NAO
National Audit Office
MALTA

An Analysis of Enemalta Corporation's Hedging Activity during 2014

Report by the Auditor General
March 2015

Table of Contents

List of Tables

List of Figures

List of Boxes

List of Abbreviations

AFC	Advisory and Finance Committee
bbl	Barrel
CAL	calendar year
CBM	Central Bank of Malta
EMC	Enemalta Corporation
EUR	Euro
FX	foreign exchange
MT	metric tonnes
n/a	not applicable
NAO	National Audit Office
ppm	parts per million
Q	quarter
RMC	Risk Management Committee
USD	US Dollar

Executive Summary

1. On 23 January 2015, the Opposition Members on the Public Accounts Committee requested the Auditor General to investigate the hedging activity undertaken by Enemalta Corporation (EMC) during 2014. This analysis include an examination of the policy, strategy and governance framework adopted by EMC with respect to its hedging function; a review of hedging agreements in force in 2014; and an analysis of the financial outcomes of hedging agreements entered into. In this context, the National Audit Office (NAO) reviewed hedging undertaken by EMC with respect to crude oil, unleaded petrol and diesel, as well as foreign exchange (FX) hedging upon the Corporation's fuel oil, gasoil, unleaded petrol and diesel requirements.

2. The NAO noted that hedging policy-related shortcomings identified in the 2013 Report, wherein the Office reviewed EMC's hedging function, largely persisted. To date, the Corporation does not have a formally documented hedging policy against which the Corporation may subsequently set its strategic orientation. One notable manifested change in terms of hedging policy was the Corporation's decision to extend hedging operations to include unleaded petrol and diesel. EMC and Enemed stated that the rationale motivating policy decisions was driven by efforts at ensuring price stability while more generally adopting a risk-averse approach.

3. This Office noted the significant improvement registered in terms of the Advisory and Finance Committee's (AFC) governance. Documentation and correspondence exchanged by members of the AFC indicated that the Committee was continuously monitoring oil and FX markets. All members of the AFC were included in such correspondence and decisions taken were appropriately authorised by the Committee Chair. Even during periods of AFC inactivity (such as the period between 12 March 2014 and 19 September 2014), the Committee members maintained a constant watch over developments. The NAO reviewed all decisions taken by the Committee and the Office established that the absolute majority of decisions were reflected in hedging deals concluded by EMC.

4. The NAO has reservations regarding the manner by which the decision to hedge unleaded petrol and diesel requirements for Q3 and Q4 2014 was taken. Documentation reviewed by this Office, which solely focused on the setting of targets, failed to provide a comprehensive account of the AFC's sourcing of final approval and the subsequent placement of order with SOCAR Trading SA. Minutes of the Petroleum Procurement Committee meeting dated 3 April 2014 indicated that the deal with SOCAR had been concluded following "*ministerial direction*". Explanations and documentation put forward by the Minister for Energy and Health, as well as by the then Chair EMC, provided an element of context, particularly in terms of the stated Government policy of price stability. Furthermore, the Minister stated that the direction provided to EMC was limited to, and in line with, Government's efforts at reducing consumer prices. In addition, the Minister claimed that EMC was advised to maintain its targets and widen its supplier base. This was corroborated by the then EMC Chair. Notwithstanding the review of emails exchanged by the AFC and clarifications put forward by the Minister and the then Chair EMC, the NAO is of the opinion that documentation detailing final approval issued by the Committee and the subsequent placement of orders with SOCAR Trading SA was incomplete. This rendered it impossible for the Office to determine the extent of ministerial direction exercised and responsibilities assumed by the AFC. Given the magnitude of the agreement reached with SOCAR Trading SA, this Office considers the lack of documentation as detracting from the process' accountability and a shortcoming in terms of governance.

5. The NAO reviewed all hedging contracts that EMC entered into with third parties. From the verification carried out, the NAO confirmed that all hedging contracts corresponded to the entries prepared by EMC, and therefore, this Office considers hedging-related data provided by the Corporation in this respect to be complete and accurate. The NAO verified that invoices and settlement statements issued by the various brokers backed all of the corresponding individual monthly settlements as reported by EMC. The Office positively noted that all invoices precisely corresponded to the settlement data recorded and provided by EMC.

6. Finally, during 2014, EMC registered a loss of €8.6 million with respect to hedging undertaken on crude oil and a loss of €5.5 million with respect to unleaded petrol and diesel hedging. Central to the loss registered by EMC with respect to hedging on crude oil, unleaded petrol and diesel were the significant market movements recorded during Q4 2014, which were not and could not have been anticipated when such agreements were entered into. On the other hand, the Corporation registered a gain of €5.5 million in terms of FX hedge undertaken for fuel oil and gasoil and an additional €2.5 million gain from FX hedges entered into with respect to unleaded petrol and diesel requirements.

1. Background and Terms of Reference

1.1 On 23 January 2015, the Opposition Members on the Public Accounts Committee requested the Auditor General to investigate the hedging activity undertaken by Enemalta Corporation (EMC) during 2014. The terms of reference adopted were as follows:

a. An examination of the policy, strategy and governance framework adopted by EMC, or its subsidiaries, with respect to its hedging function;
b. A review of hedging agreements in force in 2014; and
c. An analysis of the financial outcomes of hedging agreements entered into.

1.2 The National Audit Office (NAO) considered the investigation as an extension of audit work undertaken with respect to the period 2008 to 2011, as addressed in the Report published in July 2013 and entitled 'An Analysis of the Effectiveness of Enemalta Corporation's Fuel Procurement.' Specific reference is made to Chapter 4 of the said Report, which addressed hedging activity undertaken by EMC with respect to crude oil and corresponding foreign exchange (FX) requirements. This is an important point especially with respect to sub-point (a) cited above, as this investigation effectively adopts the findings reported upon in the 2013 Report as its point of reference, a benchmark against which to compare and contrast developments in terms of policy, strategy and governance.

1.3 With respect to sub-points (b) and (c), the NAO took into consideration all contracts that matured during 2014. In effect, this meant that hedging contracts undertaken in 2013, which matured in 2014, were in fact included in the audit review, whereas contracts entered into in 2014, yet which matured in 2015 were scoped out of this audit.

1.4 Similar to the 2013 Report, crack hedges and the trading of greenhouse gas emission allowances were scoped out of this audit. With reference to crack hedges, only one agreement was in place during 2014, which resulted in a net gain of $36,000 for EMC. However, in contrast with the 2013 Report, this analysis also encompassed the review of hedging undertaken with respect to unleaded petrol and diesel, as well as the relevant FX hedging requirements for these products.

Hedging Policy and Strategy

1.5 The NAO noted that hedging policy-related shortcomings identified in the 2013 Report largely persisted. To date, EMC does not have a formally documented hedging policy against which the Corporation may subsequently set its strategic orientation. When queries on the matter were raised with EMC, the Corporation acknowledged that it had no formal policy with respect to hedging. In this Office's opinion, such a policy could have formalised the Corporation's approach towards hedging, essentially outlining a framework governing the regulation of meetings by the Advisory and Finance Committee (AFC)[1], ensuring appropriate levels of governance and accountability, delineating levels of tolerable risk, establishing the range of instruments to be used as well as introducing monitoring and feedback mechanisms.

1.6 Although EMC provided the NAO with a document entitled 'RMC Procedures', this Office considers this as a procedure-based brief, rather than an actual policy document. This document

[1] The AFC is effectively the same committee previously referred to as the Risk Management Committee (RMC).

was also forwarded to the Office when conducting the July 2013 audit, and although the procedures provide form and structure to the Committee's operations, they do not address policy considerations, hence its inadequateness in NAO's views.

1.7 Hedging strategy-related shortcomings were similar to concerns identified with respect to policy. In essence, the Corporation does not have a formally documented strategy regulating its hedging activity. EMC stated that the Corporation was guided, in a general sense, by that stated within the RMC Procedures, which reportedly mandated the Committee to draft strategy according to prevailing scenarios with the main objective being that of risk mitigation. Following the review of the RMC Procedures, the NAO noted that the following extract bears relevance to that stated by EMC, "*The committee's main goal is to enhance and structure EMC's own risk management function and take some prudent measures in order to mitigate the corporation's financial risks, mainly the market risks related to oil commodities and foreign exchange*." Notwithstanding that stated by EMC to the NAO, the Corporation acknowledged that the situation regarding hedging strategy was as reported upon in the 2013 Report.

AFC – Governance Considerations

1.8 During the period under review, the AFC was chaired by the EMC Chairperson/Executive Chair. The NAO noted that Committee meetings were attended by a varied composition of the following: Chief Executive Officer (during the period when this role was not vested in the Executive Chair), Chief Financial Officer, Board Directors, Executive Head Finance, Financial Risk Manager, and a Central Bank of Malta (CBM) representative in the capacity of FX Adviser. The Secretary to the Committee was the Financial Controller of the Petroleum Division (now Enemed Company Limited). In total, the AFC met six times during 2014, as follows:

a. 3 February 2014;
b. 12 March 2014;
c. 19 September 2014;
d. 30 September 2014;
e. 7 October 2014; and
f. 20 November 2014.

