| | |
|---|---|
| **From:** | Morelli, Emer |
| **To:** | Kerr, Sean; DoF Private Office |
| **Cc:** | Brennan, Mike; Sterling, David; McBurney, Joanne; Scott, Michelle; Downie, Jill; Frazer, Helen; Cairns, Robyn |
| **Subject:** | RHI engagement between DoF and DfE |
| **Date:** | 14 December 2016 11:56:00 |
| **Attachments:** | Supple - DfE - Budget Monitoring meeting July 2016 (2).docx<br>Supply - DfE - Stocktake 11 Nov 2016 - Minutes (2).docx<br>Letter to DfE RHI 13 December 2016.docx<br>Supply - DfE - Budget Meeting Tuesday 23rd Aug 2016 MS.DOCX<br>June 2016 Monitoring - letter to DFP.DOCX<br>Supply - DfE - Approval RHI consultancy addendum - Oct 2016.docx<br>Supply - DfE - points agreed at 27 May meeting and comments on NIAO account report.MSG.msg<br>Supply - DfE - Approval RHI consultancy addendum - Oct 2016.DOCX<br>Supply - DfE - RHI consultancy second extension approval.DOCX |

Sean

As requested by Minister I attach copies of correspondence between Supply and DfE from June monitoring 2016 to date.

There are quite a few documents here. Please let me know if you would like a hard copy folder brought to Stormont Castle for the Minister.

Many thanks

Emer

# DFE – DOF BUDGET STOCKTAKE

## 14 July 2016

**ATTENDEES**

| **DfE** | **DoF** |
|---|---|
| Stephen McMurray | Emer Morelli |
| Bernie Brankin | Michelle Scott |
| Andrea Quail | |

1. Budget 2016

DoF set out the latest position in regard to Budget 2016.

DfE advised that they were currently not planning for a range of cut scenarios but were linking budget requirements to current PfG.

DoF clarified that at this stage no protection has been agreed for any department. Departments should plan for a range of funding scenarios, including budget reductions. DfE was advised to consider the department's inescapable pressures and then set out any additional funding requirements to deliver PfG priorities.

DfE confirmed work is ongoing within the department on a paper which will quantify the cost of various policy responses to the reduction in corporation tax. The majority of this funding requirement will be for the HE sector. DfE agreed to share the detail once agreed within the department.

DoF asked for an update on Student Fees. DfE confirmed a paper is being prepared for the Economy Minister, who may take this to the Executive.

DfE agreed to engage closely with DoF over the coming weeks on resource and capital budget requirements.

2. RHI

DfE flagged the in year and future financial pressures resulting from the RHI commitments. DfE confirmed the £32m, which had previously been reported as a worst case scenario, was now considered to be a more realistic estimate of the 2016-17 pressure. The RHI inescapable commitment may increase in future years if Combined Heat and Power plants with preliminary accreditation proceed.

DoF asked for an update on the actions taken to identify the options available to DfE to reduce this financial pressure. DfE confirmed discussions are ongoing with DSO and state aid compliance is being investigated. DfE are taking steps to start a consultation exercise which will take time to ensure it is completed properly.

DoF again stressed the need to urgently progress the audit and compliance checks. DfE provided update that external consultancy of approx £200k will be required to complete this work properly and that a business case would be with DoF soon to consider.

3. Monitoring

DfE provided an early indication of the potential departmental pressures

Resource
£12m – RHI (Balance of £32m flagged at June)
£3m – possible FE colleges EYF (Balance of £8m flagged at June)

DoF referenced the recent engagement on United Airlines. While a formal response will issue on the value for money, approval and affordability issues raised in David Sterling's recent correspondence, DfE confirmed the assistance was not affordable within the 2016-17 financial allocation. If this project proceeds the key priorities within InvestNI budget allocation will have to be re-considered and the Department may make a bid under October monitoring. DoF reminded DfE of the revised Monitoring process as set out within Mike Brennan's note of 17 June 2016.

DoF also asked about the DfE Public Sector Transformation Fund allocation for FE colleges. DfE confirmed it was likely that a significant proportion of the allocation would be surrendered in the next monitoring round. DoF stressed the need for early and regular engagement with the PSRD team on this allocation.

# DfE – DoF Stocktake

# Friday 11th November 2016

**In attendance**
Stephen McMurray
Andrea Quail
Emer Morelli
Michelle Scott
Sarah Benton

## 1. BUDGET 2017 INFORMATION GATHERING

**Resource**
DoF asked for an update on DfE's outstanding budget submission, which was commissioned by DoF on 17 August and due on 10 October. SM advised that officials were liaising with their Minister on this issue, and would follow up. EM stressed the importance of providing the information to DoF as soon as possible to inform ongoing work on the budget.

As part of a wider discussion on the use of VES in ALBs, SM advised that FE colleges are progressing 50-60 redundancies. On top of the previous redundancies, this will result in a 10% reduction in staffing over the past 2 years. Invest NI will be surrendering some VES funding - this is as a result of an overestimation of costs rather than numbers exiting via the scheme. SM advised that there is currently no appetite for further redundancies through VES for 2017/18. EM stressed the need to actively consider the use of available VES funding going forward, and confirmed that VES were not available for universities as they are not NDPBs.

**Action: DfE**

**Capital**
MS asked for an update on various queries put to DfE on departmental capital requirements. AQ agreed to come back to DoF as soon as possible on these queries and with a list of asset disposals although it is still in draft format.

**Action: DfE**

DoF highlighted the considerable uplift in capital requirements flagged by DfE as part of the budget exercise. While the overall capital envelope will not be known until after the Autumn statement, DoF reiterated the affordability concerns. This led to a discussion regarding the considerable spend planned for FE colleges across the budget period, and the potential to reprofile the projects in the event that the full funding requirement could not be made available.

DoF stressed that contracts should not be entered into which require a significant uplift in the departmental capital budget in advance of the budget position being confirmed by the Executive.

**2. BUDGET DOCUMENT CHAPTERS**
While accepting that the budget position in currently unconfirmed, DoF highlighted the need to start considering budget chapters, which will be required within a relatively short timeframe following the Autumn statement. MS asked that these be kept to approximately 4 pages. The headings and layout will be similar to last year.

**3. RENEWABLE HEAT INCENTIVE**
SM suggested amendments to the minutes of the meeting on 17 October. These will be forwarded to DoF.

**Action: DfE**

EM stressed that DoF need the most accurate financial position to inform key decisions going forward. SM confirmed that the funding shortfall remains at £32m for 2016/17.

In the context of future funding requirements, DoF stressed need to ensure work is progressing at pace to explore all options open to the department for managing the RHI financial pressures and ensuring a value for money outcome. DoF also stressed the need to ensure the team responsible for this task are appropriately skilled and resourced, and welcomed the confirmation that DSO officials have been involved with the project.

In respect of the actions points from the 17 October meeting, DfE reported that while it had been the intention to have a submission with the Economy Minister by end of October, this target was not met. DfE agreed to provide DoF with a revised timeline.

**Action: DfE**

SM confirmed that OFGEM is still working through the backlog of applications and he would provide an update on this backlog..
MS asked DfE to provide an update on the addendum to the consultancy business case.

**Action: DfE**

**4. JANUARY MONITORING**
SM advised that in light of recent developments, funding is no longer required for the United Airline assistance package.

There was a general discussion around the funding for City of Derry, and DfE advised that the department may not have sufficient time to spend the money in-year, however this will be confirmed as soon as possible.

**Action DfE**

**5. FINANCIAL TRANSACTIONS CAPITAL**

DfE asked for an update on the issue of timing of FTC drawdown. DoF advised that the FTC loan payment can go out in its entirety on the condition that the capital project commences within 24 months of the business case approval (which must pre-date the loan payment). If a project has not commenced within this 24 month period, then the FTC allocation should be reviewed.

**6. CURRENT AND ANTICIPATED CASEWORK**

DfE raised the Training for Success business case which will require DoF approval. DoF commented that any approach for approval should include all relevant post and interim evaluations.

There was also a discussion around the retrospective request on allowances. DoF highlighted the need for both departments to be content that all allowances represent value for money, and that the appropriate processes are being followed.

