Chapter 3 – Funding and the RHI scheme

3.1 During the course of the Inquiry’s investigation it became apparent that there were issues surrounding the nature of the funding made available for the NI RHI scheme, how it was understood by various officials, whether the greater risk it carried had been properly communicated to those who should have been made aware of it, and whether the greater risk had been adequately catered for in the design of the NI RHI scheme.

3.2 The Inquiry received a considerable volume of detailed and often technical evidence about these matters. Government funding is often complex and technical. What follows in this chapter is an examination of some of the key issues surrounding matters of funding as far as it related to the NI RHI scheme and findings the Inquiry needs to make in relation thereto.

AME and DEL

3.3 Public expenditure provided by HMT and approved by Parliament is generally classified as either Annually Managed Expenditure (AME) or Departmental Expenditure Limit (DEL). The former is for expenditure that is demand-led and/or volatile and, therefore, difficult to predict or control by a UK Department or a devolved administration.154

3.4 The October 2010 HMT Statement of Funding Policy (SFP) for the devolved administrations described the concepts of DEL and AME in the following way:155

“1. Departmental Expenditure Limits (DELs) set firm, multi-year spending limits. Expenditure in DEL is split between those items within the assigned budget and those within the non-assigned budget. Spending within DEL is generally undifferentiated, as the devolved administrations will have full discretion over their spending priorities; these are ‘assigned budget’ items. Changes in provision for these items are determined through the Barnett Formula (see Chapter 4). If spending in DEL, however, is exceptionally ring-fenced and specific to that spending priority, these are known as ‘non-assigned budget’ spending items; and

2. Annually Managed Expenditure (AME) covers items whose provision is reviewed and set for the coming year annually (at spring Budget) and certain self-financed expenditure. AME expenditure cannot be recycled from one AME programme to another or recycled to increase the DEL. Within AME, expenditure is classified between ‘Main Departmental programmes in Annually Managed Expenditure’ and ‘other AME’ spending. Main Departmental programme spending covers policy-specific, ring-fenced items where provision is included within the Vote from the United Kingdom Parliament. The AME element of the budget is reviewed twice-annually, and forecasts are made for a number of years ahead. Thus the AME element of the budget can move up or down and, hence, the total budget itself may move up or down in line with AME. ‘Other AME’ spending includes locally financed expenditure, including expenditure financed by the Scottish Variable Rate of Income Tax; these are not ring-fenced and may be allocated, as the devolved administrations consider appropriate.”

154 WIT-180025
155 INQ-50008
3.5 In Northern Ireland’s own “Managing Public Money Northern Ireland”, issued by DFP/DoF, the concepts are defined as follows:

**Departmental expenditure limits (DEL):** provision planned and managed over three years, with some scope (subject to DFP agreement and rules) for carrying forward unspent provision into future years. Usually comprises most of each department’s resource budget. Includes limits on near-cash expenditure and on the cost of administration.

**Annually managed expenditure (AME):** expenditure which is not as readily controlled as DEL is but which must be budgeted for each year, including social security expenditure.

Both DEL and AME may include capital and resource provision.”

3.6 The vast bulk of AME funding goes towards welfare and pensions expenditure and interest on debts. For other programmes to end up funded through AME, rather than DEL, is an exception rather than the rule, and it is a decision specifically reserved for HMT to make.

3.7 In contrast, Ministers may allocate the DEL funds provided to their departments at their discretion in support of Government programmes and their priorities, provided that they stay within the relevant DEL limits set by HMT.

3.8 The ‘HMT Consolidated Budgeting Guidance’, an annual HMT publication designed to set out the applicable budgeting rules (and guidance as to their application) for a given year, sets out the criteria that are applied by HMT in determining whether spending can be classified as AME. The March 2010 version, setting out the guidance for financial year 2010-11, described the position in this way:

“Criteria for Treatment in DEL or AME

1.33 All programmes are in DEL unless the Chief Secretary has determined that they should be in AME. The Chief Secretary may agree to put programmes into AME if:

- They are demand-led or exceptionally volatile in a way that could not be controlled by the department and where the programmes are so large that departments could not be expected to absorb the effects of volatility in their DELs; or
- For other reasons they are not suitable for inclusion in firm three year plans set in the spending review. For example: Lottery spending is the product of the hypothecated tax on the National Lottery and may not be reprioritised elsewhere. Certain levy-funded bodies, which serve particular industries, are in AME – see Appendix 4 to this chapter.

1.34 Not all departments have AME programmes.

1.35 The Treasury regularly reviews whether programmes in AME are still suitable for AME treatment. Where appropriate programmes are moved into DEL.”

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156 WIT-35242
157 WIT-180025
158 INQ-51727 to INQ-51868
159 INQ-51739
AME

3.9 AME expenditure is subject to a different management process from DEL budgets in order to reflect its different nature, and there are different rules that apply as to how it can be used.

3.10 AME is managed through a forecasting process reviewed twice annually and money cannot be recycled from one AME project to another or recycled to increase the DEL. AME generally also cannot be used to fund administration or civil service staff costs, all of which have to be met from a Department’s DEL.\(^{160}\)

3.11 The same HMT Consolidated Budgeting Guidance from 2010-11 explains\(^{161}\) what is expected of Departments that are in receipt of AME funding:

“Management of AME Programmes

1.40 The management of AME programmes serves the same ends as the management of DEL programmes, but the system for managing AME programmes is different. AME programmes are often demand-led or otherwise volatile programmes when it would be unreasonable to expect departments alone to bear the risks associated with variations in demand or spending. The volatility of many AME programmes means that careful management is important.

