REVIEW OF COMPTROLLER & AUDITOR GENERAL'S REPORT: "ENERGY FROM WASTE PLANT – MANAGEMENT OF FOREIGN CURRENCY EXCHANGE RISKS"

SUBMISSION TO PUBLIC ACCOUNTS COMMITTEE

Deputy Wimberley
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NOTE Somewhat confusingly the Comptroller & Auditor General's report takes as its baseline cost for the incinerator the cost as it was on the date of the signing of the contract on November 14th 2008 - £114.23 million - and then calculates the possible final costs to the taxpayer under different scenarios as being more or less than that baseline. (see Para. 414)

This enabled Ministers to claim that the losses surrounding the incinerator were of the order of £3 million. This figure stuck in the minds of States and public for some considerable time.

But £3 million is the figure of probable losses <u>from the date of signing the contract.</u> **In fact the <u>total</u> overspend due to currency fluctuations and overspends will be over £11 million.**

In this submission I use the figure actually presented to States members in Propositions 72 and 73 in 2008 – namely £106.31 million – as the baseline. Then any cost over and above what the States voted in July 2008 shows up in a clear and transparent way.

1 INTRODUCTION

1.1 The thrust of the Panel's questioning so far, as reported in the media has been to focus on the failings on and around November 14th, the date the contract was signed.

1.2 As a result the blame seems to be settling on the lack of expertise within the Treasurer's Department, and in particular, on the possible failings of the Treasurer himself as the man in charge at the Treasury.

1.3 In fact the evidence of the Comptroller & Auditor General's report is quite clear and it shows that the problem goes back <u>much earlier</u> and that it is <u>much wider</u> than that.

1.4 I suggest to the panel that they may have been hoodwinked into looking under a few stones and leaving most of the other stones untouched. Or to put it another way: this is a big can of worms and you need to open the whole tin and take out <u>all</u> of the worms. [1]

1.5 If the Panel fails to properly report on all aspects, it will damage the reputation of Scrutiny (even though technically PAC is not a scrutiny panel) by not holding Ministers effectively to account on a matter of great importance.

1.6 Further, their report would be incomplete, it would fail to address all the issues and it would therefore fail the taxpaying public. The goal is presumably that this sorry tale of concealment, dishonesty and disregard for the express wishes of the States must never happen again.

2 COST INCREASES – BEFORE THE CONTRACT WAS SIGNED IN NOVEMBER

2.1 On November 14th 2008, the contract was signed and subsequently arrangements were made for payment, purchase of Euros etc.

2.2 The fact that the exchange rate was not frozen at this date seems to have been the main focus of both the PAC investigation and the Comptroller and Auditor General's report. It has certainly been the aspect which has been consistently highlighted in the media. And this emphasis throws the spotlight on the officials at the Treasury and the States Treasurer himself.

2.3 The fact that the Comptroller and Auditor General took as his baseline sum for comparisons, not the amount voted by the States, but the amount at the signing of the contract, bears out this view.

2.4 **By November 14th the extra cost over the baseline cost of £106.31 million was already £7.90 million.** [2]

2.5 **Of this sum, £5.25 million was due to currency fluctuations and the remaining sum of £2.65 million was due to other additional expenditure not approved by the States. (All figures rounded)** [3]

2.6 **This additional expenditure of nearly £8 million pre-dates the signing of the contract. So freezing the exchange rate at the point of signing has no bearing on this loss.**

2.7 This submission focuses on that loss. It is almost certain to turn out greater than the losses which the States will incur from the date of the signing of the contract onwards, and it seems to have slipped under the radar.

2.8 For example, P73/2008 states at para. 3.2 that "This exchange risk will be eliminated upon the signing of the contract with the preferred bidder at which time the Euro/Sterling rate will be deemed to freeze for the purposes of the contract payments." But the point is that the loss has already been incurred by that time.

2.9 So the question is: how did this additional £8 million loss arise?

3 SOME BACKGROUND CONSIDERATIONS

3.1 The Funding Working Group of the Project Board for the new incinerator "considered draft terms of reference for the financial advisers to be appointed." (Comptroller and Auditor General's report Para. 72) These terms of reference included:

ii) To investigate and advise the States of Jersey's Transport and Technical Services and Treasury and Resources Departments on the most appropriate (best value for money) funding source for the Energy from Waste Project, contributing to the Project Board Working Group on funding as required.