**7. TOURISM POLICY AND DFE ASSISTANCE TO THE HOTEL SECTOR**

DoF had raised a query regarding the level of displacement tolerated by the department in relation to assisting the hotel industry. MS reported that a single issue meeting had been proposed by the policy team, through Iain McFarlane, which should be helpful in exploring the issue.

**8. PPES – ANY WIDER LESSONS TO DISSEMINATE?**

In response to a query about lessons from DfE PPEs, S McM highlighted that there will be lessons from the administration of the RHI scheme.

**9. AOB –**

APPRENTICESHIP LEVY –DoF updated DfE on most recent Ministerial correspondence

MINERAL ROYALTIES – DfE provided a brief overview of potential ministerial royalties income and agreed to follow up with Treasury in respect to devolved administration retaining some or all of these royalties..

STUDENT SUPPORT (NATIONAL LOAN SUBSIDY) – DfE highlighted a potential underspend in the ring fenced funding line. DoF to follow up.

**Action: DoF**

CITY OF DERRY AIRPORT – following a general discussion on the monitoring allocation, DfE colleagues agreed to follow up with their senior management on the funding, but it looks highly unlikely funds can be spend in-year.

TOURISM IRELAND – DfE staff briefly mentioned that approval may be required for a cash increase. DfE agreed to follow up with DoF staff.

**Action: DfE**

**EMER MORELLI**
**Head of Supply Division**

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An Roinn Airgeadais
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Stephen McMurray
Finance Director
DfE
Adelaide House
39-49 Adelaide Street
BT2 8FD

13 December 2016

Dear Stephen

**NON-DOMESTIC RENEWABLE HEAT INCENTIVE**

The issue of the Non-Domestic Renewable Heat Incentive scheme was discussed in detail at a DfE/ DoF meeting on 17 October 2016. A number of actions were agreed at that meeting as set out in the agreed minutes of the meeting, copy appended to this letter.

At the meeting it was noted that DfE had given an undertaken, at an earlier meeting with DoF on 27 May 2016, that urgent steps would be taken to address the ongoing budgetary pressures associated with the RHI scheme going forward. These included legal advice on the options available to reduce the ongoing RHI financial pressure. DfE therefore agreed at the 17 October 2016 meeting to document the actions that have been taken and will be taken to address the failure of this scheme, including all engagement with DSO, from when problems with this scheme first became evident.

I should be grateful if DfE could now provide this information as a matter of urgency.

The issue of RHI was also discussed in detail at a routine DfE/ DoF stocktake meeting on 11 November 2016. In respect of the action points from the 17 October meeting, DfE reported that while it had been the intention to have a submission with the Economy Minister by end of October, this target was not met. DfE agreed to provide DoF with a revised timeline.

I should be grateful if DfE could now also provide this information as a matter of urgency.

I also acknowledge that DfE has established a Steering Group to oversee this work and that an invitation has been extended to DoF Supply to attend a meeting of the Group. I would advise that DoF Supply could only have observer status at a Steering Group meeting given Supply's potential approval role in respect of any business case underpinning a recommended way forward. I should be grateful if the Steering Group could advise as to whether it is content for any future DoF Supply representation to be on this basis.

Yours sincerely

Emer Morelli

**EMER MORELLI**

**cc** **David Sterling**
**Mike Brennan**
**Heather Cousins**
**Michelle Scott**

**Renewable Heat Incentive - Meeting between DoF Supply and DfE**

**Note of meeting**
**Netherleigh, 17 Oct. 2016**

In attendance:
DoF: Mike Brennan, Emer Morelli, Michelle Scott, Giulia ní Dhulchaointigh.
DfE: Heather Cousins, Stephen McMurray, Stuart Wightman, Lucy Marten.

| Item | Description | Action |
|---|---|---|
| 1 | **Update since last meeting**<br><br>DoF asked for an update since the last meeting on this issue. DfE said that the situation remained the same –with an in-year pressure of £32 million for this scheme .<br><br>The departmental officials stated that the £32 million pressure is a realistic scenario, the actions that they are taking to address deficiencies in the scheme will not have a major impact on the funding required for this year.<br><br>In respect of the in-year pressure, DfE confirmed that approx £5 million of the £12 million has been found from within the departmental baseline.<br><br>DfE asked whether there was any way that the necessary AME funding could be found from AME underspend elsewhere in the NI Block. DoF advised that this has been explored with Treasury and is not an option. | |
| 2 | **DSO advice**<br><br>DoF asked for an update on the legal advice which DfE has sought from DSO. DfE said that there were two separate issues on which they were taking advice:<br>• Taking any necessary enforcement action<br>• Revising the scheme to bring the rates of return in line with the original policy intent<br><br>DfE advised that they are waiting for a response from the EU on notifying changes from the assumptions DfE had made about the operation of the scheme at its beginning. In the meantime, advice from DSO has confirmed that concerns regarding continued State Aid compliance are a solid rationale for consulting on the introduction of cost controls.<br><br>In response to a query from DoF, DfE confirmed that DECC are aware of the engagement on State Aid issues. | |

| | | |
|---|---|---|
| 3 | **Enforcement**<br><br>DfE advised that payments to a small number of installations are on hold following the PWC report. These were in category 4. However these payments are not significant in terms of the scale of the overall cost of the scheme the scheme.<br><br>DoF asked, in light the views expressed regarding Ofgem's administration of the scheme, if DfE were considering terminating their contract with Ofgem. DfE said that they were considering taking inspection and decision-making responsibility following inspections for this scheme from Ofgem. DoF highlighted concerns previously raised by the department in relation to the in-house capacity to administer the domestic scheme. DfE confirmed that if elements of the administration were taken in-house the department would have to buy in appropriate expertise.<br><br>DoF asked whether, there will be an attempt to claw back administration fees paid to Ofgem. DfE said that they have been advised that legally this will not be possible. DoF asked if DSO advice had also been sought on a prospective clawback through a reduction in future administration fees rather than a retrospective clawback mechanism. | |
| 4 | **Regulations**<br><br>DoF asked whether any changes to primary legislation would be required should DfE decide to amend any component of the scheme. DfE advised that none were necessary and that the necessary changes could be made through subordinate legislation. DOF queried whether DECC approval was required at any stage given that the primary legislation was UK wide, albeit with specific NI clauses. DoF also queried whether there was any concern at a UK level as to potential EU infraction fines.<br><br>DoF asked whether there was scope to adjust the time period over which payments would be made.<br>DoF asked whether the regulations were drafted in such a way that the tariffs could be changed again if market conditions changed to ensure that there was no possibility of over-incentivisation. DfE agreed to seek DSO advice on this. | DfE<br><br><br><br><br><br><br><br>DfE |
| 5 | **Consultation**<br><br>DfE said that they aim to have a paper with the Minister by the end of October seeking his approval to consult on new draft regulations that would amend the tariffs for the scheme. DfE will conduct pre-consultation with major stakeholders prior to consultation. DoF queried whether the consultation would only consider amendments to tariffs or if any other cost control | |

| | | |
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| | measures would also be included including the definition of eligible usage etc.<br><br>DoF asked whether there was a statutory duty to consult on these regulations. DfE said that although there was no statutory duty they have received strong advice from DSO that they will need to consult those involved.<br><br>DoF asked DfE consider all options on speeding up consultation if consultation has to be undertaken, by reducing the number of weeks of consultation or carrying out a focused consultation with those affected rather than a full public consultation. DfE agreed to seek DSO advice on these points. | DfE |
| 6 | **Legal challenges**<br><br>DfE advised that a legal challenge could lead to delays. The risk of any challenge was more likely when the regulations had been implemented. The regulations would remain in place while any challenge proceeds. | |
| 7 | **New Combined Heat and Power (CHP) installations**<br><br>DoF asked about the large installations that are coming into the scheme. DfE said that there was no legal way to stop these from proceeding. However, they will be adding a time limit to the new regulations and reducing the tariff. DoF asked whether there was any danger of the same problem arising with these installations as with others. DfE advised that there was not as it was different technology. DoF asked whether this was State-Aid complaint. DfE confirmed that it was. | |
| 8 | **Documentation**<br><br>DoF asked DfE to document the actions that have been taken and will be taken to address the failure of this scheme, including all engagement with DSO, from when problems with this scheme first became evident. | |
| 9 | **Finance Minister statement**<br><br>DoF said that the Finance Minister will have to make a statement to the Assembly around October Monitoring. He will need to include some detail on RHI as this accounts for such a large percentage of the Resource DEL over-commitment. DfE agreed to put together lines for this including the remedial actions that have been taken.<br><br>DoF said that due to the challenging nature of the cuts that will be announced, RHI will come under renewed scrutiny and DfE will | DfE to provide lines |

| | | |
|---|---|---|
| | want to explore every option available to reduce the overall cost of this scheme and take all actions as necessary moving forward.<br><br>DfE asked if it was possible to go back to Treasury for additional funding in light of high take up of scheme in NI. DoF commented that discussions had taken place with Treasury on this point following the Autumn statement in 2015, however HMT set out their final position in the January 2016 letter from the CST. | |

**Budget Meeting DoF & DfE Tuesday 23rd August**

**Attendees**
Stephen McMurray
Bernie Brankin
Jeff Partridge
Michelle Scott
Angela Millar
Sarah Benton

1. **NI BUDGET - INFORMATION GATHERING EXERCISE**

**Capital**
BB advised that DfE's capital submission was due to go to their Minister that afternoon. The Minister had already indicated that the submission could not be shared with DoF in advance of Ministerial clearance.

