NIAO

Northern Ireland Audit Office

Our purpose ...

Promoting better use of public money, through independent professional scrutiny, underpinned by our commitment to:

- Integrity
- Equality
- Openness
- Innovation

To make a difference for the people of Northern Ireland.

The Comptroller and Auditor General, Mr Kieran Donnelly, is an Officer of the Northern Ireland Assembly. He is the Head of the Northern Ireland Audit Office. He, and the Northern Ireland Audit Office, are totally independent of Government. He certifies the accounts of all Government Departments and a wide range of other public sector bodies; and he has statutory authority to report to the Northern Ireland Assembly on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

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DEPARTMENT OF ENTERPRISE, TRADE AND INVESTMENT AUDIT OF 2015-2016 FINANCIAL STATEMENTS

REPORT TO THOSE CHARGED WITH GOVERNANCE

Contents

29 July 2016

Introduction

1. This report summarises the key matters arising from our audit of the 2015-16 financial statements for the benefit of those charged with governance[1]. We would like to thank management and their staff for their co-operation during the audit process.

2. The examination of the 2015-16 financial statements was undertaken in accordance with auditing standards issued by the Auditing Practice Board (APB), taking into account the UK Auditing Practice Board's Practice Note 10 (Revised); Audit of Financial statements in Public Sector Bodies in the United Kingdom Our approach to the audit was planned and executed in accordance with the Audit Strategy presented to the Audit Committee in March 2016.

3. This report has been prepared for the sole use of the Department of Enterprise, Trade and Investment (DETI) and the Department to whom its functions transferred to in May 2016, the Department for the Economy (DfE). Our prior consent should be sought before any distribution (including web publication) either in full or in part is made. The Northern Ireland Audit Office (NIAO) does not accept responsibility to any third party for losses arising from reliance being place on this report.

4. Now that certification has taken place the Annual Report and Accounts have been laid in the Assembly.

Actions for those charged with governance

5. Those charged with governance are invited to review the findings set out in this report, including the letter of representation, audit certificate and C&AG's report included in Annex A, Annex B and Annex C respectively.

6. Those charged with governance recommended to the Accounting Officer that the unadjusted misstatement set out in Section 3 was not corrected within the final Annual Report and Accounts. We were also content with this.

Status of audit

7. The audit is now complete and the accounts were certified on 28 June 2016.

8. The notional fee for the audit of the Department's accounts is £58,000. This has been communicated previously in the Audit Strategy and is not subject to change.

Overall conclusion and opinion

9. The Comptroller and Auditor General (C&AG) reported his opinion to the Assembly in the format set out in Annex B – Audit Certificate. The C&AG's certificate includes an opinion as to the truth and fairness of the financial statements, and that the expenditure and income have been applied to the purposes intended by the Assembly and that the transactions conform to the authorities which govern them ('regularity'). The C&AG's certificate also includes an opinion on the parts of the Remuneration Report and Staff Report and the Accountability and Audit Report to be audited have been properly prepared and that certain information given in the Annual Report is consistent with the financial statements.

10. The C&AG certified the 2015-16 financial statements with a qualified audit opinion relating to irregular expenditure on the non-domestic Renewable Heat Incentive (RHI) scheme and the lack of monitoring controls over the scheme.

[1] In accordance with ISA 260, those charged with governance are those individuals accountable for ensuring that the entity achieves its objectives, with regard to reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws, and reporting to interested parties.

11. The Department of Finance (formerly the Department of Finance and Personnel) did not approve £11.9 million expenditure incurred in a seven month period during 2015-16 on the non-domestic RHI scheme and as a result, this expenditure is irregular as it has been incurred without conforming to the authorities which govern it.

12. In addition, we did not consider that the systems in place to prevent or detect abuse of the scheme were adequate and we are unable to obtain enough evidence to be assured that expenditure on the non-domestic RHI scheme amounting to £30.5 million in 2015-16 had been incurred for the purposes intended.

13. The C&AG's reqularity opinion is qualified in respect of these two issues.

14. Further details of these qualifications are included in the C&AG's Report at Annex C.

Audit judgements

15. In reaching our opinion we have made the following key audit judgements:
    - The accounts have been qualified in respect of the matters relating to the non-domestic RHI scheme as outlined in paragraphs 10 to 14 above;
    - Prior year audit certificates included an emphasis of matter paragraph in respect of the material uncertainty of the Presbyterian Mutual Society (PMS) financial asset. We have decided this year to remove this emphasis of matter paragraph for the following reasons:
        - DETI appear to have adequate security over these assets;
        - the loan is being serviced with no repayments missed (£14m was received in November 2015);
        - the assets are worth more than the overall debt; and
        - the property market valuations are rising.
    - Prior year audit certificates also included an emphasis of matter paragraph in respect of the material uncertainty of the Harland & Wolff (H&W) provisions. We have also decided this year to remove this emphasis of matter paragraph for the following reasons:
        - based on claims experience both in-year and post year end, nothing came to our attention to suggest that either the actuarial valuation at 31 March 2014 nor the 2015-16 update calculations by DETI should be amended; including the assumptions upon which they are based;
        - we are satisfied that DETI have made adequate disclosures in Note 16.2; especially in relation to actuarial uncertainties such as future mortality rates, emergence of new diseases, improvements in medical treatments, and the outcome of future legal cases; and
        - we have had another year's experience on this audit which helps to reduce the extent of the uncertainty over this provision.
    - DETI have now split their Financial Asset Investments on the Statement of Financial Position between non-current and current assets – this adjustment of £8.9 million is included at Section 3 – Audit Adjustments. Previously these were all included within non-current assets.

Audit findings

16. In Section 2 we outline the quality, effectiveness and transparency of DETI's financial reporting and its accounting policy selection, and our audit findings including any issues identified relating to regularity and the internal control environment.

17. We found that the draft accounts presented for audit and the accompanying working papers to be of good quality.

18. The accounting policies adopted are in accordance with the 2015-16 Government Financial Reporting Manual.

19. Except for issues outlined above in relation to the non-domestic RHI scheme no significant internal control weaknesses were identified.

20. The final format and content of the Governance Statement had sufficient information and detail to adequately disclose and review the effectiveness of the system of internal control.

21. Further issues of interest are set out in the Other Matters of Governance Interest section.

Identified misstatements

22. In the course of the audit two misstatements were identified which have been adjusted in the financial statements, as detailed in Identified Misstatements in Section 3. The net effect of this adjustment on the Statement of Comprehensive Net Expenditure (SoCNE) and Statement of Financial Position (SoFP) was £282k.

23. Section 3 also details one uncorrected misstatement which would decrease expenditure and increase net assets by a further £82k. Management have not corrected this misstatement as they do not consider it to material in the context of the financial misstatements as a whole. We are also content with this.

Section 1

Audit Risks

Significant risks

1.1. In our Audit Strategy issued in March 2016, our assessment of DETI's operations and control environment identified a number of significant risks. A significant risk is an identified and assessed risk of material misstatement that, in the auditor's judgement, requires special audit consideration.

1.2 No new risks were identified since the Audit Strategy was issued.

1.3 The table below describes how we addressed these matters through our audit process.

Significant risks of material misstatement

Risk 1: Non-Domestic Renewable Heat Incentive Scheme
The above scheme is a DETI initiative which provides financial support for renewable heat technologies for the lifetime of the installation, to a maximum of 20 years. Department of Finance and Personnel approval for this scheme expired on 31 March 2015. The time bound nature of the approval was overlooked by DETI and as a result, approval to operate the scheme beyond this date was not sought at the appropriate time. In October 2015, DETI sought both prospective approval for the scheme going forward until December 2016 and retrospective approval for the operation of the scheme for the period 1 April 2015 to 27 October 2015. During this 7 month period in 2015-16, 788 applications were received. The cost incurred in this period for these applications amounted to £11.9 million and the 20 year cost for these applications is estimated to be £445 million. The Department of Finance and Personnel decided that, while it was prepared to provide prospective approval for expenditure from 28 October 2015, it would not approve commitments entered into in the 7 month period to 27 October 2015. Consequently the expenditure of £11.9 million incurred in that period is irregular and will result in a qualification of the C&AG's regularity opinion.
Audit Response
We will review the circumstances which gave rise to this non-approval and what processes can be put in place to ensure there is no reoccurrence. As the C&AG will be qualifying his regularity audit opinion, there will also be a report outlining the background to this issue, what might have been done better and how DETI has addressed the issue. We will seek to agree this report at an early stage.
Outcome
The accounts have been qualified in respect of this issue and further details are included in the C&AG's report in Annex C.

Risk 2: Harland and Wolff Provision
At 31 March 2015, the Statement of Financial Position included a significant provision of £66 million in relation to the Harland & Wolff liabilities arising from the collapse of the group's insurer. The liabilities relate mainly to asbestos related illnesses of former employees of Harland and Wolff and the most recent actuarial valuation of the provision was carried out in 2013-14. This provision is based on a number of assumptions as to future liabilities and revenues, the outcomes of which cannot be certain. Given this uncertainty, there is a risk that this provision could be materially misstated.
Audit Response
We will review the continuing appropriateness and valuation of the Harland and Wolff provision disclosed in the financial statements with particular emphasis on: Detailed review of the actuarial valuation in line with updated interest rates; Emerging trends in relation to Pleural Plaque claims in NI and the associated settlements; and

Section 1

Audit Risks

Trends of claims in the year.
Outcome
Based on claims experience both in-year and post year end, nothing came to our attention to suggest that either the actuarial valuation at 31 March 2014 nor the 2015-16 update calculations by DETI should be amended; including the assumptions upon which they are based. A more accurate assessment of the provision will be provided in 2016-17; when the next full actuarial valuation is due to be completed. It appears that that the assumptions upon which the actuarial review has been based are still valid and we are satisfied that the estimates have been appropriately made. Furthermore we are satisfied that DETI have made adequate disclosures in Note 16.2 of the financial statements; especially in relation to actuarial uncertainties such as future mortality rates, emergence of new diseases, improvements in medical treatments, and the outcome of future legal cases.