1.9 An important development was registered with respect to the AFC in the meeting of 19 September 2014, wherein it was stated that following the Petroleum Division's set-up as a separate entity, hedging with respect to unleaded petrol and diesel, as well as corresponding FX requirements would no longer be addressed by the Committee. Instead, this function was assumed by a separate committee under the responsibility of Enemed Company Ltd. The minutes of this Enemed Committee were reviewed by the NAO; however, these were deemed tangential to this audit, as all unleaded petrol and diesel, as well as the respective FX requirements had already been hedged by the AFC for the period under review.

1.10 Aside from variations in terms of attendance from one Committee meeting to the next, NAO's concern was drawn to the resignation of the CBM representative, whose valid and specialised input was deemed by this Office as instrumental to the operations of the AFC. In the meeting dated 7 October 2014, the Executive Chair informed the AFC that the CBM representative had resigned from his role within the Committee. The AFC agreed to contact the CBM for a replacement; however, no such replacement was effected.

1.11 This Office noted the significant improvement registered in terms of the AFC's governance. Documentation and correspondence exchanged by members of the AFC indicated that the Committee was continuously monitoring oil and FX markets. All members of the AFC were included in such correspondence and decisions taken were appropriately authorised by the Committee Chair. The NAO reviewed all decisions taken by the Committee and the Office established that the majority of decisions were reflected in hedging deals concluded by EMC. One shortcoming of note identified in this respect is dealt with specifically in paragraphs 3.5 and 3.6.

1.12 Even during periods of AFC inactivity (such as the period between 12 March 2014 and 19 September 2014), the Committee members maintained a constant watch over developments. This is rendered evident by the multiple emails exchanged by the members of the Committee, with the Corporation's Executive Head Finance and the FX Adviser submitting valid contributions in this sense. During quarter (Q) 4, when the oil market registered significant fluctuations in price, the Committee members were in daily contact and closely supervising ongoing developments.

2. Crude Oil Hedging

2.1 The Office considers it important to clarify why the Corporation undertakes hedging with respect to ICE Brent crude oil, while in fact purchasing fuel oil and gasoil, utilised for the generation of electricity. EMC concluded hedges on crude oil and not directly on its underlying products, that is, fuel oil and gasoil, because the fuel market is not considered as liquid as the crude market, and therefore, an element of liquidity premium exists in trading directly on fuel oil. The Corporation's purchase of fuel oil or gasoil results in imperfect hedging, which subsequently gives rise to basis risk. EMC mitigates this risk, in terms of the Corporation's position on the crude hedging portfolio, through its hedging on the spread between the price of fuel oil and ICE Brent crude oil. This spread is more precisely termed as the fuel oil crack spread, and as indicated in paragraph 1.4, this type of hedging activity was scoped out of this audit.

Deals Concluded for 2014

2.2 The NAO reviewed the manner by which the AFC effected hedging on crude oil, paying particular attention to the volume and rates at which orders were placed and subsequently concluded. The Office observed that decisions taken by the AFC members consistently reflected the crude oil hedging deals concluded by EMC.

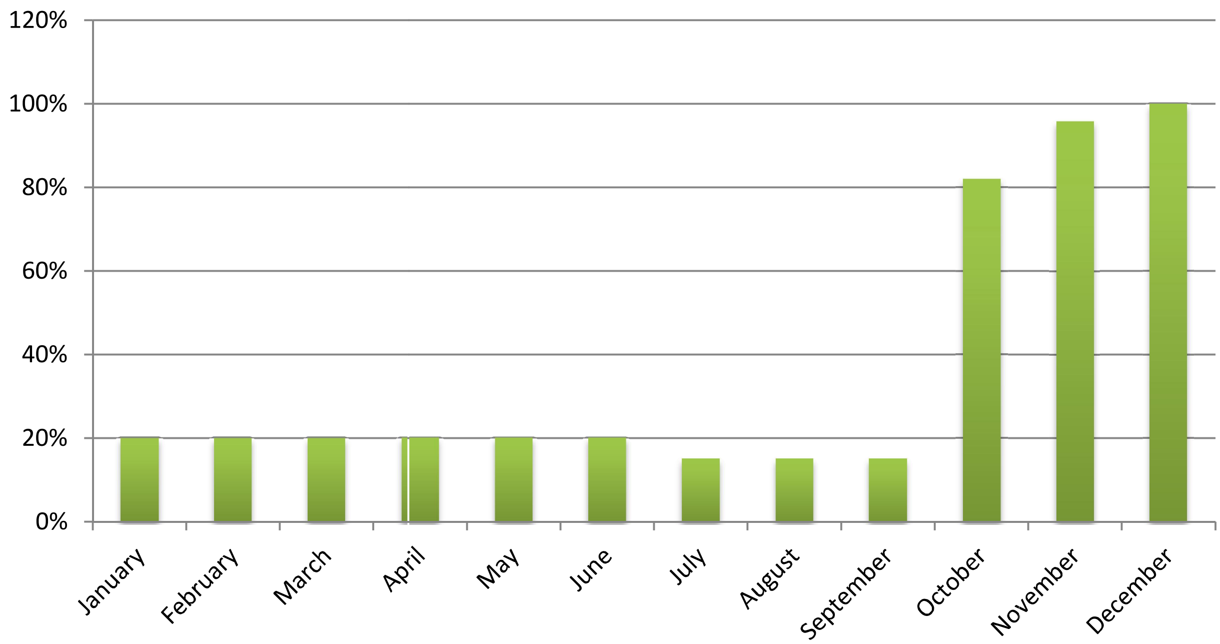
2.3 As at 1 January 2014, EMC's hedged position with respect to crude oil was as follows – 20 per cent of Q1, Q2 and Q3 2014 and 10 per cent of Q4 2014. This position was registered following decisions taken during the RMC meeting of 28 March 2013, wherein the Committee Chair indicated that the Minister had sanctioned hedging for 2014, subject to the attainment of favourable market rates. This position reflected two orders of approximately 10 per cent each for CAL 2014, which were fulfilled on 12 April 2013 at $99.60/bbl and on 16 April 2013 at $97/bbl. The latter deal did not cover Q4 2014 as it was assumed that the interconnector would be operational at this stage.

2.4 Following the orders fulfilled in April 2013, the NAO noted that other orders were placed and continuously altered by the AFC. In effect, no orders were fulfilled for a period of 16 months, as the target price was never reached. This period ended when an order of approximately 15 per cent of the remaining balance of CAL 2014 at $101/bbl was filled on 10 September 2014. In addition, during the 30 September 2014 meeting, the Committee decided to maintain a 25 per cent of the remaining balance of CAL 2014 $96/bbl target as established in AFC meeting of 3 February 2014, and to this end, the orders held with various brokers were reiterated. However, during the September meeting it was recorded that extraordinary movements in price were registered and deals were closed at $96/bbl. The volume of such deals corresponded to approximately 37 per cent of Q4 2014 requirements.

2.5 An email circulated among members of the AFC on 1 October 2014 provided context to the increased hedging activity registered by the Committee, wherein the following was stated, "*The Committee yesterday took the decision to lock in given that we had not seen these levels since June 2012. The amount hedged is significant however there was consensus to place other orders in case there is room for more correction. The benefits are that we are hedging below budget estimates and introducing an element of certainty in one of our major cost items. The risk is that* *the market will continue to slide but to mitigate that risk we have placed order at levels that would lower our average price going forward*."

2.6 Substantial hedging activity was also registered during the meeting of 7 October 2014, wherein orders for approximately 20 per cent of the remaining balance of CAL 2014 at $92/bbl were placed and concluded with two brokers. An additional order for approximately 10 per cent of the remaining balance of CAL 2014 at $88/bbl was also placed and subsequently filled on 14 October 2014. Finally, on 14 November 2014, EMC concluded a hedge for the remaining balance of CAL 2014, which balance stood at less than 10 per cent. This order was filled at $79/bbl. This transaction brought to a close crude oil hedging activity for 2014. Figure 1 indicates the Corporation's hedged position with respect to its estimated exposure for crude oil on a monthly basis.

Figure 1: EMC's hedged position with respect to crude oil in 2014



Review of Hedging Contracts

2.7 The NAO reviewed all of the crude oil hedging contracts that EMC entered into with brokers. All crude oil hedging contracts corresponding to 2014 were scrutinised by the audit team, thereby ensuring the accuracy, or otherwise, of the variables presented in these contracts. The variables analysed in this respect included the hedging counterparty, the derivative instrument used, the commodity reference price, trade date, effective date, termination date and notional quantity. In this context, the NAO confirms that all crude oil hedging contracts corresponded to the entries prepared by EMC, and therefore, this Office considers crude oil hedging-related data provided by the Corporation in this respect to be complete and accurate.