MS highlighted the references within Mike Brennan's 17 August and stressed the need for detailed engagement on DfE's capital requirements as soon as possible.

**Resource**
MS clarified that the 10 October deadline relates to all three stages set out within Mike Brennan's commissioning letter, however confirmed that the information gathering will be an iterative process and there will be opportunities to refine this submission in consultation with Supply.

MS provided an overview of the three stages and clarified that the information should be presented at Unit of Service level. It was also stressed that proposed reductions to address inescapable pressures must be from the lowest priority spending areas.

The annual RHI pressure was discussed and MS stated that DfE should prepare two sets of scenarios, one which assumes the RHI pressure is addressed at the centre and one which assumes it must be met from the DfE baseline. The RHI pressure should also be included in the stage 3.

There was some discussion on the £20m allocation for skills. While it had been the previous Finance Minister's intention to baseline this amount for future years, this remains subject to Executive agreement. The £20m is therefore not included within the baseline for this exercise (as it was allocated via in-year monitoring) and MS suggested that as part of stage 3 of the exercise, DFE should make the case for this £20m to be baselined.

SMcM confirmed that the remaining funding requirements are likely to be Corporation Tax (which includes significant uplift in skills funding) and Apprenticeship Levy.

## 2. APPRENTICESHIP LEVY

MS referred to the 12 August HMT correspondence which provided details of a small additional Barnett consequential arising from the introduction of the Apprenticeship Levy. This additional funding will be part of the NI block and it will therefore be for the Executive to determine allocation. DfE should use stage 3 of the information gathering exercise to register their proposals for spend in relation to this levy.

## 3. AOB

**VES**
BB advised there are currently no plans for further utilisation of VES. However it was agreed that DfE would keep DoF informed of any change in this position.

**COMMONWEALTH YOUTH GAMES**
MS asked for an update on the department's support of the Commonwealth Youth Games. MS advised that as this Business Case has not been approved a limited company cannot be established and no expenditure can be incurred on the project.

**UNITED AIRLINES**
Following a short discussion on the DfE support package for United Airlines, MS advised DfE to ensure they have comprehensive legal advice to support any decisions taken.

**INVEST NI**
SMcM advised of two ongoing proposals in relation to buying out of debt. One related to buying out the PFI contract on the Bedford Street building and one in relation to the Belfast MET. The total amount involved will be £20m, with approximately £10m-£12m in-year. MS agreed to follow up with Mike Brennan.

**RHI**
In relation to the RHI pressure, SMcM reported that there would be consultation on options to introduce some form of cost control into the scheme. DfE are engaged in regular meetings with PwC who have been tasked with carrying out an independent review of the scheme.

Department for the Economy

FROM SENIOR MANAGEMENT
Finance Directorate

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Tel: 028 9025 7810
e-mail: Stephen.McMurray@economy-ni.gov.uk

FROM: Stephen McMurray
Finance Director

cc: see below

DATE: 6 June 2016

TO: Emer Morelli
DFP Supply

**PUBLIC EXPENDITURE: JUNE MONITORING 2016-17**

1. As per Stephen Barrett's letter dated 28 April 2016, I attach the Department for the Economy's June Monitoring return. This has been agreed by our Minister and our Permanent Secretary.

2. I enclose details of transactions requiring Executive approval:

   a. Reduced requirement (ring-fenced depreciation/impairment expenditure);

   b. Bids (resource expenditure and capital investment); and

   c. Details of any technical issues to be addressed, including movement of budget allocations across spending areas to reflect Ministerial priorities.

**Ring-fenced Reduced Requirement**

3. We have one Treasury ring-fenced reduced requirement of £0.6m in this monitoring round relating to Financial Transactions Capital due to delays in securing approvals.

**Resource Bids**

4. We have the following resource bids in this monitoring round:

4.1 ***Renewable Heat Incentive Scheme (RHI) £20.0m*** (Inescapable) - to meet increased demand. The bid is to cover additional firm contractual obligations under RHI, the costs of which were not previously anticipated and which, if not met, may lead to proceedings being taken against the Department.

4.2 ***End Year Flexibility (EYF) £8.0m*** (Inescapable) – this relates to the Further Education (FE) Colleges. The EYF scheme has been approved by the Executive and there is a requirement in June Monitoring to draw down £8.0m of the EYF stock in 2015-16 to ensure inescapable pressures are met across the sector.

4.2 ***Skills Agenda £20.0m*** (Inescapable) – The previous Finance Minister stated in his letter dated 26 January 2016 that the first £20.0m Resource Departmental Expenditure Limit made available in the June 2016 Monitoring Round will be recommended for the skills agenda within the Department for the Economy. the previous Finance Minister noted in his letter dated 26 January 2016 that it is his intention that this £20.0m, once agreed by the Executive, will be baselined for future years. The previous Finance Minister endorsed his commitment for this allocation in an Assembly Meeting on 8 February 2016.

**Capital Bids**

5. We have the following capital bids in this monitoring round:

5.1 ***Northern Ireland Broadband Improvement Project £1.56m*** (Inescapable) – for the provision of 'in-fill' broadband solutions. This requirement was to be part-financed by the European Regional Development Fund and expenditure now falls outside the period of the Sustainable Competitiveness Programme, European Regional Development Fund funding has been withdrawn. This has led to a shortfall in funding and Telecoms are bidding to meet this shortfall.

5.2 ***HMS Caroline project £1.25m*** (Inescapable) – An updated business case and economic appraisal by the project promoters identified an increase in costs required to complete the project.

**Technical Adjustments**

6. There are thirteen outward budget transfers to other Departments totalling £7.530m and eleven inward budget transfers from other Departments totalling £9.542m to be made in this monitoring round.

6.1 The Department will be transferring £5.8m of Financial Transactions Capital to The Executive Office as we have no power to issue Financial Transactions Capital loans to higher education institutions and that such loans have been made by The Executive Office through the Strategic Investment Board.

**Reclassifications**

7. There are some minor reclassifications required totalling £0.35m.

**Pressures Across Departments**

8. The following is being taken forward by DFP centrally as they relate to all departments.

8.1 No bids were made for the Voluntary Exit Scheme in Tranche 2. Bids for £1.2m additional funding were made through the Tranche 1 reallocation process.

8.2 All of the appropriate forms have been keyed on to the RBM database.

**STEPHEN MCMURRAY**
**Finance Director**

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DOF-57029

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---

**FROM:** **EMER MORELLI**

**cc:** *Copy distribution list below*

**DATE:** **4 October 2016**

**TO:** **STEPHEN MCMURRAY**
**FINANCE DIRECTOR**
**DEPARTMENT FOR THE ECONOMY**

**INDEPENDENT REVIEW OF THE NON-DOMESTIC RENEWABLE HEAT INCENTIVE SCHEME - ADDENDUM**

Thank you for your letter of 3 October in which you requested DoF approval to extend the above mentioned independent review at an estimated cost of £45,000. It is noted that you have consulted CPD who have advised that the existing contract can be extended to facilitate this additional work.

On the basis that the Terms of Reference reflects your Accounting Officer's requirements for the investigation into the Department for the Economy's management and governance of the RHI scheme, I am content to grant DoF approval to this extension of the contract.