(xiv) To monitor the commercial position and sensitivity analyses consequent on shifts in risk apportionments as the programme developed throughout the procurement

process.

3.2 From the outset, the expectation was that the contractors would bid in sterling and be paid in sterling. This would remove currency risk from the States. The importance of this risk was known about from November 2007 onwards, following the appointment of Deloitte and Touche as financial advisers to the project. [4]

3.3 However reality intervened in the form of a memo dated 24th January from CNIM, the eventual winners of the contract, at that time "one of the bidders." They suggested that they would not give a straight sterling price in the following words:

"We propose to submit a price splitted in Pounds and Euros and to fix the conversion rate if we are declared preferred bidder."

This suggestion was accepted, and so currency risk was now built in to the entire process of selecting a bidder. [5] However it should be noted that CNIM are here suggesting to TTS that they would, if successful, hedge the currency risk

3.4 In his evidence to the PAC, John Richardson said he first became aware that there may be a Euro currency risk "when the tenders came in . . . . in April 2008"

4 RESPONSIBILITY - TTS

Currency fluctuations and TTS's role

4.1 TTS were clearly responsible for managing the costs of the Project. The costs of the Project included currency fluctuations risk from the point when all concerned agreed that the bids would not all be denominated in sterling.

4.2 So for example, if a UK company had been selected, or a bid denominated in sterling, then the Euro risk would have been zero. And this selection process was controlled by TTS.

4.3 This must include the possibility of the contractor taking the risk of the currency fluctuations and quoting for hedging this. CNIM in their email of January 24th in fact suggested that they would do this (see above, para. 3.3). And much much later, in October, TTS asked for precisely this. [6]

4.4 **Treasury were clearly responsible for "finding the Euros" if Euros had to be found. But the question of whether in fact Euros would have to be found, and <u>how many</u> Euros would have to be found was the responsibility of TTS.** And TTS controlled the bidding process. So on an unbiased reading of the situation the question of currency risk was a divided responsibility – or, better put, a shared responsibility. Perhaps the difference between "divided" and "shared" is at the root of this whole sorry mess.

4.5 The Chief Officer of TTS, John Richardson, insisted at the PAC hearing on 11/05/09 that not only finding the money, but also managing the currency risk was the exclusive preserve of the Treasury, and further that they had not asked for help, and that if they had, then appropriate steps would have been taken by him to acquire the necessary expertise.

4.6 But in fact a more practical approach was adopted. On April 3rd a report about funding options was presented to the Council of Ministers. (Comptroller and Auditor General's report Para. 90) This report was prepared by SIMT&R <u>incorporating Deloitte's material</u> on funding options and currency exposures. (Comptroller and Auditor General's report Paras. 86 - 89)

4.7 So Deloitte, who were retained as TTS's advisers, wrote a detailed memorandum for a T&R official. This procedure was agreed between SIMT&R and DWSPT&TS (see Comptroller and Auditor General's report Para. 84). "This was confirmed in an e-mail from Deloitte to DWSPT&TS and others on 17 March 2008 which confirmed that "options around currency hedging" represented one of the principal areas to be dealt with by Deloitte in the context of the work required to complete the report." This work falls within their draft terms of reference (see para. 3.1 above)

4.8 This is entirely to be expected, the people with the necessary expertise were being used. But it does show that the clear and hard demarcations did not exist. The Funding Working Group must have known that this advice was being asked for and accepted.

4.9 Babtie Fichtner also contributed to the discussions re currency. They got it right on the 13th February – "a sizeable risk" (Comptroller and Auditor General's report Para. 83) and disastrously wrong on May 16th - "*Whilst CNIM can hedge if you insist, …………………. it is probably better for you to arrange the hedging so it is open." (Comptroller & Auditor General's Report Para. 96).*

4.10 As an aside, were TTS more inclined to listen to Babtie-Fichtner, who had been paid millions in consultancy fees over the Waste Strategy and the Energy from Waste plant, or to Deloitte and Touche, drafted in in November 2007 and paid less than £100,000?