Exposure

2.8 EMC's hedged position with respect to its estimated exposure for fuel oil and gasoil for 2014 stood at a weighted average of 36 per cent (Table 1 refers). This figure is arrived at when one considers the quantity hedged, that is, 1,231,183 bbls as a proportion of the Corporation's estimated fuel requirements, in this case set at 3,455,682 bbls. On the other hand, the Corporation's hedged position as a percentage over actual fuel procured stood at a weighted average of 41 per cent, that is, reflecting the proportion between the 1,231,183 bbls hedged and the 2,994,954 bbls actually purchased.

Table 1: Analysis of exposure in 2014 with respect to fuel oil and gasoil

Quarter	Estimated exposure (bbl)	Actual fuel procured (bbl)	Quantity hedged (bbl)	Percentage hedged over estimated exposure	Percentage hedged over actual fuel procured
Q1	798,033	583,969	159,000	20%	27%
Q2	791,436	763,817	159,000	20%	21%
Q3	1,051,923	895,669	159,000	15%	18%
Q4	814,290	751,499	754,183	93%	100%
Total	**3,455,682**	**2,994,954**	**1,231,183**	**36%**	**41%**

Notes:

1. Actual fuel procured in barrels was converted from figures presented in metric tonnes (MT) utilising a conversion rate of 6.35 with respect to fuel oil (that is, 1 MT is equivalent to 6.35 bbls) and 7.45 with respect to gasoil.
2. Figures relating to actual fuel procured are reported upon as provided by EMC and no verification of the accuracy, or otherwise, of these figures was carried out by the NAO.

Gains and Losses Registered

2.9 The NAO verified that invoices and settlement statements issued by the various brokers backed all of the corresponding individual monthly settlements as reported by EMC. The Office positively noted that all invoices precisely corresponded to the settlement data recorded and provided by the Corporation. The monthly ICE Brent crude oil prices upon which settlements were effected were compared to the corresponding quoted average monthly Platts prices. The NAO noted that the figures corresponded to the prices independently reconciled by the audit team.

2.10 From this Office's review of settlements, the NAO established that the EMC registered a loss of $9,855,463 during 2014. This loss is attributable to developments that took place in Q4 2014, which starkly contrast against previous gains recorded in Q1, Q2 and Q3 2014. In determining Euro equivalence of gains and losses registered through the hedging of crude oil, the NAO utilised the European Central Bank EUR/USD exchange rate for 2014 (Table 2 refers). Applying this method of conversion, the total loss registered by EMC with respect to crude oil hedging undertaken in 2014 amounted to €8,623,434.

Table 2: Crude oil hedging settlements in $ and € with respect to 2014

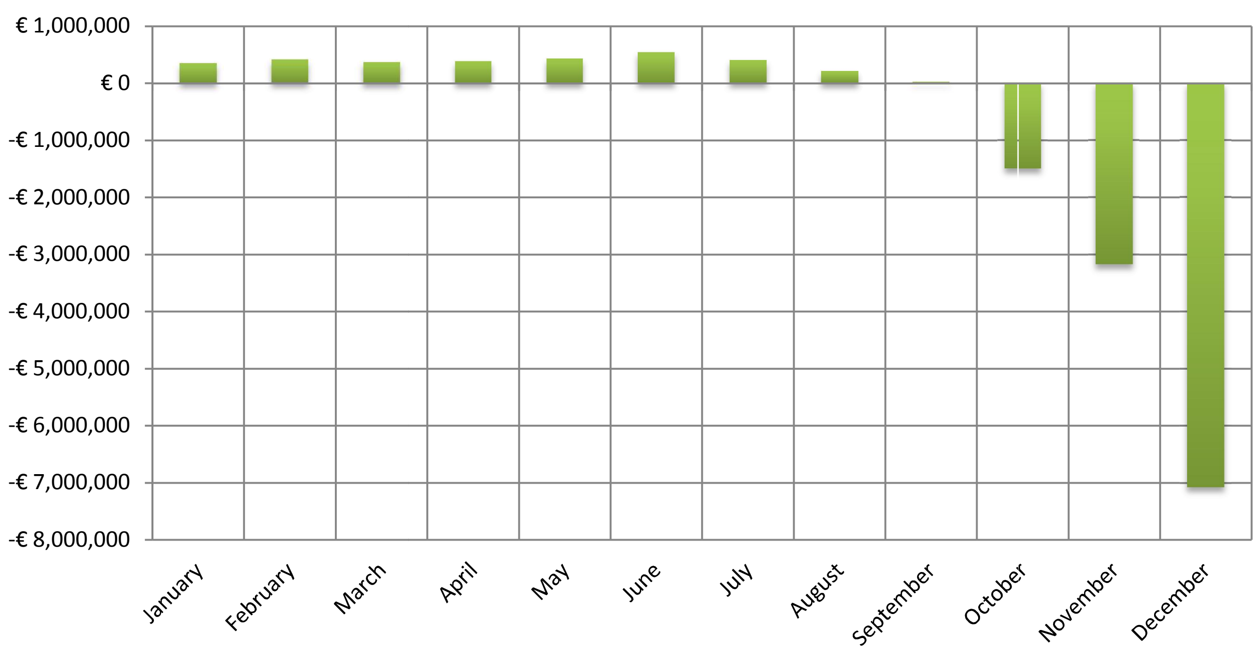
Month	Settlement ($)	€/$ exchange rate[1]	Settlement (€)
January	472,956	1.3574	348,428
February	566,925	1.3894	408,036
March	508,943	1.3723	370,869
April	529,560	1.3927	380,240
May	585,634	1.3642	429,287
June	731,066	1.3589	537,984
July	536,079	1.3368	401,017
August	279,347	1.2947	215,762
September	26,378	1.2607	20,923
October	(1,849,760)	1.2393	(1,492,585)
November	(3,915,977)	1.2362	(3,167,753)
December	(8,326,614)	1.1768	(7,075,641)
Total	**(9,855,463)**	-	**(8,623,434)**

Note:

1. Hedging settlements are effected one month in arrear, therefore and by means of example, settlements attributed to January are realised in February. In this respect, the conversion to EUR for January was carried out by quoting the daily exchange rate when actual payment was effected, that is February.

2.11 The shift from consistent gains registered in Q1, Q2 and Q3 2014 to substantial losses registered in Q4 2014 (in Euro terms) is rendered evident in Figure 2.

Figure 2: Crude oil hedging gains and losses registered by EMC during 2014



3. Product Hedging

3.1 In the July 2013 NAO report, the Office had reported that EMC followed a non-hedging policy with regard to unleaded petrol and diesel products during the period 2008 to 2011. This stance was not maintained with respect to 2014, in which case EMC hedged its unleaded petrol and diesel requirements. The main rationale behind this change in policy was minuted in the AFC meeting dated 23 October 2013, wherein the Committee noted that such hedging would serve to introduce an element of price stability. EMC's decision to this effect may be traced back to correspondence exchanged between members of the AFC, including, the Corporation's Chair, and CEO. Final approval authorising the Committee to pursue the hedging of unleaded petrol and diesel was issued by the Corporation's Chair (also Chair of the AFC) on 26 September 2013.

3.2 The NAO also noted a presentation attached to the minutes of the AFC meeting dated 23 October 2013, which served to highlight the underlying assumptions and workings for hedging unleaded petrol and diesel requirements as well as the pros and cons for fixing the price of such products through swaps. Supporting documentation presented with the AFC meeting minutes of 23 October 2013 indicated that such hedging was to be based on premium unleaded gasoline 10ppm CIF Med and diesel EN590 10ppm CIF Med.

3.3 For matters of precision and completeness, responsibility for this hedging function, as recorded in the AFC meeting of 19 September 2014, would no longer be addressed by the Committee. Instead, this function was assumed by a separate committee under the responsibility of Enemed Company Ltd. The minutes of this Enemed Committee were reviewed by the NAO; however, these were deemed tangential to this audit, as all unleaded petrol and diesel, as well as the respective FX requirements had already been hedged under the AFC for the period under review.

Deals Concluded for 2014

3.4 The NAO reviewed the manner by which the AFC effected hedging on unleaded petrol and diesel, paying particular attention to the volume and rates at which orders were placed and subsequently concluded. The NAO observed that decisions taken by the AFC members consistently reflected unleaded petrol and diesel deals concluded by EMC for Q1 and Q2 2014. The Office noted that market developments were continuously being monitored and all AFC members communicated through the exchange of emails.