The business case sets out very challenging timing for this exercise and, given the complex issues under investigation, it will be important that you ensure the investigation is sufficiently thorough and robust – and commensurate with the cost of the contract extension. You will also which to ensure the investigation is compliant with the relevant personnel guidance.

As with the previous consultancy approval, please note there is no 10% tolerance on this approval amount, and therefore any proposal to incur expenditure above £295,000 will require further DoF approval.

**Copy Distribution List**
**Andrew McCormick**

**DOF-57030**

**Heather Cousins**
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**Lee-Anne Hutchinson**
**Victoria Reid**

**From:** Scott, Michelle
**To:** McMurray, Stephen
**Cc:** Brennan, Mike; Cousins, Heather; Morelli, Emer
**Subject:** FW: RHI note to DfE
**Date:** 01 June 2016 09:55:00
**Attachments:** Draft C AG report 15-16 AMcC (3).docx

Stephen

We had a useful meeting on Friday on RHI

In response to DoF queries, it was confirmed that DfE has sought legal advice (DSO) on options available to reduce the ongoing RHI financial pressure. These options include the introduction of a cap for all installations. DoF welcomed this approach - and asked whether DfE had also sought legal advice on other cost control measures including the introduction of a tiered tariff to be applied on a prospective basis to installations established under original tariff conditions. In addition, DoF questioned the legal position regarding the large installations which have been granted preliminary accreditation. DfE agreed to follow up on these points with DSO - DoF would be kept informed of progress.

DoF also asked for an update on the ongoing audits, and stressed the need for a timely field audit given the concerns raised. DfE representatives set out the inspection schedule which had been agreed between Ofgem and Deloitte, and reported that Michael Woods, the DfC internal auditor, has reviewed and agreed the audit approach.

The funding requirement at June monitoring was also discussed. It was confirmed at the recent DoF/DfE stocktake that the £32.4m RHI bid was based on a worst case scenario, and it was agreed that the DfE bid should be based on a more realistic scenario to reflect inevitable drop outs, along with the outworkings of the ongoing assessment and audit process. It was confirmed that any tariff adjustments which can be introduced would not impact on the 2016-17 funding requirement.

Turning to the recent NIAO report, I have added some comments in the attached document and I am happy to discuss. The figures in relation to applications and annual costs are different to the latest position notified to DoF – in particular Trevor Cooper's letter of 7 December outlined 828 applications during the retrospective period whith an annual cost of £17.74m – which is the figure notified by DoF to NIAO. We have no way of checking the figures, but have assumed DfE are content.

I am happy to discuss

Michelle

DOF-57032

DRAFT COPY – TO BE REVIEWED FOR FACTUAL ACCURACY ONLY

N I A O

Northern Ireland Audit Office

# Report by the Comptroller and Auditor General for Northern Ireland

# Department for Enterprise, Trade and Investment

# Resource Accounts

# 2015-16

**DRAFT COPY – TO BE REVIEWED FOR FACTUAL ACCURACY ONLY**

## Introduction

1 The Department of ~~for~~ Enterprise, Trade and Investment (the Department) had~~s~~ responsibility for a range of functions including economic development policy, economic advice and research, business regulation, research and statistic services, health and safety at work and mineral development (these responsibilities transferred to the new Department for the Economy (DfE) on 8 May 2016). In 2015-16 the Department spent a total of £xxx million (2014-15 - £228 million). Of this total expenditure around £35.1 million ~~x~~ was spent promoting the use of and providing support for the use of various renewable heating energy technologies.

Comment [SW1]: Updated figure

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

- expenditure amounting to £~~17.74~~11.9 million which was incurred without the necessary approvals in place for the non-domestic Renewal Heat Incentive (RHI) scheme (paragraphs 5 to 16) and is therefore irregular; and
- because I was unable to obtain enough evidence to be assured that expenditure on the non-domestic RHI scheme amounting to £xx million had been incurred for the purposes intended (paragraphs 17 to 25). This was due to the fact that I did not consider that the systems in place to prevent or detect abuse of the scheme were adequate.

Comment [SW2]: Updated figure

3 The report also highlights general concerns in relation to the operation of the scheme and the circumstances surrounding the large increase in demand in October and November 2015 which will result in a significant cost to the Northern Ireland block grant for many years (paragraphs 26 to 53).

4 My audit certificate also includes two emphasis of matter paragraphs and this report also provides an update on these two important issues (paragraphs 54 to xx).

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

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

6 The Department of Finance and Personnel (DFP) did not approve £11~~7~~.~~74~~ 9 million expenditure incurred in a seven month period during 2015-16 on the non-domestic RHI scheme and as a result, this expenditure is irregular. Consequently, I have qualified my opinion on the 2015-16 Departmental Resource Accounts on the regularity of expenditure incurred on the non-domestic RHI scheme as this expenditure has been incurred without conforming to the authorities which govern it.

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**Background to the Audit Qualification**

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

8 RHI is administered on behalf of the Department by the Office of Gas and Electricity Markets (OFGEM). Anyone wishing to take advantage of the scheme was required to purchase a suitable system from an approved installer and once installed apply to OFGEM, who would review the claim and once approved would manage quarterly payments to the applicant and then recover these payments from the Department. Once the scheme had been approved by OFGEM, the subsidy is paid to the applicant at a fixed rate each year, increasing in line with inflation. Each applicant has to submit quarterly meter readings to OFGEM. The Department is ~~only became~~made aware of ~~the approved grant~~new applications and their progress through a weekly update report. ~~at the end of OFGEM's approval process and~~ Given the design of the scheme ~~therefore this made~~ it ~~much more~~is difficult to manage the demand ~~–~~ – in hindsight, this was a flaw in the system, albeit that it's fundamental design ~~replicated~~paralleled the process in GB. ~~However, t~~The NI Non Domestic RHI scheme (like the GB scheme) was designed ~~(and funded through AME)~~ as a demand–led scheme whereby applicants must install their renewable heating system before making an application. ~~.~~

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

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

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

**Source: Department**

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

~~10~~11 I asked the Department why it had not sought approval to continue the scheme from DFP well before the original approval expired. The Department's ~~told me …………….~~explanation lies in a combination of staff changes and an administrative oversight. Subsequent to the requirement for re-approval being put in place, there were multiple staff changes~~ in the Department's personnel in the relevant chain of command at every level from DP to Permanent Secretary~~, and the ~~corporate memory lapsed~~key information was not passed on from departing staff to their successors. ~~In addition, the ongoing legal basis of the scheme never suggested that it might be timebounded to end after 33 months. Conversely, approval had been secured for the Domestic RHI for 6 years from 2014/15 to 2019/20.~~ Nevertheless, the Department recognises that administrative arrangements ought to have been in place to trigger an application for re-approval at the appropriate time. They were not; and the matter came to light only when budget confirmation was sought.

~~11~~12 As well as the expiry of the DFP approvals in April 2015, around that time it also became clear that the number of applications was beginning to increase significantly. The Department reviewed this over the summer months and decided that changes would be required to the tariffs under the scheme to manage the demand.

~~12~~13 The amended scheme proposed a much lower second tier tariff once the heating equipment had been used for 15 per cent of the total hours in a year. This followed a similar two tier approach that had been used in Great Britain since the RHI scheme began there, with the intention of the higher rate providing a return on the capital cost while the lower second tier rate minimised any incentive to unnecessarily generate heat just to claim under the scheme.

~~13~~14 The timescale for approving and making the legislation using normal procedures meant that the new arrangements did not come into force until 18 November 2015. There was a very large spike in demand during the 10 week period between the announcement of the new arrangements and their coming into operation. ~~The amended scheme was announced on 8 September 2015 but had to be~~ ~~In line with normal processing times for such legislation, topen to a period of consultation so that it only came into effect some ten weeks later on 17 November 2015 resulting in a large spike in demand in that period.~~ The impact of this increase in demand is discussed in more detail later in this report.

~~14~~15 Based on the revised tariff approach, DFP approved the business case for the revised scheme on 29 October 2015 but did not give retrospective approval for the ~~828~~ 788 non-domestic RHI applications with an annual estimated cost of £11.89~~7.74~~ million that had been completed between 1 April 2015 and 29 October 2015. Because of this non-approval, the estimated current year expenditure of £11.9~~7.74~~ million expenditure

**Comment [MS3]:** This insertion suggests there were cost controls in place prior to April 2015. This report highlights there were not – as outlined in para 13

**Comment [MS4]:** The use of the word nevertheless in this context detracts from the subsequent statement.

**Comment [EM5]:** The original text regarding the inclusion of the consultation requirement provides a rationale for the delay in amending the scheme.

