IA06/DETI/15

DEPARTMENT FOR THE ECONOMY (DfE)

REVIEW OF NON DOMESTIC RENEWABLE HEATING INCENTIVE

FINAL INTERNAL AUDIT SERVICE REPORT

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Introduction, Purpose and Scope, Control Objectives

Introduction

Internal Audit Service (IAS) has completed a review of the System of Control over the Non-Domestic Renewable Heat Incentive (RHI) scheme within the Department for Enterprise, Trade and Investment (DETI), in accordance with the agreed terms of reference. The review forms part of the overall Audit Plan for 2015/16 which was agreed by the DETI Accounting Officer and endorsed by the DETI Audit Committee. The audit fieldwork was undertaken during the period December 2015 to April 2016.

Purpose and Scope

The purpose of the review was to provide an independent professional opinion on the adequacy and effectiveness of risk management, control and governance over the Non Domestic Renewable Heat Incentive Scheme.

The scope of the audit included reviewing control, governance and risk management arrangements in respect of the following areas:

- Scheme Design
- Financial Management – Payments and Budgetary Control
- Governance and Oversight Arrangements

The review focused particularly on the effectiveness of internal controls exercised from the initiation of the scheme and the actions taken to address concerns which arose over regularity, affordability and value for money with the scheme. The review initially also sought to assess the potential for fraudulent activity in regard to applications to the scheme.

Control Objectives

The following objectives were used as a basis for our evaluations and opinion about the adequacy and effectiveness of risk management, control and governance. The review sought to ensure that:

- The non-domestic RHI scheme had been designed so that awards are only made for valid applications that demonstrate they have met all of the scheme criteria, including that the purpose is for a valid business activity. In addition that the proposed heat output of the application is only at a level that is necessary for the proposed business described, and by design the scheme incentive is not such that the award generates payments that would exceed the costs of the heat being generated. Finally, that there is a valid legally binding agreement between DETI and the applicant;
- An adequate and effective budgetary control system was established to enable complete, accurate and reliable financial management information to be extracted for monitoring and reporting purposes. In addition, to ensure that the long term budgetary commitments for the scheme are monitored and that formal budgetary cover for the life of the scheme is in place to make sure that all commitments can be met;
- Adequate and effective governance and oversight arrangements have been established over the relationship between DETI and OFGEM and robust assurances are provided over budgetary transfer payments made to OFGEM and the administration of Departmental funds, including the award and payment processes; and
- In light of recent experience with the operation of the scheme, a key objective is to provide a full assessment of:
    - the factors which contributed to the large spike in scheme demand and costs;
    - the effectiveness of existing internal controls;

- the management of the risks; and
- on the lessons to be learnt.

Background

The Strategic Context

The 2009 EU Renewable Energy Directive set a binding target for EU member states to collectively produce 20% of its energy requirement from renewable sources by 2020. Each EU member state was subsequently set a target for their domestic contribution to this target, based on, amongst other factors, their current renewable energy consumption. The UK, due to its historically low levels of renewable energy consumption, made a commitment to achieve a total of 15% energy consumption from renewable sources by 2020. In order to help the UK achieve this target, the Department of Energy and Climate Change (DECC) was allocated £860m of funding from Her Majesty's Treasury (HMT) to support the introduction of a Renewable Heat Incentive scheme from 2011-2015.

Whilst a UK wide RHI scheme was designed by DECC, to be implemented by the Office of Gas and Electricity Markets (OFGEM), it was agreed that due to the unique composition of the Northern Ireland heating market and its disproportionately high reliance on oil, that a separate NI scheme would be developed. Although Northern Ireland was closely following its UK counterparts in terms of the design and implementation of the scheme, it was agreed that a separate budget would be allocated. HMT subsequently notified the Northern Ireland Executive that £25m of funding would be allocated over the same period, 2011-15. This was approximately 3% of the total UK allocation and based on the Barnett formula, which dictates the level of funding provided from HMT to devolved administrations.

Once funding was agreed, DETI commissioned an economic appraisal to consider the available options. The final report – *A "Renewable Heat Incentive for Northern Ireland* "was completed by specialist consultants, Cambridge Economic Policy Associates (CEPA) and AEA Technologies, in June 2011. The report provided the basis for a public consultation on the proposals for a Northern Ireland Renewable Heat Incentive scheme. During the consultation process, which closed in October 2011, it was recognised that there were a number of areas where consultees were not in agreement with the proposals, in particular the proposed tariff structure and levels. DETI therefore engaged CEPA and AEA Technologies to undertake some additional analysis in light of the information provided by respondents, in order to assess the additional evidence provided and to update the economic model where appropriate. The work was completed in February 2012 and informed the final business case which was approved by DETI's casework Committee on 9 March 2012.

Each EU member state was allocated an individual national target as a result of the EU Directive and this rationale was followed within the UK, with each devolved administration being provided a separate target, based on their current renewable energy consumption levels and their overall potential for growth. The Northern Ireland Executive, as outlined in its Programme for Government (PfG) set a target of achieving 4% of renewable heat by 2015. This was an interim milestone to achieving 10% renewable heat by 2020, in line with the Executive endorsed Strategic Energy Framework (SEF). In pursuit of these targets, the interim Renewable Heat Premium Payment (RHPP) and the Non-Domestic Renewable Heat Incentive (RHI) scheme were introduced in May 2012 and November 2012 respectively. The full Domestic RHI scheme was introduced in December 2014 to replace the RHPP. It should be noted that this report focuses solely on the Non Domestic RHI Scheme. A separate report will be provided on the Domestic RHI scheme, which is administered by DETI.

Scheme Objectives

The fundamental objective of the Non Domestic RHI scheme was to increase the uptake of renewable heat to the levels outlined above. To achieve this, the scheme offered a range of financial incentives to installers of renewable technologies with payments being made on a quarterly basis. Incentives were provided through tariff payments, and were set in the form of pence per kilowatt hour (p/kWh) with the level of tariff being dependent on the type and size of the technology introduced.

Generally speaking, particularly in 2011 and 2012 when the scheme was being designed, renewable heating technologies were unable to compete financially with existing fossil fuel alternatives from two perspectives. Firstly, renewable heating technologies require a higher initial investment based on increased capital costs. Secondly, the running cost of renewable heating technologies also tends to be higher than fossil fuel alternatives. Without the introduction of financial incentives there was a risk of market failure and of NI being unable to meet the targets set by both the NI Executive and DECC.

Tariffs

One of the key factors in the design of the Non Domestic RHI scheme was the setting of tariffs. Tariffs needed to be sufficient enough to stimulate demand and not too high as to over incentivise the technologies. The proposed tariffs, as outlined in the original business case, were based on advice provided by consultancy firms CEPA and AEA Technologies and were calculated to cover the cost differential between a traditional fossil fuel heating system and a renewable heat alternative. The proposed tariffs were set to account for the differences in capital, operating and “hassle” costs against a counterfactual position of heating oil. Oil was used as the counterfactual for the NI Scheme as Northern Ireland was and still is primarily dependent on oil and it was envisaged that the vast majority of installers would be switching from an oil heating system.

A range of tariffs were introduced, the level of which varied depending on the type and size of technology and support was designed to be paid over a period of 20 years, which is the expected lifetime of the technology. The tariffs in place at the point in which an installer applied remain the same through the 20 years of the scheme, with any revised tariffs only applying to subsequent applicants. The rationale behind ‘grandfathering’ rates was to provide certainty and security to investors regarding the level of support they receive.

Scheme Performance

The initial approved funding covered the four year period from 2011/12- 2014/15, however, it should be noted that the Non Domestic Scheme did not commence until November 2012. Initial uptake was poor and remained low in the 2013/14 financial year.