3.5 However, the NAO has reservations regarding the manner by which the decision to hedge requirements for Q3 and Q4 2014 was taken. In the AFC meeting dated 12 March 2014, no targets for Q3 and Q4 2014 were set. This is further corroborated through an email exchange between Committee members dated 20 March 2014, where indications of the prevalent market rates at the time for unleaded petrol (Q3 $948.50/MT and Q4 910.50/MT) and diesel (Q3 $913.50/MT and Q4 $908.75/MT) were provided. This email was sent following the then Chair AFC's proposal to review targets for Q3 and Q4 2014. To this end, the AFC member proposed targets of $920/MT for unleaded petrol and $905/MT for diesel, which proposal was agreed to by another AFC member. These targets were set with the intention of reducing the consumer price of unleaded petrol by €0.02 and that of diesel by €0.01.

3.6 Following this account of events, in developments registered following the AFC meeting of 12 March 2014, a record of deals corresponding to 100 per cent of EMC's Q3 and Q4 2014 unleaded petrol and diesel requirements was noted by the NAO. These hedge agreements were entered into with SOCAR Trading SA on 1 April 2014 and 2 April 2014 for diesel and unleaded petrol, respectively. The agreement with respect to unleaded petrol was at a rate of $920/MT, while that for diesel was at a rate of $910/MT.

3.7 In view of the lack of documentation relating to the final AFC approval and placement of order with SOCAR Trading SA, further queries were addressed to EMC on the matter. To this end, the Corporation provided the NAO with the minutes of the Petroleum Procurement Committee (equivalent to the Fuel Procurement Committee in the July 2013 audit). Although the focus of the Petroleum Procurement Committee centres on the actual purchase of fuel and not hedging activity, the following was noted in the minutes of the 3 April 2014 meeting, "*The Chairman also informed the Committee that in relation to the petrol and diesel hedges for the second half of 2014, deals have been concluded with Socar Trading as per ministerial direction.*" A detailed timeline outlining developments recorded by EMC with respect to the hedging agreement concluded with SOCAR Trading SA is presented in Table 3.

Table 3: Timeline of events leading to agreement with SOCAR Trading SA

Date	Event	Details
3 February 2014	AFC meeting 7	No reference was made to unleaded petrol and diesel hedging for Q3 and Q4 2014.
12 March 2014	AFC meeting 8	Meeting minutes made no reference to unleaded petrol and diesel hedging for Q3 and Q4 2014; however, indirect reference to volumes required was made in appendix to meeting.
20 March 2014 [12:42]	Email circulated among AFC members	Chair AFC states that targets for Q3 and Q4 2014 are to be revised.
20 March 2014 [15:03]	Email circulated among AFC members	Statement made by a member of the AFC to the effect that the Committee had set no targets, therefore proposed targets were set with unleaded petrol at $920/MT and diesel at $905/MT.
20 March 2014	Minuted development after AFC meeting 8	AFC member proposed consideration of Q3 and Q4 2014 hedging, yet no decision was taken.
21 March 2014	Email circulated among AFC members	AFC member agrees with proposed targets.
1 April 2014	Hedge deal agreed	Date of effect of deal entered into by EMC with SOCAR Trading SA with respect to diesel hedge at a rate of $910/MT.
2 April 2014	Hedge deal agreed	Date of effect of deal entered into by EMC with SOCAR Trading SA with respect to unleaded petrol hedge at a rate of $920/MT.
3 April 2014	Petroleum Procurement Committee meeting	Petroleum Procurement Committee members informed that hedge deals with SOCAR Trading SA were concluded following ministerial direction.
May 2014 (date not specified)	Minuted development after AFC meeting 8	Deal with SOCAR reported as concluded in the AFC meeting minutes section entitled 'Developments after meeting'.

3.8 Explanations and documentation put forward by the Minister for Energy and Health, as well as by the then Chair EMC, provided an element of context, particularly in terms of the stated Government policy of price stability. Furthermore, the Minister stated that the direction provided to EMC was limited to, and in line with, Government's efforts at reducing consumer prices. In addition, the Minister claimed that EMC was advised to maintain its targets and widen its supplier base. This was corroborated by the then EMC Chair.

3.9 Notwithstanding the review of emails exchanged by the AFC and clarifications put forward by the Minister and the then Chair EMC, the NAO is of the opinion that documentation detailing final approval issued by the Committee and the subsequent placement of orders with SOCAR was incomplete. The lack of documentation rendered it impossible for the Office to determine the extent of ministerial direction exercised and responsibilities assumed by the AFC. Given the magnitude of the agreement reached with SOCAR Trading SA, this Office considers the lack of documentation as detracting from the process' accountability and a shortcoming in terms of governance.

3.10 As at 1 January 2014, EMC's hedged position with respect to unleaded petrol and diesel was 50 per cent of Q1 2014 for both products. This position was registered following decisions taken by the Committee to capitalise upon favourable market movements and close off various deals. This position was reported upon in the meeting of 18 November 2013, wherein 50 per cent of Q1 2014 unleaded petrol requirements and 50 per cent of Q1 2014 diesel requirements were hedged. Deals for unleaded petrol were closed at $923.25/MT and $922.25/MT (each corresponding to 25 per cent of Q1 2014 requirements), whereas those for diesel were struck at $912.50/MT and $913.50/MT (each corresponding to 25 per cent of Q1 2014 requirements).

3.11 Other orders were placed between the AFC meeting dated 18 November 2013 and that of 3 February 2014, amending orders that had been previously set and creating new ones. Orders were placed and targets revised in accordance with developments of market conditions monitored by the AFC.

3.12 Orders were revised once again on 3 February 2014, as market conditions were deemed well off targets that had been established by the Committee, thereby necessitating appropriate adjustments. Here, orders were placed for 50 per cent of unleaded petrol requirements for Q1 2014 at $940/MT and 100 per cent of Q2 2014 requirements at $930/MT. Similar adjustments were effected with respect to diesel, where orders were placed for 50 per cent of diesel requirements for Q1 2014 at $915/MT and 100 per cent of Q2 2014 requirements at $910/MT.

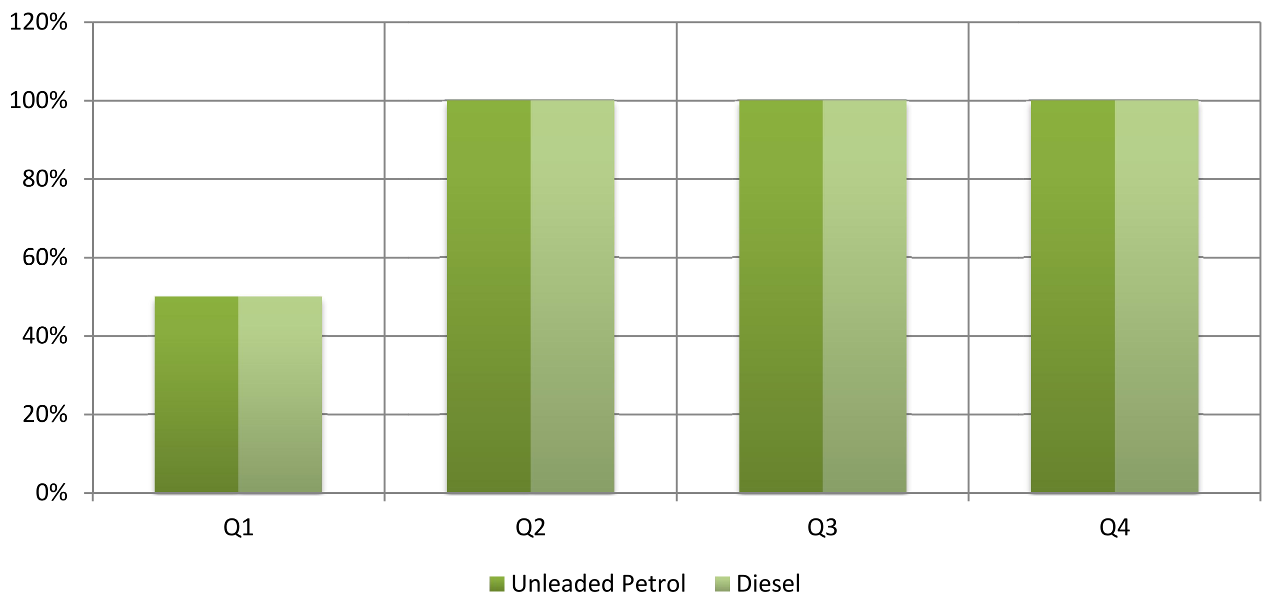
3.13 On 6 March 2014, the Committee was briefed with respect to its current hedged position vis-à-vis unleaded petrol and diesel swaps. While the market for diesel was moving in the region of $930/MT, the Corporation had placed orders still considerably off target, that is, at $ 910/MT. A similar situation prevailed with respect to unleaded petrol, with the market reporting rates of $1,005/MT, compared to Q2 2014 orders of $930/MT. The Committee agreed to close the swap for diesel at $930/MT or better, and monitor developments with respect to unleaded petrol. The swap for 100 per cent of diesel requirements for Q2 2014 was concluded at $ 928.50/MT on 7 March 2014.

