



SAINT HELENA **AUDIT SERVICE**

BULK FUEL INSTALLATION



VALUE FOR MONEY REPORT

V01 - MAY 2009

Value for Money audits are conducted by the Audit Service on behalf of the Legislative Council, in order to determine whether St Helena Government resources have been used with proper regard to economy, efficiency and effectiveness.

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Report Distribution: Financial Secretary, Chief Secretary, and Legislative Council.

The executive summary is provided to the Public Accounts Committee and Audit Committee.

It is available to the public through our website (www.audit.gov.sh), in the Public Library and at the Audit Service Office.

BULK FUEL INSTALLATION

EXECUTIVE SUMMARY

The Value for Money Audit of the Bulk Fuel Installation (BFI) forms part of the Value Money plan for 2008/09. This plan of audits is conducted by the Audit Service on behalf of the Legislative Council in line with the Audit Ordinance (Cap 143 at section 6.2.a) and aims to determine whether resources have been used with proper regard to economy, efficiency and effectiveness.

The Bulk Fuel Installation imports, stores and wholesales all St Helena's diesel and petrol. Its turnover for the year ended 31 March 2007 was £2.4 million.

The Bulk Fuel Installation is managed for Saint Helena Government (SHG) by Solomon & Company (St. Helena) Plc ('Solomon's'). Solomon's, who are majority owned by SHG, own all the petrol stations and so are, along with the power station, one of the two major customers of the BFI. Solomon's have managed the BFI since its construction was completed in 1987.

The scope of our audit does not cover the operations of fuel retailers. It also does not cover the level of duty payable on diesel and on petrol which are set by the Governor in Council, with the most recent increase being on 1 June 2008 when the duty on Petrol was raised to 48 pence per litre. SHG has commissioned consultants to review the shipping arrangements for bulk fuel and received a draft report in May 2008. We have reviewed this draft and make some comments in relation to import and shipping arrangements, but have not conducted detailed fieldwork in this area.

Based upon the work undertaken and the findings detailed in the body of this report, the overall opinion is given below. The range of possible audit opinions given for Value For Money is good, adequate and inadequate. Definitions of the audit opinions can be found at Appendix A to the main report.

BULK FUEL INSTALLATION

ADEQUATE

	Management arrangements are generally conducive to achieving Value For Money – but further important enhancements could be made.
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We found the day to day operations of the BFI within the scope of our review to be well managed by Solomon's and Co. We have made recommendations to SHG in relation to powers they retain direct responsibility for (pricing policy, contracting agents, major investments) and in relation to the way that SHG manages Solomon's as their agents.

Overall ten recommendations were made from this audit for SHG to consider. The four high priority recommendations are as follows:

1. We recommend that Executive Council should agree a pricing policy for the BFI and allow officials to make pricing decisions in accordance with the policy.

2. We recommend that when the arrangements for the management of the BFI are next considered, and within two years at the latest, expressions of interest are sought from alternative potential managers.
3. We recommend that the resale provisions of the agreement with Solomon's be considered alongside the development of a Competition and Monopolies Policy.
4. We recommend that, should the airport 'pause' continue to the point where a new tender procedure would be required, SHG consider applying for funding to enable investment in both storage capacity and mooring infrastructure.

The assistance given by all SHG staff and third parties is acknowledged with appreciation. A list of those involved is included at Appendix C.

1. FINDINGS AND CONCLUSIONS

1.1 The main findings and conclusions are presented here and are based upon the actual work undertaken and evidence gathered.

Pricing Policy

1.2 The price at which the BFI sells fuel is determined by Executive Council. In our 2003 Value for Money Audit of the Bulk Fuel Installation, we recommended that Executive Council should agree a sales pricing policy, to ensure that price changes are effected as required without delay. Since then there has been some progress and Executive Council now make pricing decisions with reference to a target markup on landed cost. But decisions on pricing are still made by Executive Council, in the absence of any well defined policy, rather than by officials operating within a policy adopted by Executive Council. We consider that the latter would be preferable. It would avoid the delays in making unpopular price increases that have been seen on several occasions. These have resulted in the BFI making losses over several quarters and higher price rises eventually having to be made in order to recover these losses as well as to reflect increased

fuel costs. We recommend that a pricing policy be put in place. (See recommendation 1)

1.3 A pricing policy can ensure that a balance is struck between the desire to avoid frequent price changes and the desire to avoid large price changes, but a pricing policy cannot isolate St Helena from the effects of changes in international oil prices over the economic cycle, or from permanent increases in the costs of importation.