It was not until 2014/15 that uptake of the scheme began to significantly increase. Table 1 below shows the number of applications and the actual spend against budget over this period.

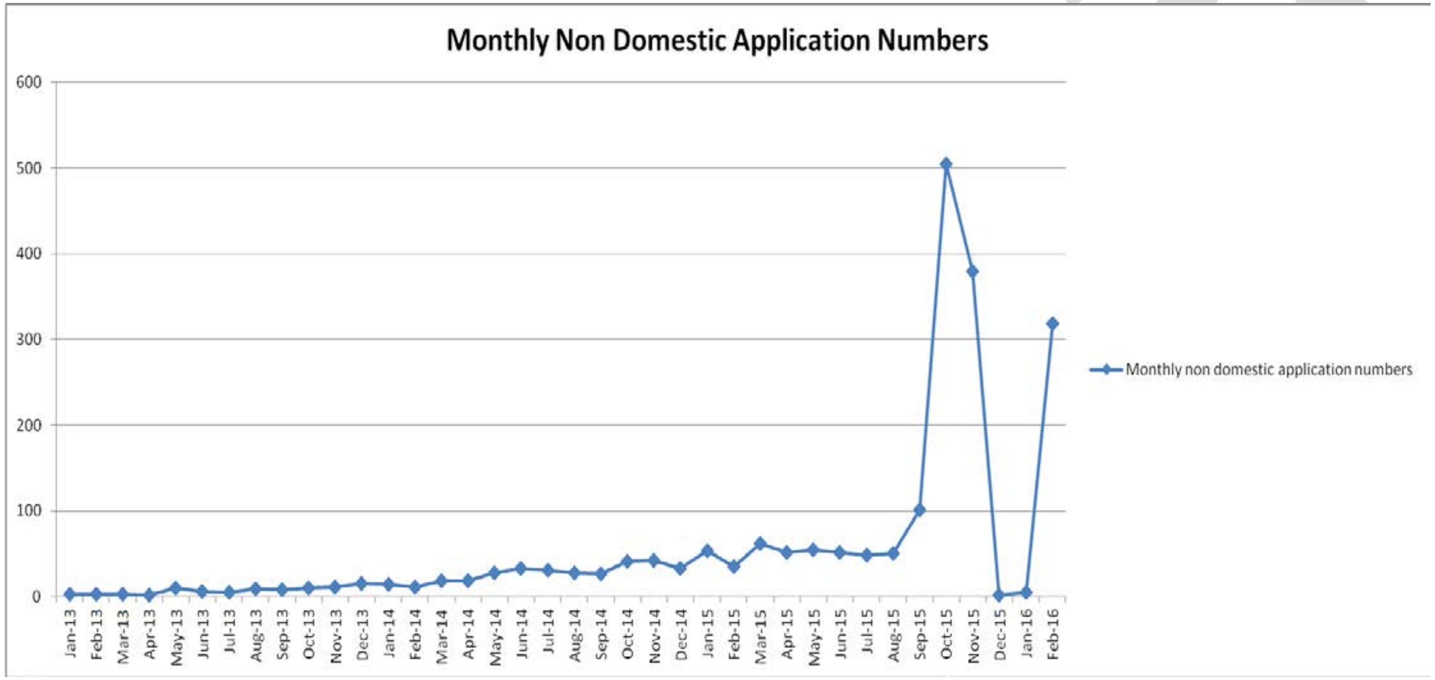
Table 1: Budget v Actual Spend

	2011/12	2012/13	2013/14	2014/15	Total
Total number of applications	0	9	119	435	**563**
Annual AME allocation from HMT (£m)	2.0	4.0	7.0	12.0	**25.0**
Actual Expenditure incurred (£m)	0.0	0.5	1.6	7.9	**10.0**
Annual under spend of AME allocation (£m)	2.0	3.5	5.4	4.1	**15.0**

As the table above demonstrates, only £2.1m of the £13m Annual Managed Expenditure (AME) budget allocation was spent during the first 3 years of the scheme. Internal Audit was informed that the priority within Energy Division was to try and improve uptake of the scheme. The subsequent consultation for Phase 2 included proposals for a new Domestic Scheme, new tariffs and technologies for the Non Domestic Scheme and proposals for cost control, which were similar to those being progressed by DECC at that time.

Uptake of the Non Domestic Scheme improved in 2014/15 and 435 successful applications were received, resulting in a further £7.9m of expenditure, leaving a total under spend of £15m (60%) over the 4 year period. The graph below (Table 2) shows the number of monthly applications made to the Non Domestic Scheme from its commencement in November 2012, up until scheme closure in February 2016. It demonstrates that there was a slow but steady increase in applications throughout the period up until March 2015 with a major increase in demand in the 3rd Quarter of 2015. There was a further increase in demand of 318 applications in the run up to the closure of the scheme in February 2016 and a total of 2,128 non domestic installations registered of which approximately 1200 have been processed and accredited to date and total RHI expenditure (including Domestic installations) is estimated to be in the order of £50m per annum from 2016/2017 onwards.

***Table 2*[1]**



[1] Energy Division paper to DETI Audit Committee March 2016.

It was in March 2015 that Energy Division began to act on the pattern of increasing costs, the focus of attention being on securing additional budget cover.

Budget Cover

DECC was allocated £860m of AME funding from Her Majesty's Treasury (HMT) to support the introduction of a Renewable Heat Incentive scheme from 2011-2015. In terms of budget arrangements for Northern Ireland, it was agreed that DETI would receive 2.98% of DECC's budget, in line with the Barnett formula and be allowed to enter into 20 year commitments providing payments were flat over the 20 year period in real terms.

One of the key issues highlighted at this time was that this was not standard AME, where the Exchequer assumes all risks of overspend. Instead the funding would be part of a risk-sharing arrangement between HMT and DECC. Any scheme overspends would have implications to DECC's Departmental Expenditure Limit (DEL) budget with penalties "likely to be the order of 5%" in any given year. These rules would be applied in equivalent fashion to NI spend.[2]

As noted above, in March 2015 Energy Division, through their internal budget monitoring and cost forecasting system, identified a pattern of increasing costs. It was becoming apparent that a significant pressure was emerging. At this point the focus was on clarifying the Department's position around the RHI budget cover via the Department of Finance and Personnel (DFP) and HMT; and securing additional resource to address the emerging pressures. Whilst the Department's Energy Division had known of the

[2] Email correspondence with HMT 2011

possibility of some risk to Resource DEL, based on the e-mail correspondence from HMT in April 2011, they had been operating under the assumption that funding for RHI was essentially an AME issue.

In March 2015, Energy Division was forecasting monthly expenditure of £1.7m by March 2016 rising to £2.5m by March 2017. The corresponding projected annual level of expenditure at this time was estimated as £16m in 2015/16 and £25.5m in 2016/17. While Energy Division understood that in excess of 200 new applications for biomass heating systems, linked to the Moy Park expansion, were expected in the following 12 months, there was not at the time a sense of how rapidly demand for the scheme would grow during 2015/2016 or that the potential final annual expenditure on the RHI scheme overall would reach £50m.

Due to the escalating costs and subsequent financial resource issues, Energy Division formally sought clarification from DETI finance on:[3]

1. Whether or not prior year under spend from the initial £25m AME allocation be carried forward to future years;
2. What the RHI budget allocation for 2015/16 was likely to be; and
3. Maximum annual budget allocations from 2016/17 onwards would be.

Energy Division was advised in May 2015[4] that clarification would be sought from DFP but that, in line with previous correspondence from HMT, it was likely that a cap of 2.98% of DECC's budget would be applied and that the 2015-16 allocation would therefore be in the region of £12.8m. They were also advised that in line with previous correspondence from HMT, that RHI budget was not treated as standard AME and overspends would have consequences for Resource DEL budgets.