3.14 During the AFC meeting of 12 March 2013, it was agreed that orders for unleaded petrol with respect to Q1 2014 and the balance of Q1 2014 for Diesel at $915/MT were to be withdrawn as time had effectively run out. Moreover, the previous order placed for 100 per cent of unleaded petrol requirements for Q2 2014 at $930/MT was revised upwards to $985/MT. This deal was subsequent closed on 17 March 2013, and therefore, at this stage, the AFC had effectively hedged 100 per cent of unleaded petrol and diesel requirements for Q2 2014 (aside from 50 per cent of Q1 2014 unleaded petrol and diesel requirements hedged late in 2013).

3.15 In contrast to the pace of developments registered with respect to Q1 and Q2 2014, deals closed with respect to Q3 and Q4 2014 took place within a short period of time, noted as developments following the AFC meeting of 12 March 2013. In fact, on 1 April 2014, the AFC concluded deals corresponding to 100 per cent of Q3 and Q4 2014 diesel requirements at a rate of $910/MT. Subsequently, on 2 April 2014, deals covering 100 per cent of Q3 and Q4 2014 unleaded petrol requirements were concluded. The rate agreed to with respect to unleaded petrol hedges was that of $920/MT. The context relating to these particular deals was elaborated upon in paragraphs 3.5 to 3.9.

3.16 This transaction brought to a close unleaded petrol and diesel hedging activity for 2014. Figure 3 indicates the Corporation's hedged position with respect to its estimated exposure for unleaded petrol and diesel on a quarterly basis.

Figure 3: EMC's hedged position with respect to unleaded petrol and diesel in 2014



Review of Hedging Contracts

3.17 Similar to the analytical work undertaken with respect to crude oil hedging, the NAO reviewed all product hedging contracts entered into by EMC with its brokers. All product hedging contracts corresponding to 2014 were reviewed by this Office, thereby ensuring the accuracy, or otherwise, of the variables presented in these contracts. The variables analysed in this respect included the hedging counterparty, the derivative instrument used, the commodity reference price, trade date, effective date, termination date and notional quantity. In this context, the NAO confirms that all product hedging contracts corresponded to the entries prepared by EMC, and therefore, this Office considers product hedging-related data provided by the Corporation in this respect to be complete and accurate.

Exposure

3.18 When queries regarding exposure calculations were raised by the NAO, EMC stated that the import and sale of fuel is relatively constant, particularly in view of the Company's stable market share and consistent consumption patterns. Therefore, EMC stated that its product requirements are ordinarily based on the previous year's demand while allowing for particular market trends.

3.19 EMC's hedged position with respect to its estimated exposure for unleaded petrol for 2014 stood at a weighted average of 90 per cent (Table 4 refers). This figure is arrived at when one considers the quantity hedged, that is, 69,200 MT as a proportion of the Corporation's estimated fuel requirements, in this case set at 76,500 MT. On the other hand, the Corporation's hedged position as a percentage over actual unleaded petrol procured stood at a weighted average of 89 per cent, that is, reflecting the proportion between the 69,200 MT hedged and the 77,848 MT actually purchased. The NAO noted that the estimated exposure calculated by EMC generally corresponded and reconciled with the actual procurement of unleaded petrol when analysed in aggregate, yet was not the case when such an analysis was carried out on a quarterly basis.

Table 4: Analysis of exposure in 2014 with respect to unleaded petrol

Quarter	Estimated unleaded petrol requirements (MT)	Actual unleaded petrol procured (MT)	Quantity hedged (MT)	Percentage hedged over estimated exposure	Percentage hedged over actual procured
Q1	14,600	22,475	7,300	50%	32%
Q2	21,900	16,009	21,900	100%	137%
Q3	16,000	15,857	16,000	100%	101%
Q4	24,000	23,508	24,000	100%	102%
Total	**76,500**	**77,848**	**69,200**	**90%**	**89%**

Note:
1. Figures relating to actual fuel procured are reported upon as provided by EMC and no verification of the accuracy, or otherwise, of these figures was carried out by the NAO.

3.20 The Corporation's estimated exposure with respect to diesel for 2014 stood at 88 per cent (Table 5 refers). This percentage is based on the proportion between the quantity of diesel hedged, that is, 57,750 MT, and EMC's estimated fuel requirements, which stood at 66,000 MT. Furthermore, the Corporation's hedged position as a percentage over actual diesel procured stood at a weighted average of 87 per cent, that is, reflecting the proportion between the 57,750 MT hedged and the 66,501 MT actually purchased. The NAO noted that the estimated exposure calculated by EMC generally corresponded and reconciled with the actual procurement of diesel when analysed in aggregate as well as on a quarterly basis.

Table 5: Analysis of exposure in 2014 with respect to diesel

Quarter	Estimated diesel requirements (MT)	Actual diesel procured (MT)	Quantity hedged (MT)	Percentage hedged over estimated exposure	Percentage hedged over actual procured
Q1	16,500	16,044	8,250	50%	51%
Q2	16,500	17,457	16,500	100%	95%
Q3	16,500	16,500	16,500	100%	100%
Q4	16,500	16,500	16,500	100%	100%
Total	**66,000**	**66,501**	**57,750**	**88%**	**87%**

Note:

1. Figures relating to actual fuel procured are reported upon as provided by EMC and no verification of the accuracy, or otherwise, of these figures was carried out by the NAO.

Gains and Losses Registered

3.21 The NAO verified that invoices and settlement statements issued by the various brokers backed all of the corresponding individual monthly settlements as reported by EMC. The Office positively noted that all invoices precisely corresponded to the settlement data recorded and provided by the Corporation. The monthly premium unleaded gasoline 10ppm CIF Med and diesel EN590 10ppm CIF Med prices upon which settlements were effected were compared to the corresponding quoted average monthly Platts prices. Aside from minor and immaterial discrepancies, the NAO noted that the figures corresponded to the prices independently reconciled by the audit team.

3.22 Based on information reviewed by the NAO, EMC registered a loss of $6,420,518 with respect to unleaded petrol and diesel hedges undertaken during 2014. This loss is attributable to developments that took place in Q4 2014, where the negative balance of settlements starkly contrasts against previous gains recorded in Q1, Q2 and Q3 2014. When converted to Euro, the equivalent loss incurred by EMC in terms of unleaded petrol and diesel hedges undertaken in 2014 amounted to €5,518,807 (Table 6 refers).

Table 6: Product (unleaded petrol and diesel) hedging settlements in € and $ with respect to 2014

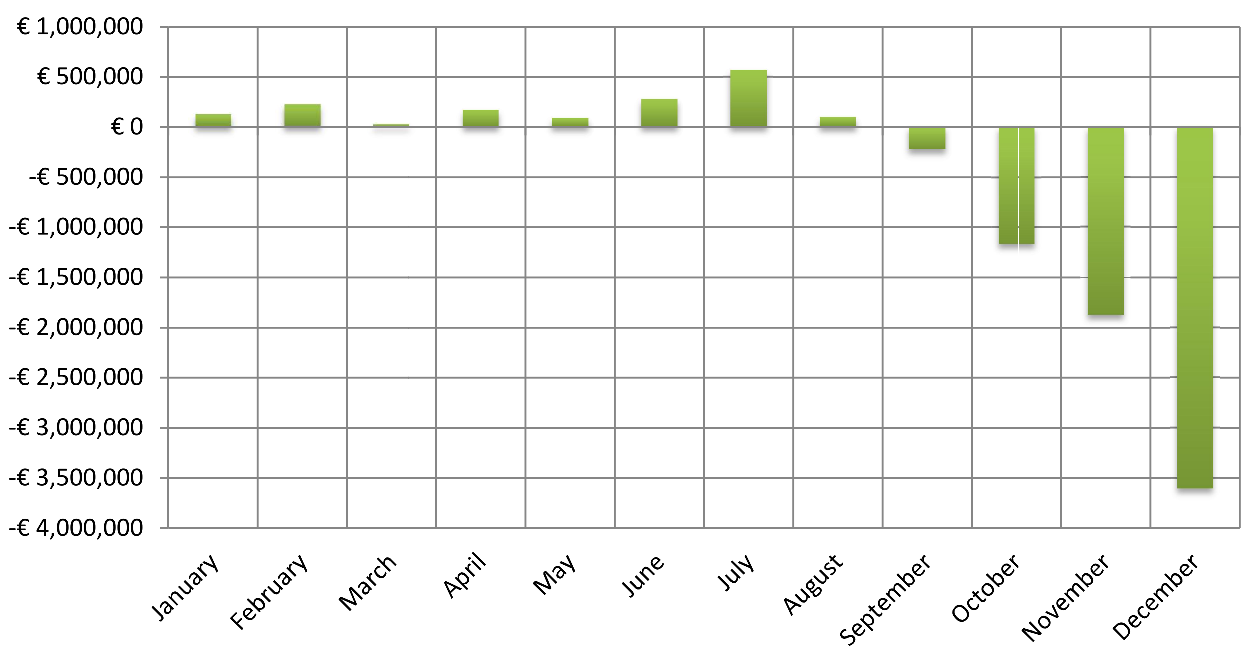
Month	Settlement ($)	€/$ exchange rate	Settlement (€)
January	167,020	1.3574	123,044
February	297,138	1.3894	213,861
March	33,017	1.3723	24,059
April	234,344	1.3927	168,266
May	119,170	1.3642	87,355
June	372,668	1.3589	274,242
July	770,844	1.3386	575,858
August	130,059	1.2902	100,805
September	(282,689)	1.2607	(224,232)
October	(1,477,203)	1.2393	(1,191,966)
November	(2,337,338)	1.2362	(1,890,744)
December	(4,447,547)	1.1768	(3,779,357)
Total	**(6,420,518)**	-	**(5,518,807)**