Risk 3: Financial Assets
The Statement of Financial Position includes a significant financial asset investment in relation to the monies due from the Presbyterian Mutual Society Limited for a fixed rate loan of £175 million – at 31 March 2015; the value of this investment was £144 million. The collectability of this loan is largely dependent on the current market value of commercial properties which provide collateral for the loan. We understand that during the course of the financial year there have been changes to the repayment projections, although expert advice to DETI continues to suggest there is no indication of default on the loan. Nonetheless, should market values/conditions change there is a risk that the value of the Financial Asset investment could be materially misstated.
Audit Response
We will perform a detailed review of the Administrator's report and the independent advice received by DETI on this report. We will review the Presbyterian Mutual Society Project Board minutes and associated papers to confirm repayment schedules. We will also consider the need for any bad debt provision against the loan based upon the most current information available.
Outcome
We are content that: • DETI appear to have adequate security over these assets; • the loan is being serviced with no repayments missed (£14m was received in November 2015); • the assets are worth more than the overall debt; and • the property market valuations are rising. We are also content there is adequate disclosure at note 11 to the accounts on this matter.

Section 2

Audit Findings

Financial Reporting and Accounting Policies

2.1 The Annual Report and Accounts are required to comply with the Government Financial Reporting Manual (FReM) in accordance with the Accounts Direction issued by the Department of Finance and Personnel (DFP).

2.2 In this section we draw to your attention our review of qualitative aspects of the accounting practices and financial reporting. This includes any significant changes or issues in respect of the accounting policies; estimates; judgements and the adequacy of disclosures affected by unusual or non-recurring transactions recognised during the period. We also review the overall balance and clarity of information contained in the Annual Report.

2.3 Financial Reporting and Accounting has been high quality, effective and transparent.

2.4 We are content with the appropriateness of the accounting policies judged against the objectives of relevance, reliability, comparability and understandability.

Review of information in the Annual Report

2.5 We review information in the Annual Report only to the extent that we confirm it is consistent with the financial statements and our understanding of the business. Except as noted in the audit opinion, the Annual Report is not subject to our audit opinion.

2.6 The Annual Report was considered to be consistent with our understanding of the business, and was in line with the other information provided in the financial statements.

Regularity, propriety and losses

2.7 Except for the irregular expenditure of £11.9m in relation to the non-domestic RHI scheme there were no other significant regularity, propriety and losses issues identified during the audit.

Internal Control

2.8 We have reviewed the Governance Statement and in our opinion, it fairly reflects our understanding of the state of internal control systems within the entity during the year and the changes made to the Governance Statement during the course of the audit.

Remuneration and Staff Report

2.9 The Remuneration and Staff Report has been properly prepared in line with Department of Finance directions. No findings or recommendations were made.

Observations & Recommendations

2.10 This section outlines the findings arising from our audit, as well as management's response and target date for implementation to these recommendations.

2.11 We have included the significant, important and best practice findings arising from our audit which are defined as:

- Priority 1 – significant issues for the attention of senior management which may have the potential to result in material weakness in internal control.
- Priority 2 – important issues to be addressed by management in their areas of responsibility.
- Priority 3 – issues of a more minor nature which represent best practice.

Other issues of a more minor nature have been sent to the DfE management.

Section 2

Audit Findings

2.12 As outlined in our Audit Strategy our procedures included a review of the internal controls and accounting systems and procedures only to the extent considered necessary for the effective performance of the audit. Audit findings and observations therefore should not be regarded as representing a comprehensive statement of all the weaknesses which exist, or all improvements which could be made to the systems and procedures operated.

Index of recommendations

Issues raised at Final Audit

No.	Description	Priority	Page
1	Renewable Heat Incentive Scheme	1	7

1. Renewable Heat Incentive Scheme

Observation
<u>1 – Irregular payments in respect of the non-domestic Renewable Heat Incentive (RHI) scheme</u> The non-domestic RHI scheme was introduced by DETI in 2011-12 and approval from DFP had been obtained to operate the scheme up to 31 March 2015. DETI was due to seek re-approval of the scheme from DFP from 1 April 2015 however this was overlooked and was not sought from DFP until 29 October 2015. DFP did not approve £11.9 million expenditure incurred in this seven month period during 2015-16 on the non-domestic RHI scheme and as a result, this expenditure is irregular and has been incurred without conforming to the authorities which govern it. It is likely that this expenditure, which has been committed to during the unapproved period for the 788 applications and will continue to be paid for the next twenty years, will also be irregular. The impact of this irregular expenditure on the C&AG's audit opinion in future years will need to be considered. **<u>2 – Inadequate controls on the non-domestic RHI scheme</u>** The non-domestic RHI scheme is administered on behalf of DETI by the Office of Gas and Electricity Markets (OFGEM) via a Service level agreement. OFGEM operate a similar scheme in Great Britain. It appears to us that DETI largely left the administration and monitoring of the scheme to OFGEM and we have been unable to obtain sufficient evidence to be satisfied that the controls over spending incurred on the scheme were adequate to prevent or detect abuse of the scheme. • Key controls to prevent abuse of the scheme included the tiering of payments and the degression model in GB (reducing costs when demand reached a certain level), but these did not apply in Northern Ireland prior to November 2015. • This left the physical inspections by OFGEM as one of the key remaining controls, however, only a very low level of site inspection was carried out at around 0.86 per cent of applications (compared to around 1.86 per cent in Great Britain). • In 2015-16, of the four schemes that have so far been inspected, compliance issues were identified in three, but the Department has not been provided with any detail of these issues by OFGEM. • Given the high risk of heat being generated which is not needed, this level of inspection in a scheme with such a significant level of expenditure is concerning. • Another key control operated by OFGEM is that it will query any increase in boiler hours used which is more than 25 per cent higher than had been predicted in the original application. However it appears to us that the Department has not been routinely involved in considering the veracity of any explanations received and does not routinely get to see the explanations. • The Department has also not (until recently) had any details of the names of companies in receipt of grants. We were unable to gather sufficient evidence that appropriate monitoring controls are in place for the non-domestic RHI scheme and as a result, we are unable to determine whether the expenditure on the non-

domestic RHI scheme amounting to £30.5 million has been incurred for the purposes intended.
Implication
The 2015-16 accounts have been qualified in respect of these matters.
Priority Rating
1
Recommendation
All relevant approvals should be obtained from the Department of Finance on a timely basis. DETI should review the non-domestic RHI scheme and ensure proper controls are now in place to prevent or detect abuse of the scheme.
Management Response
Agreed. The Department has established an “RHI Steering Group” to oversee the actions being taken to address the issues raised by the NIAO. A review of the scheme will be carried out by independent consultants. A report is expected towards the end of September and the Department will carefully consider the recommendations made to enhance controls over the Scheme.
Target for Implementation
Immediate

2.13 In accordance with International Standards on Auditing we have to consider significant weaknesses identified in our prior year audit. There were no Priority 1 recommendations made in our prior year Report to those charged with Governance. The Audit Committee should continue to track progress on all recommendations, including Priority 2 and Priority 3 points.

Section 3

Identified Misstatements

3.1 This section contains details of adjustments made to the financial statements during the course of the audit, as well as unadjusted misstatements which are not considered material in the context of the financial statements as a whole.

3.2 We do not consider that the adjusted or unadjusted misstatements indicate a significant weakness in accounting or control which needs to be reflected in the Governance Statement.

Significant adjustments made to the financial statements

3.3 As a result of our audit, adjustments were made to the first draft financial statements presented for audit. The adjustments are shown below. The presentation of this information enables those charged with governance to assess the extent to which the draft financial statements presented for audit have been subject to change as a result of the audit process.

3.4 The audit adjustments made to the initial draft financial statements presented for audit are noted in the table below. The net effect of the adjustments on both the SoCNE and the SoFP was £0.

Audit adjustments

Reason adjustment is required	Proposed by	Account area	[SoCNE]		[SoFP]	
			Debit £'000	Credit £'000	Debit £'000	Credit £'000
Split Financial Asset Investments between non-current and current assets	NIAO	Current Assets			8,930	
		Non-Current assets				8,930
Pension Accruals for Tourism Ireland Ltd. were overstated	DETI	Accruals			282	
		Programme Costs – Grants		282		
Overall Total			**0**	**282**	**9,212**	**8,930**
Net Effect			**0**	**282**	**282**	**0**

3.5 The first adjustment (which has been reflected in DETI final version of accounts) was made to recognise the fact that part of the Financial Asset Investments will be received in less than one year and should therefore be reflected in current investments. We also made a number of other suggestions to improve narrative disclosures and to ensure completeness of the disclosures required under the FReM.

