



Kieran Donnelly
Comptroller and Auditor General for Northern Ireland and
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Northern Ireland Audit Office
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By post and email: info@niauditoffice.gov.uk

15 June 2017

Dear Sir

Re: The Independent Public Inquiry into the Non Domestic Renewable Heat Incentive (RHI) Scheme
Provision of a Section 21 Notice requiring the provision of evidence in the form of a written statement

I am writing to you in my capacity as Solicitor to the Independent Public Inquiry into the Non Domestic Renewable Heat Incentive (RHI) Scheme (known as 'the RHI Inquiry') which has been set up under the Inquiries Act 2005 ('the Act').

I know that you are aware of the RHI Inquiry's Terms of Reference and of its ongoing work from previous communications which I have had with you. You may also be aware that the Inquiry has begun the process of requiring individuals and organisations who have been, or who may have been, involved in the range of matters which come within the Inquiry's Terms of Reference to provide written evidence to the Inquiry Panel.

As you know, the Inquiry's Terms of Reference specifically require it to take into account, where appropriate, the work of the Northern Ireland Audit Office (NIAO). In this context, it would be of assistance to the Inquiry to have a statement from

you, as the Comptroller and Auditor General for Northern Ireland and Head of the NIAO, especially in light of your previous investigative work in relation to the RHI Scheme in Northern Ireland (and, relatedly, in light of the fact that the Assembly's Public Accounts Committee's investigation in relation to the RHI Scheme was not completed at the time of dissolution of the last Northern Ireland Assembly). In particular, it would be of assistance for you to provide information about the nature and purpose of your involvement; the outcome(s) of your work in relation to the RHI Scheme; and your view, given your unique experience of Government accounts and audit in Northern Ireland, on some of the wider context of the issues arising in respect of the RHI Scheme.

In light of this, and in keeping with the approach we are taking with others, the RHI Inquiry is now issuing to you a Statutory Notice (known as a 'Section 21 Notice') pursuant to its powers to compel the provision of evidence in the form of a written statement in relation to the matters falling within its Terms of Reference.

The Section 21 Notice enclosed with this letter requires you to provide evidence to the RHI Inquiry Panel in the form of a written statement addressing the matters identified in the Schedule to the Section 21 Notice. As the text of the Section 21 Notice explains, you are required by law to comply with it. This should, I hope, allay any concerns you might otherwise have about confidentiality or data protection.

The Schedule to the enclosed Section 21 Notice provides further detail as to the matters which should be covered in the written evidence which is required from you.

Please also bear in mind that, although the RHI Inquiry now has a good working knowledge of the RHI Scheme, Northern Ireland Civil Service administration and government accounting, the witness statement required by the enclosed Notice is likely, in common with others, to be published by the RHI Inquiry in due course (subject to any redactions the RHI Inquiry Chairman considers necessary). It should therefore ideally be written in way which is as accessible as possible in terms of public understanding.

You will also find attached to the Section 21 Notice a Guidance Note explaining the nature of a Section 21 Notice and the procedures that the RHI Inquiry has adopted in relation to such a notice. In particular, you are asked to provide your evidence in the form of the template witness statement which is also enclosed with this correspondence.

Given the tight time-frame within which the RHI Inquiry must operate, the Chairman of the Inquiry would be grateful if you would comply with the requirements of the Section 21 Notice as soon as possible and, in any event, by the date set out for compliance in the Notice itself.

Finally, I would be grateful if you could acknowledge receipt of this correspondence and the enclosed notice by email to Patrick.Butler@rhiinquiry.org.

Please do not hesitate to contact me to discuss any matter arising.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Patrick Butler', with a long horizontal stroke extending to the right.

Patrick Butler

Solicitor to the RHI Inquiry

0289040892

SCHEDULE
[No 286 of 2017]

Background

1. Set out a description of your occupational history, qualifications and experience.
2. Set out a summary of your role as Comptroller and Auditor General for Northern Ireland (CAG) and the role of the Northern Ireland Audit Office (NIAO).
3. Explain how and why you and the NIAO came to be involved in relation to the Non Domestic Renewable Heat Incentive (RHI) Scheme in Northern Ireland ('the Scheme'); and outline the work undertaken by the NIAO in relation to the Scheme.