Note:

1. Hedging settlements are effected one month in arrear, therefore and by means of example, settlements attributed to January are realised in February. In this respect, the conversion to EUR for January was carried out by quoting the daily exchange rate when actual payment was effected, that is, February.

3.23 The shift from consistent gains registered in Q1, Q2 and Q3 2014 to substantial losses registered in Q4 2014 (in Euro terms) is rendered evident in Figure 4.

Figure 4: Product (unleaded petrol and diesel) hedging gains and losses registered by EMC during 2014



4. FX Hedging for Fuel Oil and Gasoil

4.1 While EMC trades and procures oil in dollars, its income from the generation of electricity is denominated in Euro. This consequently gives rise to FX risk, which is understood as the risk related to when the value or exchange rate of one currency in relation to another experiences change over time in response to market forces. In order to mitigate FX risk EMC hedges its exposure towards fluctuations in the EUR/USD rate.

Deals Concluded for 2014

4.2 The NAO reviewed the manner by which the AFC effected hedging on FX for fuel oil and gasoil, paying particular attention at the volume and rates at which orders were placed and subsequently concluded. The NAO observed that decisions taken by the AFC consistently reflected FX deals concluded by EMC. The Office noted that market developments were continuously being monitored and all AFC members maintained constant contact.

4.3 The first FX hedge undertaken by EMC with respect to the Corporation's fuel oil and gasoil needs was concluded on 17 June 2013, whereby 20 per cent of Q1 and Q2 2014 as well as 10 per cent of Q3 2014 requirements were closed. These orders were filled at a rate of $1.3350 spot. The Committee registered notable activity in the interim period between the meetings of 11 July 2013 and that of 23 October 2013. In fact, 50 per cent of CAL 2014 FX requirements were hedged under three separate deals, with 10 per cent filled at $1.3250 spot, another 10 per cent at $1.3390 spot and 30 per cent at $1.3490 spot. In view of hedges undertaken, the Corporation reported that it was effectively 60 per cent hedged for 2014 as at 23 October 2013, and it was in this context that the Committee decided to increase its hedged position.

4.4 Two additional orders, each equivalent to 5 per cent of CAL 2014 requirements, were filled on 24 October 2013 and 25 October 2013 at rates of $1.3812 spot and $1.3781 spot, respectively. Following this, two other orders, each equivalent to 10 per cent of CAL 2014 requirements, were concluded on 9 December 2013 and 11 December 2013 at rates of $1.38 spot and $1.37 spot, respectively. In the context of these developments, during the AFC meeting of 3 February 2014, the Committee noted that 90 per cent of EMC's FX requirements for fuel oil and gasoil had been concluded at an average rate of $1.3521, and therefore, no further hedging activity was considered at this stage. However, following recommendations by the Committee's FX Adviser, two other deals, each corresponding to 5 per cent of CAL 2014 requirements were triggered on 7 March 2014 at a rate of $1.39 spot.

Review of FX Hedging Agreements

4.5 As part of its review of FX hedging agreements, the NAO reconciled decisions taken during AFC meetings to the corresponding contracts concluded by EMC. All FX hedging contracts in force during 2014 were scrutinised by the audit team, thereby ensuring the accuracy, or otherwise, of the variables presented in these contracts. The variables reviewed were the trade date, the forward exchange rate agreed upon, the amount in USD and corresponding amount in EUR, as well as the FX hedge contracts' utilisation or maturity dates.

Exposure

4.6 In addition to the above, the NAO also undertook a review of FX hedging expected exposure. Here, the NAO reviewed documentary evidence attesting to the Corporation's relevant analysis undertaken in conjunction with the compilation of its expected exposure with respect to FX hedging. Of importance is the fact that all records utilised in this review were provided by EMC, and therefore, the following analysis is solely based on information rendered available by the Corporation.

4.7 Table 7 provides a synopsis of the analysis carried out by the NAO, outlining a monthly overview of EMC's FX exposure with respect to purchases of fuel oil and gasoil. The calculation of expected MT is based on the consignments that are to be received by EMC throughout the year. Naturally, the timing of consignments is a variable subject to change due to various reasons, which change gives rise to the discrepancy between expected MT and actual MT.

4.8 EMC stated that the Corporation estimated its expected exposure and established actual exposure by applying quotes of the future prices of fuel oil and gasoil to expected MT and actual MT. The applicable premium, negotiated by the Petroleum Procurement Committee, is also added to the price. Another factor considered is the credit granted by the supplier, which could vary from 15 to 60 days, thereby impacting upon the timing of payment. It is important to note that the expected and actual exposure of the Corporation's USD requirements also takes into consideration hedging crude oil settlement gains and losses.

Table 7: Monthly overview of FX exposure for fuel oil and gasoil during 2014

Month	Expected MT	Expected exposure USD	Actual MT	Actual exposure USD	Forward agreements USD	Hedged % over expected exposure USD	Hedged % over actual exposure USD
January	43,987	32,612,465	52,261	35,281,358	34,600,000	106%	98%
February	47,763	33,505,831	0	(472,956)	29,800,000	89%	N/A
March	34,000	22,427,272	28,936	21,278,139	22,725,000	101%	107%
April	66,000	37,989,219	52,036	34,339,063	34,610,000	91%	101%
May	44,000	25,179,746	39,928	26,567,724	27,800,000	110%	105%
June	27,000	18,252,639	26,983	19,185,141	37,700,000	207%	197%
July	47,000	27,461,130	47,986	32,233,160	33,900,000	123%	105%
August	44,000	25,083,116	43,585	28,840,413	38,790,000	155%	134%
September	22,000	12,293,783	21,997	13,810,208	46,600,000	379%	337%
October	74,000	45,254,813	70,616	46,404,418	46,382,000	102%	100%
November	47,000	32,177,114	44,848	32,615,380	32,800,000	102%	101%
December	52,968	33,095,332	54,667	30,449,391	31,700,000	96%	104%

Notes:

1. In general, the above-stated forward agreements include all contracts maturing in their respective month; however, these agreements also feature contracts that were not utilised upon maturity but swapped to future months.
2. Forward agreements also include USD balances received from gains resulting from crude oil settlements and swapped to future months.

4.9 The expected exposure in USD serves as the basis for the subsequent forward agreements entered into by the Corporation. Here, the parameters relating to how much USD, and when such USD is required, are established and matched to FX hedge agreements. This analysis is presented under the heading 'Hedged percentage over expected exposure USD'. On the other hand, one may then compare the actual exposure in USD with the forward agreements entered into by EMC. This comparison provides insight into the Corporation's hedged position vis-à-vis its actual exposure. This analysis is captured under the heading 'Hedged percentage over actual exposure USD'.

4.10 The NAO noted that EMC was long on its USD position throughout 2014, as in fact reported in the AFC meeting dated 30 September 2014, wherein the Committee stated that the Corporation was over-hedged by approximately $32 million. This situation partly arose as a result of EMC's long USD position with respect to February 2014, which amounted to approximately $30 million. The AFC cited two factors as possible explanations for this state of affairs, that is, an extension in credit terms by one of its fuel oil suppliers, as well as the postponements of gasoil shipments. These two sets of circumstances resulted in EMC not needing the $30 million that were available and intended for utilisation in February 2014. In addressing this matter, the AFC decided to swap this USD balance to future months, effectively rolling over its long position to forward months or sell at spot.

4.11 In addition, the NAO observed that the Corporation was notably over-hedged during the months of June, August and September 2014. Generally, EMC addressed this situation by swapping FX contracts to future months, with a number of September 2014 contracts swapped to January 2015. Notwithstanding the corrective action taken by EMC, the NAO considers such over-hedged positions not consistent with the Corporation's stated risk-averse approach.