1.4 A further consideration in setting pricing policy is the lack of 'backing' for the asset replacement fund. The Asset Replacement Fund is established to provide funds for the replacement of the fixed assets of the BFI. The fund represents a claim on the assets of the BFI as a whole, including equipment, stocks of diesel etc, rather than particular assets of the fund. Currently there are insufficient liquid assets (cash and investments) to match the value of the fund. The result is that the BFI does not actually have as much money available to replace assets as the balance on the Asset Replacement Fund might lead one to expect.

1.5 In our 2003 VFM report on the BFI we recommended that 'The backing for

the Asset Replacement Fund should be restored to the appropriate level as soon as possible' and the Financial Secretary responded: 'Agreed, but this will depend on an appropriate pricing structure being agreed by Executive Council'.

- 1.6 Executive Council did not adopt a formal policy on pricing, but did keep prices at a level that led to the backing of the Asset Replacement Fund being restored by March 2004 and maintained through the following year.
- 1.7 In the year ending 31 March 2006, the backing of the Asset Replacement Fund was eroded due to losses incurred and the backing had not yet been restored at the end of the following year.
- 1.8 In any case, the balance on the Asset Replacement Fund is arrived at by transferring depreciation on assets and some interest received from the profit and loss account, rather than being based on an estimation of future replacement costs, so there is no solid reason to believe that this fund will provide sufficient money to pay for the replacement of BFI assets as they come to the end of their useful lives. Similarly it is possible that the amounts in the Asset Replacement Fund are excessive.
- 1.9 We recommend that a pricing policy be based on an agreed understanding as to the costs that are expected to be covered by the revenues of the BFI – i.e. whether covering operating costs and replacement of assets, as at present, is sufficient or whether additional investments in expansion or improvement should also be funded from BFI revenues. A pricing policy

will need to take into account the requirements for investments in assets, either by restoring the backing of the asset replacement fund, or preferably, by forecasting capital expenditure requirements and ensuring that prices are set a level which would allow the forecast expenditure to be funded.

Contracting

- 1.10 SHG awarded the contract for the management of the BFI to Solomon's in 1987 when the BFI was built. The contract was renegotiated in 2006. In neither case was a tendering process undertaken, nor could we find any evidence that any alternatives were formally considered by Executive Council before deciding to renegotiate with Solomon's in 2006.
- 1.11 The general policy, as outlined in the Contract Regulations is that large contracts should be awarded on the basis of competitive tender. The Governor has the power to waive Contract Regulations where it is in the public interest to do so and in any case the Financial Secretary, who signed the new contract on behalf of SHG, has the power to authorise variations to contracts. Therefore we do not consider that a breach of the Contract Regulations occurred.
- 1.12 We have already made recommendations elsewhere that Contract Regulations should be amended to explicitly cover the extension of contracts, which at the moment are dealt with under the provisions covering variations to contracts.
- 1.13 We consider it unlikely that the contract fee negotiated is such that

international contractors would be interested in doing it for less, and do not ourselves know of any potential contractors on island with the requisite knowledge of both procurement and the operation of bulk fuel installations. Nevertheless seeking expressions of interest in the contract might have identified potential alternatives and would have been preferable in terms of transparency. Given the scale of the BFI's operations and their vital role in the economy of the Island this contract is of particular interest to the public and we consider that expressions of interest should be sought out in future. (See recommendation 2)

- 1.14 An upward revision of the contract fee after an eighteen year period is certainly not unreasonable and the level of the current fee is also not unreasonable in relation to the estimated management time involved.
- 1.15 The management agreement requires that the BFI sell directly only to the Saint Helena Fisheries Corporation, the Power Station and to Solomon's itself. It covers the prices at which Solomon's is entitled to sell fuel on to others. This raises issues of competition policy that should be examined as part of work already planned. (See recommendation 3).

Importation of Fuel

- 1.16 SHG has commissioned consultants to review the shipping arrangements for bulk fuel and received a draft report in May 2008. SHG have yet to decide upon actions in response to the report. The report assumes that a new bulk fuel installation will become available as a result of the airport construction project. The largest

savings in annual fuel costs would be dependent on investment in both storage capacity and mooring infrastructure, to enable St Helena to be served by fewer deliveries by bigger vessels.



The consultants also discuss smaller potential savings from joint arrangements with Ascension Island and from shifting from Lead Replacement Petrol to Unleaded Petrol. (See recommendations 4 and 5).

