

RHI

**Frazer, Helen**

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**From:** Brennan, Mike  
**Sent:** 19 October 2016 09:10  
**To:** Sterling, David  
**Subject:** RHI - DoF Lines  
**Attachments:** RHI Additional briefing from Supply October 2016 v2.docx

David – I've attached the RHI lines that I mentioned yesterday. They cover the DoF position in terms of engagement with then DETI and relative responsibilities. They do give considerable comfort to us.

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**TOPIC: BUSINESS CASE PROCESS - SUPPLY APPROVAL**

- The DoF Supply approval process represents a second round of scrutiny, challenge and quality assurance.
- DOF are content that the review carried out on this business cases is reasonable from an overall perspective. ?
- In reviewing a business case Supply will seek to make a judgement as to whether a project is affordable, in line with other objectives and demonstrates the potential to deliver value for money.
- In forming this judgement, Supply considers the costs, benefits and balance of risks associated with the project.
- It is the responsibility of departments to ensure that they adhere to all Supply approval conditions.
- This is consistent with NIGEAE where it talks about Departments notifying and informing Supply when tolerances are breached or conditions haven't been met. This is an important principle which underpins concepts such as retrospective approval as laid out in MPMNI.

## Background to Business Case Process

1. Departments are required to submit a high level Strategic Outline Case to DoF for all major and high profile cases (capital projects over £20m, revenue projects above DoF delegated limits with a total cost over £20m across the life of the project and novel and contentious projects) . The purpose of the SOC is to confirm the strategic context to the proposal; to make a robust case for change and to provide stakeholders and customers with an early indication of the proposed way forward.
2. The second stage in the process is the more detailed Outline Business Case (OBC). The purpose of the OBC is to revisit the SOC in more detail and to identify a preferred option which demonstrably optimises value for money. It also assesses affordability. This is usually the main Supply approval decision point.
3. Where there is a material change to the original assumptions or costs as set out in the OBC, departments are required to bring this to the attention of Supply and seek further approval through the addendum process.

**What is the internal process for Business Case assessment within Supply?**

- Business case assessment is one part of DoF Supply's wider public spending control work.
- Subject to a Department's invitation to attend, Supply officers may have already attended a case work committee on the draft business case. Supply only has observer status at case work committees.
- On formal receipt of a Strategic Outline Case/ Outline Business Case, Supply staff will ensure that the case has been signed off at the appropriate level by the submitting departments and that the covering proforma has been completed correctly.
- The case will then be sent to Strategic Policy Division for technical assessment by DoF economists.
- Supply has a 15 working day target for the assessment of business cases and the provision of comments back to departments.
- Supply will assess the economists' response and review the overall case for affordability. At this stage Supply will seek further information/ clarification from Departments as required.
- Subject to Department's responses to these queries, a Supply decision will be provided to departments.
- At present there is one Supply Division headed by one Grade 5 with 6 Supply teams.
- A Supply team normally comprises of a Grade7, one DP and one SO. A Supply team can have responsibility for up to three departments at any one time.

Currently all Supply teams adhere to the same process and target dates in respect of business cases. Approvals are normally cleared through the Head of each Supply team except for routine approvals such as lease approvals, routine capital spend, pay remits etc which may be approved at DP/ SO level. The Grade 5 will approve or be copied into cases which are of high value/ contentious or complex.

### **If pressed on Supply in 2011**

- In 2011 there were three distinct Supply Divisions with 7 Supply teams. All Divisions adhered to the same target dates in respect of business cases but may have operated slightly different processes across each individual Division.
- Grade 5 not involved in OBC RHI approval in 2012 .

### **Background**

1. The Supply approval process was subject to an independent review in 2012. At that time the review concluded that:

"The analysis presented in this Section had demonstrated that it is rigorous and timely. It is clear from the casework that from the time business cases are submitted, there is generally a period of continual engagement between DFP, departments and the economists whereby those on both sides work very closely together to try and resolve the issues as quickly as possible. The majority of responses both by departments and DFP are of a high/acceptable standard. There are therefore no major concerns with the DFP approval process itself. Indeed, it is a highly impressive system."