Gains and Losses Registered

4.12 The NAO's review of gains and losses registered by EMC with respect to FX hedging on fuel oil and gasoil entailed the verification of FX hedging agreements utilised in 2014 as outlined in paragraph 4.5. Instrumental in this analysis is the data relating to the FX agreements, that is, the amount of USD procured, the applicable forward rate and the subsequent equivalent in Euro. This Office's analysis focused on the conversion of the USD procured to Euro using the applicable daily spot rate. The source of spot rate data utilised for this analysis was that cited by the European Central Bank. The difference between the two Euro figures equates to the gains or losses realised with respect to each agreement (Box 1 refers).

Box 1: Basis of gains/losses calculation

USD procured at forward rate = EURO 1

USD procured at daily spot rate = EURO 2

EURO 2 - EURO 1 = Gain/loss

4.13 In contrast to results registered with respect to crude oil hedging and product hedging by EMC, during 2014, the Corporation registered approximately €5.5 million in gains on FX hedging undertaken for fuel oil and gasoil requirements. Table 8, which outlines the Corporation's gains and losses on FX hedging for fuel oil and gasoil on a monthly basis, was established by the NAO following the analysis of records provided by EMC. The amounts bought at spot were not factored in this analysis, as these transactions quite evidently do not result in any material gains or losses.

Table 8: Gains and losses on FX hedging for fuel oil and gasoil during 2014

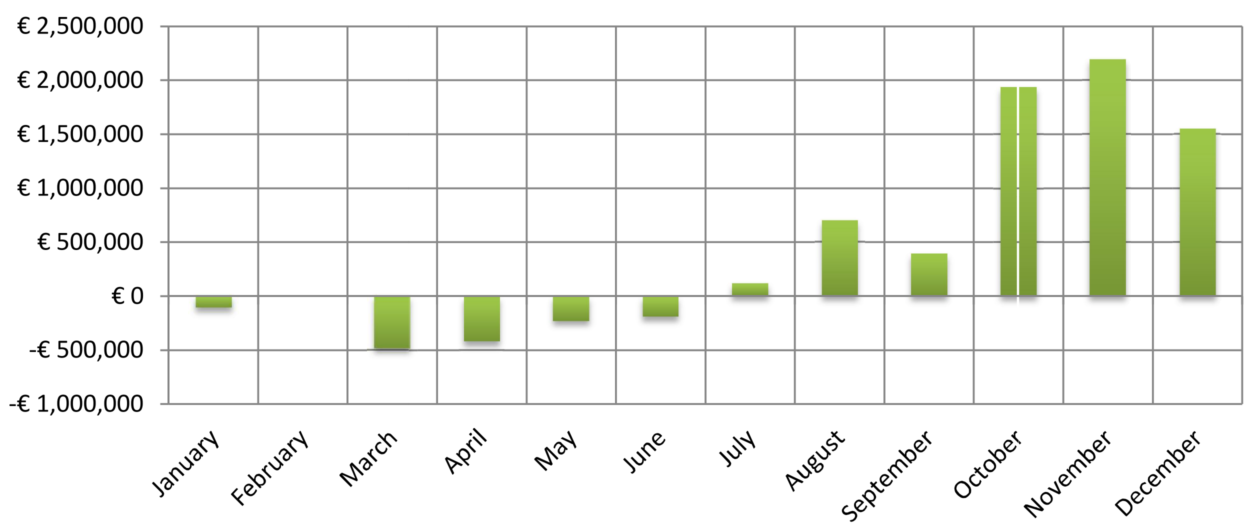
Month	Forwards EUR (EURO 1)	Spot EUR (EURO 2)	Gains / (Losses) realised
January	25,592,585	25,487,047	(105,538)
February	0	0	0
March	16,896,962	16,411,416	(485,546)
April	25,537,113	25,118,159	(418,954)
May	20,574,414	20,345,755	(228,659)
June	14,842,457	14,654,513	(187,944)
July	24,874,559	24,991,415	116,856
August	27,809,400	28,507,540	698,140
September	10,509,394	10,905,716	396,321
October	34,681,293	36,615,731	1,934,438
November	24,098,837	26,290,303	2,191,466
December	24,176,084	25,725,779	1,549,695
Total	**249,593,098**	**255,053,373**	**5,460,275**

Note:

1. The gains and losses reproduced in Table 8 include three forward contracts that were utilised during November and December to effect payments relating to crude oil hedge settlements.

4.14 As illustrated in Figure 5, the initial FX hedging losses registered by EMC during Q1 and Q2 2014 were more than offset by the subsequent FX hedging gains recorded during Q3 and Q4 2014.

Figure 5: FX hedging gains and losses (on fuel oil and gasoil) registered by EMC during 2014



5. FX Hedging for Products

5.1 Similar to FX hedging undertaken by EMC with respect to its fuel oil and gasoil requirements, the Corporation also hedges FX with regard to unleaded petrol and diesel procured. The rationale justifying such FX hedging is consistent with that stated previously, whereby the Corporation trades and procures unleaded petrol and diesel in dollars, yet generates income from the distribution of these products in Euro.

Deals Concluded for 2014

5.2 The NAO reviewed the manner by which the AFC effected hedging on FX for unleaded petrol and diesel, paying particular attention to the volume and rates at which orders were placed and subsequently concluded. The NAO observed that decisions taken by the AFC consistently reflected FX deals concluded by EMC. The Office noted that market developments were continuously being monitored and all AFC members maintained constant contact.

5.3 During the AFC meeting of 18 November 2013, 100 per cent of EMC's FX exposure for Q1 2014 with respect to unleaded petrol and diesel was closed by means of three separate deals dated 25 October 2013, 1 November 2013 and 4 November 2013. The hedged rates stood at spot $1.3778, $1.3529 and $1.3503, with each deal accounting for 25 per cent, 50 per cent and 25 per cent of Q1 2014 requirements, respectively.

5.4 On 22 November 2013, the AFC placed orders equivalent to 100 per cent of the Corporation's Q2 2014 FX requirements with respect to unleaded petrol and diesel. Three orders, equivalent to 50 per cent, 25 per cent and 25 per cent of Q2 2014 requirements were placed at the following respective rates at spot - $1.37, $1.38 and $1.355. All three orders were triggered between the 25 November 2013 and 12 December 2013, implying a 100 per cent hedged position with respect to FX requirements for product hedges for Q2 2014.

5.5 Significant activity in terms of FX hedges concluded was registered following the AFC meeting of 3 February 2014, wherein approximately 70 per cent of Q3 and Q4 2014 requirements were settled at an average rate of $1.3744. These deals were concluded after advice provided by the CBM representative. The NAO noted that the execution of deals was documented through the exchange of emails between Committee members. Furthermore, on 13 March 2014, an order for 30 per cent of FX exposure for Q3 2014 at $1.395 spot was filled following the AFC meeting of 12 March 2014. This contract was partly utilised during Q3 and exhausted during Q4 2014. Finally, on 8 May 2014, following recommendations by the Committee's CBM representative, the AFC agreed to purchase an additional $4,000,000 with respect to Q4 2014 unleaded petrol and diesel FX requirements. However, this hedge, together with 10 per cent of the above-referred Q3 and Q4 2014 deals were not utilised in 2014.

Review of FX Hedging Agreements

5.6 As part of its review of FX hedging agreements, the NAO reconciled decisions taken during AFC meetings to the corresponding contracts concluded by EMC. All FX hedging contracts in force during 2014 were scrutinised by the audit team, thereby ensuring the accuracy, or otherwise, of the variables presented in these contracts. The variables reviewed were the trade date, the forward exchange rate agreed upon, the amount in USD and corresponding amount in EUR, as well as the FX hedge contracts' utilisation or maturity dates.

Exposure

5.7 The NAO requested documentary evidence attesting to the Corporation's relevant analysis undertaken in conjunction with the compilation of its expected exposure with respect to FX hedging on unleaded petrol and diesel requirements. Enemed stated that, in view of stable market share and consistent consumption patterns, FX hedging requirements are ordinarily established through the estimation of volumes of unleaded petrol and diesel required, which are subsequently multiplied by the average price per MT of that particular product. Details relating to how fluctuating market prices are reflected in such exposure calculations were not provided by EMC/Enemed. Table 9 provides a synopsis of the forward agreements entered into by EMC with respect to FX requirements for unleaded petrol and diesel.