1.41 Departments are reminded that with AME programmes also, just as with DEL, they need to:

• Put in place processes to monitor spending in year, to identify longer-term trends in spending, and to provide robust projections of future spending. Early identification of changes in AME spending are needed to allow risks to be managed effectively;

• Review AME programmes regularly to ensure that they are helping to achieve Government objectives effectively and efficiently. Departments should discuss with the Treasury proposals for optimising AME spending programmes;

• Agree with HM Treasury prior to implementation any change which would increase AME spending – this includes both policy reforms and any administrative changes which impact on expenditure, for example measures to promote take-up;

• Consider carefully the impact of DEL spending on AME spending and vice versa, both within and across departments. For example, DEL usually includes the cost of administering AME programmes and the quality of administration can have a significant impact on AME expenditure. And some DEL and AME programmes are complementary;

• If a proposed DEL spending change has extra costs for AME spending, then the proposal needs to be cleared with the Treasury before being implemented;

• Consider with the Treasury what steps should be taken to support fiscal discipline and value for money if spending on AME programmes rises above expectation. As noted below, where the actions/inaction of a Department increase AME, they

\(^{160}\) INQ-51738 to INQ-51741

\(^{161}\) INQ-51739 to INQ-51740
are assumed to fund the increases in AME by reductions in their DEL budgets, or by identifying firm savings in AME; and

- Monitor spending in Resource AME and ensure that they take steps where appropriate to prevent undue increases in spending that affects the Surplus on the Current Budget.”

3.12 The same HMT Consolidated Budgeting Guidance indicated, though the position would be articulated differently by HMT over time, that the fact AME annual spending did not stay within forecast was not considered a breach of a spending limit in the way it would for a DEL budget. It also did not carry an automatic penalty from HMT if an AME forecast was breached. This position was no doubt to reflect the different nature of AME spending; demand-led or exceptionally volatile.

3.13 At the same time, the guidance did explain that unforeseen changes in AME spending may indicate poor financial management by Departments, and held out the potential that the additional spending beyond AME forecasts may have to be offset, for instance, through DEL in the following year.

**AME funding for devolved administrations**

3.14 UK Government funding for the devolved administrations’ budgets is normally determined within spending reviews alongside spending settlements for UK Government Departments and in accordance with the policies set out in HMT’s SFP. The 2010 SFP recorded that the majority of each devolved administration’s spending would be allocated in spending reviews by applying the Barnett Formula (a combination of a comparative population share, a V.A.T. adjustment and comparability of the allocation) but confirmed that there were a number of exceptions in respect of which that formula was not appropriate. Such exceptions included some DEL programmes and all (the Inquiry’s emphasis) AME items.

3.15 Section 5.3 of the 2010 SFP stated that the devolved administrations would not normally need to find offsetting savings from elsewhere in their budgets when AME forecasts changed at planning stage or during the financial year to cover increases; such increases would normally be met by HMT. However, increases in AME programme spending arising from policy decisions taken by the respective devolved administrations would have to be met from their respective budgets. Such decisions would generally involve action or inaction on the part of the devolved administration leading to breach of parity with relevant UK spending. The 2010 SFP, as noted above, recorded that:

“Increases in Annually Managed Expenditure programme spending, which arise from policy decisions taken by the respective devolved administrations, will be met from their respective budgets.”

3.16 This wording became even more explicit by the time of the equivalent direction in the HMT 2015 Statement of Funding Policy which read as follows:
“Where a devolved administration wishes to offer more generous terms for an AME programme, then the excess over that implied by adopting broadly similar criteria to the relevant UK government department or body (and therefore broadly comparable costs) for that programme must be met from within their DEL budgets.”

3.17 Most public expenditure in NI tends to be DEL and is provided through the block grant by means of which the NI Executive receives approximately 3% of the UK Government budget for public services. The block grant is adjusted each year in accordance with the population-based Barnett Formula. As already referred to above, the Inquiry notes that the HMT 2010 SFP specifically provided at section 5 that the application of the Barnett Formula was inappropriate for all (the Inquiry’s emphasis) AME items of devolved administration spending. The Inquiry notes that the wording of the 2010 letter from the Chief Secretary of the Treasury offering funds for the RHI referred to a “population-based share” rather than the Barnett Formula.

3.18 As discussed in more detail later, the Inquiry did hear evidence suggesting that there was a view held by some in the administration in Northern Ireland that the more AME money that came in the better. While in principle there is nothing wrong with a desire to have as much money available for the devolved administration as possible, it must be remembered that all taxpayers’ money has the same value. Paragraph 1.39 of the HMT Consolidated Budgeting Guidance from 2010-11 is instructive in this regard:

“1.39 AME programmes are spending like any other. They impact on the fiscal framework in the same way as DEL spending. They need taxes to be raised to finance them. So careful monitoring and management is just as important as it is with DEL. And the nature of certain AME programmes means that some aspects of management, e.g. forecasting, are more important than with most DEL programmes.”

DECC’s GB RHI AME funding

3.19 Prior to the RHI scheme, nearly all energy schemes had been funded by levies on consumer bills and so did not impact on departmental budgets and were not subject to the same direct involvement of HMT in setting rules for their use. For a number of reasons, it had been decided to fund the RHI scheme directly out of tax and this raised concerns in DECC.

3.20 The Inquiry had access to correspondence between DECC and HMT from 2009, wherein the basis of DECC’s request for the RHI to be classified as AME was set out. DECC at that time was a new Department and it had a relatively small DEL budget and sought the agreement of HMT to treat the GB RHI expenditure as AME on the ground that, in accordance with HMT guidance, such funding was appropriate in respect of “large, demand-led expenditure which was difficult to forecast.” DECC was concerned that the uncertainties of an RHI scheme produced a risk to its DEL budget which was already committed to other programmes. Officials pointed out the need for flexibility and stated that the decision on classification of funding was “crucial to the development of the policy”, emphasising that the renewable heat market was “small,
undeveloped and prone to large variations in demand as a result of changes in economic conditions, weather and fuel prices.”

3.21 HMT in turn was not prepared to bear the full risk either, as is clear from the outcome of its discussions with DECC. The DECC business case seeking AME funding status for RHI, and the HMT analysis of it, bears careful scrutiny for the detailed consideration that was undertaken, and the indication that collaborative monitoring was envisaged between DECC and HMT. In a letter from the Chief Secretary to the Treasury dated 6 January 2010, although agreeing to AME classification, HMT sought to ensure that DECC took a measure of responsibility for the risk of overspend by requiring the inclusion of strong cost controls.