**TOPIC: SUPPLY'S ROLE IN APPROVING TARIFFS**

- There is no requirement in MPMNI for DoF approval of Tariffs
- The RHI Regulations set the Tariff for Renewable Heat
- These Regulations were subject to the affirmative resolution procedure and were debated in the Assembly.
- The Regulatory Impact Assessment which was laid alongside the Regulations advised that:

***“Risk of incorrect subsidy level***

Probably the most obvious risk is that the subsidy levels proposed for the RHI are either too high or too low. In the former case, those installing renewable heat will be over-subsidised and less heat will be delivered per pound than under more optimal subsidy levels. In the latter, renewable heat will not be deployed to the extent expected.

The normal method of dealing with this risk is firstly to have carefully analysed and researched data in developing the tariffs. The tariffs have been developed by CEPA and AEA Technologies, subject to a public consultation and then subsequently reviewed by CEPA and AEA. Departmental Economists have also assessed the tariffs and assumptions behind the calculations and have deemed them appropriate.

In addition it is planned to have regular, planned, reviews of subsidy levels after a number of years of experience with the subsidy. This will provide an opportunity to amend tariffs if required and ensure they remain appropriate given potential changing market conditions. It is currently proposed that the first review will begin in January 2014 with any required changes implemented by 1 April 2015. This timescale ensures issues can be rectified but does not disturb confidence in the market.”

**TOPIC: DESIGN WEAKNESS NOT PICKED UP****Why did DFP not see the design weakness in this tariff scheme?**

- DFP was looking at the overall BC in terms of need for expenditure, affordability and the potential to deliver VFM
- Do not accept that the business case set out the full design and operation on the RHI scheme – nor that in providing DFP approval that each and every aspect of the scheme was satisfactory
- It was up to DETI to design, implement and operate the full scheme
- DFP does not and cannot get involved in the detailed out workings of all programmes / projects it approves
- Within the business case there was sufficient detail given on review; monitoring; risk management etc which covered these areas and from which DFP took assurance
- DFP is content that it was appropriate to approve this b/c
- And would highlight again that the approval was conditional on reviews being carried out as stipulated in the business case.

**TOPIC : COST CONTROL****How did DFP think cost control was to be covered within the BC?**

- It was recognised that there was £25m funding available – DETI and DFP knew this
- It was for DETI to monitor the expenditure against this budget
- There were references to monitoring and oversight in the BC
- BC also set out some options for limiting access to a limited pool
- It was for DETI to consider how this worked in practice
- At an overall level DFP was aware of budget spend – this was done through the submission of monthly returns to CED
- This did not flag up any issues with budget spend in the early stages
- DFP were not made aware of budgetary pressures until June 2015 when advised by DETI
- DoF considers that had suitable monitoring arrangements being put in place and acted on the need for cost control measures would have been identified.
- DFP expected DETI to do this.
- It is not DFP's role to manage the operational finances of individual depts.



**TOPIC: TIERING FOOTNOTE****What is DFP's explanation of the key footnote that ruled out tiering?**

- DFP considers that this relates to the fact that within the tariff calculation a deduction is made for the fuel cost element
- In NI this reflects that oil was more expensive than biomass and therefore the fuel element did not have to be subsidised
- Read in this context DFP consider that the footnote is factually accurate and would not in itself have alerted DFP to query tiering being discounted.

**The DETI AO says it should have been capped? Do we agree?**

- With hindsight and knowing now that the assumptions re usage in the BC were not accurate the capping of tariffs would have been appropriate
- At the stage DFP approved the business case it was not known that this assumption would not be valid in the real world.
- The scheme approved by DFP in 2015 is both tiered and capped.

