action after his holidays in September. Another non-native was hired for three months in December 1974 to train the **planer crew**.

The departure of Allan West, although not as serious as the possible departure of Ray Orbell, still presents an essential problem to the ongoing viability of the Mill. Besides Ray Orbell, Allan West was the only employee who knew logging, milling and planing operations and who could be counted on to properly maintain and repair, when necessary, the complicated machinery. It has been stated that several attempts have been made to instruct the employees in the art of maintenance and repair but -they have been unable, either through inability or lack of concern and initiative, to master this aspect which is so essential to the ongoing success of the Mill. Whatever the reason, and we do not want to act as judges, the **Mill's** equipment and machinery must be maintained in good running order so as to prevent costly damage and breakdowns. At present there doesn't seem to be anybody but Ray Orbell to carry the burden of maintaining the equipment which, together with the other requirements on his time, is a very onerous task.

Another non-native was hired briefly in the Spring of 1977 to **help** Tim Acey run the office. The Board of Directors stressed they want natives to assume more responsibility in the running of the office and it is understood that steps **have** been taken to train a young native in the offices of Hinchey & Co. until he can assume a position of responsibility in the office management. The Company undertook a contract with Hinchey & Co., a firm of accountants in Yellowknife, in January 1976 to provide accounting and management services. Bob Williams CGA of Hinchey & Co. has assumed the responsibilities and in January 1977 was appointed Secretary-Treasurer of the 'Company,

The employment history of the Mill would not be complete without mentioning the untold hours of effort undertaken by officials of the Government of the N.W.T. and by the forestry consulting firm of C.D. Schultz & Co. From the commencement of operations the Government of the N.W.T. played a direct role in the management of the Company. Initially the Mill reported directly to the Fort Smith regional office and its various Economic Development officers. In January 1976 the Mill began reporting **directly** to Yellowknife.

Also, John Blackstock and the firm of C.D. Schultz & Co. have undertaken many consulting assignments on behalf of the Government of the N.W.T. These assignments have been varied and include such diverse activities as recruiting **personnel**, suggestions and planning of logging activities, search for suitable equipment and analysis of operations, to name just a few.

MARKETING HISTORY

From the outset the Company has had difficulties in selling its product. It is understood that the credibility of the quality of lumber coming from Fort Resolution had been severely undermined during the Nahanni Lumber Ltd. operations. This cannot be substantiated but was certainly alluded to in the files. "Another major problem apparently had been the unreliable delivery schedules of Nahanni Lumber Ltd. It is quite reasonable to suggest that despite the new ownership and management, sales of lumber from any company operating out of Fort Resolution were suspect and it was a difficult and time consuming task to change the image. As continues to be the case, most of the marketing of bulk sales was handled by the Government.

We do not consider ourselves to be marketing experts but from the documentation available it is possible to enumerate some of the difficulties hindering the marketing of the lumber. Some of these continue until the present.

1. Restricted markets in the N.W.T.
2. Cost of production:
 efficiency of scale.
3. Poor image of product.
4. Cost of transport.
5. Principal purchasers in the N.W.T. tied into other reliable suppliers, either within or outside the territories.
6. Universally declining market for goods in Canada and North America.
 severe price reductions
 increased competition from big producers
7. Inability of Government of the N.W.T. to 'influence' N.W.T. purchasers.

A detailed analysis of lumber sold by year follows:

1974 to 1975

The first year's operations were certainly not successful from the marketing end. Only 742,185 FBM out of 3,080,000 FBM produced, either milled and/or planed, were sold during this period. From the outset there was no definite sale price for given grades of lumber and evidence proves that prices for the same grade of lumber varied substantially. Often lumber was sold for prices substantially below cost as a means of convincing customers as to the reliability of the lumber.

Reference is made during this period to the difficulties of obtaining markets for the lumber. One particular problem is documented whereby sales to some customers, such as the N.W.T. Housing Corporation, were made at prices less than those paid by local wholesalers. Understandably the local wholesalers were upset with being undercut by their own supplier, particularly since their purchases had been "encouraged" by the Government. A similar problem is referred to whereby sales were made to an Edmonton wholesaler at prices which allowed him to undercut some of the local wholesalers. This latter case is only alluded to and not substantiated in the files.