Section 3

Identified Misstatements

Unadjusted misstatements or uncertainties arising from the audit

3.6 We are obliged to bring to your attention the misstatement found during the course of the audit that have not been corrected, unless they are 'clearly trivial', which we have identified as below £74k.

Description of adjustments	**Account area**	**SoCNE**		**SoFP**	
		Debit	**Credit**	**Debit**	**Credit**
		£'000	**£'000**	**£'000**	**£'000**
Repayment schedule for the Presbyterian Mutual Society financial asset investment now updated	Financial Asset Investments			82	
	Revaluation of assets		82		
Overall Total		**0**	**82**	**82**	**0**
Net effect		**0**	**82**	**82**	**0**

Section 4

Other Matters of Governance Interest

4.1 International Standard on Auditing 260 requires us to communicate with those charged with governance any other audit matters of governance interest. These include matters which have come to our attention which may present future risks, enhance overall governance or where those charged with governance might wish to seek assurance on controls and processes.

Fraud and Regularity

4.2 We are required by Auditing Standards to report to you if we identify a fraud or obtain information that indicates that a fraud may exist. We found no such instances during our testing.

4.3 Except for the inadequate controls relating to the non-domestic RHI scheme, as referred to earlier in this Report, we are not aware of any other material weaknesses of internal controls to prevent and detect fraud.

4.4 In the course of our audit we have not identified any suspected or non-compliance with the laws and regulations.

Going concern

4.5 In the course of our audit, we have not identified any material uncertainties relating to events and conditions that may cast doubt on the continued delivery of the entity's services and functions.

Management of information and personal data

4.6 DETI was required to comply with the Data Protection Act 1998 in the handling and storage of personal data and those charged with governance should ensure they have made sufficient enquiries of management to form a view on whether there were any significant specific data incidents which should be disclosed in the Governance Statement. We are unaware of any data handling incidents during the year. Confirmation of this is sought within the letter of representation (Annex A).

Statement on personal data

4.7 During the course of our audit we have access to personal data to support our audit testing. We have established processes to hold this data securely within encrypted files and to destroy it where relevant at the conclusion of our audit. We can confirm that we have discharged those responsibilities communicated to you in accordance with the requirements of the Data Protection Act 1998.

Disagreements with management

4.8 There are no audit disagreements with management, about matters that individually or in aggregate could be significant to the financial statements to report.

Co-operation with other auditors

Internal Audit

4.9 We did not rely on Internal Audit for any specific account areas. However we did engage with Internal Audit during the course of the audit and reviewed the finalised reports which assisted with our review of the Accounting Officer's Governance Statement.

Deficiencies in internal control

4.10 Other than the matters disclosed by the Department in its own Governance Statement we have not identified any significant deficiencies in the Department's internal controls.

Independence, integrity & objectivity of auditors

4.11 The NIAO's policy to ensure independence, integrity and objectivity of our auditors was set out in our Audit Strategy. Overall, the threat to the audit arising from issues affecting our independence, integrity and objectivity is low, and the safeguards in place ensure that the likelihood of any impact is low.

Other Matters of Governance Interest

4.12 We have complied with APB Ethical Standards and, in our professional judgement, we are independent and our objectivity is not compromised. There are no relationships between NIAO and DETI that we consider to bear on our objectivity and independence.

Reliance on other experts

4.13 We have relied on the work of the external actuary in respect of the valuation of the Harland & Wolff PLC provision. We also relied on the opinions of the insolvency advisor appointed to advise on the Presbyterian Mutual Society financial asset.

Other matters of interest

4.14 We note that DETI's land and buildings have been professionally revalued by Land and Property Services on the basis of existing use. However land at the Ulster Folk Park, Omagh was revalued at 31 March 2015 and buildings at the Consumer Affairs HQ, Newtownbreda were revalued at 31 March 2016. Given that DETI only owns these two assets, it should consider revaluing them at the same time.

Complaints procedure

4.15 NIAO seeks to ensure that, when carrying out its audit work, it complies with the principles developed by the Public Audit Forum in its paper "What Public Sector Bodies can expect from their Auditors".

NIAO also wishes to gauge public sector bodies' perceptions of its audit processes in order to promote continuous improvement. In particular, it undertakes to act quickly on any complaint and ensure that the underlying causes of problems are addressed to prevent them recurring. In the first instance, complaints can be addressed to the member of the Directorate responsible for the audit within which the concern has been raised.

Failing resolution of the problem to the satisfaction of the complainant, the Accounting Officer of the audited body can then write directly to the Comptroller and Auditor General. He will ensure that a further review of the case will be undertaken.

Annex A – Letter of Representation

[Client Letterhead]

The Comptroller and Auditor General
Northern Ireland Audit Office
106 University Street
BELFAST
BT 7 1EU

LETTER OF REPRESENTATION: Department of Enterprise, Trade and Investment 2015-16

I acknowledge as Accounting Officer of the Department of Enterprise, Trade and Investment my responsibility for preparing accounts that give a true and fair view of the state of affairs, net operating cost and cash flows of the Department of Enterprise, Trade and Investment for the year ended 31 March 2016.

In preparing the accounts, I was required to:

- observe the accounts direction issued by the Department of Finance and Personnel (DFP), including the relevant accounting and disclosure requirements and apply appropriate accounting policies on a consistent basis;

- make judgements and estimates on a reasonable basis; and

- state whether applicable accounting standards have been followed and disclosed and explain any material departures in the accounts; and prepare the accounts on a going concern basis on the presumption that the Department of Enterprise, Trade and Investment will continue in operation.

I confirm that for the financialyear ended 31 March 2016:

- other than the £11.9m irregular spend on the RHI scheme, neither I nor my staff authorised a course of action, the financial impact of which is that transactions infringe the requirements of regularity as set out in Managing Public Money Northern Ireland;

- having considered and enquired as to the Department of Enterprise, Trade and Investment compliance with law and regulations, I am not aware of any actual or potential non-compliance that could have a material effect on the ability of the Department of Enterprise, Trade and Investment to conduct its business or on the results and financial position disclosed in the accounts;

- all accounting records have been provided to you for the purpose of your audit and all transactions undertaken by the Department of Enterprise, Trade and Investment have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all management meetings which you have requested have been supplied to you; and

- all Related Parties and Related Party Transactions involving Board Members and other senior staff of the Department of Enterprise, Trade and Investment have been properly disclosed.

All material accounting policies as adopted are detailed in note 1 to the accounts.

INTERNAL CONTROL

I acknowledge as Accounting Officer my responsibility for the design and implementation of internal controls to prevent and detect error and I have disclosed to you the results of my assessment of the risk that the financial statements could be materially misstated.

I confirm that I have reviewed the effectiveness of the system of internal control and that the disclosures I have made are in accordance with DFP guidance on the Governance Statement.

FRAUD

I acknowledge as Accounting Officer my responsibility for the design and implementation of internal controls to prevent and detect fraud and I have disclosed to you the results of my assessment of the risk that the financial statements could be materially misstated as a result of fraud.

I am not aware of any fraud or suspected fraud affecting the Department of Enterprise, Trade and Investment and no allegations of fraud or suspected fraud affecting the financial statements that has not already been communicated to you.

ASSETS

General

All assets included in the Statement of Financial Position were in existence at the reporting period date and owned by the Department of Enterprise, Trade and Investment and free from any lien, encumbrance or charge, except as disclosed in the accounts. The Statement of Financial Position includes all non-current assets owned by the Department of Enterprise, Trade and Investment.

Non Current Assets

All assets over £1,000 are capitalised. They are revalued annually using indices compiled by the Office of National Statistics (ONS). Depreciation is calculated to reduce the net book amount of each asset to its estimated residual value by the end of its estimated useful life in DETI's operations.

I can confirm that Land and Property services revalued land at the Ulster Folk Park, Omagh at 31 March 2015 and buildings at the Consumer Affairs HQ, Newtownbreda at 31 March 2016.

The Database impairment (£5.6m) relates to the Tellus database which was a project that collected geological data across Northern Ireland and stored the data from which licences were granted to third parties. Due to changes in government policy, namely the Open Data Strategy, the database was made publically available and I can confirm is therefore no longer deemed to have a direct value to the Department.

Assets under construction comprise initial stage payments towards the upgrade of the Insolvency Service Case Management and Financial Management System.

Other Current Assets

On realisation in the ordinary course of the Department of Enterprise, Trade and Investment's operations the other current assets in the Statement of Financial Position are expected to produce at least the amounts at which they are stated. Adequate provision has been made against all amounts owing to Department of Enterprise, Trade and Investment which are known, or may be expected, to be irrecoverable.

The Presbyterian Mutual Society financial asset investment with a total value of £129.4 million at 31 March 2016 has now been split between non-current assets and current assets on the Statement of Financial Position and is disclosed at Note 11 to the accounts.

The timing of asset realisations and hence loan repayments to DETI remains difficult to predict. However, annual business plan updates and forecasts should identify any potential issues at an early stage to enable the Department to make informed decisions. Based on the 2014 joint supervisor's financial projections to 2020, the 2014 commentary on these projections from our insolvency advisors, the current state of the UK property market and Joint Supervisor forecasts to 2016, I am content that the financial projections remain valid to support the carrying value of the loan and that there remains flexibility to extend the terms of the loan should this be required.