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incurred by applications which were approved in this period is irregular and my audit opinion has been qualified this year in respect of this.

~~15~~ It is likely that ~~the~~ an estimated £~~17~~19.4~~.74~~ million of expenditure will continue to be incurred annually on these ~~828~~ 788 applications for the next twenty years. Unless the Department is able to obtain retrospective approval from DFP, this expenditure will continue to be irregular in the future and I will consider the impact of this irregular expenditure on my audit opinion in future years. I asked the Department what it is doing to regularise this expenditure and it told me it will be considering all possibilities for future options -around the ~~whether there is~~ the scope ~~developing policy proposals~~ to introduce additional cost controls and will advi~~c~~se the new Minister accordingly. ~~These controls may include an annual payment cap but will subject to public consultation and the approval by the new Economy Minister and incoming Assembly.~~ .~~. If a viable approach is available and is approved by the new DfE Minister, tThe Department will seek to secure DoF approval in the hope that thesesuch controls would adequately regularise the expenditure. [DN not sure that even this more cryptic version is suitable as there can be no question of announcing the exploration of a policy which may not be viable through the vehicle of an Audit Office Report].~~

16 Qualified opinion arising from limitation in audit scope

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

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

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

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

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

**Comment [SW6]:** This is the full 12month expenditure associated with the 788 installations that applied between 1/4/15 and 28/10/15.

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~~20~~ OFGEM also carried out physical inspections of the equipment installed to ensure it meets the scheme requirements. However I understand that the rate of inspection in Northern Ireland has been very low at around 0.86 per cent of applications (compared to around 1.86 per cent in Great Britain). The Department has confirmed that this rate was a result of site audits being planned on the basis of anticipated application rates. Based on the number of applications in the first 6 months of the scheme, the inspection rate was 4%, which decreased to 1.5% from scheme launch in November 2012 until September 2015. The ~~S~~significant and unprecedented increases in application volumes in the period to February 16 saw the rate fall further to 0.86%. Ofgem carries out audit activity, including via the use of 3rd parties, in line with their administrative arrangements and agreed funding. DETI and Ofgem have regularly discussed the approach to audit as the numbers of applications increased, as part of the developing audit strategy for 16/17 and beyond. The Department and Ofgem are already engaged in a joint review, which in addition to considering an approach to applications received in 2015/16 will inform the audit strategy for 2016/17 and beyond. In addition the

~~21~~20 ~~The~~ Department is proposing to procure a service provider to deliver a programme of additional audits as part of this strategy.

**Comment [MS7]:** It was DoF's understanding that this decision has been taken? Para 52 states a business case is under development – this should be straightforward with a clear need already established,

21 This very low rate of inspection is compounded by the fact that when issues are identified by the inspection process it is very unclear if anything is done about it – particularly by the Department. In 2015-16 of the four scheme inspections that had been completed at the time of this report, compliance issues were identified in three. However the Department is not routinely provided with any detail of these issues by OFGEM and it is unclear how issues arising from inspections are cleared. The Department has confirmed that energy officials have regular meetings with Ofgem at which operational issues or trends are raised as appropriate. It's important to note that there are a large number of eligibility requirements and ongoing obligations relating to the Non-Domestic RHI scheme. While Ofgem rightly and properly record and action these where identified and where appropriate, in many cases these do not have a material impact. OFGEM uses the results of its audit programme, not only to take action on individual cases, but to consider the wider approach to non-compliance, and this includes administrative/operational changes (such as via updating guidance or processes) to focus on preventative measures.

**Comment [MS8]:** Does DfE know what the specific compliance issues were – can the department say they have assessed these issues and are content with OFGEM's management of the issues? If not, can the department point to any actions taken by the deparment?

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

23 When OFGEM requests payments from the Department to the applicants, it ~~only~~ provide~~d~~s a unique ~~a~~ reference number for each installation, the amount to be paid and details on what sector the applicant works in e.g. Agricultural sector. Names of applicants are not included for data protection reasons but can be on request. As a result

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at the time this report was written, the Department was unable to provide any details of the names of companies in receipt of grants.

24 I am concerned that the design of the NI non-domestic RHI scheme and the way that the Department operated and monitored it has made it vulnerable to abuse. The high level of applications received in the current year and the specific whistleblower allegations (discussed later in this report) that the Department is currently investigating have further added to these concerns. As a result of these concerns I have qualified my regularity audit opinion because I was unable to obtain enough evidence to be satisfied that the grants paid relating to the non-domestic RHI scheme during the year amounting to £~~Xmillion~~ 30.52million had been incurred for the purposes intended.

~~25~~ I asked the Department why it left the monitoring of the non-domestic RHI scheme almost entirely to OFGEM and why it had not been involved to a greater extent in the monitoring of these schemes. The Department confirmed that the current team ~~have a close working relationship with their colleagues in Ofgem which involves~~ are in daily contact with Ofgem regarding application queries. Ofgem also provide weekly reports outlining the latest position regarding application numbers and their status (i.e. pending, approved, refused). ~~The finance team within Energy Division also has robust finance arrangements in place with Ofgem which includes provision of weekly reports on RHI payments and agreeing the forecast cash requirements to meet these commitments.~~ In addition, from August 2014 formal meetings[1] are held between the Department and Ofgem by conference call where operational, policy and budgetary issues are discussed and addressed. ~~Through these meetings, many key policy issues have been progressed including legislation to address an issue around applicants who had received 0% loans from Invest NI and the legislation needed for the tariff changes introduced in November 2015.~~

25

**Comment [MS9]:** While it is appropriate to set out any improvements which have been implemented, a corporate approach should be taken.

## Other issues relating to the non-domestic RHI scheme

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

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

**Background to non-domestic RHI**

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

28 The Department set the level of tariff (in the form of pence per kilowatt hour (p/kwh) for heat generated) which was dependent on the size and type of technology and was calculated to cover capital costs, operating costs and non-financial hassle costs (e.g.

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

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~~potential digging up ground~~removal of ash) over the lifetime of the technology. However these calculations were made in 2012 when the scheme was initially established and were not reviewed until Autumn 2015.

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

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

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

32 The consultants were asked to reconsider the rates following feedback from the industry received through the~~a~~ consultation process. ~~and i~~In February 2012, the consultant~~'~~s produced a new paper which increased the rates to account for a larger reference case boiler of 50kw in size rather than the original 20kw reference case.~~available to take into account some specific Northern Ireland issues.~~ The rate proposed in this paper for biomass boilers less than 100kw was increased ~~in this paper~~ to 5.9 pence per kwh but there was no mention of the need for tiering or that this was not in excess of the cost of wood pellets. The final business case, ~~presented by the Department to~~approved by the Department and DFP in mid 2012 ~~proposed~~ included ~~a higher rate than that~~a 5.9 pence tariff which has subsequently ~~suggested by the consultants of~~been increased with inflation to 6.4 pence per kwh. ~~The Department has told me the increase was due to inflation.~~

33 In the business case to DFP the Department states that there was no need to consider tiering because the rate proposed was lower than the cost of fuel and therefore there would be no incentive to abuse the system by generating heat just to claim the subsidy. However in the case of biomass boilers this was not ~~true~~ the case and appears ~~just~~ to have been copied from the July 2011 consultant's report without thought. In fact the cost of wood pellets was shown in the same business case [DN mid 2012?] as being 4.39 pence per kwh compared to the proposed tariff of 6.4 pence per kwh. In hindsight the failure to adequately consider the tiering of rates similar to the GB scheme was a critical mistake.

**Comment [MS10]:** Should this be 5.9p?

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

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| | Pence/Kwh |
|---|---|
| June 2011 (Consultants – original report) | 4.5p |
| Feb 2012 (Consultants – revised following consultation) | 5.9p |
| June 2012 Department business case | ~~6~~5.~~4p~~9p |
| | |
| Cost of wood pellets (per Department business case in 2012)) | 4.39p |

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

Comment [MS11]: The business case was submitted to DFP in March 2012?