Contract Management

- 1.17 Solomon's manages the Bulk Fuel installation as agents for SHG and while they manage the day to day operations, SHG retains responsibility for the Bulk Fuel Installation. We reviewed the way in which SHG manages its own responsibilities for the BFI and the way in which it ensures that Solomon's fulfills its responsibilities.
- 1.18 Within SHG, responsibility for the BFI currently rests with the Financial Secretary. The Financial Secretary has many calls on her time and we do not believe it is appropriate for the Financial Secretary to be the primary point of contact for Solomon's in relation to BFI matters. The Financial Secretary is currently a director of Solomon's and the two roles, as Director and customer may be difficult to combine. Effective management of this contract requires both financial and engineering abilities. The Financial Secretary has called on the assistance of the Chief Engineer to assist on the engineering aspects and the Chief Engineer and other PW&SD staff have provided such assistance, but such assistance is carried out over and above their existing duties and is

not planned as a significant call upon the Chief Engineer's time and on occasions the Chief Engineer has not been able to provide the desired level of support. We recommend that a less senior officer be appointed as SHG's Authorised Representative. (See recommendation 6)

1.19 By its nature as a store of flammable liquid, because of the risks associated with discharging fuel tankers, and because of its location, the BFI poses a risk of disaster. It is SHG's responsibility to ensure that such risks are appropriately managed. While work has been done recently to identify and mitigate such risks, more remains to be done. (See recommendation 6)

1.20 Solomon's prepares a monthly report for SHG on the BFI, and the management agreement specifies that such reports include indicators on debtors' recovery, return on investment, fuel losses, maintenance, health and safety, and staffing. Indicators of debt recovery and return on investment are not routinely reported. (See recommendation 7)

1.21 While Solomon's prepare a budget for the BFI each year for their own use, this is not given to SHG. A budget and monthly budget versus actual reports from Solomon's would help SHG's authorised representative to identify departures from expectations and help provide assurance that remedial actions were taken where appropriate. (See recommendation 8)

Investment

1.22 Having operated the BFI for over twenty years, Solomon's have expertise in the management of the bulk fuel installation and in the

procurement of fuel that SHG does not.

1.23 The management agreement also provides for Solomon's to manage the cash position of the BFI so that income is maximized through appropriate investment of surplus funds. SHG's Finance Department manages the investment both of SHG's own funds and those of the Currency Fund and would seem to have a capacity in this area at least equal to Solomon's. It is frequently possible to earn higher returns and incur lower charges in percentage terms, when investing larger sums of money. It is therefore difficult to see what advantage SHG obtains by contracting out the investment of surplus funds. (See recommendation 9)

Solomon's Performance

1.24 We have analysed Solomon's performance in the management of the installation, by looking at the monthly reports provided to the Financial Secretary and by analysing the overheads of the BFI.

1.25 Losses of gasoline are a continuing area of concern and losses of both gasoil and gasoline are closely monitored. It is normal for any bulk fuel installation

to lose some fuel due to evaporation etc, but fuel

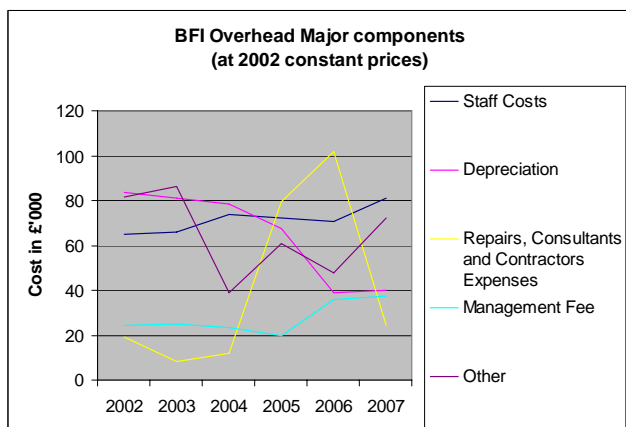
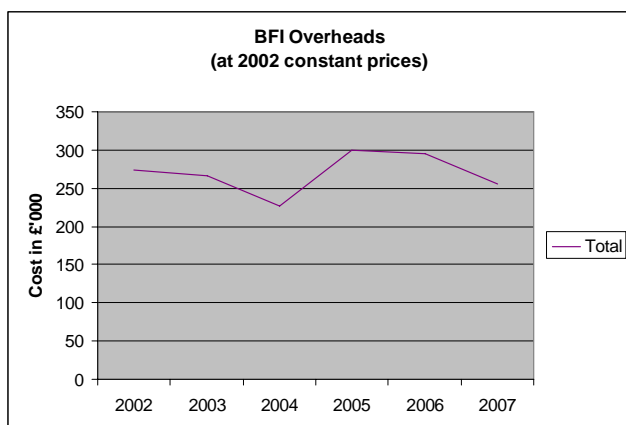


losses can also be caused by leaks from tanks or pipes or due to misappropriation. The losses of gasoil have been lower (below 1,000 litres per month for every month since April 2004, with one exception), despite stocks of gasoil being higher. This is

not entirely unexpected as gasoline is the more volatile fuel and so is more prone to evaporation, but losses do not follow the seasonal pattern that would be expected if losses were entirely due to evaporation.