LIABILITIES

General

All liabilities have been recorded in the Statement of Financial Position. There were no significant losses in the year and no provisions for losses were required at the year end.

Provisions

Provision is made in the financial statements for:

- £60m for the Harland & Wolff PLC asbestosis-related illness claims. This is the Department's best estimate of the amount to be provided for; taking into account actuarial advice. I am content that the assumptions within the last actuarial report remain valid; and
- £42k for early departure costs.

I am content that full provision is made in the financial statements for all liabilities which are expected to materialise.

Contingent Liabilities

Full provision is made in the financial statements for all liabilities which are expected to materialise.

I am not aware of any pending litigation which may result in significant loss to the Department of Enterprise, Trade and Investment, and I am not aware of any action which is or may be brought against the Department of Enterprise, Trade and Investment under the Insolvency (Northern Ireland) Order 1989 and the Insolvency (Northern Ireland) Order 2005.

OTHER DISCLOSURES

Results

Except as disclosed in the accounts, the results for the year were not materially affected by transactions of a sort not usually undertaken by the Department of Enterprise, Trade and Investment, or circumstances of an exceptional or non-recurring nature.

Unadjusted errors

The following unadjusted error has been brought to my attention:

- Net assets should have increased by £82k as the repayment schedule for the Presbyterian Mutual Society financial asset investment has now been updated.

I consider the effect of this unadjusted error to be immaterial, both individually and in aggregate, to the financial statements taken as a whole.

Events after the Reporting Period

Except as disclosed in the accounts, there have been no material changes since the reporting period date affecting liabilities and commitments, and no events or transactions have occurred which, though properly excluded from the accounts, are of such importance that they should have been brought to notice.

Dr. Andrew McCormick
Accounting Officer
Department of Enterprise, Trade and Investment
22 June 2016

Department of Enterprise, Trade and Investment

THE CERTIFICATE OF THE COMPTROLLER AND AUDITOR GENERAL TO THE NORTHERN IRELAND ASSEMBLY

I certify that I have audited the financial statements of the Department of Enterprise, Trade and Investment for the year ended 31 March 2016 under the Government Resources and Accounts Act (Northern Ireland) 2001. The financial statements comprise: the Statements of Comprehensive Net Expenditure, Financial Position, Cash Flows, Changes in Taxpayers' Equity and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the Statement of Assembly Supply and the related notes and the information in the Remuneration and Staff Report and Accountability and Audit Report within the Accountability Report that is described in that report as having been audited.

Respective responsibilities of the Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Accounting Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act (Northern Ireland) 2001. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Department's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accounting Officer; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the Statement of Assembly Supply properly presents the outturn against voted Assembly control totals and that those totals have not been exceeded. I am also required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by the Assembly and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Basis for qualified opinion on regularity arising from inadequate controls and expenditure incurred without the necessary approvals in place

I was unable to obtain sufficient evidence that the Department's controls over spending on the non-domestic Renewable Heat Incentive (RHI) scheme were adequate to prevent or detect abuse of the scheme. Because of this lack of evidence I was unable to form an opinion on whether the expenditure on the scheme of £30.5 million had been applied for the purposes intended by the NI Assembly.

Included within this expenditure is an amount of £11.9 million on which retrospective approval had not been granted by the Department of Finance (formerly Department of Finance and Personnel). This arose because the Department had been due to seek re-approval of the scheme from the Department of Finance from 1 April 2015, but this approval was not sought until the end of October 2015. Consequently, my regularity opinion has been qualified in respect of this expenditure, as the expenditure does not conform to the authorities which govern it.

Qualified opinion on regularity

In my opinion, in all material respects:

- the Statement of Assembly Supply properly presents the outturn against voted Assembly control totals for the year ended 31 March 2016 and shows that those totals have not been exceeded; and
- except for the £30.5 million of expenditure on the non-domestic RHI scheme referred to above, the expenditure and income recorded in the financial statements have been applied to the purposes intended by the Assembly and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the Department's affairs as at 31 March 2016 and of its net operating cost for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act (Northern Ireland) 2001 and Department of Finance directions issued thereunder.

Opinion on other matters

In my opinion:

- the parts of the Remuneration and Staff Report and the Accountability and Audit Report to be audited have been properly prepared in accordance with Department of Finance directions made under the Government Resources and Accounts Act (Northern Ireland) 2001; and
- the information given in the Performance Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

In respect only of the issues relating to non-domestic RHI expenditure I have not received all of the information and explanations that I require for my audit.

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements and the parts of the Remuneration and Staff Report and the Accountability and Audit Report to be audited are not in agreement with the accounting records; or
- the Governance Statement does not reflect compliance with Department of Finance's guidance.

My detailed observations are included in my report attached to the financial statements.

KJ Donnelly
Comptroller and Auditor General
Northern Ireland Audit Office
106 University Street
Belfast
BT7 1EU

28 June 2016

Introduction

1 The Department of Enterprise, Trade and Investment (the Department) had responsibility for a range of functions including economic development policy, economic advice and research, business regulation, research and statistic services, health and safety at work and mineral development (these responsibilities transferred to the new Department for the Economy (DfE) on 8 May 2016). In 2015-16 the Department spent a total of £291 million (2014-15 - £228 million). Of this total expenditure around £35 million was spent promoting the use of and providing support for the use of renewable heating technologies.

2 My report below reviews the results of my audit of the Department's 2015-16 financial statements and sets out why I have decided to qualify my regularity audit opinion in relation to two issues:

- expenditure amounting to £11.9 million which was incurred without the necessary approvals in place for the non-domestic Renewal Heat Incentive (RHI) scheme (paragraphs 4 to 16) and is therefore irregular; and
- because I was unable to obtain enough evidence to be assured that expenditure on the non-domestic RHI scheme amounting to £30.5 million had been incurred for the purposes intended (paragraphs 17 to 27). This was due to the fact that I did not consider that the systems in place to prevent or detect abuse of the scheme were adequate.

3 The report also highlights general concerns in relation to the operation of the scheme and the circumstances surrounding the large increase in demand in October and November 2015 which will result in a significant cost to the Northern Ireland block grant for many years (paragraphs 28 to 53).

Qualified opinion due to expenditure incurred without the necessary approvals in place

4 I am required under the Government Resources and Accounts Act (Northern Ireland) 2001 to report my opinion as to whether the financial statements give a true and fair view. I am also required to report my opinion on regularity, that is, whether in all material respects the expenditure and income have been applied to the purposes intended by the Northern Ireland Assembly and the financial transactions conform to the authorities which govern them.

5 The Department of Finance and Personnel (DFP) did not approve £11.9 million expenditure incurred in a seven month period during 2015-16 on the non-domestic RHI scheme and as a result, this expenditure is irregular. Consequently, I have qualified my opinion on the 2015-16 Departmental Resource Accounts on the regularity of expenditure incurred on the non-domestic RHI scheme as this expenditure has been incurred without conforming to the authorities which govern it.

Background to the Audit Qualification

6 In its Programme for Government 2011-2015, the Executive set a target of achieving 4 per cent of Northern Ireland's heat consumption from renewable sources by 2015 and 10 per cent by 2020. In pursuit of these targets the non-domestic RHI scheme was introduced in Northern Ireland in November 2012, following the introduction of a parallel scheme in the rest of the UK. The RHI scheme was a financial incentive scheme designed to increase the uptake of renewable heat technologies and for approved installations pays a fixed amount for every kilowatt of heat energy produced by various renewable technologies for a period of twenty years after installation. The main methods of generating heat included biomass heating systems (mostly burning wood pellets), solar thermal and heat pumps. A similar RHI scheme for domestic properties was introduced in December 2014.

7 RHI is administered on behalf of the Department by the Office of Gas and Electricity Markets (OFGEM). Anyone wishing to join the scheme was required to purchase a suitable system from an approved installer and once installed apply to OFGEM, who would review the claim and once approved would manage quarterly payments to the applicant and then recover these payments from the Department. Once the scheme had been approved by OFGEM, the subsidy is paid to the applicant at a fixed rate each year, increasing in line with inflation. Each applicant has to submit quarterly meter readings to OFGEM.

8 The Department is made aware of new applications and their progress through weekly updates from OFGEM. However, given the design of the scheme it is difficult to manage demand – in hindsight, this was a flaw in the system as the scheme in both NI and in GB was designed as a demand led scheme whereby applicants install their renewable heating system before making an application.

9 RHI was also intended to have a number of other wider benefits in terms of fuel security, lower emissions and 'green jobs.' The Department had approval from DFP for a total budget of £25 million for the period 2011-12 to 2014-15. However, because of a delay in introducing the scheme until late 2012 together with the low initial levels of uptake, there was a considerable under spend totalling around £15 million up to 2014-15 as can be seen in the table below. As a result of the low uptake, a lot of the Department's focus at this time was on identifying ways to increase demand.

Table 1: Under spending on the RHI scheme 2011-12 to 2014-15

	2011-12 £'000	**2012-13 £'000**	**2013-14 £'000**	**2014-15 £'000**	**Total £'000**
Budget Allocation	2,000	4,000	7,000	12,000	25,000
Total spend	0	(470)	(1,650)	(7,925)	(10,045)
Under spend	**2,000**	**3,530**	**5,350**	**4,075**	**14,955**

Source: Department

10 The Department was due to seek re-approval of the scheme from DFP from 1 April 2015. However this was overlooked. It was only in May 2015 that the Department identified that DFP approval had expired and it then had to urgently begin the process of achieving approval and securing the necessary budget both for 2015-16 and the following years. Had the need to receive re-approval from DFP been identified when it should have been, then this would have provided an important opportunity to review the scheme and amend it to include cost control measures. As it was, this potential opportunity was missed.