4.11 In October 2008, negotiations took place with the then selected bidder about what they would charge to fix the Euro element of the contract. (Comptroller and Auditor General's report Para. 120) The subsequent email discussion was led, quite rightly, by DWSPT&TS, i.e. from within TTS. As I said, <u>how many</u> Euros would have to be found was the responsibility of TTS. <u>And it always had been.</u>

4.12 The Funding Working Group of the Project Board was chaired by John Richardson. If he is not responsible for funding, as he claims he was not, then this is a strange arrangement. Why is he chairing this group?

4.13 The question of chairing the Funding Working Group is important. 'If they (the Treasury) had come to me with their problems, then I would have . . . "as John Richardson said at the hearing on 11/05/09[7]. What did they discuss at the Funding Working Group, if not such issues as these? And more importantly perhaps, how did they discuss such matters?

4.14 Chairing also means that the Minutes are taken from the TTS side and not the T&R side. Again, curious, given that PAC were told by John Richardson, the person with overall charge of the project, that the Treasury had taken complete charge of the funding.

additional unauthorised expenditure

4.15 The additional expenditure of £2.65 million mentioned above in para. 2.5 includes an additional £3.9 million for architectural requirements, and savings of £1.9 million achieved by reducing the specification of the incinerator.

4.16 The motive for these savings was no doubt to avoid an even bigger overspend due both to the architectural demands of the Planning Minister and to the significant overshoot being caused by the fall in value of sterling.

4.17 We are assured that these cuts will not prevent the "adequate functioning of the facility." Remember these are not small sums – we are talking about millions here and millions there, being added to, and taken away from, a budget already agreed by the States. For the full detail of these financial goings-on see Appendix 1.

4.18 Part of the reason for the secrecy at TTS about the true costs was that they were acting ultra vires. Paras. 125 and 126 show clearly that the amount for contingency had been eaten away by all the additional costs, and TTS were in a budgetary fix.

4.19 This may very well have affected relations between TTS and the Treasury. PAC might like to consider how they should have acted – carry on fudging, or come clean? And a question that PAC should ask: were these overspends ever formally notified to the Treasurer of the States or formally discussed within the Funding Working Group?

5 RESPONSIBILITY - CHIEF EXECUTIVE

5.1 At the panel hearing on 11/05/09 Chief Executive Bill Ogley washed his hands of responsibility. I am aware that the Panel has looked at this aspect. I simply invite the panel to consider the following:

- The scale of the project was unprecedented – 1/6 of the total States budget
- The scale and type of the risk was unprecedented
- The impact of this project on States finances overall
- There was no active monitoring of this project
- It was not discussed as an agenda item at the Corporate Management Board
- The role of the Chief Executive to give guidance and support to chief officers
- Spending money that is approved is clearly part of the Treasurer's role – but what about spending money that is not approved?

5.2 The Corporate Management Board discuss risk and have a sub-committee to do this, which presumably reports to the main Board. But this risk was not discussed.

5.3 I invite PAC to take an unbiased view of the situation and consider whether the above is satisfactory, and whether sole responsibility can be laid at the door of the States Treasurer.

6 RESPONSIBILITY - COUNCIL OF MINISTERS

6.1 On April 3rd 2008 a report detailing the funding options and the currency risk and how the risk could be hedged at that time went to the Council of Ministers. Included in the report was a clear statement of how Euro purchasing options worked.

6.2 Did the Council of Ministers appreciate how serious this situation of currency exposure was? Was there any discussion or explanation? Was the advice "filtered out"?

6.3 When the highly misleading propositions P72 and P73 were lodged, had the Council of Ministers approved their final form?