It is understood that sales were normally made F.O.B. Fort Resolution, however, this fact cannot be substantiated or quantified to any reliable degree.

Essentially the marketing strategy was to encourage local users to purchase the lumber. Such local users included wholesalers in the N.W.T., the N.W.T. Housing Corporation, contractors, fish packing plants, etc. The Government had a good deal of leverage but it is impossible to determine the success of its efforts.

1975 to 1976

During the year the Company sold 159,252 FBM of logs, 603,082 FBM of rough lumber and 1,881,157 FBM of planed lumber. However, with an opening total inventory of 3,806,115 FBM of lumber (1,789,961 logs, 1,150,422 rough and 865,732 planed) and logging of 2,270,300 FBM, the Company was left with substantial inventory at a time when the market for lumber in North America was reaching its lowest levels. The world wide recession had left its mark on housing starts and other construction and as such there was an over supply of good lumber available. It isn't out of line to suggest that, given this soft market and competing against the giants with their efficiency and marketing strength, the company didn't stand a chance.

Inventory as at July 31, 1976 included (per company records):

Logs	1,852,642 FBM
Rough	1,406,820 "
Planed	613,220 "
	<hr/>
	<u>3,872,682 FBM</u>
	<hr/>

However, as previously stated, our year end reconciliation of physical flows of lumber suggest that inventory might have been overstated by some 475,000 FBM. However, since the records cannot be relied on and regular physical stocktaking wasn't completed this discrepancy cannot be verified. Weber Homes^t Hay river plant became an increasingly important customer.

1976-1977

Although the final results for the year haven't been analyzed as of yet; it is possible to say that -the year saw both the low point in the market as well as a tremendous strengthening of demand and prices. It is apparent that as housing starts and other capital projects increased in North America it caught the prod-ucers operating at reduced levels. Consequently there was insufficient supply to meet the demands and prices rose dramatically. The net result was that the **Company's** competition was reduced for the giant's were busy filling their southern orders, and towards the late spring and summer of 1977 such clients as Weber Homes in Hay River were buying all the lumber the Mill could produce and at top prices.

This upsurge in damand came at a very untimely point in the Company's operating history. Firstly, at the beginning of the year the Company was in a desperate financial position from a cash flow point of view, because of the large inventory on hand. There was all that lumber in the yard while on the other side of the ledger there were all those debts.' Decisions were made to alleviate part of the financial problems by selling the lumber at prices substantially below cost. Consequently, the Company had very little inventory to sell as demand improved.

Secondly, because of the thaw during the winter the Mill didn't-get enough logs delivered to the mill site to allow it to operate for the entire milling season. The summer logging option had to be ruled out because it was considered too late to be effective. Consequently, for the **first** time in its history the Mill virtually had a demand for all the lumber it could produce only to be saddled with a shortage of logs. There **couldn't** have been a worse turn of events.

During the period from November 1976 to February 1977 large sales were made to three principal purchasers at prices substantially below production costs of approximately \$170/1000 FBM. Please refer to appendix I for a detailed breakdown of these sales. Hindsight certainly is wonderful, but we find it disturbing that such market-in-g decisions were made without a proper analysis. of economic trends. It **seems** , without documenting the fact, that the sales were made at a point in time when the U.S. and Canada were showing signs of economic recovery.

Included as appendix H is an analysis of sales to major customers by calendar year.

INVESTMENT HISTORY

EQUITY INVESTMENT

Nahanni Lumber Ltd.

On May 25, 1972 the Department of Indian Affairs gave financial assistance of \$25,000 to Mr. D. Brand, as trustee for the Fort Resolution Indian Band, to purchase 8,571 shares of Nahanni Lumber Ltd. These 8,571 shares represented 30% of the outstanding issued shares, the remaining shares (70%) being held by **J.H. MacCalder** (40%) and M.N. MacCalder (30%). These shares **are still held in** .
" trust by Mr. D. Brand. Any further description of the source of funds is unavailable at the present.