11 I asked the Department why it had not sought approval to continue the scheme from DFP well before the original approval expired. The Department has told me that their explanation lies in a combination of staff changes and an administrative oversight. Subsequent to the requirement for re-approval being put in place, there were multiple staff changes, and the key information was not passed on from departing staff to their successors. The Department recognises that administrative arrangements ought to have been in place to trigger an application for re-approval at the appropriate time. They were not; and the matter came to light only when budget confirmation was sought.

12 As well as the expiry of the DFP approvals in April 2015, around that time it also became clear that the number of applications was beginning to increase significantly. The Department reviewed this over the summer months and decided that changes would be required to the tariffs under the scheme to manage the demand.

13 The amended scheme proposed a much lower second tier tariff once the heating equipment had been used for 15 per cent of the total hours in a year. This followed a similar two tier approach that had been used in Great Britain since the RHI scheme began there, with the intention of the higher rate providing a return on the capital cost while the lower second tier rate minimised any incentive to unnecessarily generate heat just to claim under the scheme.

14 The timescale for approving and making the legislation using normal procedures meant that the new arrangements did not come into force until 18 November 2015. There was a very large spike in demand during the 10 week period between the announcement of the new arrangements on 8 September 2015 and their coming into operation. The impact of this increase in demand is discussed in more detail later in this report.

15 Based on the revised tariff approach, DFP approved the business case for the scheme on 29 October 2015 but did not give retrospective approval for the 788 non-domestic RHI applications with an annual estimated cost of £11.9 million that had been completed between 1 April 2015 and 29 October 2015. Because of this non-approval, the estimated current year expenditure of £11.9 million expenditure incurred by applications which were approved in this period is irregular and my audit opinion has been qualified this year in respect of this.

16 It is likely that an estimated £19.4 million of expenditure will continue to be incurred annually on these 788 applications for the next twenty years. Unless the Department is able to obtain retrospective approval from DFP, this expenditure will continue to be irregular in the future and I will consider the impact of this irregular expenditure on my audit opinion in future years. I asked the Department what it is doing to regularise this expenditure and it told me it will be considering all possibilities for future options around the scope to introduce additional cost controls and will advise the new Minister accordingly.

Qualified opinion arising from weaknesses in control

17 I was also unable to obtain sufficient evidence to be satisfied that the controls over the spending incurred on the non-domestic RHI scheme were adequate to prevent or detect abuse of the scheme. As discussed later in this report there have been allegations of significant abuses of the scheme from an anonymous whistleblower and while these are still under investigation it appears to me that the controls in the scheme would not have prevented the alleged abuses.

18 The non-domestic RHI scheme was intended to be similar to that which operated in Great Britain. In the GB scheme there were some important controls built into the scheme which were not included in the NI scheme. These were:

- Tiering of payments – a reduced rate (tier 2 rate) applied in Great Britain after the equipment had been operated for 15 per cent of the hours in a year. This prevented abuse of the scheme by operating the equipment simply to increase the grant received. This was because the reduced tier 2 rate was significantly lower than the cost of fuel required to claim the grant. In Northern Ireland there was no tiering until November 2015 and the single tariff was higher than the cost of fuel; and

- Degression – this was a means by which the tariff in Great Britain changed quarterly in response to changes in demand. This helped to ensure that excessive profits were not made by applicants.

19 The Department largely left the administration of the scheme to OFGEM. OFGEM were responsible for receiving claims from applicants who had installed relevant equipment using approved installers. OFGEM reviewed the applications, approved them and then managed payments to the applicants based on the amount of heat they had generated and recorded on meters attached to their equipment.

20 OFGEM also carried out physical inspections of the equipment installed to ensure it met the scheme requirements. However I understand that the rate of inspection in Northern Ireland has been very low at around 0.86 per cent of applications (compared to around 1.86 per cent in Great Britain).

21 I asked the Department why these rates of inspection were so low. The Department has explained that this was a result of site audits being planned on the basis of anticipated application rates. Based on the number of applications in the first 6 months of the scheme, the inspection rate was 4 per cent, which decreased to 1.5 per cent from scheme launch in November 2012 until September 2015. The significant and unprecedented increases in application volumes in the period to February 2016 saw the rate fall further to 0.86 per cent. The Department also told me that it and OFGEM have regularly discussed the approach to audit as the numbers of applications increased, as part of the developing audit strategy for 2016-17 and beyond. The Department has said that it and OFGEM are already engaged in a joint review, which in addition to considering an approach to applications received in 2015-16 will inform the audit strategy for 2016-17 and beyond. In addition the Department is in the process of procuring a service provider to deliver a programme of additional audits as part of this strategy.

22 The low rate of inspection is compounded by the fact that when issues are identified by the inspection process it is very unclear if anything is done about it – particularly by the Department. In 2015-16 of the four scheme inspections that had been completed at the time of this report, compliance issues were identified in three. The Department has told me that it views the non-compliance issues in the three cases as being minor.

23 The Department has also told me that it is routinely provided with an indication of the kind of issues that are identified and it is OFGEM's responsibility to escalate and act on any material non-compliance issues. The Department has regular meetings with OFGEM at which operational issues or trends are raised as appropriate and note that there are a large number of eligibility requirements and ongoing obligations relating to the Non-

Domestic RHI scheme. The Department believes that while OFGEM rightly and properly records and actions these issues where identified and where appropriate, in many cases these do not have a material impact. OFGEM uses the results of its audit programme, not only to take action on individual cases, but to consider the wider approach to non-compliance, and this includes administrative/operational changes (such as via updating guidance or processes) to focus on preventative measures.

24 Another important control operated by OFGEM to prevent abuse of the scheme is that it will query any increase in heating equipment hours used which is more than 25 per cent higher than had been predicted in the original application. However it is unclear how OFGEM challenges the veracity of the explanations received and in any case the Department does not routinely get to see the explanations. The Department told me that individual responses to requests for information are assessed on a case-by-case basis by OFGEM who will not release payments if it has evidence or reasonable grounds such that it is not satisfied that ongoing obligations have been met. Outcomes of this review includes referral of individual installations for further investigations, either by compliance teams or via inclusion in the site audit programme.

25 When OFGEM requests payments from the Department to the applicants, it provides a unique reference number for each installation, the amount to be paid and details on what sector the applicant works in e.g. Agricultural sector. Names of applicants are not included, which the Department has told me is for data protection reasons, although names can be provided on request. As a result at the time this report was written, the Department was unable to provide any details of the names of companies in receipt of grants.

26 I am concerned that the design of the NI non-domestic RHI scheme and the way that the Department operated and monitored it has made it vulnerable to abuse. The high level of applications received in the current year and the specific whistleblower allegations (discussed later in this report) that the Department is currently investigating have further added to these concerns. As a result of these concerns I have qualified my regularity opinion on the non-domestic RHI scheme because I was unable to obtain enough evidence to be satisfied that these grants paid during the year amounting to £30.5 million had been incurred for the purposes intended.

27 I asked the Department why it left the monitoring of the non-domestic RHI scheme almost entirely to OFGEM and why it had not been involved to a greater extent in the monitoring of these schemes. The Department told me it is in regular contact with OFGEM regarding application queries and that OFGEM provide weekly reports outlining the latest position regarding application numbers and their status (i.e. pending, approved, refused). In addition, the Department said that from August 2014, it has held formal meetings[2] with OFGEM by conference call, where operational, policy and budgetary issues are discussed and addressed.

Other issues relating to the non-domestic RHI scheme

28 As well as the fact that irregular expenditure has been incurred due to non-approval by DFP, I also have significant concerns in relation to;

- the amount of expenditure that has been committed to in the future;
- the future impact on the Northern Ireland block grant; and
- the allegations that have been received from a whistleblower.

Background to non-domestic RHI

29 Non-domestic RHI aimed to provide long term financial support for those with heating systems in commercial, public or industrial premises wishing to switch from conventional heating to renewable heating solutions, such as biomass (mostly wood pellets), heat pumps and solar thermal. The scheme was intended to be a long term approach to developing the renewable heat market by providing consistent, secure, long term payments for renewable heat generation.

30 The Department set the level of tariff (in the form of pence per kilowatt hour (p/kwh) for heat generated) which was dependent on the size and type of technology and was calculated to cover capital costs, operating costs and non-financial hassle costs (e.g. removal of ash) over the lifetime of the technology. However these calculations were made in 2012 when the scheme was initially established and were not reviewed until Autumn 2015.

[2] These meetings have been formally minuted from November 2015.

31 The Great Britain (GB) non-domestic scheme had two tiers of payment from the outset - a higher Tier 1 rate payable for the first 1,314 hours of use (representing 15 per cent of total hours in the year) and then a lower Tier 2 rate for the remaining hours. The Tier 1 payment was considered to be sufficient to cover most of the installation costs and the lower Tier 2 rate was to discourage users from simply running the heating system to generate the tariff benefit.