3.22 DECC undertook to ensure that there were appropriate mechanisms in place to control the overall costs. Such controls were of fundamental importance since the scheme would be a world first, incentive-based with volatile, unpredictable demand and funded with public money. The 6 January 2010 HMT letter to DECC referred to above, which confirmed that the GB RHI could be budgeted through AME, required that the funding would be subject to a number of specific conditions, which included:

(i) A charging arrangement to ensure that DECC faced real financial incentives to prevent overspends. DECC agreed that any RHI AME overspending in one year would be repaid out of the AME budget in future years and, as a further incentive, DECC would be required to fund a proportion of any such repayment from their wider DEL budget;

(ii) DECC would be expected to give HMT regular, detailed updates on cost drivers and compliance activity under the scheme; and

(iii) Given the long period between regular reviews of support, there had to be legislative scope for an emergency review should levels of spend through the scheme rise significantly above forecast.

3.23 Following a 12-week DECC GB RHI consultation in February 2010, the feedback from which was overwhelmingly supportive, detailed proposals were published in March and a commitment to renewable heat was included in the 2010 Spending Review.

3.24 The 2010 settlement letter issued to DECC by HMT following the 2010 Spending Review specifically stated that:

“Spending through the Renewable Heat Incentive will be budgeted through AME, but a condition of this treatment is that DECC will need to contribute towards any overspend above the Spending Review forecast...in order to provide sufficient incentive to manage spending to forecast and to take on a fair share of the fiscal risk.”
NI RHI’s AME funding

3.25 On 20 October 2010 Danny Alexander, then Chief Secretary to the Treasury, wrote to the then First and deputy First Ministers of the NI Executive setting out the Northern Ireland Executive’s funding allocation arising from the 2010 Spending Review. The direct quotation from that letter, as far as it relates to RHI, reads as follows:

“If NIE choose to introduce an NI Renewable Heat Incentive Scheme then AME funding of £2/4/7/12 million will be available over the SR period (2011/2012 – 2014/2015) based on a population-based share of the GB scheme. NIE officials should inform my officials of their intentions to feed into AME forecasts.”

3.26 No further information was provided. The Inquiry found no evidence that the devolved administration in Northern Ireland, or DETI in particular, was informed of the background behind why the potential NI RHI scheme was to be funded by AME. DETI had no knowledge of the detailed discussions that had taken place between HMT and DECC over the issue, or the nature of the formal parameters of the RHI funding that had been communicated by HMT to DECC.

3.27 In a written response to a series of questions addressed to HMT by the Inquiry, the Director of HMT’s Public Services Group, with responsibility for the relationship with the NI Executive, advised that: “As heat is a devolved policy area, the NIE had full autonomy over scheme design.” However, as noted above, the 2010 edition of the SFP confirmed at paragraph 5.3 that the devolved administrations would not normally need to find off-setting savings from elsewhere within their budgets when forecasts changed at planning stage or during the financial year to cover expenditure upon AME items, the exception being expenditure which arises from decisions taken by the respective devolved administrations which would have to be met from their respective budgets.

3.28 A further response to the Inquiry from HMT stated that it was standard practice for Departments to be expected to manage their AME spend and continued:

“Where the spending department has levers to control the spend, the Treasury may expect the department to use those to control spending and, where the department fails to (or indeed takes action that would increase spending), the department would be expected to meet the costs from within its DEL budget.”

180 DFE-257518 to DFE-257527
181 DFE-257522
182 WIT-180027
183 INQ-50017
184 WIT-180048
11. Neither the content of HMT’s confirmation letter to DECC of 6 January 2010 nor the details of the earlier funding negotiations with DECC were communicated to the relevant NI Departments, whether in the NI Settlement Letter of 20 October 2010 or otherwise.

12. No information was given to either DFP or DETI about the exchanges that had taken place between HMT and DECC with regard to the unusual nature of the form of AME funding for the RHI scheme or to the conditions that had been imposed on DECC in response to the request for funding in that form. That was of particular significance bearing in mind that the budget capped on population share was an unusual form of AME. Indeed, applying a cap to an AME budget was essentially a contradiction in terms given the unpredictable nature of the schemes in respect of which AME funding was usually considered appropriate. Most significant of all was the omission by HMT, the source of the funding, to formally provide the devolved legislature with details of the “risk sharing” agreement reached with DECC that overspending might have an impact on the DEL budget. The only source of such information for DETI was to be the Parker and Patel emails in 2011 (which are dealt with later in this chapter). While certain relevant policy decisions were subsequently taken by DETI, such as the omission to provide budget cost controls and tiering, the Inquiry finds that, when the funding was originally notified, HMT ought to have clearly informed DETI of the basic structure of the particular form of AME funding including the “risk sharing” element that had been agreed with DECC. Such clear notification would have provided DETI with an added impetus to ensure it had the necessary ‘levers’.

13. The Inquiry notes that the differences in HMT’s communications to DECC and to DETI continued. The spending settlement letter to DECC in respect of the 2015-16 financial year specified that:

   “Spending through the RHI will be budgeted through AME but a condition of the treatment is that DECC will need to contribute towards any overspend above the Spending Review forecast…”

The Inquiry finds that no such warning was included in the equivalent NI 2013 spending round letter, which did not even make a reference to RHI. HMT provided AME cover for the RHI overspend in 2015-16 without qualification.
The communication of the funding message

3.29 During the course of the Inquiry’s work it became evident that there was a long chain of communications involved in discussions about funding issues in Northern Ireland. The Inquiry was told that pursuant to a long-standing protocol or convention, all communications between HMT and DFP/DoF should be between the devolved administration spending team in HMT and the Central Expenditure Division (CED) in DFP/DoF. Onward communication from CED should be through the Supply Team in DFP/DoF, whose role should be to inform the relevant Finance Division in the spending Departments, which, in turn, should liaise with the relevant Department’s policy/spending divisions.