Slave River Saw Mill Ltd.

a) The Company was incorporated April 15, 1975 and two class "A" common shares were issued to Murray Sigler and J. Edward Richard respectively. These shares are

held in trust for the Commissioner of the N.W.T. Even though the people of Fort Resolution believe they are the beneficial owners of the shares, there is no formal legal documentation to support this claim. A trust agreement has never been drawn up stating that the Commissioner holds the shares in trust for the people of Fort Resolution. The Commissioner is the beneficial owner of the shares and unless some retroactive documentation can be drawn up the Government of the N.W.T. appears to own Slave River Saw Mill Ltd. This point is one of the outstanding issues to be resolved in our audit and we have asked the Government of the N.W.T., including Legal Services, to resolve this issue for us. Unfortunately, we haven't received any further clarification on this issue.

Murray Sigler wrote to the Government of the N.W.T. on April 30, 1975 suggesting "at this time that you draw up the terms upon which the Commissioner holds the shares in trust for the people of Resolution, so that we might prepare a trust declaration for the Commissioner to sign in that regard". His suggestion was never acted upon. Similarly, apart from the initial minutes of incorporation, apparently all the minutes were prepared by persons other than lawyers. Consequently, policies were determined and transactions undertaken by the Board of Directors which were duly included in the minutes without being reviewed by a party versed in corporate law. As an example of the problems which can arise, the December 15, 1975 minutes state that the people of Fort Resolution were the beneficial owners of the shares of Slave River Saw Mill Ltd. If a lawyer, particularly the Company's lawyer, had prepared, or at least reviewed the minutes, it would have become quickly apparent that the Board was operating on a misunderstanding. At this point, matters would have been rectified.

Throughout many of the principal transactions involving the financial matters of the Company there was an apparent lack of appreciation for the formalities of corporate law which had to be observed.

b) On December 11, 1975 Slave River Saw Mill Ltd. purchased the shares of Nahanni Lumber Ltd. held by J.H. MacCalder and M.N. MacCalder. The Government of the N.W.T. issued funds of \$30,000 in the form of a grant to allow Slave River Saw Mill Ltd. to purchase the shares. There is some discrepancy surrounding this transaction and we refer to our correspondence in appendix B and the unresolved issues of our audit enumerated in the last section of this report. Apparently another \$2,000 was also paid to the MacCalders in this transaction to obtain a general release. It is uncertain who paid this amount and how it was charged.

The same uncertainty applies to the legal fees for this transaction.

To digress for a moment, according to generally accepted accounting principles, when a company owns a majority interest in another company the former company must issue consolidated financial statements which, to simplify matters, includes the proportionate share of assets and liabilities and revenues and expenses of the latter company. All intercompany transactions are excluded. However, since consolidated enterprises are not separate legal entities for both company and tax laws separate financial statements of the two individual companies must also be prepared for these purposes - often referred to in accounting jargon as legal statements.

Consolidated financial statements must be prepared for all fiscal periods subsequent to the purchase of the Nahanni shares. It is very important to our audit that we determine just who **owns** what in law, particularly since Slave River Saw Mill Ltd. now owns 70% of the shares of Nahanni Lumber Ltd. In the opinion of the Department of Indian and Northern Affairs the Fort Resolution Indian Band, the beneficial owners of 30% of Nahanni Lumber Ltd., is a different entity **than** the people of Fort Resolution, the purported defacto owners of the issued shares of Slave River Saw Mill Ltd. As such the minority interest of the **Fort** Resolution Indian Band will receive proper presentation in the consolidated financial statements of Slave River Saw Mill Ltd. We include correspondence from this Department as appendix C.

LONG TERM DEBT FINANCING

Nahanni Lumber Ltd.

a) I.E.D.F. - **\$100,000**

"In late 1971 it became evident that in order to keep Nahanni Lumber in operation that it would be necessary to provide financing for operating capital and modernization of the plant. The amount required was beyond the capability of the S.B.L.F. Therefore the Indian Economic Development Fund was approached. They agreed to take a look at the proposal. A consultant, L. Hird from Thurso, Quebec, was hired by the I.E.D.F. to assess the operation and make recommendations. His report indicated that the operation was viable and that with adequate financing would be producing a profit by July of 1972 and commence repayment of all outstanding loans by January of 1973. He recommended that the I.E.D.F. make a loan

to Nahanni Lumber in the amount of \$125,000.0.0.