32 When the scheme was first considered in 2011 the Department decided that the GB scheme could not be simply taken across to Northern Ireland because of significant differences between the two areas, mainly as a result of the wider availability of natural gas in GB compared to a more general dependence on oil for heating in Northern Ireland. Consultants were engaged to suggest appropriate rates in Northern Ireland and in their report they recommended that the Department should consider using the GB rates before also going on to suggest various Northern Ireland specific rates.

33 The suggested rate for biomass boilers below 100kw (which became by far the most popular heat generating method in Northern Ireland) was recommended at 4.5 pence per kwh based on a 20kw biomass boiler reference case. At this rate the consultants noted that there was no need for tiering as at that time the proposed rate was less than the cost of wood pellets and therefore there was no incentive to excessively use the boilers just to claim the subsidy.

34 The consultants were asked to reconsider the rates following feedback from the consultation process, and in February 2012 the consultants produced a new paper which increased the rates available to take into account a larger reference point boiler. The rate proposed in this paper for biomass boilers less than 100kw was increased to 5.9 pence per kwh but there was no mention of the need for tiering or that this was not in excess of the cost of wood pellets. The final business case, approved by the Department and DFP in mid 2012 included the 5.9 pence subsidy rate which has subsequently been increased in line with inflation to 6.4 pence per kwh.

35 In the business case to DFP the Department states that there was no need to consider tiering because the rate proposed was lower than the cost of fuel and therefore there would be no incentive to abuse the system by generating heat just to claim the subsidy. However in the case of biomass boilers this was not the case and appears to have been copied from the July 2011 consultant's report without thought. In fact the cost of wood pellets was shown in the same business case as being 4.39 pence per kwh compared to the proposed subsidy rate of 5.9 pence per kwh. In hindsight the failure to adequately consider the tiering of rates similar to the GB scheme was a critical mistake.

Table 2: Development of NI Non-domestic RHI rates*

	Pence/Kwh
June 2011 (Consultants – original report)	4.5p
Feb 2012 (Consultants – revised following consultation)	5.9p
June 2012 Department business case	5.9p
Cost of wood pellets in 2012 (per Department business case)	4.39p

*based on rate for a biomass boiler up to 100kw

Source: Department

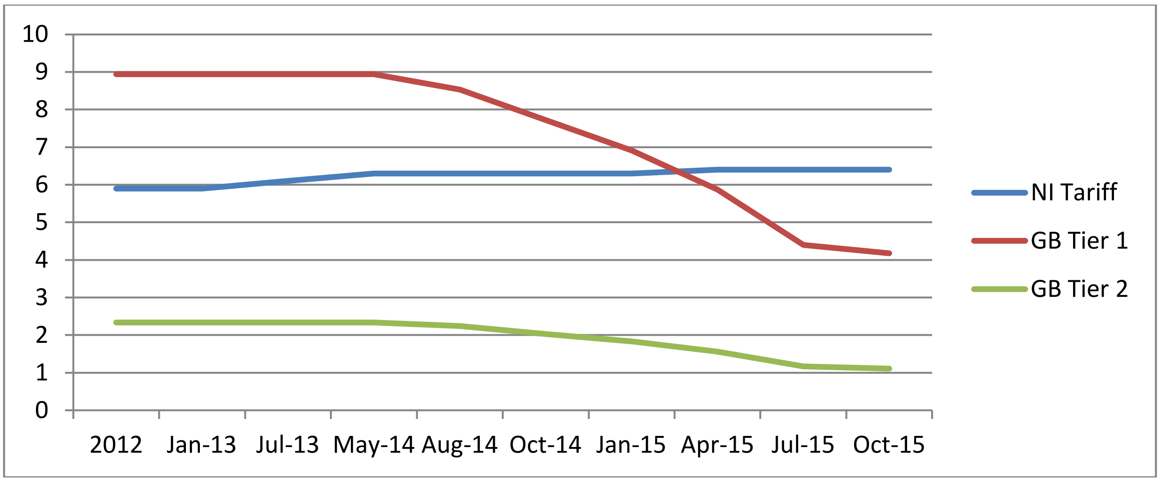
36 The GB scheme also had a system (known as degression) built in from April 2013 to allow the tariff paid to reduce in response to an increase in demand. This meant that the tariff paid was reviewed each quarter and revised (with a month's notice) according to the level of demand for the scheme. Degression was introduced in GB to ensure affordability and value for money.

37 At the time degression was introduced in GB in April 2013, demand for RHI was very low in Northern Ireland, thus creating a significant under spend for the Department (see Table 1). The Department has told me that its priority at that time was in identifying ways to increase demand and also on the introduction of a similar scheme for domestic applicants. As a result the degression system (or an alternative cost control system) was not introduced

in Northern Ireland and the tariff rate was unchanged (other than being increased by inflation) for a long period of time. Once it became apparent that demand was increasing significantly the Department was unable to react quickly due to legislative constraints.

38 The graph below shows a comparison (in pence) between the Northern Ireland tariff and both GB tariffs. The Northern Ireland single tariff increased from 5.9 pence in 2012 to 6.4 pence in 2015, while the two tariffs in GB halved over the same period.

Graph 1: Comparison of Northern Ireland and GB RHI non-domestic tariffs from 2012 to 2015 in pence (based on a typical 99kw biomass boiler) *



*the 99kw biomass boiler was the main source used in NI non-domestic RHI claims

Source: Department

39 This meant that typical returns were much higher for applicants in Northern Ireland than in GB, especially since 2015. The tables below show that the annual Northern Ireland RHI grant for a typical boiler installed in May 2015 could have been almost twice as much as for the same boiler in GB and when this continues to be paid over 20 years, those recipients in Northern Ireland stand to receive a substantial amount more than those in GB.

40 A comparison of the returns achieved by a typical wood pellet boiler operating for 12 hours a day, 5 days a week and achieving 93 per cent efficiency in Northern Ireland and in Great Britain is shown in Table 3 below.

Table 3: Comparison between NI and GB – Biomass boiler used 60 hours per week

	Northern Ireland	**Great Britain**
	£	**£**
Annual profit by using biomass	**15,484**	**6,795**
Profit over 20 years	309,680	135,900
Initial capital cost to install biomass boiler	(45,000)	(45,000)
Net Profit over 20 years	**264,680**	**90,900**
Annual return on investment	**30%**	**10%**

The detail and sources behind these calculations is shown in Annex A, Example 1

41 As there was no tiering of tariff rates in Northern Ireland for installations approved before November 2015, even greater amounts of grant could be obtained by running the boiler for up to 24 hours a day as there is no upper limit on the amount of energy that would be paid for. The more heat that is generated, the more is paid. Indeed with the cost of running a biomass boiler estimated at around 4.01p/kWh[3] and the RHI grant at 6.4p/kWh it

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would appear to benefit those in receipt of a grant approved prior to November 2015 to use the boiler 24 hours a day, even if the heat generated is not being used.

42 In some cases such as in the Poultry industry, it is possible that a biomass boiler could be used almost all of the time in order to replace an oil boiler. In an extreme case of the boiler being operated 24 hours a day and only being stopped for servicing, as shown in Table 4 below, very large profits could be realised, even though the use of the biomass boiler would still be in line with the spirit of the scheme.

Table 4: Biomass boiler used 24 hours a day all year round, replacing an oil boiler

	Northern Ireland	Great Britain
	£	£
Annual profit by using biomass	**43,179**	**9,621**
Profit over 20 years	863,580	192,420
Capital costs (including replacement every 5 years)	(126,000)	(126,000)
Net Profit over 20 years	**737,580**	**66,420**
Annual return on investment	**82%**	**7%**

The detail and sources behind these calculations is shown in Annex A, Example 2

43 Alternatively it has been alleged by a whistleblower that the scheme's inherent weaknesses have led to abuse of the scheme, with biomass boilers purchased just to collect the subsidy, while not replacing any previous heating and just heating empty space for no legitimate business reason. This can also generate significant returns as can be seen in the example below, which is also based on the extreme assumption of virtually continuous use.

Table 5: Biomass boiler used 24 hours a day, heating empty space, not replacing oil boiler

	Northern Ireland	Great Britain
	£	£
Annual profit/(loss) by using biomass	**19,146**	**(14,412)**
Profit/(loss) over 20 years	382,920	(288,240)
Capital costs (including replacement every 5 years)	(135,000)	(135,000)
Net Profit/(loss) over 20 years	**247,920**	**(423,240)**
Annual return on investment	**27%**	**n/a**

The detail and sources behind these calculations is shown in Annex A, Example 3

44 Each of these examples show an unacceptably high rate of return for businesses taking advantage of the non-domestic RHI scheme in Northern Ireland. The potential for these types of returns should have been identified and prevented when the scheme was being designed.

Domestic Renewable Heat Incentive

45 RHI was extended to homes in the domestic sector in December 2014 to encourage people to switch renewable heating systems and reduce carbon emissions. Similar to the non-domestic scheme, the main methods of generating heat included biomass (burning wood pellets), air and ground source heat pumps and solar thermal. The benefits to applicants are less lucrative, with an upfront payment to a maximum of £3,500 and up to £2,500 a year for seven years, depending on heat requirements. Uptake for the domestic scheme is comparable to the non-domestic scheme but the costs are considerably less with the total cost of the scheme being estimated at around £30 million compared to £1.15 billion for the non-domestic scheme.