[3] Email from Energy Division to Finance 26 March 2015
[4] Email from Finance Division 19 May 2015

As the process of budget clarification was taking place, it became apparent that the need for DFP approval to continue the scheme beyond March 2015 had not been sought, when before the original approval period (2011/12 – 2014/15) ended. DETI Energy officials had wrongly assumed that like the domestic scheme, approval for the Non Domestic scheme had been secured until scheme closure in March 2020. The advice received from the Departmental Solicitor's Office (DSO) on 25 June 2015 concluded that "the Department cannot suspend the operation of the scheme without amendments to legislation" and "before the Department can amend the legislation to provide for a suspension, it will have, at the very least, to consult".

The Department submitted an addendum business case to DFP on 27 October 2015, which sought both approval for the amended scheme going forward and retrospective approval for the operation of the scheme during the first seven months of 2015/16. DFP responded on 29 October 2015 advising that they were "content to grant DFP approval to the interim arrangements. At this stage, DFP approval can only be granted to new installations until 31 March 2016 due to the uncertainty around future funding of the scheme." In their subsequent letter dated 21 December 2015 DFP confirmed that retrospective approval would not be provided for expenditure in the period 1 April 2015 to 28 October 2015, they stated that "all commitments entered into between 1 April 2015 and 28 October 2015 will result in irregular expenditure". DFP also advised that a "possible, and indeed probable, outcome" of their discussions with HM Treasury was that "the NI Executive will have to fund all costs above the AME profile from the Executive's DEL allocation".

Departmental response to growing demand

Concerns over rising expenditure became acute in July 2015, and a course of action proposed to:

- Legislate to introduce tariff controls as soon as possible; and
- Review the underpinning legislation and bring forward proposals for further controls in due course.

The introduction of a tiered tariff for biomass systems (which account for 97% of installations) was agreed by the Minister in early September 2015. This was subsequently followed by a public announcement on 8 September 2015. It was anticipated that these changes would take effect from 4 November 2015. The necessary legislation to introduce cost controls was agreed on 17 November 2015.

During the 10 week period between the Minister's initial announcement on tiered tariffs, and their introduction there was a sudden, significant and unforeseen spike in demand. In the space of 6 weeks the number of installations doubled from the 900 that had been received in the previous 3 years. At peak demand in October 2015, NI application numbers were running at twice that of the total for GB.

In January 2016, in light of the significant financial risk faced by the Department, it was agreed that further legislation would be passed to suspend the scheme at the earliest possible juncture. Urgent procedures were used to secure Executive agreement to proceed with the closure of the scheme. The closure of the scheme was announced on 5 February 2016, less than two weeks ahead of the planned closure date of 16 February 2016. Due to the short notice period, and the significant risk of challenge through judicial review stemming from the lack of consultation, it was subsequently agreed to delay the closure until 29 February 2016.

Allegations of abuse

On 28 January 2016, the Department, through the Office of the First and Deputy First Minister (OFMDFM) received an anonymous letter alleging abuse of the scheme in Northern Ireland. The Department has appointed external consultants to conduct an investigation of the allegations received, which will include a programme of site inspections.

Acknowledgement

Internal Audit would like to thank management and staff for their assistance and co-operation throughout this review.

Overall Findings and Audit Opinion

Overall Findings

IAS findings and recommendations have been prioritised using the following as per HIA (DFP) 1/12:

Priority	Definition
1	An issue which requires urgent management decision and action without which there is a substantial risk to the achievement of key business/system objectives, to the reputation of the organisation, or to the regularity and propriety of public funds.
2	An issue which requires prompt attention, as failure to do so could lead to a more serious risk exposure.
3	Improvements that will enhance the existing control framework and/or represent best practice.

The number of findings and recommendations (by risk priority) is summarised as follows:

Priority 1	Priority 2	Priority 3
7	1	-

Overall Audit Opinion

Internal Audit considers that the system of risk management, control and governance established by management over the Non Domestic Renewable Heat Incentive Scheme is **Unacceptable** (see Annex 1 for a definition of Internal Audit opinions as per DAO (DFP) 07/13). In forming this opinion Internal Audit recognises that the Scheme has been successful to the extent that the Programme for Government target to achieve 4% of heat generated from renewable sources by 2015 has been met. However, the scheme lacked by design an effective response to the spike in applications in late 2015/2016. The scheme was formally closed to new applications from 29 February 2016, at which point a total of 2,128 applications had been received over the life of the scheme. All applications received before the scheme closed are required to be considered by OFGEM and if valid, approved and funded. The potential annual liability for 2016/2017 if all applications are successful is estimated as £50m.The funding available from HM Treasury, based on 3% of DECCs projected budget (£640m) is estimated as £18.3m. The consequence of the shortfall between the Scheme's commitments and the available funding means there is a potential shortfall of £140m in the period 2016/2017- 2020/2021 and this could rise to approximately £400m- £450m over the life of the Scheme.

Internal Audit has identified a number of control and design issues with the scheme, some of the recommendations that we have made are actions that should still be taken even though the Scheme has now closed. In particular, Internal Audit considers that a Value for Money Study to be undertaken on the Scheme to assess whether or not the level of subsidy provided by the scheme is necessary and that the assumptions made at the design stage on costs of installations and fuel are still valid.

Internal Audit has also made a number of other recommendations, which given the Scheme has now closed, are targeted at ensuring that future or current programmes within the Department learn lessons from this Scheme.

A report on the review by Internal Audit of the Domestic RHI scheme will issue separately, the Domestic Scheme while part of the overall RHI scheme was administrated by DETI Energy Division, rather than OFGEM.

Finally, Internal Audit notes that in response to the allegations received that the scheme is subject to abuse, the Department has appointed external consultants to conduct an investigation which includes a programme of site inspections.

6. Detailed Findings and Recommendations

Finding and Recommendation Number	1

1. Scheme by Design Vulnerable to Demand

Finding: The Non-Domestic element of Northern Ireland Renewable Heat Incentive (NIRHI) Scheme was introduced from the 1 November 2012 in parallel with comparable schemes for the rest of UK led by DECC. The NIRHI initiative was central to achieving the Executive's Programme for Government (PfG) target of having 4% of Northern Ireland's heating needs met from renewable sources by 2015, and a further target in the Strategic Energy Framework of achieving 10% renewable heat consumption by 2020.

DETI commissioned consultants Cambridge Economic Policy Associates Ltd (CEPA) to carry out a Review of Renewable Heating for Northern Ireland (12 July 2011) and potential approaches to be taken developing the RHI scheme for Northern Ireland. The report advised that DETI should adopt DECC's approach and develop a parallel scheme of the Northern Ireland Renewable Heating Incentive (NIRHI) which would in principle mirror the scheme in the GB but should differ slightly in the approach due to differences in the sources of heating in the markets in which the scheme operates (the main source of fuel for heating in GB – natural gas, NI – oil, LPG). Both GB and NI Non Domestic RHI schemes are administered by OFGEM which has responsibility for assessing applications and controlling contracts and individual payments. The initial Business Case for the scheme recognised a number of potential risks including the risk of insufficient budget for administration of future payments.

The NIRHI scheme is underpinned by the Energy Act 2011 and the subsequent The Renewable Heat Incentive Scheme Regulations (Northern Ireland) 2012. The legislation requires that applications are made after installation of the technology and instructs that all properly made applications must be accredited. This aspect of the design of the scheme meant that demand for the scheme could increase without the constraint of an approving body having considered and approved an application before the applicant incurred eligible expenditure. Internal Audit also notes that the legislation that brought the scheme into effect did not include specific automatic provisions for suspension or closure of the scheme if required. This was also true of the GB Scheme.