Comment [SW12]: This increased to 6.4p with inflation.

Source: Department

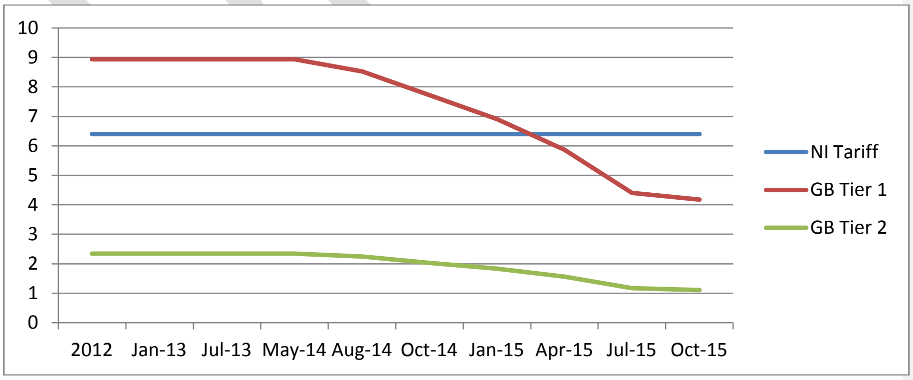
34 The GB scheme also had a system (known as degression) built in from April 2013 to allow the tariff paid to reduce in response to an increase in demand. This meant that the tariff paid was reviewed each quarter and revised (with a month's notice) according to the level of demand for the scheme. Degression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

35 At the time degression was introduced in GB in April 2013, demand for RHI was very low in Northern Ireland, thus creating a significant under spend for the Department (see Table 1). The Department has told me that its priority at that time was in identifying ways to increase demand and also on the introduction of a similar scheme for domestic applicants. As a result the degression system or alternative costs control system was not introduced in Northern Ireland and the tariff rate was unchanged for a long period of time. Once it became apparent that demand was increasing significantly the Department was unable to react quickly due to legislative constraints.

36 The graph below shows a comparison (in pence) between the Northern Ireland tariff and both GB tariffs. The Northern Ireland single tariff remained unchanged for the whole period up to November 2015 at 6.4 pence, while the two tariffs in GB halved over the same period.

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

Comment [MS13]: The graph does not show the NI tarrif increasing inline with inflation from the 5.9p originally introduced. While it is only a marginal increase, should this be corrected




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

**Source: Department**

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37 This meant that typical returns were much higher for applicants in Northern Ireland than in GB, especially since 2015. The tables below show that the annual Northern Ireland RHI grant for a typical boiler installed in May 2015 could have been almost twice as much as for the same boiler in GB and when this continues to be paid over 20 years, those recipients in Northern Ireland stand to receive a substantial amount more than those in GB. [DN not sure the comments SW5~~7 and SW8~~ undermine the main point being made here or provide an alternative like for like comparison]

Comment [SW14]: Can we suggest that some context is provided around the difference in rates. Unlike the GB scheme the NI scheme had underperformed with this level of tariff for two and a half years. The GB scheme, which began with higher tariffs than NI ever had was well established. By May 2015 the situation on uptake in NI was changing and work had already commenced to bring forward cost control measures in response.

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

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

| | Northern Ireland £ | Great Britain £ |
|---|---|---|
| Annual cost of wood ~~chips~~pellets | 12,639 | 12,639 |
| Annual oil cost not incurred | (8,618) | (8,618) |
| Annual net cost of supplying fuel to biomass boiler | **4,021** | **4,021** |
| RHI annual subsidy | 18,385 | 9,696 |
| Annual saving | **14,364** | **5,675** |
| | | |
| Saving over 20 years | **287,280** | **113,500** |
| Initial capital cost to install biomass boiler | 45,000 | 45,000 |
| Profit over 20 years | 242,280 | 68,500 |
| | | |
| Payback time | 3.1 years | 7.9 years |
| Annual rate of return | **27%** | **7.6%** |

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

Comment [SW15]: No allowance appears to be made for the additional maintenance / servicing costs associated with biomass. There is likely to be a difference between GB and NI costs.

Comment [SW16]: It is not clear what basis has been used for oil price.

39 As there were no tiering of tariff rates in Northern Ireland, even greater amounts of grant could be obtained by running the boiler for up to 24 hours a day as there is no upper limit on the amount of energy that would be paid for. The more heat that is generated, the more is paid. Indeed with the cost of wood pellets at around 4.4p/kWh[2] and the RHI grant at 6.4p/kWh it would appear to benefit those in receipt of a grant approved prior to November 2015 to use the boiler 24 hours a day, even if the heat generated is not being used. This type of use may be an example of the scheme's inherent vulnerability to fraud~~t of the scheme~~. This can be seen in the example below based on the same 99kw boiler being used 24 hours a day, 7 days a week and achieving 93 per cent efficiency.

**Table 4: Comparison between NI and GB –boiler used 168 hours per week**

| | Northern Ireland £ | Great Britain £ |
|---|---|---|
| Annual cost of wood chips | 35,390 | 35,390 |
| Annual oil cost not incurred | (24,130) | (24,130) |
| Annual net cost of supplying fuel to biomass boiler | **11,260** | **11,260** |
| RHI annual subsidy | 51,477 | 17,762 |

Comment [SW17]: No allowance appears to be made for the additional maintenance / servicing costs associated with biomass. There is likely to be a difference between GB and NI costs.

[2] Biomassenergycentre.org.uk - Fuel costs per kWh, December 2013

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| | | |
|---|---|---|
| Annual Saving | **40,217** | **6,502** |
| Saving over 20 years | **804,340** | **130,040** |
| Initial capital cost to install biomass boiler | 45,000 | 45,000 |
| Profit over 20 years | 759,340 | 85,040 |
| Payback time | 1.1 years | 6.9 years |
| Annual rate of return | **90%** | **9.5%** |

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

Comment [SW18]: We recognise that this comparison is for illusttative purposes but it islikely that the boiler would have to be replace at least once durimg the 20 year period if it was run continuously for 24 hours a day.

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

**Domestic Renewable Heat Incentive**

41 RHI was extended to homes in the domestic sector in December 2014 to encourage people to switch renewable heating systems and reduce carbon emissions. Similar to the non-domestic scheme, the main methods of generating heat included biomass (burning wood pellets), air and ground source heat pumps and solar thermal. The benefits to applicants are less lucrative, with an upfront payment to a maximum of £3,500 and up to £~~1~~2,~~200~~ 500 a year for seven years, depending on heat requirements. ~~There was a much smaller take up~~Uptake for the domestic scheme is ~~compared~~ comparable with the non-domestic scheme. As outlined in Table 4 below, total applications for the domestic scheme were ~~xxx~~2,721, compared to ~~xxx~~ 2,128 for the non-domestic scheme. In addition, there was not the same spike in demand for the domestic scheme as there was for the non-domestic scheme in the Autumn of 2015.

Comment [SW19]: The proposed tariff changes would appear to have been the catalyst for the spike in on domestic applications. No tariff changes were made to the Domestic Scheme which was only introduced in Dec 2014. A significant spike in domestic applications was received prior to closure in February 2016.

**Demand for the non-domestic scheme**

42 By May 2015 it was apparent that demand for the non-domestic scheme was increasing and coupled with the need to receive DFP approval for future budget cover, meant that the level of support for the scheme and the scheme legislation urgently had to be reviewed. During July and August 2015 it was decided to introduce a two tier tariff system, similar to GB and also to review the legislation for the scheme. The reduced tariff rate was publicly announced on 8 September 2015 but ~~with~~ there was a ten week ~~consultation~~ period before the legislative changes came into effect on ~~17~~ 18 November 2015. Table 3 below shows the old and new tariffs for a typical 99kw boiler, which was the most popular boiler used in the scheme.

**Table 5: Comparison of non-domestic tariffs before and after 17 November 2015 in Northern Ireland**

| | Boilers installed before 17 November 2015 | Boilers installed after 17 November 2015 |
|---|---|---|
| Tier 1 | 6.4p/kWh | 6.4p/kWh |
| Tier 2* | N/A | 1.5p/kWh |

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

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**Source: Department**

43 Following the announcement of the tariff change in September 2015, during October 2015 and the first half of November 2015, there was a huge spike in applications with almost as many applications being received in those seven weeks as had been made in the previous 34 months since the scheme began. The expected cost of the applications made during this seven week period will be around £20 million annually for the each of the next twenty years. The numbers of applications and expected costs of both schemes are shown in Table 4 below.