After some discussion and consultation with us and the Industrial Development Bank, it was decided to handle the financing as follows:

Loan	\$ 100,000.00
Grant	27,000.00

(Note: \$2,000.00 went to the lawyer)

The purpose of the grant was to" permit the purchase of 8,751 common shares which represented 30% of the stock to be held in trust for the Indian residents of Fort Resolution.

This Government agreed to postpone any accrued interest on the balance owing to us until December 1972 at which time 50% of the interest accrued would be paid with the remaining 50\$ plus any other accrued interest being paid June 30, 1973. We also agreed to defer any principal payments until December 31, 1973 at which time regular payments would commence.

This loan/grant was finalized in April of 1972 and it appeared for the first few months" that all was going smoothly. In October danger signals began to flash and very soon it became evident that the company was once again in trouble.

'As DIAND/I.E.D.F. were not prepared to assist any further, we hired their consultant, L. Hird, to once again assess the operation and make recommendations. His report indicated complete mismanagement on the part of Jack MacCalder and no support from the parent company, MacCalder Construction of Edmonton. Confidentially, he advised us that he suspected that Nahanni Lumber was being milked by MacCalder Construction but this could not be proved. We endeavored to secure further financing and/or deferment of payments in an attempt to keep the operation going. When all attempts failed, we asked L. Hird to try to find a buyer. He came up with two groups, both of which were well financed and fully capable of running a sawmill. Both deals fell through because MacCalder, after agreeing to **asale**; reneged on the agreement.

Subsequently, MacCalder Construction raised some capital and have operated the mill this year (1973). They have installed a planer and in May/June produced 441,765 FBM. However, they are once again shut down and DIAND have advised us that they propose to call their loan. This will, in effect, force Nahanni Lumber into bankruptcy. This may not be a bad move and possibly should have been the course followed a year ago. Nahanni Lumber is bankrupt and no one could operate it and carry its present debt load. If they do go into bankruptcy, outside of the MacCalders, the two biggest losers will be I.D.B. and the I.E.D.F. The I.E.D.F. is prepared to operate the mill once a trustee is appointed and will protect the equity held by the Indians^{ff}. (By J.A. Bergasse).

On November 23, 1972 Nahanni Lumber Ltd. negotiated a Chattel mortgage in the amount of \$100,000 with the Department of Indian and Northern Affairs and the Indian Economic Development Fund. The circumstances surrounding this loan are confusing at best. Firstly, the chattel mortgage was issued on the planer, which burned in Septemeber 1976 and had to be rebuilt and replaced, and a twenty-four foot wooden boat, which has also burned to nothing but for which there was no insurance. Insurance proceeds have helped to pay part of the cost of replacing the planer mill. The lack of insurance on the boat was directly contrary to Article 2 and 3 of the mortgage agreement. Secondly, this debt was the principal reason Nahanni Lumber Ltd. was to be placed in bankruptcy in 1973, until the Government of the N.W.T. stepped in and asked for a moratorium on the debt. From this point on the Governments records are almos't comical in their treatment of this debt, as many references are made to moratoriums and write-offs which never took place, much to the surprise of many it seems, up to the current date when another attempt is being made to request that Treasury Board write off this debt.

However, at the present time, the debt plus accumulated interest still exists and will certainly appear on the consolidated financial statements of Slave River Saw Mill Ltd. for the year ending July 31, 1976 and, unless we receive official word that is was written off before July 31, 1977, for the subsequent year as well.

b) F.B.D.B.

At the time of the failure of Nahanni Lumber Ltd. approximately \$40,000 was owing to the I.D.B. - Industrial Development Bank the previous name of F.B.D.B. - Federal Business Development Bank. Although we haven't analyzed the loan agreement the

files seem to suggest that the claim of the F.B.D.B. was secondary to the I.E.D.F. and consequently the F.B.D.B. went along with the approach of the I.E.D.F. in the negotiations regarding the termination of Nahanni Lumber Ltd. activities. It is unclear as to what exactly transpired after the change of activities to Slave River Saw Mill but it appears as though F.B.D.B. agreed to a moratorium on principal payments for a number of years provided the Mill continued to make interest payments. It appears as though the Mill never made any interest payments. The loan was said to have remained in the name of Nahanni Lumber Ltd. until June 1977 when the Mill formally accepted responsibility for the loan and agreed to make principal and interest payments on the balance of principal and accrued interest outstanding. We have not reviewed this transaction as at this date.