3.30 Breach of the protocol was treated as a serious matter and was illustrated by the DETI Finance Director, Trevor Cooper, who told the Inquiry that he received a telephone “roasting” from Stuart Stevenson in DFP as a result of DETI failing to observe the protocol when it engaged directly with HMT over RHI funding.\textsuperscript{187}

3.31 DFP CED (from May 2016, DoF CED) was responsible for the planning and management of public expenditure in Northern Ireland, including the provision of biannual forecasts of AME spending to the Office of Budget Responsibility (OBR) and liaison with HMT. In her oral evidence to the Inquiry, Joanne McBurney, a grade 5 accountant and head of CED in the Public Spending Directorate (PSD) of DFP/DoF from September 2014, described the RHI funding as coming “out of the blue” in respect of which the initial reaction would have been to welcome any additional funding for investment in Northern Ireland.\textsuperscript{188} She accepted that AME with annual caps, as outlined in the 20 October 2010 letter from the Chief Secretary to the Treasury, would be unusual and she was not aware of any other specific AME funding that was similarly subjected to a cap in this way.\textsuperscript{189}

3.32 Given the volatile and unpredictable demand-led feature of schemes for which AME was generally felt appropriate, some witnesses told the Inquiry that a capping mechanism would almost amount to a contradiction in terms. It was certainly unusual in NI experience and should have alerted DFP officials to make inquiries of HMT as to the circumstances in which it was to apply in this case. However, Ms McBurney thought that the need to keep “in budget” was something which Departments would regard as normal practice. She considered that once DETI had been informed of the cap, the onus was on that Department to manage within that limit and to comply with other public spending guidance such as Managing Public Money NI and the Consolidated Budgeting Guidance.\textsuperscript{190} The CED responsibility was to query DETI if any of the AME forecasts they provided exceeded the relevant cap and, as far as Ms McBurney was aware, the AME forecasts provided by DETI did not exceed the caps from the inception of the scheme up to and including 2014-15.\textsuperscript{191}

3.33 Agnes Lennon, who was a grade 7 in CED when the funding was initially provided for RHI and responsible for AME forecasts, felt that the concept of “a population-based share” was “a slight anomaly” and “a little unusual” since it was calculated and capped as a population share of the...
DECC spend.\textsuperscript{192} She explained that although they had experience of the potential for a DEL impact arising from breaking ‘parity’ and deviating in the type of service provided, in the case of the RHI scheme the DEL impact related to any overspend above the unusual population-share cap. She recalled that after receiving the October 2010 HMT settlement letter she had spoken to both Keith Jarret of the HMT NI Spending Team and to Jon Parker of the HMT Energy Team and subsequently discussed the matter with the DETI Supply Officer.\textsuperscript{193} She concluded that, in keeping with all AME funding, expenditure needed to be carefully and properly managed and controlled. As a consequence of her contacts with HMT, Ms Lennon was certain that she emphasised to DFP Supply that the allocation for the NI RHI scheme was capped. She considered that, in the circumstances, it was the responsibility of DETI to devise an appropriate scheme with cost controls firmly in place.\textsuperscript{194}

\textbf{Attempts to clarify the funding arrangements}

\textbf{The April 2011 Parker email}

3.34 In early 2011 a very important email exchange relating to the proposed funding took place. Alison Clydesdale of DETI was, in 2011, the grade 7 head of Sustainable Energy Branch, reporting to Fiona Hepper the then head of Energy Division. Ms Clydesdale had taken over responsibility for renewable heat within DETI from July 2009.\textsuperscript{195} Ms Clydesdale, emailed Rosalind Leeming of DECC on 4 March 2011 to update her on the progress on the LCM for the 2011 Energy Act amendment to facilitate the introduction of an NI RHI scheme and asking if she could have early sight of DECC’s proposals for the GB RHI scheme (NI already having opted to proceed separately from the GB RHI).

3.35 In the course of her reply on 11 March Ms Leeming, having identified an error in DETI’s LCM instructions over how funding would be provided, confirmed that DECC had previously abandoned the proposal to adopt levy-based funding as had been used previously on most energy incentive schemes, adding that “...funding has been made available for the GB and prospective NI scheme through standard AME spending.”\textsuperscript{196} Ms Clydesdale responded on the same day acknowledging the error in the DETI drafting and indicating that “we have accepted the AME funding – indeed we had a call from Treasury on it yesterday”.\textsuperscript{197}

3.36 Following at least one telephone conversation on the subject, and in answer to a request for further information from Ms Clydesdale, Mr Parker of HMT, on 15 April 2011, confirmed to DETI that HMT had an agreement with DECC to cover spending commitments up to 20 years for installations installed within the Spending Review (SR) period, and indicated that similar terms would apply to an NI scheme. He set out the escalating funding profile that had been allocated to DECC for each of the financial years within the spending review period and advised that the NI share would be 2.98% of DECC’s RHI budget, which the NI scheme would need to follow “as much as possible.”\textsuperscript{198} However, he then proceeded to point out the following:
“The other key point it is necessary to let you know is that the DECC RHI spending is not being treated as standard AME, where the Exchequer takes on all risks of overspend. Instead, there is a risk-sharing arrangement whereby should RHI spending in one year exceed the SR profile, then DECC would need to repay this in future years. They can do this through announcing changes to the SR that will bring cost savings relative to the SR profile in future years. However, a small proportion of any required future savings (still to be determined, but likely to be of the order of 5%) will have to be funded through contributions from DECC’s DEL. Again, these rules would be applied in equivalent fashion to NI.”

3.37 The Inquiry notes that Mr Parker was emailing as joint head of the Energy Policy Team in HMT and not as a member of the HMT NI Spending Team (though members of the HMT NI Spending Team were copied in). However, he had clearly been of assistance to Ms Clydesdale, who found his reply most helpful and who passed on the Parker email to Ms Hepper, the head of Energy Division, and to the DETI finance team with a question about the involvement of DFP.

3.38 Ms Clydesdale passed on this exchange to, and sought advice from, Ms Brankin in Finance Division of DETI, who was aware of the HMT 20 October 2010 settlement confirming the availability of AME funding for an NI RHI scheme that she described as her first experience of “gift funding” for which it had not been necessary to bid.