1.26 Solomon’s staff and the Chief Engineer have been investigating possible reasons for the losses, checking pipelines, etc, and improvements appear to have cut losses which have been much lower in the last four months. Problems have however recurred repeatedly over the last few years and this area requires continued close monitoring by both Solomon’s and SHG.

1.27 The BFI’s overheads over the period 1st April 2001 to 31st March 2007 are shown below:



1.28 Overall, Solomon’s have performed well in containing the overhead costs of running the BFI.

1.29 The cost of repairs, consultants and contractor expenses was high in 2005 and 2006 due principally to the costs of repairs to tanks that required off-island engineers.

Demurrage

1.30 One area where avoidable costs appear to be incurred is in demurrage charges. These are charges from the tanker owners that are made when offloading of the tanker takes more than a day. At the moment it is not considered safe to discharge fuel from the tanker when it is dark, and this increase the likelihood of demurrage charges being incurred. Further enhancements to the lighting, so that any leaks from the pipe could be promptly detected at night, might enable the Harbour Master to permit nighttime discharging of fuel, at least when sea conditions are good. Discussions between the Harbour Master, Environmental groups, Solomon’s and others have yet to identify a way forward. The decision is complex as it involves investment appraisal, risk assessment and balancing of potential financial gains with risks to the environment and to personnel. The lifetime of the present BFI is also a factor in the decision and this in turn depends on the airport decision. (See recommendation 10)

2. MANAGEMENT RESPONSE AND ACTION PLAN

	RECOMMENDATION	Officer responsible for implementation	Priority	Implementation expected to be complete by: (Month, Year)	Management Comments
1.	<p>We recommend that Executive Council should agree a pricing policy for the BFI and so that officials may make pricing decisions in accordance with the policy.</p> <p>Such a policy should be based on an agreed understanding as to the costs that are expected to be covered by the revenues of the BFI – i.e. whether covering operating costs and replacement of assets, as at present, is sufficient or whether additional investments in expansion or improvement should also be funded from BFI revenues. It should take into account the requirements for investments in assets, either by restoring the backing of the asset replacement fund, or preferably, by forecasting capital expenditure requirements and ensuring that prices are set at a level which would allow the forecast expenditure to be funded.</p>	Financial Planning Manager	High	March 2010	<i>This is currently already planned in conjunction with the establishment of a Fuel Pricing Authority.</i>

	RECOMMENDATION	Officer responsible for implementation	Priority	Implementation expected to be complete by: (Month, Year)	Management Comments
2.	We recommend that when the arrangements for the management of the BFI are next considered, and within two years at the latest, expressions of interest are sought from alternative potential managers.	Financial Secretary	<i>High</i>	<i>Dependant on outcome of consultation process.</i>	<p><i>Without an airport it is unlikely that any other company would be able or willing to undertake the management of the BFI. Furthermore, the existing management agreement can only be terminated in the event of a breach of the agreement or in exceptional circumstances.</i></p> <p><i>A new expanded BFI may constitute exceptional circumstances and if funding was forthcoming then a new fuel contract would be tendered in line with the new installation.</i></p>
3.	We recommend that the resale provisions of the agreement with Solomon's be considered alongside the development of a Competition and Monopolies Policy. (The development of a Competition and Monopolies Policy, according to the Sustainable Development Plan, page 62, and key action for 2007/08 under the responsibility	Financial Secretary	<i>High</i>	<i>Pending development of a Competition and Monopolies Policy</i>	<i>Agreed that this issue should be considered when a Competition and Monopolies Policy is developed. However, this is not in the current work plan. We do not agree that this is a High Priority recommendation.</i>