One audit problem still to be resolved is whether the F.B.D.B. loan was in fact transferred to Slave River Saw Mill Ltd. prior to July 1977. Our confirmations of loan payable sent to F.B.D.B. for Slave River Saw Mill Ltd. were returned with balances outstanding of \$44,859.90 as at July 31, 1975 and July 31, 1976. We have to determine, by further communication with F.B.D.B., whether this debt should be shown on the books of Slave River Saw Mill Ltd. or Nahanni Lumber Ltd. At any rate, the loan will be included in the consolidated financial statements as at July 31, 1976 and for subsequent years.

Res Logging Co-operative Limited

a) I.E.D.F. - \$70,000

The Department of Indian and Northern Affairs through the Indian Economic Development Fund financed the activities of Res Logging Co-operative Limited to the amount of \$70,000. This loan was never repaid primarily because Slave River Saw Mill Ltd., the only customer of Res Logging, never paid \$110,000 of the amount outstanding for logs delivered to it. In March 1976 it was decided to dissolve Res Logging. Its only asset was a receivable from Slave River Saw Mill Ltd. and its offsetting liabilities were amounts owing to the Government - \$70,000 to I.E.D.F. and \$40,000 to the Government of the N.W.T. The balance of the liabilities were trade payables subsequently paid by Slave River Saw Mill Ltd. Please see appendix J for copies of financial statements of Res Logging.

At a meeting of the charter members of Res Logging Co-Operative Limited held March 4, 1976, it was resolved that the Co-operative be dissolved and that all its assets and liabilities be assumed by Slave River Saw Mill Ltd. This resolution

was signed by four members including the President, Robert Sayine, who is also the President of Slave River Saw Mill Ltd. To the best of our knowledge, Slave River Saw Mill Ltd. never formally accepted the assets and liabilities of Res Logging. It is essential to the completion of our audit to determine whether in law this dissolution was binding. Slave River Saw Mill Ltd. has to logically have an outstanding liability either to Res Logging or to the I.E.D.F. It is not logical, as has been stated, that it doesn't have a liability to either of them. We have written Hinchey & Co. who were appointed Liquidators of Res Logging in January 1977 regarding this point and include a copy of the correspondance as appendix D.

b) Government of the N.W.T. - \$40,000

We understand that the Government of the N.W.T. loaned Res- Logging \$40,000 and that this loan was subsequently forgiven. , It is important for our audit to determine the timing of the forgiveness and whether the dissolution into Slave River Saw Mill Ltd. is binding in law, as it is possible that the forgiveness could be a grant to Slave River Saw Mill Ltd.

Slave River Saw Mill Ltd.

a) Canadian Imperial Bank of Commerce

The principal source of operating capital for Slave River Saw Mill Ltd. has been a demand loan with the Canadian Imperial Bank of Commerce guaranteed by the Government of the N.W.T., with a form of sub-guarantee to the Government of the N.W.T. by the Department of Indian and Northern Affairs. We are uncertain at the present as to the actual terms and procedures of this sub-guarantee.

As at July 31, 1975 and July 31, 1976 \$225,000 was outstanding to the bank, the terms of the loan can best be stated by using the Bankts own terminology.

General assignment of accounts receivable registered in Alberta and N.W.T. Assignment under Section 88 or the Bank Act covering all the company's lumber, logs, cord wood with adequate insurance loss payable first to the Bank. Guarantee and postponement of claim for \$100,000 from the Government of N.W.T. Letter from the Government of the N.W.T. confirming that the Government will cover the operating deficits incurred by the Mill for a period of 3 years and that it will review its commitments again in January 1978.