3.39 Ms Brankin informed Ms Clydesdale on 15 April 2011 that she had now received confirmation from DFP of the annual AME allocations for Energy Division totalling £25 million over the four financial years from 2011-12 to 2014-15 as noted above. Ms Brankin explained that she discussed the non-standard nature of the AME funding with her head of Finance Division, Trevor Cooper, because she had no prior experience of it. Mr Cooper advised Ms Brankin that it would be necessary to speak to Stuart Stevenson, DETI’s DFP Supply Officer.

The 3 May 2011 Brankin warning

3.40 On 3 May 2011 Ms Brankin emailed Ms Clydesdale confirming Energy Division’s AME but also now pointing out that she had since spoken to Mr Stevenson, the DFP supply officer for DETI, about the NI RHI AME allocation. Ms Brankin informed Ms Clydesdale “RHI AME funding is not being treated as standard AME” and that one of the effects would be that “if you overspend in any year, DETI’s budget will be reduced by the amount of overspend in future years”. She explained that “your RHI budget allocation is being treated the same as DEL allocations.”

3.41 According to Ms Brankin, Mr Stevenson advised that it would be best to treat the budget “the same as DEL allocations.” The effect of this was said to be that underspends in any year would be lost while overspends would be taken out of DETI’s budget for future years. She advised her Energy Division colleagues that this treatment of AME should be taken into account when drawing up any proposals and made the following request:
“Please copy Finance into your draft proposals which would need to address the
controls that you would put in place to prevent significant under/over spending.
These proposals will also require DFP approval.”206

Ms Brankin explained in her oral evidence that the reference to “Finance” in this advice had been to the Accountability and Casework Branch of Finance Division that also reported to Mr Cooper.207

Ms Brankin had also reminded Ms Clydesdale of the problems of budget control that had been encountered in relation to the Reconnect Scheme, albeit that was a domestic grant-based scheme.208

On the following day, 4 May 2011, Ms Clydesdale passed on Ms Brankin’s communication to Mr Hutchinson, copying in Ms Hepper, and Mr Connolly. Ms Clydesdale described it as a “significant challenge” and informed him that DFP would require evidence of “…our ability to control the scheme in order to minimise over/under spending in any one year.”209 She referred to the Reconnect Scheme stating:

“From a finance perspective grant is the riskiest route financially as it is hard to
control the number of applications especially at the end of the programme. But
from the policy side I expect we will need some element of front-loaded grant to
stimulate demand.”210

The Inquiry notes the perception of problems with the administration of Reconnect. The most recent evidence from DfE suggests this was not about breaching the budget, so is likely to have been about the difficulties in forecasting and managing described by Ms Clydesdale.211

Ms Clydesdale also advised her colleagues in her 4 May email that it was necessary for CEPA to be asked to factor in the information from Ms Brankin as a risk factor in the economic appraisal that they were preparing, noting that no relevant reference had been included in the draft already received.212 However, this requirement does not seem to have been passed to CEPA, who appear to have based their reports upon the working assumption that the figures making up £25 million over 4 years, possibly followed by some continuing funding to 2020, were effectively capped on a ‘first come first served’ basis.213

Ms Clydesdale told the Inquiry in oral evidence that she believed that Ms Brankin was telling her that, as the funding was being treated as DEL, there was a need to control it within each relevant year. She said that she had discussed the matter with Ms Brankin and that they agreed that a tariff-based scheme would technically be more predictable, based on a metered quarterly basis, as well as easy to predict and monitor. She explained that any unpredictable increase in the number of applicants could be controlled by:

“…putting in a control to either stop applications coming in or to delay them.
Bernie and I were discussing in-year budget management, and it was the nice,
predictable, smooth pattern of an RHI tariff-based, quarterly, metered data [sic] seemed attractive.”

3.48 Ms Clydesdale also mentioned in her Inquiry witness statement that in June 2011, although she had by then moved to a new role, she was still asked to provide comments on the DETI RHI public consultation document, which included a draft copy of the proposed NI RHI regulations. However, she does not appear to have made any representation or comment upon the obvious absence of any administrative or statutory power of suspension of the scheme or control of the budget.

3.49 On 27 May 2011, on the front page of the first submission from Ms Hepper to the Minister and her SpAd after the 2011 email exchanges, Ms Hepper informed the Minister that “HMT has advised that £25 million of AME is available over the spending period should Northern Ireland choose to introduce a RHI”, but no reference was made to the qualifications, risks and consequential necessary steps confirmed by the earlier email exchanges.

3.50 When questioned about this omission by Inquiry Counsel, Ms Hepper said “…I think we have obviously been aware of the qualification on it but we keep using that as shorthand.” When asked whether the funding could have been more accurately described she said:

“I certainly think it wouldn’t have been unhelpful to have been a little more explicit, but it’s with hindsight, absolutely. In writing it at the time we probably made an assumption that people knew there was a qualification there which does not reflect with hindsight.”

3.51 Ms Hepper also told the Inquiry in her oral evidence that she was “pretty sure” that she had told Minister Foster of the unusual nature of the funding and that she was “pretty sure” that the Minister would have seen that in some budgetary documents. In the course of questioning by the Inquiry Counsel as to whether she had a specific recollection of informing the Minister, Ms Hepper said “Not a specific recollection, no, but I would be fairly sure that she would have been informed. But I can’t point to something in particular.”

3.52 For her part, the former Minister has denied that she was ever aware that the funding was qualified before the autumn of 2015. She told the Inquiry that she had never encountered AME funding with DEL consequences and that she was not familiar with the HMT Statement of Funding Policy.

3.53 Dr Crawford, who also denied being informed of the important qualifications or additional risks, said that if the Minister had been so informed, she undoubtedly would have asked to see the correspondence.
The June 2011 Patel warning

3.54 Further efforts were made to clarify the funding situation by Mr Hutchinson engaging with DECC’s Akhil Patel on 8 June 2011. In addition to questions about the availability of funding beyond 2015 (and the answer’s potential effect on the length the scheme could stay open to new applicants) and about funding rising with inflation, Mr Hutchinson asked, given the funding was AME, whether unspent money from one year could be rolled over into the next. Further, and importantly, Mr Hutchinson asked Mr Patel: “how will you manage against overspend in your budget – i.e. could the scheme close temporarily if it was oversubscribed?”