**TOPIC : TARIFF CALCULATION****Why was a 12% rate of return considered appropriate? Did DFP think it was?**

- DFP was content that this was a reasonable rate of return to use
- It was the rate of return used in GB
- Indeed it was possible that a higher rate of return was required to encourage renewable uptake

**Why did DFP not look for sensitivity analysis to be done?**

- CEPA report section 8 covered sensitivity analysis including discount factors used, technology awareness and ability to borrow
- Also looked at the risk of the subsidy being incorrect (section 8.2.1.) – set out that this would be dealt with by having regular planned reviews of subsidy levels after a number of years of experience with the subsidy
- This was considered appropriate by DFP and was reflected in the approval letter???
- If pressed would have to accept that detailed sensitivity analysis around useage and rates of return was not included in the BC, but DFP would expect this to be covered by the dept's monitoring and review arrangements.

**Why did DFP consider it was the correct decision not to just go with the GB Scheme?**

- Because of the different energy market conditions
- The fact that gas was used in GB while oil was the most common fuel in NI and to move to renewable technologies required less incentive in NI
- Based on the research and analysis undertaken

**Is DFP content with its review and approval of this case?**

- Yes. DFP considers that sufficient review was done on this business case
- It followed the standard Supply approval process
- The fact that approval was conditional on monitoring and review is a key point which reflects DFP's recognition of the need for DETI to keep the scheme under review

**Do you accept that an opportunity to identify this weakness was missed by DFP?**

- In reviewing the BC the particular weakness that later manifested itself was not specifically picked up by the DFP approval process
- DFP do not consider that this was unreasonable based on the information and assumptions set out within the BC
- The fact that DFP approval highlighted the need for review was key.
- If pressed DFP acknowledges that there was a limited opportunity to challenge the assumptions made which had ruled tiering out but consider that it was not unreasonable to approve the business case conditionally – especially as it highlighted the need to reviews to be carried out.

### **Have any lessons been learned? Would DFP do anything different today?**

- DFP considers that it carried out sufficient review of this business case which resulted in DFP providing conditional approval
- In reviewing the business case DFP staff are not expected to have a detailed knowledge of the activities , sectors etc to which each and every business case relate
- In this case they did however seek assurances from DETI that they were content with the underpinning assumptions in the tariff model; – DETI advised they were;
- If pressed we accept that there was a potential opportunity to identify this issue but that would be dependent on DFP knowing that any of the assumptions on which tariffs were based were not valid – this could only be determined through the scheme's operation. Review of this would have enabled DETI to increase or decrease tariffs as appropriate to meet the objective set.
- DFP also took assurance from the review of the BC that had been carried out by DETI based on the detailed work undertaken by consultants and the consultation process which had followed.
- DFP would accept that were a flat rate tariff scheme to be presented today DFP would be robust in its challenge with a dept regarding the need for them to consider cost control measures. This is with the benefit of hindsight and the lessons learned from this example.

**TOPIC: EXPIRED APPROVAL**

**Why did DFP not picked up the expired approval?**

- This is a departmental responsibility
- DFP not responsible for managing schemes
- DFP does not have the resources to follow up on business cases
- The monitoring and oversight of schemes are a dept's responsibility
- Supply is a small function, consisting of 6 teams (Grade 7 and DPs) who in addition to approving business cases, sometimes for up to three depts., are involved in a range of other supply processes.
- Departments are aware that this is a departmental responsibility

**TOPIC : FUNDING ISSUES**

**Did DFP tell DETI to go and ask DECC for more money? Note PAC page 19 refers to discussions with DFP**

- DETI were liaising with DECC to clarify the RHI funding arrangements.
- DFP content with this.

**2011 Emails copied to DFP**

- This email was copied to DFP
- Was not a key issue for DFP at the time as was to be clarified
- It was up to DETI to work through – DFP took no action at this stage as none was required
- BC submitted - referred to £25m being available
- DFP was clear that the allocation was limited
- Copying in of DFP 4 years earlier tenuous