It is uncertain at the present just exactly which Government hag" made the guarantee. We include three letters as appendix E outlining part of the uncertainty. It is understood that in April 1977 further negotiations with the Canadian Imperial Bank of Commerce were undertaken and "possible further funds and/or commitments were given. We haven't had time to resolve this matter as we haven't commenced our audit of the year ending July 31, 19770

CAPITAL EQUIPMENT

When Slave River Saw.Mi-11 began operations on July 17, 1974 .i.t was intended to use the assets of Nahanni Lumber Ltd. **There is** a good deal of discrepancy surrounding the extent and quality of assets located on the site when Ray Orbell arrived to begin operations. It has been suggested that one of the reasons Nahanni Lumber went broke was that it tied up so much of its financing in capital equipment and consequently couldn't maintain the necessary cash flow to keep operating. It is uncertain as to what equipment was left behind by the MacCalders and in what state of repair or disrepair! but according to Ray Orbell the mill site was a sorry site to any experienced lumberman. Ray claims he had to virtually rebuild everything. It is possible that during the time period elapsing between operations substantial theft and vandalism- took place. At any rate, it was apparent that the equipment was not in the desired state of -repair and certainly not ready to begin operating to meet the highly optimistic production forecasts which had been prepared to support implimentation of the project.

From the beginning it is apparent that the results of operations were affected by the time, funds, material, labour and energy required to bring the Mill up to production capability. The forecast for start up costs was totally unrealistic. It is our contention that-the financial statements presently available are misleading in that there is no attempt made to measure the amount of material, labour, and overhead which went into bringing the Mill into operating shape; rather these co-st are reported as operating expenses. ' One of the open points in our audit is an attempt to measure the value of such material, labour and overhead and to present them as assets, as leasehold i.mprovements, on the Balance Sheet.

If the analysis can be completed on time it will be included as appendix F. If it can't, we will indicate in appendix F the kind of capitalization we are considering{

Technically the assets are still the property of Nahanni Lumber Ltd. When the mill went into production the Government of the N.W.T. entered into a contract with Nahanni Lumber Ltd. to lease the assets on a basis of \$5 for every 1000 FBM lumber milled. Subsequently the Government of the N.W.T. entered into a option to purchase the shares of Nahanni Lumber Ltd. (70%) with the MacCalder's for \$30,000, the payment of which would be offset by any amounts paid or owing on the lease arrangement. At the time of the actual purchase of the shares, there was a dispute as to whether the option agreement had been validated. At any rate, the lease payments did play a role in the final determination of price, however there are other offsetting" items which also had an effect for which we don't have the details at the present. Please also note the problem regarding the lease agreement included in unresolved audit problems.

In the first **year** of operations the assets will appear on the financial statements, at a value still to be determined, as a good portion was junk and consequently scrapped or used as parts, of Nahanni Lumber and any improvements on those assets will appear on the financial statements of Slave River Saw Mill Ltd. together with any new assets purchased by the Company. In subsequent years the legal statements will indicate a similar breakdown between the companies, but on the consolidated financial statements the two will be combined to more adequately present the actual make up of fixed assets. It is our opinion, based on comments to us to that effect, that ownership of the assets was not previously transferred because it was hoped that by not owning the assets the Company would not have to show the outstanding liabilities. The assets were to have been transferred over once the liability to I.E.D.F. was written off by Treasury Board. Of course, by purchasing the shares of Nahanni Lumber Ltd. the debt to I.E.D.F. now has to be included on the consolidated balance sheet anyway.

In June 1975 a good portion of the assets of the closed lumber mill at Arctic Red River were dismantled and shipped to Slave River Saw Mill Ltd. Some of these assets have been used in operations, others as parts, and still others lie rusting in the yard. These assets remain on the Government inventory records for the Fort Smith-Regional Office and no charge has been made for their use. At some future time it has been suggested that the Government will sell these assets to the Slave River Saw Mill Ltd. for \$1.

GOVERNMENT OF THE N.W.T.

This area remains unresolved in our audit as there is a good deal of uncertainty as to the extent and nature of Government funding. Please refer to appendix G for a copy of the letter in which we request official confirmation of all financing. Included below is the information presently available to us, with the caveat that we are uncertain as to the extent of any discrepancies.

Year ending July 31, 1975.

Operating Capital:	
- December 31, 1974	\$ 10,000.00
- April 30, 1975	10,000.00
Recoverable advance Oct. 6, 1975	25,000.00
Loan to allow payment to Deines Bros. on behalf of Res Logging Co-Op.	50,000.00
	<u>\$ 95,000.00</u>

Also, we understand that initially all funds were advanced in the form of a loan, and subsequent to June 31, 1975 \$45,000 of the loan was changed to a grant. This cannot be confirmed at present.