Internal Audit was informed that DECC made changes to their scheme in 2013 to introduce further cost control measures and in response the Department in 2013 consulted on the potential cost control measures for the NIRHI scheme. The suggested cost controls set out in the consultation included an automatic halt to the scheme if 90% of available budget for NIRHI Non-Domestic was committed. The proposed cost controls were not subsequently introduced, although no decision not to introduce cost controls was taken, rather resources were focused on Phase 2 of the scheme.

After the Non Domestic NIRHI scheme started the initial uptake in demand was slow with only 9 applications registered at the end of 2012/13 and increasing to 127 registered in 2013/14. From the second half of 2014 the demand for the scheme started to increase and at the end of 2014/15 a total of 697 applications were either accredited or pending accreditation. On 26 March 2015, Energy Division contacted colleagues in Finance to highlight, based on a trend of increasing demand during 2014/15, that the allocated budget for the financial year of 2015/16 of £12.9m was unlikely to be sufficient and estimating that a budget of £16m for 2015/16 and £25.5m for 2016/17 was required.

By June 2015, it was clear that there was significant uncertainty around the level of funding required as a result of increased scheme demand and the available budget cover. A number of different options were considered including the scheme stopping or being suspended for new applications. On 25 June 2015 Energy Division received advice from Departmental Solicitor's office which concluded that "the Department cannot suspend the operation of the scheme without amendments to legislation" and "before the Department can amend the legislation to provide for a suspension, it will have, at the very least, to consult".

The Department, with the agreement of the Minister announced plans for the introduction of Cost Controls to manage the increased demand and to keep budget under control for all new installations on 8 September 2015. The cost controls came into force from 18 November 2015 and were as follows:

- Tier applied to biomass heating up to 199kWH (range increased from 99kW to 199kW in parallel with GB) incentive of 6.4p dropping to 1.5p after 1314 hours of operation; and
- Annual cap of 400,000kWh applied to all incentive payments.

During the period between the announcement of the proposed cost controls and their introduction demand for the scheme continued to grow. The largest spike in applications occurred during October and November 2015 and by the end of November 2015 the total number of applications registered for the Non Domestic RHI scheme was approximately 1980. Due to the unprecedented growth in applications and the constrained finances available, the NIRHI scheme was subsequently closed for new applications from the 29th of February 2016 after brief consultation. When the scheme closed at the end of February 2016 a total of 2,128 applications had been received over the life of the scheme. As result of the spike in applications in late 2015, the annual amount needed to cover the potential liability, if all applicants are approved, is estimated as £50m for 2016/17. Internal Audit notes that AME allocation for RHI from the HM Treasury for 2016/17 is currently estimated as £18.3m based on 3% of DECCs projected budget which is £614m. As a result of this difference between the expenditure already committed and the budget available from HM Treasury Energy Division has estimated that there is a potential short fall in available funding in the period 2016/17 – 2020/21 of £140m and this could rise to approximately £400m over the remaining life of the scheme.

Conclusion
Internal Audit considers that the NIRHI Scheme was, inherently vulnerable to the risk of any sudden major increase in demand. This risk was further exacerbated by the nature of the funding for the scheme which was not AME without limitations but rather was based on 3% of DECC's estimated overall budget for RHI in a given period.

The absence in the design of the scheme of readily available measures to respond to major increases in demand and the resulting pressure on agreed budgets was a major weakness in the initial design. Ideally the scheme design and legislation would have included a provision for halting or stopping the scheme. Preferably, the scheme would have included a cost control that would have automatically caused the scheme to halt if demand reached a critical point which outstripped or threatened to outstrip the available or projected budget.

The scheme should have adopted robust cost control measures at the outset or at least when GB chose to introduce these in 2013. Internal Audit has noted that the Department consulted stakeholders in 2013 on introducing cost controls which would have allowed the scheme to be stopped automatically for new applications if greater than 90% of budget available was committed. Internal Audit was advised by Energy Division that this change was not implemented due to competing pressures at the time. Ultimately when the spike occurred in 2015/16 the Department did not have a mechanism in place to respond quickly.

In conclusion, whilst we accept that the initial NIRHI scheme mirrored by design the GB scheme, the NI scheme was inherently vulnerable to a major increase in demand and lacked an appropriate automatic response that would have allowed the scheme to close to new applicants until such time as additional budget was secured.

Risk: The Department is open to significant financial risks if demand led schemes and programmes do not have inbuilt demand led controls such as the ability to suspend or stop the scheme.

2. Recommendation:

The Department should ensure that all schemes, particularly those which are demand led, have appropriate controls in place to mitigate any risk of unforeseen major increases in demand. Where possible schemes should be designed in such a way that applicants do not incur a liability which the Department must honour unless budget cover is in place or where it is not practical to identify future commitments in advance schemes should have a controls which automatically close the scheme when Demand v Budget based trigger points are reached.

In addition, the Department should ensure that OFGEM, in assessing those applications that were received before the introduction of cost controls in November 2015, confirms that these met all conditions of the scheme at the point in time at which they submitted their applications.

3. Priority	1	**4. Time scale:**	As soon as possible

5. Management Response:

RHI Branch – Agreed. In any future schemes cost controls and a means to close in the face of increasing demand will be included. Energy Renewables Division will write to Ofgem asking them to confirm that all applications prior to the introduction of cost controls in November 2015 met the conditions of the scheme at the point of application.

Corporate Governance, Planning and Equality Branch (CGPEB) – CGPEB will produce a summary of the recommendations which will be disseminated to staff by way of a Corporate Governance Bulletin which will issue to all G7s and above as well as being published on the DfE Intranet.

6. Management's Planned Implementation Date: RHI Branch – 31 July 2016. CGPEB 30 September 2016

7. Officer Responsible (name and grade) for Ensuring that the Recommendation is Implemented: Alison Clydesdale Grade 6 (acting) / Brendan McCann Grade7

Finding and Recommendation Number	2
1. Programme / Project Management	

Finding:

Programme/Project Management frameworks provide a structured approach to co-ordinate, communicate, align, manage and control the activities involved (https://www.dfpni.gov.uk/articles/programme-management). The Office for Government Commerce (OGC) Managing Successful Programmes methodology (MSP ™) provides best practice guidance on managing programmes and projects. The MSP states that a programme is designed as a temporary flexible organisation structure to coordinate, direct and oversee the implementation of a set of related projects and activities in order to deliver outcomes and benefits related to the strategic objectives. Projects should be focussed on the creation of a set of deliverables within agreed cost, time and quality parameters.

The NIRHI Scheme was not managed within a formal Programme / Project Management Structure. Internal Audit was advised by Energy Division, that due to the small number of staff involved in the development and implementation of the Scheme, the adoption of a more formal structure would not have been seen as proportionate. However, Internal Audit considers that adopting a recognised structured programme/ project framework would have been beneficial. There are a number of reasons for this:-

1. **Oversight of the Programme and Budget**. In response to casework, management committed to establishing a Budget Monitoring Committee (BMC), however, this did not happen. The establishment of the BMC could have been addressed through the establishment of an overall Programme Board. If the BMC had been established it may have provided a forum for a better understanding of the NIRHI budget and in particular, clarity on whether the budget was or was not AME fund limited to 3% of DECC and the consequences of this for the programme. A Programme Oversight Board would have had a challenge role on delivery of outcomes of the programme, the programme plan, programme budget and programme risks. For example, management advised that with the pressure on resources there was a need to prioritise the introduction of the Domestic RHI scheme in 2014 ahead of the introduction of the cost controls. A Programme Oversight Board would have allowed greater visibility and consideration of the risks that related to this decision.