7 RESPONSIBILITY – TREASURY MINISTER

7.1 On 18th May, a Sunday, SIMT&R sent a detailed briefing paper to the Treasury Minister "asking the Minister to consider the draft proposition of the Minister for Transport and Technical Services to procure an Energy from Waste Plant and to agree a preferred funding solution for the plant and to lodge a report and Proposition (which was attached in draft form)." (Comptroller and Auditor General's report Para. 101)

7.2 This briefing paper set out the range of risk due to currency fluctuation. A "worst case scenario" would lead to an extra cost of £6 to 7 million at the date of signing, due to changes in the Euro/£ rate between the date of writing and the projected date of signing, October 31st. This assumed the Euro rate was frozen at that date. It also set out the cost of hedging this risk, presenting the Minister with an indicative quote of £1.97 million. (Comptroller and Auditor General's report Para. 103)

7.3 So on May 18th, 2 days before the proposition was lodged, the Treasury Minister knew the scale of the risk, knew that the risk arose out of possible exchange rate movements <u>between</u> debate and signing, and knew how much it would cost to hedge that risk.

7.4 None of this information was included in P73.

7.5 And yet the risk arising between the debate and the signing of the contract was not only quantified in the briefing paper, but the paper promised the Minister a further paper when the States had approved the procurement, "*recommending how the risk should be managed between the approval date and the signing of the EPC contract.*"

7.6 So the officers at the Treasury were quite clear what the position was in May and what further action had to be taken immediately, and had informed their Minister. But according to the JEP, the Treasury Minister at the time, Terry Le Sueur told the PAC recently that he knew of the risk "in early November" (JEP July 16th page 7)

7.7 I find it significant that SIMT&R, who wrote the briefing paper, resigned on Tuesday 11th, just 2 days after the States debate.

7.8 The further paper referred to in Para. 7.5 above was never submitted. [8]Perhaps because SIMT&R had resigned? This paper might have saved the day . .

7.9 Instead of informing States members correctly in accordance with SIMT&R's briefing paper, P73 informed the States that the exchange rate would be "managed" and that "this exchange risk will be eliminated upon the signing of the contract with the preferred bidder:" (See footnote for full quotation. [9])

7.10 This is of course too late, as the briefing paper sent to the Minister had made clear. The risk arose <u>between</u> the States debate and the signing of the contract. P73 misled the House.

7.11 P73 referred to the purchase of an Energy from Waste plant from CNIM "for a fixed price of £93.35 million." Compare this to the observation in a Babtie Fichtner memo sent on 16th May: "The fixed sterling price of £93.35M is therefore only valid at a €/£ rate of 1.27285." [10]

7.12 In addition, by the time the States voted on the scheme on July 9th, just 6 weeks after the propositions were lodged on May 20th, the cost of the scheme was already £109.93 million (see Comptroller and Auditor General's report Table at para. 33), that is, £3.62 million more than was written down in the two propositions P72 and P73 2008.

7.13 The States were not informed of this increase in the cost. There can be no doubt that Ministers, in particular, the Minister for TTS at the time, Guy de Faye, and the Treasury

Minister at the time, Terry Le Sueur, were aware of this increase. The currency risk was known about from soon after the appointment of Deloitte and Touche as Financial Advisers to the project group (around November 1st 2007, (see Comptroller and Auditor General's report, para. 75) and was in the minds of the Project Group from then on. (see paragraphs 79, 80, 81, 82, 83 et seq.).

8 MISLEADING THE STATES

8.1 Departments do not present propositions to the States. Officers prepare, they discuss, they advise, but the political responsibility, the absolute responsibility, especially in a project as big as this, lies with Ministers. In this case, the TTS Minister, the Treasury Minister and presumably also the Chief Minister were responsible.

8.2 In presenting P73 to the States, Ministers broke the Code of Conduct for members repeatedly, in that they

- Concealed the actual cost at the time of the debate, even though it was £3.6 million more than what was in the proposition
- Concealed the level of currency risk attached to the project
- Concealed the likely cost of hedging that risk
- Claimed that the purchase of the Energy from Waste plant was at a "fixed price" when it was not.

Ministers broke the Code by not being "as open as possible about all the decisions and actions that they take" (Standing Orders Schedule 3 "Openness") and because by their actions they reduced "the public's trust and confidence in the integrity of the States and its members in conducting public business" (Standing Orders Schedule 3 "Leadership")

9 DEPARTMENTS AND MINISTERS ACTING ULTRA VIRES

9.1 P73 authorised the expenditure of £106.31 million. [11]

9.2 The States did not approve at any time the additional sum of £7.9 million made up of £5.25 million due to currency fluctuations and £2.65 million due to other additional expenditure which had been incurred at the time of the signing of the contract on November 14th 2008. (All figures rounded)

9.3 How then did the then Minister for TTS Guy de Faye and his accounting officer at the time John Richardson, think that it was proper, or even legal, to sign the contract?