Table 9: 2014 monthly overview of FX forward agreements for products

Month	Forwards utilised USD
January	13,000,000
February	11,900,000
March	11,900,000
April	5,100,000
May	12,000,000
June	12,000,000
July	15,000,000
August	13,000,000
September	12,000,000
October	9,000,000
November	6,000,000
December	7,000,000
Total	**127,900,000**

Gains and Losses Registered

5.8 The NAO's review of gains and losses registered by EMC with respect to FX hedging on unleaded petrol and diesel entailed the verification of FX hedging agreements utilised in 2014 as outlined in paragraph 5.6. Instrumental in this analysis is the data relating to the FX agreements, that is, the amount of USD procured, the applicable forward rate and the subsequent equivalent in Euro. This Office's analysis focused on the conversion of the USD procured to Euro using the applicable daily spot rate. The source of spot rate data utilised for this analysis was that cited by the European Central Bank. The difference between the two Euro figures equates to the gains or losses realised with respect to each agreement (Box 1 refers).

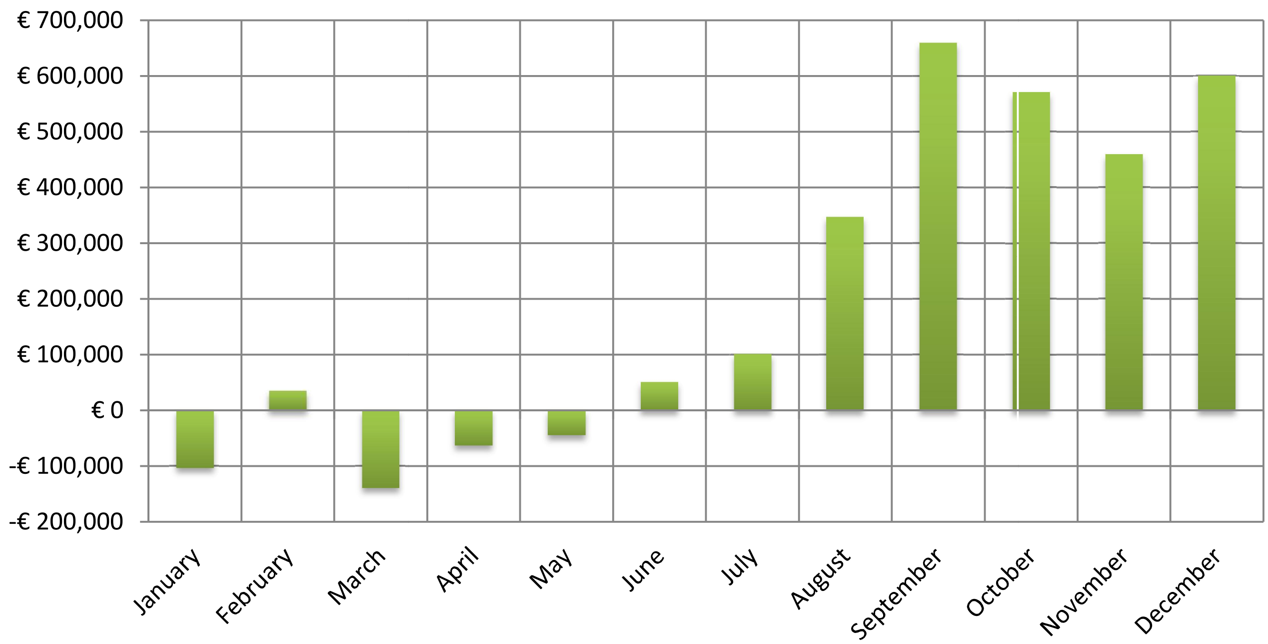
5.9 Similar to results obtained by the Committee with respect to FX hedging on fuel oil and gasoil requirements, during 2014, the Corporation registered approximately €2.5 million in gains on FX hedging undertaken for unleaded petrol and diesel. Table 10, which outlines the Corporation's gains and losses on FX hedging for products on a monthly basis, was established by the NAO following the analysis of records provided by EMC.

Table 10: Gains and losses on FX hedging for unleaded petrol and diesel during 2014

Month	Forwards EUR (EURO 1)	Spot EUR (EURO 2)	Gains / (Losses) realised
January	9,647,138	9,543,756	(103,382)
February	8,759,748	8,794,660	34,912
March	8,760,618	8,621,606	(139,012)
April	3,754,897	3,691,579	(63,317)
May	8,770,697	8,726,690	(44,007)
June	8,770,616	8,821,262	50,646
July	10,970,683	11,072,312	101,629
August	9,405,488	9,753,101	347,613
September	8,678,257	9,337,555	659,299
October	6,517,162	7,088,375	571,213
November	4,360,735	4,819,909	459,173
December	5,100,287	5,700,784	600,497
Total	**93,496,325**	**95,971,589**	**2,475,264**

5.10 Similar to trends exhibited with respect to FX hedges for fuel oil and gasoil, Figure 6 illustrates that the initial hedging losses registered by EMC in terms of FX hedges on products during Q1 and Q2 2014 were more than offset by the subsequent gains recorded during Q3 and Q4 2014.

Figure 6: FX hedging gains and losses (on products) registered by EMC during 2014



6. Conclusion

6.1 In conclusion, and in response to the terms of reference established by the Public Accounts Committee, the NAO noted that EMC did not have a formally documented hedging policy against which the Corporation could subsequently set its strategic orientation. This Office noted the significant improvement registered in terms of the AFC's governance. Documentation and correspondence exchanged by members of the AFC indicated that the Committee was continuously monitoring oil and FX markets. In this context, the NAO review established that decisions taken were appropriately authorised by the Committee Chair. Moreover, the absolute majority of decisions agreed to by the AFC were reflected in hedging deals concluded by EMC.

6.2 The NAO noted that hedging policy-related shortcomings identified in the 2013 Report, wherein the Office reviewed EMC's hedging function, largely persisted. To date, the Corporation does not have a formally documented hedging policy against which the Corporation may subsequently set its strategic orientation. One notable manifested change in terms of hedging policy was the Corporation's decision to extend hedging operations to include unleaded petrol and diesel. EMC and Enemed stated that the rationale motivating policy decisions was driven by efforts at ensuring price stability while more generally adopting a risk-averse approach.

6.3 This Office noted the significant improvement registered in terms of the AFC's governance. Documentation and correspondence exchanged by members of the AFC indicated that the Committee was continuously monitoring oil and FX markets. All members of the AFC were included in such correspondence and decisions taken were appropriately authorised by the Committee Chair. Even during periods of AFC inactivity (such as the period between 12 March 2014 and 19 September 2014), the Committee members maintained a constant watch over developments. The NAO reviewed all decisions taken by the Committee and the Office established that the absolute majority of decisions were reflected in hedging deals concluded by EMC.

6.4 The NAO has reservations regarding the manner by which the decision to hedge unleaded petrol and diesel requirements for Q3 and Q4 2014 was taken. Documentation reviewed by this Office, which solely focused on the setting of targets, failed to provide a comprehensive account of the AFC's sourcing of final approval and the subsequent placement of order with SOCAR Trading SA. Minutes of the Petroleum Procurement Committee meeting dated 3 April 2014 indicated that the deal with SOCAR had been concluded following "*ministerial direction*". Explanations and documentation put forward by the Minister for Energy and Health, as well as by the then Chair EMC, provided an element of context, particularly in terms of the stated Government policy of price stability. Furthermore, the Minister stated that the direction provided to EMC was limited to, and in line with, Government's efforts at reducing consumer prices. In addition, the Minister claimed that EMC was advised to maintain its targets and widen its supplier base. This was corroborated by the then EMC Chair. Notwithstanding the review of emails exchanged by the AFC and clarifications put forward by the Minister and the then Chair EMC, the NAO is of the opinion that documentation detailing final approval issued by the Committee and the subsequent placement of orders with SOCAR Trading SA was incomplete. This rendered it impossible for the Office to determine the extent of ministerial direction exercised and responsibilities assumed by the AFC. Given the magnitude of the agreement reached with SOCAR Trading SA, this Office considers the lack of documentation as detracting from the process' accountability and a shortcoming in terms of governance.

6.5 The NAO reviewed all hedging contracts that EMC entered into with third parties. From the verification carried out, the NAO confirmed that all hedging contracts corresponded to the entries prepared by EMC, and therefore, this Office considers hedging-related data provided by the Corporation in this respect to be complete and accurate. The NAO verified that invoices and settlement statements issued by the various brokers backed all of the corresponding individual monthly settlements as reported by EMC. The Office positively noted that all invoices precisely corresponded to the settlement data recorded and provided by EMC.

6.6 Finally, during 2014, EMC registered a loss of €8.6 million with respect to hedging undertaken on crude oil and a loss of €5.5 million with respect to unleaded petrol and diesel hedging. Central to the loss registered by EMC with respect to hedging on crude oil, unleaded petrol and diesel were the significant market movements recorded during Q4 2014, which were not and could not have been anticipated when such agreements were entered into. On the other hand, the Corporation registered a gain of €5.5 million in terms of FX hedge undertaken for fuel oil and gasoil and an additional €2.5 million gain from FX hedges entered into with respect to unleaded petrol and diesel requirements.