3.55 Mr Patel replied on 8 June 2011 and confirmed that any overspend that could not be met out of the following year’s AME budget would have to be taken from the DEL budget. In view of the “large financial risk” this represented, Mr Patel informed Mr Hutchinson that the DECC policy team were developing a system of “tariff degression” that could be deployed at key points to ensure that the risk of overspending could be managed. He provided his contact details and invited Mr Hutchinson to contact him to discuss the issues further as required.

3.56 Mr Hutchinson told the Inquiry that he did not know why the information about the funding qualifications had not been “front and centre” in the communications with CEPA. Ms Hepper confirmed in oral evidence that after that June 2011 exchange it was clear that any overspend would come out of the DEL budget and that represented a significant financial risk. She was uncertain as to what happened to the Patel email:

“I’m pretty sure that it was drawn to my attention, and I’m not sure if I discussed it with my line manager or whether the team discussed it with finance; I genuinely don’t know.”

Confusion over the nature of the RHI funding

3.57 The Inquiry notes witnesses’ varying degrees of understanding of the funding arrangements for the NI RHI.

3.58 Ms Clydesdale, who engaged with HMT’s Jon Parker and DETI Finance’s Ms Brankin in April and May 2011, described her understanding as “crystal” – it was not standard AME and any overspend would come from the NI Block. She engaged with Mr Hutchinson and Ms Hepper about it. Mr Hutchinson later engaged with Mr Patel as discussed above.

3.59 In October 2011, Joanne McCutcheon (who in May 2011 had succeeded Ms Clydesdale as the head of what became Energy Division’s Renewable Heat Branch, the new home for officials working on the NI RHI, and who reported directly to Ms Hepper, the then head of Energy Division) approached DETI Finance’s Ms Brankin about the potential to re-profile the £2 million from the 2011-12 financial year through one of the biannual AME forecasting exercises, that was otherwise going to go unspent (as the RHI was not up and running at that point).
3.60 Ms Brankin replied on the same day, attaching to her response the April 2011 email exchange between Ms Clydesdale and Mr Parker, and her own May 2011 email warning to Ms Clydesdale. Ms Brankin had also copied Ms Hepper into her reply, as well as some of her own finance officials. Her reply contained the following emphatic warning:

“However, as I advised Alison earlier (see attachment), RHI spending is not being treated as standard AME. This means that your RHI NI budget allocation is being treated the same as DEL allocations. If you underspend in any year, that part of your budget is lost to the department, but you may wish to reduce budgets to prevent building underspending in to your outturn. If you overspend in any year DETI’s DEL budget will be reduced by the amount of overspend in future years which is a position that we would not want to be in. Therefore, you should not increase AME expenditure in any year.”231

3.61 Ms McCutcheon forwarded Ms Brankin’s email to Sandra Thompson.232 She was a Staff Officer in Energy Division’s Energy Co-Ordination Branch who assisted Energy Division officials with financial matters. Ms Thompson was to discuss the question of the potential £2 million RHI underspend with Ms Hepper the next day.

3.62 Ms Hepper was asked about the 5% penalty for potential RHI overspends mentioned in the Parker April 2011 email. She told the Inquiry in oral evidence:

“Well, the other thing was that Jon Parker was in the energy team in DECC, [sic] and we got useful information from them, but then it had to move into the devolved budgets team, and that was most definitely DFP engaging with them, and they never came back to confirm that it would only be a 5% DEL. So we just always assumed if you went over by any amount that you were liable for the whole amount.”233

3.63 Mr Connolly, the DETI economist who advised Energy Division on the RHI, said that he did not recall seeing the Parker email exchange. He explained that he had been absent from work for three weeks and only returned on 8 May 2011, some four days after being copied in to the email chain starting with Ms Clydesdale’s email of 4 April to Mr Parker.234 Mr Connolly told the Inquiry that he was not familiar with the distinction between AME and DEL funding.235 No one appears to have brought that distinction to his attention, notwithstanding the clear warning in the emails about the need for cost controls.236 He also informed the Inquiry that he had not been made aware of the exchange between Mr Hutchinson and Mr Patel of 6 June 2011 nor told that the funding represented a “large financial risk”.237

3.64 DFP CED’s Ms Lennon maintained that “complexity did not exist in the straightforward capped allocation” and it would not have been “in order for HMT to interfere and discuss cost controls” with a devolved administration.238 She found the April 2011 Parker email “irritating” as being a direct communication with HMT outside the usual protocol.239 However, Ms Lennon has

231 DFE-463386
232 DFE-463386
233 TRA-01857
234 TRA-03392
235 TRA-03394
236 TRA-03395
237 TRA-03409
238 WIT-44663
239 WIT-44664
described the ‘key message’ from DFP to DETI as being “DO NOT OVERSPEND this capped AME allocation as it will have a DEL impact.”

3.65 Whilst Ms Lennon was clear in her recollection, and the Inquiry accepts her evidence, the Inquiry has been unable to identify a clear and objective communication chain ensuring that a message in such stark terms was passed from DFP to DETI.

3.66 Her colleagues in DFP, Mr Brennan, then head of CED, and Mr Stevenson, then DFP’s DETI Supply Officer, do not appear to have fully understood the potential risks implicit in the NI funding in the event of an overspend. In his written evidence, Mr Brennan confirmed that, prior to the RHI scheme, he could not recollect any other funding proposal with a similar AME limit and associated DEL penalty and that he had not appreciated that the actual scheme funding had an implication beyond the AME profile initially agreed by DETI. Mr Brennan was copied into Ms Clydesdale’s reply to HMT’s Jon Parker on 15 April 2011, along with members of the HMT NI Spending Team. As a consequence of Ms Clydesdale copying him in, Mr Brennan forwarded her email to Mr Stevenson, Ms McBurney and Ms Lennon asking:

“Do you know what DETI are up to? We just need to be sure about what commitments they might be entering into and the possible wider consequences for the NI Executive – especially if the DETI actual spend deviates from forecast and the Centre has to pick up the pressure (even if it all remains in AME).”