2. **Organisational Knowledge**. During the initial four years of the scheme there was high turnover of staff within Energy Division. The impact of these staff changes was a loss of the organisational knowledge from those staff involved in the initial implementation of the scheme. A formal Programme/Project Structure and its composite elements such as a formal Programme Plan would have at least served as a certain element of *aide memoire* to ensure that critical dates were not missed. For example, the failure to get DFP approval in good time for expenditure post 2014/15 could have been captured in a programme/project plan as an important action to be delivered in 2014. A formal programme oversight may also have sought assurance that the risks of loss of organisational knowledge had been assessed and were being managed.

Conclusion

The use of programme/ project oversight arrangements for this scheme would have provided greater structure and challenge at key stages of the programme, and would have been appropriate considering the long term nature of the programme (20 years) and the amount of funding involved. At the very least the Budget Monitoring Committee should have been established as originally planned.

Risk: In the absence of formal programme oversight processes there is an increased risk that a programme/ project may fail to deliver on planned outcomes and outputs and project specific risks could materialise if best practice of programme/ project management guidance is not considered and appropriate governance structures are not established from the outset.

2. Recommendation:

The Department should formally review its existing major programmes and consider whether or not appropriate programme/ project oversight arrangements are in place, which are sufficiently robust and proportionate to the level of risk and expenditure and that staff involved in the delivery of programmes / projects have sufficient knowledge ,expertise and for major projects, formal training.

When new programmes are being developed or implemented, consideration should be given at the earliest opportunity to the development of appropriate programme/ project oversight arrangements and as a minimum requirement all programmes/ projects should have a plan with key actions and dates when these actions are due to be completed, which should be subject to review. Assurance on the delivery against these plans should be a fixture of future assurance statements. In order to provide a source of advice and expertise the Department should consider establishing a Programme Management Office to help co-

ordinate major projects and ensure appropriate programme/project management methodologies are in place In addition, a programme/ project specific risk register which considers all risks inherent in the project needs and a formal programme/ project plan which sets out key milestones and decision points should be maintained to provide the basis for the formal challenge from the programme/ project oversight group.			
3. Priority	**1**	**4. Time scale:**	As soon as possible
5. Management Response: Partly Agreed – RHI oversight steering group established May 2016. Review of existing major programmes and establishment of wider programme management office is outside the remit of Energy Renewables Division. Energy Renewables Division will table the IA recommendations at the RHI steering board **CGPEB –** The Bi-Annual assurance statements will be updated before they issue for the mid-year assurance statement process at 30 September 2016. The Assurance Statements will require Directors to confirm that all programmes/ projects within their divisions have the correct approvals in place, funding secured and have been appropriately risk assessed. Establishment of a Programme Office to be considered by the RHI Steering Group			
6. Management's Planned Implementation Date: Next RHI steering board is scheduled for 28 June / CGPEB 30 September 2016			
7. Officer Responsible (name and grade) for Ensuring that the Recommendation is Implemented: Alison Clydesdale Energy Renewables Grade 6 (Acting) / Brendan McCann Grade 7			

Finding and Recommendation Number	3

1. Risk Management

Finding:

In accordance with the DFP best practice guidance on Programme and Project management (https://www.dfpni.gov.uk/articles/programme-and-project-risk-management), the purpose of risk management is to support effective decision making by dealing with risk in a way that is visible, repeatable and consistent. A meaningful risk management process should provide an organisation with a better understanding of risks and their likely impact and enables a cost effective process based on series of well defined steps.

The original Business Case presented by Energy Division for implementing the NIRHI scheme provided a brief analysis of the risks that were identified as inherent to the type of the scheme. Although for the purposes of the Business Case a Risk Register was developed which included the possible risks listed below, it was not maintained, updated or subject to a formalised review process to keep up with the developments in the scheme. The risks identified in the initial Risk Register included:

- Incorrect subsidy set, either too high or too low;
- Lack of uptake;
- Harm to other sectors;
- Failure of renewable heat supply;
- Insufficient budget for administration or future payments;
- Failure to meet EU and Executive set targets;
- Failure to receive State Aid approval;
- Inadequate resource to deliver project/separate key functions including staff;
- Instances of fraud; and
- Failure in administration of RHI.

Internal Audit also notes that Ofgem developed a Fraud Prevention Strategy for the overall Non Domestic Renewable Heat Incentive Scheme. The Fraud Prevention Strategy was updated in August 2012 to include the Northern Ireland Non-Domestic RHI scheme. The current version of the strategy was included as an annex in the July 2015 Feasibility Study for the Implementation of the Phase 2 amendments to the NI RHI. However, Energy Division had no record of having previously received this document. The strategy sets out a number of specific fraud risks to the scheme and outlines the preventative and detective controls in place to mitigate these risks. The risks are grouped into “RHI specific”, “Internal” and “Gaming” and include:

RHI specific Risks

- Risk that the scheme may be targeted by organised criminals/money launderers.
- The risk of participants providing false metering or periodic data information in order to increase the level of RHI support payments they receive.
- The risk that participants may purposefully generate unwanted heat purely to claim RHI support payments, which is in breach of the RHI regulations

Internal Risks

- The risk that an Ofgem staff member fraudulently manipulates the RHI IT system to divert payments into other bank accounts or otherwise misuses confidential personal data held on the system; and
- The risk of bribery or corruption of Ofgem staff, which may lead them to collude with a participant using their knowledge to set up new accounts or circumventing inbuilt controls.

Scheme Gaming Risks

- Participants may generate heat for eligible purposes but which do not meet the spirit of the RHI Regulations (e.g. heating empty buildings or empty greenhouses, using inappropriately sourced fuel), or may waste heat in a compliant manner by using heat in a non-energy efficient way; and
- Over sizing of boilers to ensure high proportion of heat is generated at a higher tariff rate; under sizing of boilers/installing multiple separate boilers in order to maximise the applicable tariff rate.

A number of the key preventative controls outlined in the strategy include references to the tiered tariffs introduced by GB in 2013 which can act as one of the disincentives to the risks of gaming the scheme. There is no formal assessment in the strategy of how the differences in the NI Scheme impact on these risks, how the risks are controlled in the NI Scheme and whether the level of risk exposure is acceptable. Internal Audit has confirmed that DETI does not have a separate Fraud Risk Management strategy for the NIRHI scheme.

Conclusion
Given the differences in scheme design post 2013, Internal Audit considers that the Energy Division should have re-developed an NI specific Risk Strategy. This Strategy should have set out how the risks identified in the original business case were assessed and the mitigations required. In particular, the risk strategy should have assessed the specific risks of fraud and how these risks were managed. There should have been a clear assessment undertaken, after the changes were made to the GB scheme, of any increase in risk exposure for the NI scheme in not implementing similar cost control measures as GB. In their 2012 Feasibility study for the implementation of Phase 2 of the RHI scheme, OFGEM undertook to commission an independent risk assessment of the NI Scheme. Internal audit has confirmed that that risk assessment was deferred and no separate assessment of the risks in the NI Scheme has been completed.

Risk: The absence of a clearly documented Fraud Risk Strategy for the NIRHI scheme meant that the difference in how risks in the NI scheme were managed was not subject to a formal assessment. In particular, after changes were introduced to the GB scheme there was no formal assessment of how these changes helped to manage risks in the GB scheme and the consequences to NI of not following suite.

2. Recommendation:
In developing significant programmes and projects a robust formal Risk Management Strategy should be developed at the outset. Where a scheme is based on a similar scheme being run elsewhere the Department should ensure that the risks associated with deviating from that scheme or not following changes made to that scheme are formally documented and considered.

3. Priority	**1**	**4. Time scale:**	As soon as possible

5. Management Response: Agreed. RHI already included in Departmental Risk Register. Energy Renewables Divisional Business Plan is based on risk based business planning and includes a risk rating. A specific Risk Register has also been developed for the RHI Steering Group in line with good governance. This Risk register is reviewed at each meeting of the Steering group and is updated as required.
The recently appointed external consultants will also undertake a risk assessment of the RHI scheme to inform the sample of sites to be inspected.