The Government also guaranteed a \$30,000 demand loan at The North of 600 Savings & Credit Union Ltd.

Year ending July 31, 1976.

Grants & advances:	
- Management grant Nov.21, 1975	\$ 11,200.00
- Production grant April 23, 1976	10,000.00
<u>Tote trial assistance April 15, 1976</u>	<u>14,860.00</u>
- Acquisition of automatic adjusting Head Rig Log Carriage Oct. 15, 197-5----	7,000.00
- Recoverable grant - assistance to industry May 7, 1976.	31,538.97
- Recoverable grant - assistance to industry April 27, 1976.	18,500.00
- Assistance to Industry Grant re 50% of operating deficit June 10, 1976	15,000.00
Recoverable grant December 8, 1975	50,000.00
- Assistance to industry Sept.9, 1975'	14,000.00
 Grant purchase of Nahanni shares December 1975.	 30,000.00
 Direct payments by Government of the N.W.T.	 Insurance
	15,000.00
	Insurance
	3,438.00
	Insurance
	9,735.00

If is Claude Bennett's understanding this was never purchased!

Uncertain Points:

- Accountable advance to pay creditors
of Nahanni Lumber Ltd. \$ 47,000.00
- Amount returned by trustee (6,527.00)
- General release purchase of shares 2,000.00

The Government also guaranteed a \$30,000 loan with the Toronto Dominion Bank.

Information obtained for fiscal period 1976 - 1977 (not complete)

- Assistance to Industry Sept. 23, 1976 \$ 15,000.00
non recoverable
- Assistance to Industry Sept. 9, 1976 15,000.00
non recoverable.

In April 1977 an accounts receivable of the Government of the N.W.T. with MacCalder Construction Ltd. of \$14,600 was written off. It is uncertain whether this write off will have any bearing on either Nahanni Lumber Ltd. or Slave River Saw Mill Ltd.

MANAGEMENT HISTORY

Corporate and Management History

Much of the corporate history has previously been outlined in one of the other topical headings. Included below is a chronological sequence of events.

Nahanni Lumber Ltd.

- Essentially a one man operation from the outset by M.N. MacCalder.
- January 10, 1969, incorporated in Alberta.
July 24, 1970, extra-territorial registration in the N.W.T.
- May 25, 1972, purchase of 30% of shares by Fort Resolution Indian Band.
- August 1973, termination of operations.
- December 11, 1975, purchase of shares (70%) held by MacCalders by Slave River Saw Mill.

Slave River Saw Mill Ltd.

July 17, 1974, commencement of operations on inventory obtained by winter logging of Res Logging Co-operative Ltd.

- Saw Mill Manager hired - Ray Orbell.
Saw Mill reporting directly to Fort Smith Regional Office of the Department of Economic Development and **Tourism**.
- Government officials looking after marketing.
- April 15, 1975, date of incorporation. Slave River Saw Mill Ltd.
- Initial Board of Directors elected December 8, 1975:

James Haining	Joseph Bergasse-
Ray Orbell	Michael Morcus
Robert Sayine	Henry Pierrot
- December 1975, Mill begins reporting directly to Yellowknife.
December 6, 1976, election of new members to Board of Directors:

Ray Orbell	C.A. Bennett -
Henry Pierrot	Joseph Bergasse -
Lawrence Fabien	S. Dietch -
Robert Sayine	
- January 27, 1977, S. Dietch and J. Bergasse resign to be replaced by:

R. Milligan ✓	
B. Hill `	

 B. Williams - appointed Secretary Treasurer but not a director.

Management Problems

- Communications
- Marketing
- Operational Analysis
- Timely accounting data.

Hinchey & Co., B. Williams, have undertaken a contract to improve **timeliness** and re-liability of accounting information and to suggest improvements as to presentation of data in a format conducive to effective analysis of operations. As we feel they are in the process of fulfilling their contract, we will not make suggestions 'for improvements. However, we do feel--that a form of production budget and standards and regular analysis of variances from standard to actual would prove to be useful. Initially problems would occur in arriving at meaningful budgets and standards but the sooner the exercise is started the sooner the bugs can be worked out.