3.67 Mr Stevenson forwarded the Parker email to DETI Finance Director Trevor Cooper and appears to have spoken to him about it. Mr Stevenson could not remember the conversation he appears to have had with Mr Cooper, and could not remember going back to Mr Brennan, though he thought it highly unlikely he would not have done so in some way, given Mr Brennan had asked him for information as to what DETI was doing. Mr Stevenson did have further conversations with DETI’s Ms Brankin about RHI in advance of her 3 May 2011 email to Ms Clydesdale warning that the RHI funding should be treated like DEL.

3.68 In the course of giving oral evidence to the Inquiry, David Sterling, Permanent Secretary of DETI between October 2009 and June 2014, agreed that he was not aware of any other projects that were similarly funded. He added that, at the time he was Permanent Secretary at DETI he knew that whilst this was an unusual funding arrangement and that it was AME, nonetheless it was capped and it really needed to be treated as if it was conventional DEL, because exceeding that budget cap would have consequences. However, he also accepted that into 2014-15 officials entertained the misconception that the funding was conventional AME and that exceeding the budget would not lead to any impact on the DEL budget.

3.69 Nevertheless, it appears quite clear to the Inquiry that there was awareness of a risk (the Inquiry’s emphasis) of some degree to the DETI DEL budget and that, given the novelty of the scheme and the unpredictability of demand, careful consideration of some form of budget
control was essential. What is less clear is how the documentation relating to this, and a clarity of understanding about it, at least among some officials, was lost over time. It is also unclear why the unusual nature of the funding, and its potential consequences, together with the heightened need for budget protection, were not specifically brought to the attention of those being asked to approve the NI RHI scheme, such as the members of the Casework Committee and, more importantly, the DETI Minister.

3.70 It appears that the relevant email exchanges were placed in a TRIM (an electronic file management system) folder under the label ‘RHI Funding’ but in separate chains and not in such a way that a civil servant colleague could easily recover the whole chain without searching through all the contents. The records of who accessed TRIM indicate that Ms McCay, who temporarily filled the gap at grade 7 level for 6 weeks in May and June 2014, between the departure of Ms McCutcheon and the arrival of Mr Stuart Wightman, did later retrieve all the emails, although in both her written and oral evidence to the Inquiry she maintained that she was not told of the April 2011 Parker email chain and that her general understanding was that the funding was AME outside the DEL budget.248

3.71 In later evidence to the Inquiry it became clear that the information did not survive the 2013-14 staff changeover in any unified, objective and easily identifiable form. Thus, the funding position was ‘clarified’ in the First Day Brief for the new Permanent Secretary, Dr McCormick, who replaced Mr Sterling in June 2014 as follows:

“Funding stream for grant payments is Annually Managed Expenditure (AME) directly from HMT with no separate bidding process.”249

3.72 There were no words of qualification or caution as to the funding being subject to a cap, with DEL implications if the cap were exceeded, or of the clear consequential need for some type of cost control. The same inaccurate sentence was incorporated into the briefing for the new Deputy Secretary, Chris Stewart, who took over the Policy Group from Mr Thomson in August 2014.250

3.73 Mr Wightman, who became head of the new Energy Efficiency Branch (which included RHI) in July 2014, did recover the Parker email in September 2014 as part of his work on obtaining DFP approval for the introduction of the domestic RHI scheme, but, according to his evidence, without understanding its full significance at that time.251

3.74 The Inquiry was not provided with any clear objective evidence that an accurate description of the funding arrangements and risks ever reached any Minister before late 2015/early 2016.

3.75 The loss of this vital information seems to have been an example of the price paid as a result of there being no effective project management ensuring an objective record of progress and continuity of relevant knowledge and experience.

**Early confusion over permitted use of RHI funding**

3.76 The evidence considered by the Inquiry also suggests that there was an initial confusion over how the funding that HMT was making available for renewable heat could be used.
3.77 In the context of tendering for economic consultancy during an email exchange between Carmel McConville (DETI Strategic Planning & Economics) and Ms Clydesdale (into which Mr Connolly and Ms Hepper were copied) Ms Clydesdale, on 29 October 2010, wrote:

“Options – when I spoke with Sam we agreed that since the funding was only being made available for an RHI that this essentially meant that our other options could not proceed....The previous study has identified various options (such as grant support, industrial sector support only etc.) but there is no funding for these as the HMT funding is ring fenced for us to deliver an RHI. Do you mean for us to look at these other options in the EA or do you mean to look at various options for delivering the RHI only – I’m hoping it’s this second point.”

3.78 Ms McConville responded that, while it made sense to only consider the option relating to the RHI scheme, the appraisal might need a small paragraph to explain why that was the case. She wrote:

“This may include why this money has been ring fenced and what are the rules governing the funding. Carrying on from this the appraisal should then look at the various options for delivering the RHI.”

Paragraph 3 of the terms of reference subsequently issued to potential candidates to perform the economic appraisal exercise then included the following wording:

“This funding has been provided by HMT and is only available for a Renewable Heat Incentive. This is to ensure that Northern Ireland is not disadvantaged compared to the rest of the United Kingdom. The economic appraisal needs to therefore identify the most cost-effective option for implementing the policy of a renewable heat incentive.”

3.79 However, as can be seen in the CEPA section, because the economic analysis was showing that the Challenge Fund “might have been an attractive route”, Ms Clydesdale sought further clarification from HMT regarding the possible use of the funding for a grant scheme instead. The answer came back from HMT’s Jon Parker on 15 April 2011 that:

“This funding does have to be used for renewable heat, but if NIE decide you would like to use it for a grant scheme or some such then this would be permissible as long as the cost of NIE spend is constrained to the AME consequential.”