	RECOMMENDATION	Officer responsible for implementation	Priority	Implementation expected to be complete by: (Month, Year)	Management Comments
	of the Finance Department.)				
4.	We recommend that, should the airport 'pause' continue to the point where a new tender procedure would be required, SHG consider applying for funding to enable investment in both storage capacity and mooring infrastructure.	Financial Secretary	<i>High</i>	<i>Dependant on outcome of consultation process.</i>	<i>This has already been raised with DFID as an important requirement regardless of an airport.</i>
5.	We recommend that SHG decide how to respond to the other recommendations made in the consultants' report.	Financial Secretary	<i>Medium</i>	<i>March 2010</i>	<i>Solomon's are currently investigating alternative fuel shipping arrangements. Many recommendations are dependant on funding becoming available to increase storage.</i>
6.	We recommend that a less senior officer be appointed as authorised representative. This officer should also have responsibility for managing the risks of disaster associated with the BFI. The support required in terms of engineering (if the officer is from Finance) or Finance (if the officer is from PW&SD) should be agreed and incorporated into planning in the department concerned. The reporting arrangements from the authorised representative to	Financial Secretary / Chief Secretary	<i>Medium</i>	<i>Dec 2009</i>	<i>This would best be considered as part of the work of the Public Sector Modernisation Programme (PSMP) in reviewing the work of SHG departments and roles.</i>

	RECOMMENDATION	Officer responsible for implementation	Priority	Implementation expected to be complete by: (Month, Year)	Management Comments
	senior officers and, if thought appropriate, to a Council Committee should also be agreed by the Financial Secretary and the Chief Secretary.				
7.	We recommend that Solomon's provide regular information on debtor recovery and return on investment as required by the management agreement.	Financial Planning Manager	<i>Low</i>	<i>June 2010</i>	<i>FPM to contact Solomon's to ensure this is incorporated in monthly information.</i>
8.	We recommend that Solomon's provide annual budgets for the BFI to SHG's authorised representative and include a monthly statement of budget versus actual income and expenditure in their monthly reports.	Financial Planning Manager	<i>Medium</i>	<i>April 2009</i>	<i>Solomon's have provided a budget for 2009/10 and the monthly management accounts (as from December 2008 accounts) do now show budget versus actual comparison.</i>
9.	We recommend that responsibility for the investment of surplus BFI funds be retained by SHG to maximize returns and minimize management costs.		<i>Medium</i>		<i>Not sure I would agree with this. This would involve SHG having to manage and monitor the BFI's cashflows to result in effective investment of the BFI's funds. The current agreement could be improved by requiring indicators for performance of investments, while seeking to ensure that security and liquidity of the funds are the</i>

	RECOMMENDATION	Officer responsible for implementation	Priority	Implementation expected to be complete by: (Month, Year)	Management Comments
					<i>priorities.</i>
10.	We recommend that the Financial Secretary or an authorized representative of SHG if appointed, decide how to proceed in the matter of lighting.	Financial Secretary	<i>Medium</i>	<i>Mar 2010</i>	<p><i>Agreed but dependant on outcome of consultation on access and funding opportunities for new installation.</i></p> <p><i>Considerable work has already been done on trying to achieve a solution. However, it has not been possible to reach agreement with all parties so far.</i></p>

APPENDIX A**AUDIT OPINION DEFINITIONS**

Every Value For Money audit concludes with an overall opinion based upon individual opinions that are applied to each of the review areas identified in the scope of the audit. The range of opinions, together with an explanation of their meanings, is as follows:

<i>Value Form Money Opinions</i>	
GOOD	Management arrangements are conducive to achieving Value For Money and only minor enhancements, if any, can be identified.
ADEQUATE	Management arrangements are generally conducive to achieving Value For Money – but further important enhancements could be made.
INADEQUATE	Management arrangements are not considered to be adequately conducive to achieving maximum Value For Money.

APPENDIX B**SCOPING AND RESOURCING**

To examine whether the Project's objectives were achieved with regard to economy, efficiency and effectiveness, the Audit Service planned programmes to assess:

- Whether the outputs of the Bulk Fuel Installation are being achieved;
- Whether the management agreement is reviewed and is complied with; and
- Whether any additional duties that are carried out by Solomon's are to an adequate standard.

This was done by:

- Interviewing Financial Secretary, General Manager - Agencies (Solomon's), Harbour Master and other key SHG employees;
- Reviewing documentation relating to BFI; and
- Analysing the overhead and fixed costs.

The audit was undertaken during the period September 2008 to February 2009. The total cost of undertaking the audit was £6,300.

APPENDIX C**LIST OF PERSONS CONSULTED**

The assistance given to the Audit Service by all those listed below during the course of the audit is acknowledged with appreciation.

Names	Title	Department
Virginia Grace	Financial Secretary	Finance
Christina Henry	PA to Financial Secretary	Finance
Eric Constantine	Operations Director	Solomon's
Paul Ellick	General Manager - Agencies	Solomon's
Julie Lawrence	General Manager – Financial Services	Solomon's
Barry Williams	Harbour Master	DEPD
Kelly Clingham	Statistics Assistant	DEPD
Aldhem Garner	Clerk of Councils	OCS