CGPEB – The need for Programmes and Projects to develop formal Risk Management Strategies has been included in the

Draft DfE Risk Management Framework which is currently being considered by Senior Management.
6. Management's Planned Implementation Date: 31 July 2016 / CGPEB September 2016
7. Officer Responsible (name and grade) for Ensuring that the Recommendation is Implemented: Alison Clydesdale Energy Renewables Grade 6 (Acting) / Brendan McCann Grade 7

Finding and Recommendation Number	4

1. Budget Management / Funding Post 2014/15

Finding:

The original Business Case for the NIRHI was developed by DETI Energy Division in early 2012 and covered Phase 1 of the scheme. As part of Phase 1 the Department aimed to introduce the RHPP (Renewable Heating Premium Payments) grant scheme for Domestic customers and the RHI scheme for the Non Domestic. The Business Case and the funding from Treasury of £25 million were approved by DFP on 27th of April 2012. The DFP approval instructed that:

“Whilst the scheme is envisaged to be open to new installations until 2020, approval is given for the period 1 July 2012 to 31 March 2015, representing the period for which HMT funding has been secured. Any decision to continue the scheme beyond 2015 would require further/separate DFP approval”.

It was clear in the business case and in email correspondence from HM Treasury in April 2011 that the NI funding for RHI was restricted to 2.98% of the DECC’s spend on RHI in line with the Barnett formula. The same correspondence highlights that “DECC RHI is not being treated as standard AME, where Exchequer takes on all risks of overspend” and that there might be a penalty imposed on DETI in the region of 5%. However the quantum and mechanism by which any overspend would be addressed was never formally confirmed.

At the time the scheme was introduced it was reasonable to assume that funding in future years would be available as the GB RHI scheme was predicated on being open for new applications until 2020. However, the exact level of funding post 2014/15 was not specified or guaranteed. The DECC Minister of State in response to a request for clarification about the NI RHI Budget post 2014/15 advised in January 2014 that the NI allocation would be a Barnett Formula share of the DECC (GB) budget, and that that was a matter for HM Treasury (see TRIM record number DT1/16/0064779).

Although the original DFP approval for NIRHI ran out at the end of March 2015, additional approval for funding post 2014/15 was not sought in time and despite the fact that the necessary approvals from DFP were not in place Energy received a budget allocation for RHI of £12.9m based on 3% of DECC’s allocation of £430m for that year. Management has advised the non renewal of the DFP cover happened due to a combination of staff changes and an administrative oversight.

Post March 2015 there was a protracted period of uncertainty over the level of funding available from HM Treasury and how expenditure incurred in 2015/16 and for which DFP cover was not in place would be treated. However, it was clear from as early as 26 March 2015 that the NIRHI scheme would require substantially more funding than the initial £12.9m allocated to cover the existing commitments and the estimate of new applications expected to be received. Internal Audit understands that HM Treasury advised DFP in November 2015 and formally confirmed on 22 December 2015 that all RHI overspending including future years would have to be met from Resource DEL.

DFP approval for expenditure on the scheme after 2014/15 was obtained on 29 October 2015 and was limited to the expenditure in the period from 29 October 2015 to 31 March 2016, the latter due to the uncertainty around future funding of the scheme. DFP then wrote to DETI on 21 December 2015 to advise of their decision not to grant the retrospective approval for commitments entered into between 1 April 2015 and 28 October 2015. This has resulted in the expenditure being deemed irregular. The amount affected was quantified by Energy Division at £17.4m in 2015/16.

The annual amount needed to cover the potential liability, if all applicants are approved, is estimated as £50m for 2016/17. Internal Audit notes that AME allocation for RHI from the HM Treasury for 2016/17 is currently estimated as £18.3m based on 3% of DECCs projected budget which is £614m. As a result of this difference between the expenditure already committed and the budget available from HM Treasury Energy Division has estimated that there is a potential short fall in available funding in the period 2016/17 – 2020/21 of £140m and this could rise to approximately £400m over the remaining life of the scheme.

Conclusion

Energy Division should have submitted a new Business Case to DFP for funding NIRHI scheme post 2014/15 well before the end of that financial year. This would have clearly established the basis of the funding in future years, the extent to which funding was capped at 3% of DECC spend and the scope if any for DETI to have flexibility in future years of funding outside of 3% allocation based on DECC's spend.

Internal Audit considers that at the outset clarity should have been sought on the conditions attached to funding and a formal agreement reached with HM Treasury on the extent to which the Department's funding was without risk and clarity on any potential liabilities and the consequences to the Department of its' expenditure exceeding the agreed allocation. Internal Audit considers that the implementation and oversight of the Scheme could have benefitted from the expertise of a Finance expert given the level and nature of the funding involved.

It is possible, had it been understood at Scheme Design stage that budget for the RHI Non Domestic was limited, that demand could significantly escalate and that the consequences would have to be borne by the NI Block grant; that the design of the scheme would have included controls to automatically halt the scheme when there was a risk of budgets being exceeded. Internal Audit notes that such controls formed part of the consultation in 2013. However with the scheme underperforming at that stage the introduction of these controls was not considered a priority.

Risk: Internal Audit recognises that the risk of budget pressure on the NI Block grant as a result of significant increase in the demand for the scheme has crystallised.

2. Recommendation:

The Department should ensure when setting and agreeing annual budgets for future years that confirmation is requested and obtained from business areas as part of the budget setting process that they have the necessary approvals in place (including where necessary DFP approval) to cover expenditure in that coming year.

The Department should also ensure that when similar schemes are being introduced in the future, particularly where funding is dependent upon a proportion of funding in GB, that such schemes have a) sufficient controls to ensure demand does not exceed budget b) a clear formally documented understanding of the consequences for the Department of any expenditure exceeding budget c) a formal assessment of the risks and controls within each scheme, taking into consideration the Financial risks. The Department should consider embedding staff with appropriate finance/ accounting knowledge into major projects.

Furthermore, the Department should carry out the review of current major programmes/schemes to ensure that the basis of funding is properly understood, the consequences and risks for exceeding the agreed budgets are known and have been considered and that appropriate controls have been established to monitor and mitigate the effects of unexpected spikes in demand.

3. Priority	1	**4. Time scale:**	As soon as possible
5. Management Response: Agreed.			

Brendan McCann – CGPEB Grade 7: The Bi- Annual Assurance Statements will be updated before they issue for the mid-year assurance statement process at 30 September 2016. The Assurance Statements will require Directors to confirm that all programmes / projects within their divisions have the correct approvals in place, funding secured and have been appropriately risk assessed. Stephen McMurray – Finance Director – Grade 5 When issuing annual budget allocations to business areas the Finance Directorate will ensure that budget holders are reminded of the need to ensure the necessary approvals are in place or will be in place at the time of expenditure. The process for introducing new schemes is that the Business Case is completed, assessed and approved at the appropriate level. It is at this stage that the most effective controls to ensure demand issues and budget risks are robustly considered. Finance Directorate will ensure that the casework process covers these key points and the “lessons learned” communication process as outlined in recommendation 1 will also cover this point. The Department is not planning to complete a major review off all current major programmes but will ensure that the “lessons learned” communications process, particularly around the unexpected spikes in demand is fully implemented and periodically enforced.
6. Management’s Planned Implementation Date: CGPEB – 30 September 2016- Stephen McMurray July 2016
7. Officer Responsible (name and grade) for Ensuring that the Recommendation is Implemented: Brendan McCann (Grade 7) / Stephen McMurray (Grade 5)

Finding and Recommendation Number	5

1. Resources and Staff Changes

Finding:

Throughout this review a constant narrative from staff currently in post and from staff who worked on the scheme previously, was that pressures developed as a result of competing demands to both manage the existing NIRHI scheme and implementation of the new aspects of the scheme.