The risk of continuing confusion over RHI funding

3.80 The Inquiry notes that, in practice, some aspects of the way the funding was treated by DFP and HMT could have reinforced misconceptions about the unusual nature of the RHI AME arrangements.

3.81 Firstly, contrary to what had been said about the inability to carry forward any purported underspend, £1.8 million from the £2 million funding allocation in 2011-12 was subsequently moved forward to 2012-13 and confirmed by DFP through the budgetary process. Ms Brankin offered the explanation that this was a re-profiling exercise for the start of the scheme and not
3.82 Secondly, as explained later in this Report, the ease with which additional AME funding was provided in 2015-16, when the AME profile for that financial year had been considerably exceeded, led to false reassurance among DETI officials (already lacking in their understanding of the true nature of the RHI funding) that subsequent overspends would also be treated as standard AME.

Inherent uncertainty about future RHI budget allocations

3.83 As described earlier in this chapter, it was highly unusual for AME funding to be capped at all, let alone on the basis of a population share, yet this was how DETI’s initial RHI budget allocation for the years 2011-12 to 2014-15 was set. It was also assumed to be the basis for the subsequent 2015-16 allocation in correspondence between DETI Minister Foster and DECC Minister Barker at the end of 2013/early 2014. This suggested that Northern Ireland would receive a population share based on the £430 million cap set for the GB RHI scheme. As it turned out, HMT in error never actually set a cap in Northern Ireland for 2015-16 as discussed in more detail elsewhere in this Report.

3.84 For allocations in the period from 2016-17 onwards the Inquiry saw some evidence of DETI officials considering the risk that might result from any reduction in DECC’s budget. In March 2015 Mr Hughes, who worked on RHI under Mr Wightman in Energy Division’s Energy Efficiency Branch from July 2014, had received a copy of DECC’s November 2014 RHI forecasts which set out three different estimates for ‘low’, ‘central’ and ‘high’ cases.

3.85 In May 2015 Mr Hughes wrote back to DECC saying:

“If uptake of the GB RHI scheme (per/head of population [sic]) isn’t as high as the NI scheme, we are concerned that DECC AME [sic] might submit a reduced AME profile which would lead to consequential reduction in DETI allocation under the agreed formula.”

In this same email, he suggested that DECC might submit its ‘high’ forecast rather than the ‘central’ one and transfer any additional consequential funding to Northern Ireland. DECC did not do this and told Mr Hughes that he would need to pick this up with HMT directly.

3.86 Mr Wightman also understood the risk. He told the Inquiry in oral evidence that in March 2015 he was aware that “no matter what we do, our profile is determined on what DECC’s profile is.” However, the Inquiry saw no further evidence of this risk being evaluated or communicated. In December 2015, as discussed elsewhere in this Report, the risk then materialised when, following a sharp reduction in applications and tariff levels in the GB scheme during 2015, DECC reduced its forecast spend for the period to 2019-20 by about a third and HMT reflected this in a similar reduction for Northern Ireland’s RHI allocation for this period.
Findings

14. DETI Energy Division officials working on RHI were clearly warned by DETI Finance in May 2011 that the RHI funding was not being treated as standard AME, and that the approach to adopt to it was to treat it like DEL. This was in the context of HMT speaking of DEL penalties. The design of the RHI scheme should have included proper consideration of the controls necessary to reflect this position of heightened financial risk.

15. The important information about the unusual funding arrangements, and consequent heightened risks, should have been passed to CEPA, who appear to have based their reports upon the assumption that the funding allocations were effectively capped on a “first come, first served” basis. The Inquiry was not furnished with any evidence that Ms Clydesdale’s direction of 4 May 2011 to Mr Hutchinson – that, as regards her exchanges with Ms Brankin as to the nature of the funding, “you will need to ask CEPA to factor this in as a risk factor in the economic appraisal” – was effected.261

16. In late June 2011, about two months after she ceased work on renewable heat and moved to work on a variety of other energy-related matters, Ms Clydesdale, in company with all grade 7s in Energy Division, was circulated with a draft of the RHI consultation documents. She told the Inquiry that she thought that the reviews and monitoring referred to in the documents would be followed by costs controls at a later point in a phased process. Despite the fact that her conversation with Ms Brankin had confirmed the need to treat the funding as DEL with a need to control annual expenditure, and that her own email of 4 May 2011 had recorded that the HMT funding presented a “significant challenge” and “DFP will require evidence of our ability to control the scheme in order to minimise over/under spending in any one year”, she told the Inquiry she did not take any note of the fact that the consultation documents did not refer to any such proposals.262 While the Inquiry appreciates that, by this stage, she was engaged in different work and received the documents as part of a general circulation, the Inquiry finds that her omission to do so was unfortunate.

17. Ms Hepper, the head of Energy Division, was clearly told that RHI AME was to be treated like DEL and there can be absolutely no doubt that both she and Mr Cooper, Head of Finance, were fully informed in 2011 as to the unusual nature of the AME funding and the risk of an impact on the DEL budget of any overspend.

18. The officials in Energy Division working on RHI should have formally brought the unusual nature of the RHI funding, and the heightened risks it carried, to the attention of the DETI Minister, the DETI Casework Committee considering the RHI scheme, and the DFP Supply officials considering the RHI business case.

261 WIT-12771
262 TRA-00997; TRA-00992; TRA-01016
19. No reference was subsequently made, for example in the ministerial submission from Ms Hepper of 8 June 2011, to the qualifications and risks confirmed by the April and May 2011 email exchanges. Ms Hepper told the Inquiry that simply limiting the funding to AME was a form of “shorthand” and it was assumed that the Minister was aware of the qualifications. While Ms Hepper did go on to say that she was “pretty sure” that the officials had informed the Minister of the qualifications to this unusual type of AME funding, Ms Foster told the Inquiry that, to the best of her recollection, she was never made aware that the funding was qualified prior to the autumn of 2015, when she was in her new role at DFP. What is clear is that the information contained in the Parker email exchange was never included in any formal submission to the Minister, as it should have been. In the course of her evidence to the Inquiry Ms Hepper accepted that omission to have been “unhelpful.”