It' is difficult to effectively analyze management in an operation such as this. Mill management is on the site, marketing, finance and-accounting are in Yellowknife and the former doesn't review the results of operations. Further, the Board **isn't** sophisticated enough to understand the results of operations and the various -financial. undertakings.

Such analysis is further complicated by the underlying policy of the Government of the N.W.T. regarding the Saw Mill, namely to provide employment suitable to the desires of the residents of Fort Resolution. In such a situation effective management can only be half the answer, those residents directly concerned-have-to accept the remainder of the responsibility.

We are including the report of one Brian Penney, an Economic Development officer for the Fort Smith region, as an illustration of some of the initial problems facing day to day management during the first year of operations. We haven't seen any similar appraisals of operations since then. (See appendix K)

OUTSTANDING ISSUES TO BE RESOLVED IN AUDIT OF YEARS ENDING JULY 31, 1975 and 1976.

July 31, 1975*-

1. Res Logging Co-operative Ltd.
 - Whether Slave River Saw Mill Ltd. owes Res Logging \$174,689.00.
2. Nahanni Lumber Ltd.
 - Whether Slave River Saw Mill Ltd. is implicitly or explicitly liable to pay the lease agreements undertaken between the Commissioner and Nahanni Lumber Ltd.
 - (a) \$5/1000 FBM to Nahanni Lumber Ltd.
 - (b) \$20/1000 FBM to creditors of Nahanni Lumber Ltd.
3. Government of the N.W.T. advances, loans, payments on behalf of the Company and grants during the first year of operations.
4. Beneficial ownership of the shares of Slave River Saw Mill Ltd.
5. Capitalization of assets - material, labour and overhead.

July 31, 1976

1. Res Logging Co-Operative Ltd.
 - Whether Slave River Saw Mill Ltd. has assumed the liabilities of Res Logging Co-operative Ltd.
 - If Slave River hasn't assumed the liabilities then what is the status of the \$110,000 account payable to Res Logging in relation to the latter's dissolution.
2. Government of the N.W.T. advances, loans, payments on behalf of the Company and grants during the year.
3. Capitalization of fixed assets.
4. Minority interest of 30% held by Fort Resolution Indian Band.

5. Audit of Nahanni Lumber Ltd.

6. Consolidation of Nahanni Lumber Ltd. with Slave River Saw Mills Ltd.

Please see appendix L for copies of correspondence on outstanding audit issues.

APPENDIX A

EMPLOYMENT RECORDS

EMPLOYMENT RECORDS

<u>Month</u>	<u>Number of Employees</u>	<u>Gross Payroll</u>
July 1974	13	\$ 7,156.59
August	19	13,459.17
September	23	14,181.44
October	29	13,900.49
November	32	19,303.51
December	29	19,113.36
January 1975	11	7,605.00
February	16	11,545.00
March	31	21,075.00
April	23	20,121.00
May	12	6,436.00
June	27	22,315.00
July	17	11,983.00
August	25	18,829.00
September	27	18,969.00
October	27	17,854.00
November	10	5,987.00
December	3	3,722.00
January 1976	14	7,855.00
February	37	37,366.00
March	39	30,925.00
April	38	20,925.00
May	39	14,631.00
June	46	30,364.00
July	38	31,884.00
August	39	24,786.00
September	39	25,992.00
October	35	18,054.00
November	34	20,957.00
December	24	23,142.00
January 1977	34	22,547.00
February	39	33,733.00
March	39	34,225.00
April	32	24,731.00
May	26	18,969.00
June	35	25,988.00

105,000

Appendix A

SLAVE RIVER SAW MILL LTD.
 BREAKDOWN OF POSITIONS AND CURRENT WAGE SCALE

Sawyer	\$6.75 ✓
Tailsawyer	\$4.50
Edgerman	\$5.75
Tailedgers 2	\$4.25
Resawyer	\$5.00
Tailresawyer	\$4.25
Trimsawyer	\$4.75
Conveyor	\$4.25
Lumber filers 4	\$4.25
Millwrights helper	\$5.50
Mechanic	\$7.25 :-
Forklift operator 3	\$5.25
Planer setup man	\$5.00
Planer grader	\$5.00
Planer feeders 2	\$4.25
Grader stamper	\$4.25
Trimmerman	\$4.25
Lumber pilers 2	\$4.25
Watchmen 2	\$4.25