The introduction of cost controls formed part of the consultation undertaken by management in Energy Division in 2013. However, following the consultation there was a change of staff within the Division from DP up to and including G5. In 2014 further work on the introduction of cost controls did not take place. The focus of the team was on the introduction of the Domestic RHI and Phase 2 of the Non Domestic RHI. Management have advised that there was no formal decision not to introduce cost controls but rather in light of competing priorities and in the context at the time of initial slow take up of the scheme, the introduction of cost controls was not advanced.

Conclusion

Internal Audit consider that there are a number of key lessons to be learned concerning the differing resourcing needs between the development of policies and programmes and implementation of those programmes. In the context of NIRHI there was both the need to implement and oversee the Non Domestic scheme while at the same time introducing further proposals for Domestic RHI. Referencing back to our previous point on programme/ project oversight, a Programme Board would have provided both a forum for consideration of resourcing needs and challenge to decisions to prioritise the introduction of Phase 2 and delay cost controls.

A further contributory factor in Internal Audit's opinion was the loss in late 2013 early 2014 of key members of the team and their organisational knowledge developed in the initial implementation of the scheme. It is Internal Audit's view that this was one of the main contributing factors that led to the non renewal of DFP approval at the end of 2014/15. Internal Audit considers that there should have been a more formal handover when staff changed and that too many of the staff involved in the outset of the scheme were allowed to move on in 2013/2014. A more controlled change of staff should have taken place and an agreed list of future actions required should have been captured, ideally in a programme / project plan.

Risk: Critical programme/project dates and actions may be missed where the programmes/projects are insufficiently resourced to deal with competing demands in both oversight and implementation levels. There is also a risk that organisational knowledge was lost without a formally documented, uniform staff handover procedure.

3. Recommendation:

Internal Audit has already recommended previously in this report that major programmes should include programme oversight and programme plans. In addition, the Department should consider whether current arrangements for the handover when key staff move on to other projects are sufficiently formally robust and formalised. Such handover arrangement should have as a key requirement the need to capture and retain organisational knowledge.

3. Priority	**2**	**4. Time scale:**	As soon as possible

5. Management Response: Agreed. Energy Renewables Division will ensure that formal handover meetings between the member of staff departing and the person replacing them are scheduled as part of the transfer process and that new members of staff receive appropriate structured local induction for their new post.

CGPEB: The Corporate Governance Bulletin will remind managers throughout the Department that the induction process should cover, where possible, a formal handover.

6. Management's Planned Implementation Date: immediately

7. Officer Responsible (name and grade) for Ensuring that the Recommendation is Implemented: All Line Managers in Energy Renewables Division.
Brendan McCann Grade 7 – (CGPEB)

Finding and Recommendation Number	6

1. Oversight of the Relationship with OFGEM

Finding:

Enshrined in legislation of the Energy Act 2011 GEMA (Gas and Electricity Markets Authority) was given power to act on behalf of Northern Ireland Authority in connection with Renewable Heat Incentives (cf. Section 113 and Section 114 Energy Act 2011). GEMA is the governing and policy body overseeing the non departmental public body OFGEM (The Office of Gas and Electricity Market) which among other key functions is in charge of the delivery of government energy schemes. OFGEM is currently administrating the GB RHI schemes (both Domestic and Non Domestic) on behalf of DECC and the NI Non Domestic RHI scheme. (NI Domestic RHI scheme is delivered by an in-house team within DETI Energy)

OFGEM's experience in the delivery of such schemes especially as they managed the similar scheme for DECC was the main factor why the Department took a decision to appoint OFGEM to administer the NIRHI scheme. The Administrative Arrangements Agreement was signed between DETI and OFGEM in December 2012.

Internal Audit confirmed that the Administrative Arrangements Agreement between the Department and OFGEM allowed for communication regarding the Terms of Reference for audit activity undertaken by Deloitte LLP (OFGEM's internal auditor) and Ricardo-AEA (who undertake on-site inspections) and of the outcomes of any audits that related to NIRHI. The Agreement also made provision to give DETI or the Northern Ireland Audit Office access rights to inspect any information related to NIRHI applicants and payments. However, the Agreement did not include the requirement for an annual assurance to be provided by OFGEM to DETI on the risk management, control and governance processes operated by them on behalf of the Department.

OFGEM is a non departmental public body and as such reasonable assurance can be taken from it being subject to oversight of the sponsoring GB Department and GEMA. However, Internal Audit considers that the absence of a formal annual assurance from Ofgem to DETI is a considerable weakness in the oversight arrangements. Internal Audit also notes that key Performance Indicators were not agreed between Ofgem and the Department for the administration of the scheme.

Internal Audit were unable to find any evidence that any reviews of the internal systems in OFGEM performed by their internal auditors were either informed by concerns raised by DETI or were shared with DETI where outcomes related to NIRHI. Internal Audit considers that as a minimum DETI should have received confirmation that no issues relating to NIRHI have been identified by OFGEM's Internal Auditors.

Conclusion

Internal Audit acknowledge that management in Energy Division receive weekly information on awards made, pending or rejected and supporting information necessary for making monthly payments. However, while the original Feasibility Study submitted by OFGEM in November 2012 made reference to discussing and agreeing appropriate Key Performance Indicator's (KPI's) with DETI, Internal Audit notes that this has not happened and that DETI does not receive any information on performance other than details of system upgrades and system downtimes which while they may be important, do not provide any insight into how OFGEM are administrating the NIRHI scheme on behalf of DETI.

Risk: As the Department accountable for the expenditure incurred on the Non-Domestic RHI scheme, DETI was reliant on OFGEM for the administration and control of the Scheme but had inadequate oversight arrangements in place which lacked specific assurance on the management of risks in the NI scheme.

2. Recommendation:

Where DETI is using an external organisation to deliver services, whether that organisation is another government body or a private sector supplier, appropriate arrangements should be implemented to ensure that assurances are provided to the Department on a regular basis including the results of any internal audit work undertaken. KPI's also need to be agreed between the parties at the outset and reported back on a regular basis. It is also necessary that all of these arrangements are appropriately defined and documented in the Memorandum of Understanding or other Agreement document.

3. Priority	1	**4. Time scale:**	As soon as possible

5. Management Response: Agreed, Energy Renewables Division will revisit the Administrative Arrangements Agreement with Ofgem with a view to agreeing KPIs moving forward and including an annual assurance statement. CGPEB will provide support as required.

6. Management's Planned Implementation Date: December 2016

7. Officer Responsible (name and grade) for Ensuring that the Recommendation is Implemented: Lucy Marten Grade 7 Renewable Heat Branch

Finding and Recommendation Number	7

1. OFGEM On- site Inspection Programme

Finding: The OFGEM Fraud Risk Strategy states that "despite the mitigating actions put in place, there will be instances when fraud or non compliance will occur. In order to combat this, we have a range of mechanisms in place to identify fraud or non compliance". One of the key controls referred to in OFGEM's Fraud Risk Strategy is the use of a rolling programme of on-site inspections of accredited installations.