Demand for the non-domestic scheme

46 By May 2015 it was apparent that demand for the non-domestic scheme was increasing and coupled with the need to receive DFP approval for future budget cover, meant that the level of support for the scheme and the

scheme legislation urgently had to be reviewed. During July and August 2015 it was decided to introduce a two tier tariff system, similar to GB and also to review the legislation for the scheme. The reduced tariff rate was publicly announced on 8 September 2015 but there was a ten week period before the legislative changes came into effect on 18 November 2015. The table below shows the old and new tariffs for a typical 99kw boiler, which was the most popular boiler used in the scheme.

Table 6: Comparison of non-domestic tariffs before and after 18 November 2015 in Northern Ireland

	Boilers installed before 18 November 2015	Boilers installed after 18 November 2015
Tier 1	6.4p/kWh	6.4p/kWh
Tier 2*	N/A	1.5p/kWh

*Tier 2 applied in the revised scheme for all hours after the first 1,314 hours (representing 15 per cent of total hours in the year) of use in the year and up to a maximum of 400,000kWhth. There is no maximum number of hours that can be claimed for in the original scheme.

Source: Department

47 Following the announcement of the tariff change in September 2015, during October and the first half of November 2015, there was a huge spike in applications with almost as many applications being received in those seven weeks as had been made in the previous 34 months since the scheme began. The expected cost of the applications made during this seven week period will be around £24 million annually for each of the next twenty years. The numbers of applications and expected costs of both schemes are shown in the table below.

Table 7: RHI Applications and associated costs 2012 to 2016

Period	**Application Numbers**	**Annual Cost**	**Total 20 Year cost[4]**
		£m	**£m**
Non-domestic schemes			
Nov 2012 – March 2015	564	13.2	285
April to September 2015 *	359	6.4	195
October 2015 *	429	5.5	250
November 2015	452	4.8	235
December 2015 – March 2016	324	0.6	185[5]
Total non-domestic	**2,128**	**30.5**	**1,150**
Domestic schemes	2,721	4.6	30
Total commitment to 31 March 2016	**4,849**	**35.1**	**1,180**

* 788 non-domestic RHI applications costing £11.9 million that had been completed between 1 April 2015 and 29 October 2015 for which DFP did not give approval.

Source: Department

[4] The 20 year forecast figure can only be an indication at this point and hence is rounded to the nearest £5m. A number of uncertainties remain over such a long time frame – the figure shown is the best estimate of the worst case scenario and has been prepared on the basis of the 2016/17 estimates going forward. The 20 year figure has been adjusted for inflation at a rate of 1.6 per cent annually and no drop out rate has been assumed. It is likely that the figure could be less than shown.

[5] Assumes that 2 large CHP (combined heat and power) plants with preliminary accreditation will proceed in 2018-19

48 In early 2016 it was decided that in view of the significant financial risk to the Northern Ireland block grant for the next twenty years, legislation should be introduced to suspend the non-domestic and domestic RHI schemes. This was announced and the schemes were formally closed on 29 February 2016.

Funding for the scheme

49 The RHI scheme has been demand led from the beginning and was intended to be funded as Annually Managed Expenditure (AME). For most categories of AME spending, HM Treasury provides the amount required to fulfil defined policies and obligations (e.g. social security benefits), and the budget provided is adjusted annually (up or down) without affecting the Northern Ireland block grant – in essence the risk of the amounts required exceeding the budget is borne by HM Treasury, not the NI Executive.

50 However, in the case of RHI, there was a limit to the amount of AME funding that would be paid from HM Treasury, though there was some lack of clarity as to how this would be applied. It later became clear that HM Treasury intended to cap the amount of AME and under the Barnett formula, this was set at 3 per cent of the funding available to the GB RHI scheme. Any excess would then have to be paid from the Northern Ireland block grant.

51 The approach to the setting of budgets for the Northern Ireland non domestic RHI scheme, and in particular the AME allocations, was clarified in an email from HM Treasury and two letters to the Department from the Department of Energy and Climate Change (DECC):

- In April 2011, an email from HM Treasury officials stated that RHI spending was not being treated as standard AME, where the Exchequer takes on all risks of overspend, but instead there would be a risk-sharing arrangement. The email pointed out that the NI share of funding would be around 3 per cent of the GB funding and if RHI spending in one year exceeded the profile set in the Spending Review, then the Department would need to repay this in future years and would incur a Departmental Expenditure Limit (DEL) penalty likely to be of the order of 5 per cent. This informal information was never confirmed by HM Treasury. However, DETI officials, in an exchange of emails in May 2011, noted that the implication of the Treasury position was that it would be necessary to consider having controls in place to limit expenditure: there is no record of subsequent attention to this point;

- In November 2013, a letter drawing attention to the changes made to the GB scheme to ensure affordability and value for money (including the degression changes); and

- In January 2014, a letter confirming that the NI allocation of AME funding would be based on a Barnett formula share (3 per cent) of the GB RHI budget.

52 The Department has told me that although it was aware from January 2014 that the 2015-16 allocation would be a Barnett consequential share, officials did not know until December 2015 that the rate of increase in the DECC budget on which that share was based was to be much lower than in the plans previously communicated by HM Treasury, and that all overspend after 2016-17 would have to be met from resource DEL.

53 When demand increased dramatically between September and November 2015 this greatly increased the costs of the scheme. HM Treasury did not impose a DEL penalty in relation to the excess expenditure in 2015-16, but has ruled out any increase in the AME allocation to the NI Executive for the years from 2016-17 onwards to assist with the increased costs the Department has incurred. Because the increased costs are committed for twenty years, the excess will now have to be met from the Northern Ireland block grant. It is difficult to estimate the total amount that will have to be met from the block grant because it will depend on the AME allocation from GB in the future. However over the next five years the Department estimate a cost to the NI Block of around £140 million, if no action is taken, as shown in Table 8 below.

Table 8: Projected deficit in AME funding from 2016-17 to 2020-21

	16-17	17-18	18-19	19-20	20-21	Total
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Total cost	50,700	51,700	54,800	55,700	56,600	269,500
AME allocation	18,300	22,300	25,700	28,900	34,300	129,500
Deficit	**(32,400)**	**(29,400)**	**(29,100)**	**(26,800)**	**(22,300)**	**(140,000)**

Source: Department

Whistleblower allegations

54 In January 2016, the Office of the First Minister, Deputy First Minister (OFMDFM) received an anonymous whistle blowing letter, alleging abuse of the scheme by businesses who are not working within the intended guidelines. The allegations include:

- the scheme is not being monitored and it is left to the installer to vet whether suitable businesses can avail of the scheme;
- there is no comparison made between the cost of the current heating system and the heating generated by the new system;
- large factories with no previous heating have installed three biomass boilers with the intention to run them all year round in order to collect approximately £1.5 million over the next 20 years; and
- a farmer who has no need for a biomass boiler is aiming to collect approximately £1 million over the next 20 years for heating an empty shed.

55 I asked the Department how they are going to investigate these allegations. The Department told me that it has jointly commissioned with OFGEM an independent review of the scheme to assess whether its operation is in compliance with the Scheme Regulations and if there is any evidence of the Northern Ireland RHI scheme having been abused or if eligible scheme participants have failed to operate within the Scheme Regulations. The review is to be conducted in a two-part process:

- Phase 1 – an assessment of OFGEM's processes and controls to administer the Northern Ireland RHI scheme in accordance with the Regulations, to assess whether the scheme is operating in compliance with the legislation and highlight any areas of concern warranting further investigation; and
- Phase 2 - site inspections of a sample of (a) current applicants awaiting award; (b) scheme participants with multiple installations; and (c) scheme participants.

56 The Department told me that this independent review is still ongoing. The Phase 1 work has been largely completed and it is anticipated that the findings of this review will be finalised at the end of July 2016. The Department also advised me that, on further consideration, it has decided to supplement the work done to date through OFGEM with a new independent review, which is due to be completed in September 2016.

57 The Department has also said that it intends to respond to the large spike in demand by initiating procurement of additional auditing and checks. A business case is under development to procure an independent audit assurance body which will undertake a range of site audits on both the NI non domestic and domestic schemes. The Department has secured additional funding for extra audits in 2016/17. This will supplement the OFGEM programme of audits under the non domestic scheme. It is planned that around 1 in 10 installations will be audited annually under both schemes, (around 500 audits each year).

58 I would expect the Department to ensure any recommendations are acted upon and any necessary action is taken. I will closely monitor the outcomes of the reviews instigated by the Department.

Conclusions

59 The operation of this scheme over the last few years and its future budgetary implications give rise to a number of significant concerns. These include that the scheme:

- was not designed to include any viable cost controls despite the clear indication in April 2011 that this would not be funded without limit by HM Treasury;
- did not take the opportunity in 2013 to mirror the GB scheme and introduce some cost control measures at that time;
- did not take account of changes to underlying costs since 2012 and therefore was over-generous in incentivising renewable heat;
- couldn't be changed quickly when it became apparent that demand was rising quickly;
- wasn't approved by DFP after April 2015 and resulted in irregular expenditure. If the need for this approval had been identified at the right time then it could have been the catalyst for a wider review of the scheme;
- has at least facilitated the possibility of funding that is at best not in line with the spirit of the scheme and at worst possibly fraudulent (though there is no *prima facie* evidence of fraud at present);
- was not properly monitored and controlled by the Department who solely relied on the work being done by OFGEM; and
- did not identify the risks of overspending at an earlier stage even though AME allocations had been previously advised. This has led to an impact on the Northern Ireland block grant which is likely to be measured in hundreds of millions of pounds.