9.4 And was this overspend ever notified formally to the Treasurer of the States?

10 FURTHER QUESTIONS

10.1 Who set up the Funding Working Group? Why was John Richardson chairing this group when he was not responsible for funding?
10.2 What did they discuss at the Funding Working Group? How did they discuss this? How did it all come to this?
10.3 Was the overspend of £7.92 million at the time of signing the contract ever formally notified to the Treasurer of the States, and if so what was his response?
10.4 Was this overspend ever formally discussed in the Funding Working Group?

10.5 Are the claims that the £2 million cuts to the incinerator have not affected its performance, in particular emissions standards, valid?
10.6 How can Ministers and officers spend money the States have not approved?
10.7 How can it be that this vast project never came to the Corporate Management Board?

11 CHALLENGES FOR PUBLIC ACCOUNTS COMMITTEE

11.1 Ministers and officers have spent millions with no authorisation from the States

11.2 Ministers and officers have withheld vital information from the States prior to debating the island's biggest single capital project

11.3 Standing Orders which demand honesty and leadership have been systematically broken by Ministers.

11.4 The challenge to PAC is to recommend actions which will ensure that this does not happen again.

11.5 We need

a) to provide proper support for backbenchers and Scrutiny to ensure scrutiny with teeth so that Ministers never run riot like this again. The costs of failure in this regard are simply too high.

b) to enforce Standing Orders with sanctions proportionate to the scale of the offence. In this case, clearly severe sanctions are appropriate.

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[1] I understand that the panel may in fact looked more widely and further back than I believe. In which case apologies. In this submission I tell what I see as the full story.

[2] see Comptroller and Auditor General's report, top line of Table in Para. 33.

[3] see Appendix 1, derived from figures in Comptroller and Auditor General's report, Table in Para. 397.

[4] See Comptroller and Auditor General's report, Paras 74 and 75

[5] Comptroller and Auditor General's report, Paras. 80 and 81

[6] see Comptroller and Auditor General's report paras. 116 et seq.

[7] Now at no time - I repeat, at no time - did any Treasury officer or the Treasurer come to me and say: "The goalposts have changed, the scope of this project has changed, we cannot manage the split of it." They accepted that work and they carried on with that element of it, which was the euro management. Now, I cannot be clearer than that. No one ever came to me from the Treasury and said: "We are now getting into different waters. It is a completely different area where we need specific advice, we have not got the capacity or the resource to provide it. You will have to do it on your own." Had they, and I think this is absolutely key, certainly from my position as, certainly from my position as Accounting Officer, had the officers or the Treasurer come to me during the evaluation period where it was very clear we had the euro element to manage, and we had seen the euro rate fall during that period . . . . . But at no stage did anyone from the Treasury ever come to me and say: "We cannot manage this. We need specialist advice. We need different advisers." Had they, I would have used the mechanisms I have used for all the other appointments, and the first line would have been to . . . . .

[8] Comptroller and Auditor General's report Para. 365

[9] *"The engineering and procurement construction (EPC) contract is partially subject to currency risk with certain agreed payments being quoted in Euros. The States therefore has a currency exposure to the rate of exchange between the euro and sterling.*

This exchange risk will be eliminated upon the signing of the contract with the preferred bidder at which time the Euro/Sterling rate will be deemed to freeze for the purposes of the contract payments. All contract payments will be in sterling.

The Treasury has conducted a sensitivity analysis of the currency exposure and obtained expert advice on anticipated currency fluctuations. As with all States capital projects the Treasury will monitor and manage the fluctuations risk. The cost of any currency fluctuations will be met from the Capital Projects Reserve vote in the event this increases the cost of the project"

[10] Comptroller and Auditor General's report para. 96

1.1 To be precise, in voting for P72 the States voted £102.81 million from the consolidated fund in addition to the sum already voted of £3.5 million, making up the total cost for the Project of £106.31 million (see P72, Table in para. 2)