An independent risk assessment of the NIRHI scheme that had been planned as part of the Feasibility Study in 2012 was deferred by OFGEM and Internal Audit has been advised by management that this independent assessment has not been undertaken. Internal Audit considers that a formal documented risk analysis of the NIRHI scheme should have been completed and should have been used to inform the sample size of NI installations subject to the annual on-site inspection. Such a risk analysis would have taken into consideration the effect of any differences between the NI and GB schemes, any change in the profile or volume of NI applications and the stated level of confidence that was statistically being sought. The number of onsite inspections undertaken by OFGEM of NI installations from 2012/13 – 2015/16 are set out in the table below:

Year	Onsite inspections of NI installations	Applications received	Inspections as a % of installations
12/13	0	9	0
13/14	5	119	4%
14/15	12	434	3%
15/16	14	2128	1%

Conclusion

Internal Audit understands that Energy Division is seeking to procure an independent programme of site inspections over and above the programme undertaken by OFGEM. Internal Audit welcomes this proposal because as it will address a number of weaknesses that Internal Audit consider exist with the current on-site inspection control as these relate to the NIRHI scheme. The key weaknesses Internal Audit consider exist are as follows:

- Absence of the formal fraud risk assessment for the NIRHI;
- Lack of the formally documented sampling approach for the NIRHI and the low level of NI installations currently being inspected;
- Energy Division, whilst they are generally aware of the results of the inspections, they do not currently receive formal reports on the findings of the inspections and the impact, if any, on eligibility of installations; and
- An independent programme of site inspections commissioned by and reporting to DETI provides a useful independent assurance on participants' adherence to scheme requirements and also provides an independent form of assurance that the scheme as administrated by OFGEM is operating as intended. In the absence of any specific assurances to DETI from OFGEM such an independent inspection programme would have been a valuable source of assurance for the Department.

Risk: The current level of on-site inspections may be insufficient to provide a robust assurance to the Department on the on-going eligibility of the installations participating in the scheme.

2. Recommendation:

DETI should proceed as intended with the commissioning its own programme of independent on-site inspections. The Department should ensure that the size of the sample of installations inspected should be based on the formalised assessment of the level of statistical confidence required and should include a stratification so that it includes those with multiple installations, those installations with significant changes in heat generated within a year and those generating heat at the maximum capacity.

The Department should also ensure that the sample size used by OFGEM is agreed with the Department and that Department receives formal reports on the findings of these inspections.

3. Priority	1	**4. Time scale:**	As soon as possible

5. Management Response: Agreed. Business as usual auditing will continue with Ofgem in 2016/2017. This equates to 20-30 audits for 16/17. Energy Renewables will continue to work with CPD to procure an additional auditing programme that will be in place from 1 April 2017.

6. Management's Planned Implementation Date: Business as usual audit programme agreed with Ofgem by end August

2016. Autumn 2016 commence procurement of additional audit programme.
7. Officer Responsible (name and grade) for Ensuring that the Recommendation is Implemented: Lucy Marten Grade 7 Renewable Heat Branch

Finding and Recommendation Number	8

1. Value For Money (VFM), and Evaluation of the NIRHI Scheme

Finding:

As already addressed in Finding 1 of this report the NI Renewable Heat Incentive Scheme was introduced in Northern Ireland in November 2012. A consultancy company CEPA was contracted by DETI to research the NI market environment and to provide advice on the tariffs recommended for the NIRHI scheme. The consultants delivered a report in June 2011 and an addendum to the report in February 2012 which recommended higher tariffs than advised in the original report.

In accordance with both reviews the methodology used to set the tariffs can be summarised as: first, the required subsidy level, in pence per kWh that just covers the additional cost of a reference renewable heat installation compared to a conventional oil boiler, is identified. As for example, over its lifetime an oil boiler costs 5p per kWh of heat produced, and a reference biomass boiler of similar size costs 7p per kWh. The subsidy is therefore 7p – 5p = 2p per kWh. (Average lifetime cost was calculated from annual operating and fuel cost added to the annuitized cost of the upfront capital, installation and barrier cost divided by the average annual heat produced per year).

The above report also recommended that the NI scheme has different banding for biomass installations in comparison to the GB scheme. In NIRHI a biomass installation over 100 kW capacity was considered large and offered lower incentive rates (1.5p p/kWh) in comparison to the installations below 100 kW (6.4p per/ kWh) falling into small and medium categories. In comparison, according to the GB biomass boiler banding an installation below 200 kW was considered small, from 200 kW and below 1MW – medium and above 1MW – large.

Before the scheme started it received State Aid approval on 12 June 2012 from the European Commission. The submission to the Commission was based on both CEPA Reports and DETI Business Case and recommendation. Internal Audit reviewed the European Commission's State Aid decision letter (dated 12 June 2016) and notes that the Commission was satisfied that the scheme was compatible with the common market in accordance with Article 107(3)(c) of the Treaty for the Functioning of the European Union.

One of the key aspects in the Commission's decision on State Aid compliance was that the scheme must not allow for overcompensation of scheme beneficiaries. As such the level of compensation offered was specifically designed to cover the cost differential between a renewable heat alternative and a traditional fossil fuel heating system (which in the case of Northern Ireland is oil), plus an appropriate rate of return set at 12%, to incentivise installations.

The letter also stated that reviews of the performance of the scheme and its ongoing compliance with "will take place periodically" as part of a programmed schedule and that they would "in particular be used to monitor the performance of the scheme and the development of underlying costs for each technology, so as to ensure that overcompensation is prevented". In addition, the decision letter referred to the commitment of the UK authorities to carry out early reviews "where they became aware of significant changes in production costs".

Internal Audit was advised that due to initial low uptake of the non domestic scheme and the need to focus resource on the implementation of the domestic scheme that the evaluation of the scheme originally planned for 2014 has not been undertaken. Energy Division does not have any up to date information to allow them to assess whether the average value of the award is still in line with that envisioned in the original business case and State Aid notification. Internal Audit considers that there may be some evidence to indicate that the average value of award in 2015/16 is significantly greater than that in the first year of the scheme. There may also have been changes to underlying costs of some other of the original assumptions such as fuel and technology costs.

Conclusion

Internal Audit is of the opinion that when introducing funding schemes it is important that those schemes are regularly monitored to ensure that initial assumptions around VFM and the return on investment to applicants are still valid. In the case of the Non-Domestic RHI scheme it is important that such an evaluation of continued value for money is urgently completed. It is also likely that if an evaluation of the scheme had been undertaken in 2014 it would have been used to inform subsequent Business Case to DFP and brought focus to the financing of the scheme.

Risk:

As there has been significant changes to capital, operating and barrier costs of renewable technologies there is a potential risk that scheme participants are being overcompensated at current tariff rates. If overcompensation has taken place then the

Department may be in breach of State Aid regulations.			
2. Recommendation: Notwithstanding that the RHI scheme has been closed, the Department should ensure that the evaluation of the scheme is carried out as soon as possible. The evaluation should consider the extent to which the scheme has met its overall policy objectives and whether individual awards under the scheme are consistent with the original Business Case, State Aid approval and represents a reasonable return on investment.			
3. Priority	**1**	**4. Time scale:**	As soon as possible
5. Management Response: Agreed TOR for evaluation of Scheme complete and passed to Energy Economist.			
6. Management's Planned Implementation Date: July – September 2016			
7. Officer Responsible (name and grade) for Ensuring that the Recommendation is Implemented: Lucy Marten, Grade 7 Renewable Heat Branch			

. **Annex I**

INTERNAL AUDIT SERVICE

OVERALL AUDIT OPINIONS / ASSURANCE LEVELS

OPINION	DEFINITION OF OPINION
Substantial	There is a robust system of risk management, control and governance which should ensure that objectives are fully achieved.
Satisfactory	Overall there is an adequate and effective system of governance, risk management and control. While there is some residual risk identified this should not significantly impact on the achievement of objectives. Some improvements are required to enhance the adequacy and/or effectiveness of governance, risk management and control.
Limited	There is an inadequate and/or ineffective system of governance, risk management and control in place. Therefore there is significant risk that the system will fail to meet its objectives. Prompt action is required to improve the adequacy and/or effectiveness of governance, risk management and control.
Unacceptable	The system of governance, risk management and control has failed or there is a real and substantial risk that the system will fail to meet its objectives. Urgent action is required to improve the adequacy and/or effectiveness of governance, risk management and control.