60 This scheme has had serious systemic weaknesses from the start. The fact that the Department decided not to mirror the spending controls in Great Britain has led to a very serious ongoing impact on the NI budget and the lack of controls over the funding has meant that value for money has not been achieved and facilitated spending which was potentially vulnerable to abuse. I am very concerned about the operation of this scheme and it is an area which I expect to return to in the very near future.

KJ Donnelly
Comptroller and Auditor General
28 June 2016

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Annex A

Example 1

Based on a 99kw biomass boiler running for 12 hours a day, 5 days a week and achieving 93% efficiency.

This boiler would create:
12 hours x 99kw = 1,188kwh per day
1,188kwh x 5 days = 5,940 kwh per week
5,940 kwh x 52 weeks = 308,880 kwh per year
308,880 kwh x 93% efficiency = 287,258 kwh actual per year

The cost per kwh of energy produced (including pellet costs, increased electricity cost, servicing and remedial works) would be around 4.01 pence per kwh (based on figures produced by CAFRE Greenmount campus, May 2016) giving an annual cost of 287,258 x 4.01 pence = £11,519.

The comparative cost of oil (based on its cost of 30 pence per litre in May 2016) is a cost per kwh of 3.0 pence. The annual cost of oil which has been saved is therefore 287,258 x 3.0 pence = £8,618.

The cost of a 99kw wood pellet boiler would be about £45,000 (per Department).

Using these figures it is possible to calculate the annual return from the use of the wood pellet boiler:

	Northern Ireland[6]	Great Britain[7]
	£	£
Annual cost of operating wood pellet boiler (wood, servicing etc)	11,519	11,519
Annual oil cost not incurred	(8,618)	(8,618)
Annual net cost of supplying fuel to biomass boiler	**2,901**	**2,901**
RHI Annual subsidy in NI – 287,258 kwh x 6.4 pence per kwh	18,385	
RHI Annual subsidy in GB - see calculation below *		9,696
Annual saving	**15,484**	**6,795**
Saving over 20 years	309,680	135,900
Initial capital cost to install biomass boiler	45,000	45,000
Profit over 20 years	264,680	90,900
Payback time	2.9 years	6.6 years
Annual rate of return	30%	10%

*** RHI Calculation – Great Britain**

Total hours used – 12 hours x 5 days x 52 weeks = 3,120 hours
Tier 1 hours: 1,314 hours x 99kw x 93% efficiency = 120,980 at 5.87 pence/kwh = £7,102
Tier 2 hours: 1,806 hours x 99kw x 93% efficiency = 166,278 at 1.56 pence/kwh = £2,594
Total RHI subsidy £9,696

[6] The figures above do not include "annuitized barrier costs" which the Department consider should be included. These costs would amount to £718 per year for what it calls the hassle costs of moving to the new technology e.g. installing new pipes etc and £828 per year for additional running costs such as emptying ash from the boiler every other day. If these were included it would reduce the overall return over 20 years by £30,920.

[7] The Department have pointed out that in GB the most popular boiler used is a 199kw boiler which would change the figures in the table. However for comparison purposes the boiler used in both NI and GB examples is the 99kw boiler.

Example 2

Based on 99kw biomass boiler running 24 hours/day, 7 days/week achieving 93% efficiency.

This boiler would create: 24 hours x 99kw = 2,376 kwh per day
2,376 kwh x 7 days = 16,632 kwh per week
16,632 kwh x 52 weeks = 864,864 kwh per year
864,864 kwh x 93% efficiency = 804,324 kwh actual per year

CAFRE Greenmount campus estimate that running the boiler 24 hours a day would result in increased downtime for servicing amounting to 35 hours over the year. Therefore the total amount generated would be reduced by 35 hours x 99KW x 93% efficiency = 3,222 kwh. The total number of Kwh would then be 804,324 – 3,222 = 801,102 kwh over the whole year.

The cost per kwh of energy produced (including pellet costs, increased electricity cost, servicing and remedial works) would be around 4.01 pence per kwh (based on figures produced by CAFRE Greenmount campus, May 2016) giving an annual cost of 801,102 x 4.01 pence = £32,124. The comparative cost of oil (based on its cost of 30 pence per litre in May 2016) is a cost per kwh of 3.0 pence. The annual cost of oil which has been saved is 801,102 x 3.0 pence = £24,033.

The cost of a 99kw wood pellet boiler would be about £45,000 (per Department). CAFRE also estimate that using a wood pellet boiler constantly would mean it would have to be replaced every five years at a replacement cost of £30,000. A similar oil boiler would cost £3,000 to replace – therefore the additional cost of the wood boiler would be £27,000 every 5 years.

	Northern Ireland[8]	Great Britain
	£	£
Annual cost of operating wood pellet boiler (wood, servicing etc)	32,124	32,124
Annual oil cost not incurred	(24,033)	(24,033)
Annual net cost of supplying fuel to biomass boiler	**8,091**	**8,091**
RHI Annual subsidy in NI – 801,102 kwh x 6.4 pence per kwh	51,270	-
RHI Annual subsidy in GB - see calculation below *	-	17,712
Annual saving	**43,179**	**9,621**
Saving over 20 years	863,580	192,420
Initial capital cost to install biomass boiler	45,000	45,000
Additional costs of replacing boiler every five years	81,000	81,000
Profit over 20 years	737,580	66,420
Payback time	1.04 years	4.7 years
Annual rate of return	82%	7.4%

***RHI Calculation – Great Britain**

Total hours used – 24 hours x 7 days x 52 weeks = 8,736 hours
Tier 1 hours: 1,314 hours x 99kw x 93% efficiency = 120,980 at 5.87 pence/kwh = £7,102
Tier 2 hours: 7,387* hours x 99kw x 93% efficiency = 680,121 at 1.56 pence/kwh = £<u>10,610</u>
Total RHI subsidy <u>£17,712</u>
*7,422 hours -35 hours downtime for servicing

[8] The figures above do not include "annuitized barrier costs" which the Department consider should be included. These costs would amount to £718 per year for what it calls the hassle costs of moving to the new technology e.g. installing new pipes etc and £828 per year for additional running costs such as emptying ash from the boiler every other day. If these were included it would reduce the overall return over 20 years by £30,920.

Example 3

Based on a 99kw biomass boiler running for 24 hours/day, 7 days/week and achieving 93% efficiency – but which is abusing the scheme by heating empty space and therefore not replacing an previous form of heating.

This boiler would create: 24 hours x 99kw = 2,376 kwh per day
2,376 kwh x 7 days = 16,632 kwh per week
16,632 kwh x 52 weeks = 864,864 kwh per year
864,864 kwh x 93% efficiency = 804,324 kwh actual per year

CAFRE Greenmount campus estimate that running the boiler 24 hours a day would result in increased downtime for servicing amounting to 35 hours over the year. Therefore the total amount generated would be reduced by 35 hours x 99KW x 93% efficiency = 3,222 kwh. The total number of Kwh would then be 804,324 – 3,222 = 801,102 kwh over the whole year.

The cost per kwh of energy produced (including pellet costs, increased electricity cost, servicing and remedial works) would be around 4.01 pence per kwh (based on figures produced by CAFRE Greenmount campus, May 2016) giving an annual cost of 801,102 x 4.01 pence = £32,124.

As the boiler in this example is not replacing anything the cost of oil that would have been used is not relevant. The initial cost of a 99kw wood pellet boiler would be about £45,000 (per Department) and CAFRE estimate that using a boiler constantly would mean it would have to be replaced every five years at a replacement cost of £30,000. Using these figures the annual return from the use of the wood pellet boiler would be:

	Northern Ireland[9]	Great Britain
	£	£
Annual cost of operating wood pellet boiler (wood, servicing etc)	32,124	32,124
Annual oil cost not incurred	n/a	n/a
Annual net cost of supplying fuel to biomass boiler	**32,124**	**32,124**
RHI Annual subsidy in NI – 801,102 kwh x 6.4 pence per kwh	51,270	-
RHI Annual subsidy in GB - see calculation below *	-	17,712
Annual saving / (loss)	**19,146**	**(14,412)**
Saving / (loss) over 20 years	382,920	(288,240)
Initial capital cost to install biomass boiler	45,000	45,000
Additional costs of replacing boiler every five years	90,000	90,000
Profit / (loss) over 20 years	247,920	(423,240)
Payback time	2.35 years	n/a
Annual rate of return	27%	n/a

***RHI Calculation – Great Britain**
Total hours used – 24 hours x 7 days x 52 weeks = 8,736 hours
Tier 1 hours: 1,314 hours x 99kw x 93% efficiency = 120,980 at 5.87 pence/kwh = £7,102
Tier 2 hours: 7,387* hours x 99kw x 93% efficiency = 680,121 at 1.56 pence/kwh = £10,610
Total RHI subsidy £17,712
*7,422 hours -35 hours downtime for servicing

[9] The figures above do not include "annuitized barrier costs" which the Department consider should be included. These costs would amount to £718 per year for what it calls the hassle costs of moving to the new technology e.g. installing new pipes etc and £828 per year for additional running costs such as emptying ash from the boiler every other day. If these were included it would reduce the overall return over 20 years by £30,920.