**Table 6: RHI Applications and associated costs 2012 to 2016**
~~**(NOTE – FIGURES TO BE CONFIRMED WITH DETI)**~~

| **Period** | **Application Numbers** | **Actual Cost 2015/16 inc accrual of £14.405m** | **Total 20 Year cost[3]** |
|---|---|---|---|
| | | **£m** | **£m** |
| **Non-domestic schemes** | | | |
| Nov 2012 – March 2015 | 564 | 13.24 | 285 |
| April to September 2015 ** | 359 | 6.42 | 195 |
| October 2015 ** | 429 | 5.47 | 250 |
| November 2015 | 452 | 4.79 | 235 |
| December 2015 – March 2016 | 324 | 0.6 | 185[4] |
| | | | |
| **Total non-domestic** | **2,128** | **30.52** | **1,150** |
| **Domestic schemes** | **2,721** | **4.58** | **30** |
| | | | |
| **Total commitment to 31 March 2016** | **4,849** | **35.1** | **1,180 *** ** |

Comment [SW20]: Updated figures.

Comment [SW21]: All 20 year figures rounded to nearest £5m

** ~~828~~ 788 non-domestic RHI applications costing £11.9~~7.74~~ million that had been completed between 1 April 2015 and 29 October 2015 for which DFP did not give approval.

*** The 20 year forecast figure can only be an indication at this point. A number of uncertainties remain over such a long time frame – the figure shown is the best estimate of the worst case scenario and has been prepared on the basis of the 16/17 estimates going forward. The 20 year figure has been adjusted for inflation at a rate of 1.6% annually and no drop out rate has been assumed. It is likely that the figure could be less than shown.

**Source: Department**

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

[3] Includes annual increases for inflation.
[4] Assumes that 2 large CHP plants with preliminary accreditation will proceed in 18/19.

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**Funding for the scheme**

45 The RHI scheme has been demand led from the beginning and was intended to be funded as Annually Managed Expenditure (AME). For most categories of AME spending, HM Treasury provides the amount required to fulfil defined policies and obligations (eg social security benefits), and the budget provided is adjusted annually (up or down) without affecting ~~This meant that funding for the scheme would come directly from HM Treasury rather than from~~ the Northern Ireland block grant – in essence the risk of the amounts required exceeding the budget is borne by HM Treasury, not the NI Executive. ~~This type of expenditure was under less pressure as it was paid directly from HM Treasury rather than out of the Northern Ireland block grant.~~

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

47 ~~While there may have originally been some confusion as to t~~The AME ~~limit~~allocations ~~, this was~~were clarified in an email from Treasury and two letters to the DETI Minister from the Department of Energy and Climate Change (DECC) Minister:

- In April 2011, Treasury officials confirmed by email that RHI spending was not being treated as standard AME, where the Exchequer takes on all risks of overspend. Instead, there ~~is~~would be a risk-sharing arrangement whereby should RHI spending in one year exceed the ~~SR~~ profile set in the Spending Review, then the Department would need to repay this in future years and may incur DEL penalty likely to be of the order of 5%. [DN based on these emails, NIAO could reasonably go on to say: "It appears that this relatively informal, and explicitly indefinite, information was never confirmed by HM Treasury. However, DETI officials, in an exchange of emails in May 2011, noted that the implication of the Treasury position was that it would be necessary to consider having controls in place to limit expenditure: there is no record of subsequent attention to this point."]
- In November 2013, a letter drawing attention to the changes made to the GB scheme to ensure affordability and value for money (including the degression changes); and
- In January 2014, a letter confirming that the NI allocation of AME funding would be ~~limited to~~based on a Barnett formula share (3%) of the GB RHI budget.

48 The Department has confirmed that although it was aware from January 2014 that the 2015/16 allocation would be a Barnett consequential share, officials did not know until ~~November~~ December 2015 that the DECC budget on which that share was based was to be subject to a large cut, and that all overspend after 2016/17 would have to be met from resource DEL.

~~48~~49 When demand increased dramatically between September and November 2015 this greatly increased the costs of the scheme. HM Treasury did not impose a DEL penalty in relation to the excess expenditure in 2015-16, but has ruled out any increase in the AME allocation to the NI Executive for the years from 2016-17 onwards to assist with the increased costs the Department has incurred: because ~~beyond that which would be met by AME. These~~the increased costs are committed ~~to~~ for twenty years, the excess ~~and~~ will now have to be met from the Northern Ireland block grant. It is difficult to

**Comment [MS22]:** The deleted section seems accurate, and matches the DoF understanding of the situion. There was confusion during the summer of 2015, with DETI officials seeking clarification from their counterparts in DECC. Indeed, it was the DoF understanding that DECC officials had suggested that underspends in the GB scheme could be transferred to fund any overspends in NI

**Comment [SW23]:** A copy of this Email will be provided.

**Comment [MS24]:** The SR was announced in November 2015. Also – is it accurate to say the DECC budget was subject to a large cut? The Autumn statement containes the following text 'Funding of the scheme will continue to rise to £1.15bn in 2020-21'.

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estimate the total amount that will have to be met from the block grant because it will depend on the AME allocation from GB in the future. However over the next five years the Department estimate a cost to the NI Block of around £~~97~~ 140 million, as shown in Table 5 below.

**Table 7: Projected deficit in AME funding from 2016-17 to 2020-21**

| | 16-17 £'000 | 17-18 £'000 | 18-19 £'000 | 19-20 £'000 | 20-21 £'000 | Total £'000 |
|---|---|---|---|---|---|---|
| Total cost | 50,700~~45,195~~ | 51,700~~45,195~~ | 54,800~~45,195~~ | 55,700~~45,195~~ | 56,600~~45,195~~ | 269,500~~225,975~~ |
| AME allocation | 18,300~~18,300~~ | 22,300~~22,300~~ | 25,700~~25,700~~ | 28,900~~28,900~~ | 34,300~~34,300~~ | 129,500~~129,500~~ |
| **Deficit** | **(32,400)~~(26,895)~~** | **(29,400)~~(22,895)~~** | **(29,100)~~(19,495)~~** | **(26,800)~~(16,295)~~** | **(22,300)~~(10,895)~~** | **(140,000)~~(96,475)~~** |

Comment [SW25]: Updated figures.

**Source: Department**

**Whistleblower allegations**

~~49~~50 In January 2016, the Office of the First Minister, Deputy First Minister (OFMDFM) received an anonymous whistle blowing letter, alleging abuse of the scheme by businesses who are not working within the intended guidelines. The allegations include:

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

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

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

Comment [MS26]: OFGEM has been involved in commissioning an assessment of its own processes – is the department satisfied there is sufficient independence.

~~50~~ It is anticipated that the findings of this Review will be reported in June 2016. I would expect the Department to ensure any recommendations are acted upon and any

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necessary action is taken. I will closely monitor the outcomes of these reviews instigated by the Department.

52

~~51~~ The Department has also responded to the large spike in demand by initiating . A business case is under development to procure an independent audit assurance body which will undertake a range of site audits on both the NI non domestic and domestic schemes. The Department has secured additional funding for extra audits in 2016/17. This will supplement the OFGEM programme of audits under the non domestic scheme. It is planned that around 1 in 10 installations will be audited annually under both schemes, (around 500 audits each year).

~~52~~53

**Comment [MS27]:** Can additional information be provided on when this audit was initiated – given the time lag since the spike was experienced?

**Conclusions**

~~53~~54 The operation of this scheme over the last few years and its future budgetary implications give rise to a number of significant concerns. These include that the scheme:

- [DN NIAO could add: "was not designed to include any viable cost controls despite the clear indication in April 2011 that this would not be funded without limit by HM Treasury"
- did not take the opportunity in 2013 to mirror the GB scheme and introduce some cost control measures at that time;
- did not take account of changes to underlying costs since 2012 and therefore was over-generous in incentivising renewable heat;
- couldn't be changed quickly when it became apparent that demand was rising quickly;
- wasn't approved by DFP after April 2015 and resulted in irregular expenditure. If the need for this approval had been identified at the right time then it could have been the catalyst for a wider review of the scheme;
- has at least facilitated the possibility of funding that is at best not in line with the spirit of the scheme and at worst fraudulent;
- was not properly monitored and controlled by the Department who over relied on the work being done by OFGEM; and
- did not identify the risks of overspending at an earlier stage even though the ~~limits to~~ AME allocations had been apparent for some time. [DN see my comments re the HMT and DETI emails and the additional bullet point above] This has led to an impact on the Northern Ireland block grant which is likely to be measured in hundreds of millions of pounds.

~~54~~55 This scheme has had serious systemic weaknesses from the start. The fact that the Department decided not to mirror the spending controls in Great Britain has led to a very serious ongoing impact on the NI budget and the lack of controls over the funding has meant that value for money has not been achieved and facilitated spending which is potentially fraudulent. I am very concerned about the operation of this scheme and it is an area which I expect to return to in the very near future.

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## Other Matters

**Emphasis of Matter – Harland & Wolff plc provision [To be completed during audit]**

**Emphasis of Matter – Carrying value of Presbyterian Mutual Society Limited (PMS) loan [To be completed during audit]**



**KJ Donnelly**
**Comptroller and Auditor General**
**June 2016**

**Northern Ireland Audit Office**
**106 University Street**
**Belfast**
**BT7 1EU**

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**Annex A**

**Example 1**

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

Comment [SW28]: As highlighted in comment above, we would suggest that NI 99Kw boiler is compared against GB 199Kw boiler. Gb figures have been amended to 199KW boiler.

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

The cost of wood pellets per kwh of energy produced would be around 4.4 pence per kwh (based on Biomassenergycentre.org.uk – Fuel costs per kWh, December 2013) giving an annual cost of 287,258 x 4.4 pence = £12,639.

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

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

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

| | Northern Ireland (99KW) | Great Britain (199KW) |
|---|---|---|
| | £ | £ |
| Annual cost of wood chips | 12,639 | 12,639 |
| Annual oil cost not incurred | (8,618) | (8,618) |
| Annual net cost of supplying fuel to biomass boiler | **4,021** | **4,021** |
| | | |
| RHI Annual subsidy in NI – 287,258 kwh x 6.4 pence per kwh | 18,385 | |
| RHI Annual subsidy in GB - see calculation below * | | ~~9,696~~14,963 |
| Annual saving | **14,364** | **~~5,675~~10,942** |
| | | |
| Saving over 20 years | 287,280 | ~~113,500~~218,840 |
| Initial capital cost to install biomass boiler | 45,000 | ~~45~~65,000 |
| Profit over 20 years | 242,280 | ~~68,500~~153,840 |
| | | |
| Payback time | 3.1 years | ~~7.9~~5.9 years |
| Annual rate of return | 27% | ~~7.6~~11.8% |

*** RHI Calculation – Great Britain (199KW Boiler)**

Total hours used – 12 hours x 5 days x 52 weeks = 3,120 hours

Tier -1 hours: 1,314 h~~ou~~rs x 199kw x 93% efficiency = ~~120,980~~243,182 KWh at 5.87 pence/kwh = £~~7~~14,~~102~~275

Tier 2 hours: ~~1,806 hours x 99kw x 93% efficiency~~(287,258 – 243,182) = ~~166,278~~44,076 KWh at 1.56 pence/kwh = £~~2,594~~688

Total RHI subsidy £~~9,696~~14,963

**Example 2**

**Based on a 99kw boiler running for 24 hours a day, 7 days a week and achieving 93% efficiency.**

**Comment [SW29]:** Again, we would suggest that a GB 199Kw boiler should used for comparison purposes.

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

The cost of wood pellets per kwh of energy produced would be around 4.4 pence per kwh (based on Biomassenergycentre.org.uk – Fuel costs per kWh, December 2013) giving an annual cost of 804,324 x 4.4 pence = £35,390.

The comparative cost of oil (based on its cost of 30 pence per litre in May 2016) is a cost per kwh of 3.0 pence (Biomassenergycentre.org.uk). The annual cost of oil which has been saved is 804,324 x 3.0 pence = £24,130.

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

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

| | Northern Ireland | Great Britain |
|---|---|---|
| | £ | £ |
| Annual cost of wood chips | 35,390 | 35,390 |
| Annual oil cost not incurred | (24,130) | (24,130) |
| Annual net cost of supplying fuel to biomass boiler | **11,260** | **11,260** |
| | | |
| RHI Annual subsidy in NI – 804,324 kwh x 6.4 pence per kwh | 51,477 | |
| RHI Annual subsidy in GB - see calculation below * | | 17,762 |
| Annual saving | **40,217** | **6,502** |
| | | |
| Saving over 20 years | 804,340 | 130,040 |
| Initial capital cost to install biomass boiler | 45,000 | 45,000 |
| Profit over 20 years | 759,340 | 85,040 |
| | | |
| Payback time | 1.1 years | 6.9 years |
| Annual rate of return | 90% | 9.5% |

***RHI Calculation – Great Britain**

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Total hours used – 24 hours x 7 days x 52 weeks = 8,736 hours

| | |
|---|---|
| Tier 1 hours: 1,314 hours x 99kw x 93% efficiency = 120,980 at 5.87 pence/kwh = | £7,102 |
| Tier 2 hours: 7,422 hours x 99kw x 93% efficiency = 683,344 at 1.56 pence/kwh = | £10,660 |
| Total RHI subsidy | £17,762 |

**DoF Supply**

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**FROM:** **EMER MORELLI** **cc:** *Copy distribution list below*

**DATE:** **4 October 2016**

**TO:** **STEPHEN MCMURRAY**
**FINANCE DIRECTOR**
**DEPARTMENT FOR THE ECONOMY**

**INDEPENDENT REVIEW OF THE NON-DOMESTIC RENEWABLE HEAT INCENTIVE SCHEME - ADDENDUM**

Thank you for your letter of 3 October in which you requested DoF approval to extend the above mentioned independent review at an estimated cost of £45,000. It is noted that you have consulted CPD who have advised that the existing contract can be extended to facilitate this additional work.

On the basis that the Terms of Reference reflects your Accounting Officer's requirements for the investigation into the Department for the Economy's management and governance of the RHI scheme, I am content to grant DoF approval to this extension of the contract.

The business case sets out very challenging timing for this exercise and, given the complex issues under investigation, it will be important that you ensure the investigation is sufficiently thorough and robust – and commensurate with the cost of the contract extension. You will also wish to ensure the investigation is compliant with the relevant personnel guidance.

As with the previous consultancy approval, please note there is no 10% tolerance on this approval amount, and therefore any proposal to incur expenditure above £295,000 will require further DoF approval.

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**EMER MORELLI**
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**FROM:** **EMER MORELLI** **cc:** *Copy distribution list below*

**DATE:** **X DECEMBER 2016**

**TO:** **STEPHEN MCMURRAY**
**FINANCE DIRECTOR**
**DEPARTMENT FOR THE ECONOMY**

**INDEPENDENT REVIEW OF THE NON-DOMESTIC RENEWABLE HEAT INCENTIVE SCHEME - ADDENDUM**

Thank you for your letter of 1 December in which you requested DoF approval to a further extension of the above consultancy project. It is noted that you have consulted CPD who have advised that the existing contract can be extended to facilitate this additional work.

This is the second extension of the original consultancy project, and the cost has now increased from the original upper limit of £250k (July) to £360,000. We note from the confirmation subsequently provided that you are content that there has been ongoing monitoring of this contract and DfE is satisfied that the project has delivered value for money outcomes to date.

As with the previous consultancy approval, please note there is no 10% tolerance on this approval amount, and therefore any proposal to incur expenditure above £360,000 will require further DoF approval.

In considering this letter, it should also be noted that the standard conditions are applicable and DoF Supply approval is granted subject to the strict adherence to the following conditions:

- 0% tolerance on the approval cost as stated;

- that there are no substantial changes to the scope/scale of the project as described in the business case.

Requests for revised approval will take account of factors such as:

- where Supply is approached on the earliest indication that compliance with one or more of the above conditions is under question; and
- adherence to correct appraisal procedure

Should the request for DoF Supply approval be declined, these factors, along with any other mitigating circumstances will be taken into account when determining the extent of the irregular spend.

DoF does not require a PPE to be submitted for this project however suitable PPE arrangements must be made.

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