The NIAO report of June 2016

4. Bearing in mind that the RHI Inquiry has access to your report, please summarise the basis for each of your two reasons for qualifying the Department of Enterprise, Trade and Investment (DETI) Resource Accounts 2015-16.
5. From your investigation, explain how or why you understand the need for Department of Finance and Personnel re-approval for the Scheme funding to have been "overlooked". In the course of your answer, please address the following:
 - a. The role which both the Finance Division and Energy Division in DETI ought to have had in relation to the need for re-approval;

- b. The role which DFP ought to have had in relation to the need for re-approval, including whether there was any obligation on DFP to prompt or remind DETI of this need at any time; and
 - c. When the process of obtaining the re-approval ought to have been begun and by whom;
6. In respect of the weaknesses in control you consider existed in relation to the RHI Scheme, please provide further details of the weaknesses found by your investigation and your concerns about them.
 7. Please also specify what additional controls you would have expected to have been in place.
 8. Provide further details of the estimated costs of running a biomass boiler referred to at paragraph 41 of your report (and the information provided by CAFRE, referred to at footnote 2 at paragraph 41 of your report), including how this estimate was reached and the costs taken into account.
 9. In respect of the suggestion at paragraph 44 of your report, that the potential for unacceptably high rates of return “should have been identified and prevented when the scheme was being designed”, provide further details of how and why you reached this conclusion.
 10. From your investigations, specify when you believe civil servants within DETI (a) did and (b) ought to have realised that (i) the Scheme provided over-incentivisation generally and (ii) created an incentive to generate heat merely for the purpose of earning an income.
 11. Provide a commentary on the actions taken to date by Department for the Economy (DfE) to address the concerns raised in your report and the outcome of the close monitoring to which you referred in paragraph 58 of your report.

Financial implications

12. Set out and explain your assessment of the financial implications of the increase in demand constituting the 'spike' referred to in paragraphs 14 and 47 of your report of June 2016.
13. Give further detail and explanation in relation to the estimated cost to the Northern Ireland Block Grant, if no further action had been taken as at June 2016, of "around £140 million".
14. Without prejudice to the matters referred to in the foregoing two paragraphs, please provide your reasoned assessment of the financial implications of the Scheme for public funds in Northern Ireland (and, in particular, for the Northern Ireland Block Grant) in the following scenarios:
 - a. If the Scheme amendments brought into effect in November 2015 had not taken place and the Scheme had continued, in the form in which it applied as at October 2015, for the remainder of the lifetime of the Scheme.
 - b. If the Scheme amendments brought into effect in November 2015 applied for the remainder of the lifetime of the Scheme but the closure of the Scheme which took effect in February 2016 did not occur.
 - c. If the Scheme amendments brought into effect in November 2015 applied, the closure of the Scheme to new applicants in February 2016 also took effect, and the further tariff changes made in April 2017 (by virtue of the Renewable Heat Incentive Scheme (Amendment) Regulations (Northern Ireland) 2017) applied for one year only, at which point the tariffs reverted to those set out in the November 2015 amendments.
 - d. If the Scheme amendments brought into effect in November 2015 applied, the closure of the Scheme to new applicants in February 2016

also took effect, and the further tariff changes made in April 2017 apply for the remainder of the lifetime of the Scheme.

Please explain any assumptions used in the course of estimating the financial implications addressed above.

More recent work by you/NIAO in relation to the RHI Scheme

15. Explain any further involvement you and/or the NIAO have or have had in relation to the RHI Scheme and any further work you may currently be undertaking in relation to the Scheme, or have completed in relation to it, since your report of June 2016.
16. Set out your conclusions or findings arising out of any further work coming within paragraph 15 above.

Possible wider contributory factors

17. Please explain whether or not, in your view, there are any wider factors which gave rise or contributed to the difficulties with the RHI Scheme, including (but not limited to) matters such as the following:
 - a. Issues of mindset or culture relating to public spending and/or the concept of value for money;
 - b. Issues of the skills base available in the relevant Department or Departments;
 - c. Failure to learn lessons from previous public spending difficulties and/or NIAO reports;
 - d. Failures or weaknesses in the Northern Ireland Civil Service, or relevant Departmental, systems of:

- i. Casework;
- ii. Risk assessment;
- iii. Internal audit; and/or
- iv. Fraud investigation.

Scheme funding

18. Explain your understanding of the funding arrangements for the Scheme, including:
 - a. A description and explanation of how AME and DEL funding operates and the difference between the two funding streams;
 - b. The precise nature of the funding for the RHI Scheme in Northern Ireland;
 - c. Whether the funding for the RHI Scheme was particularly unusual (giving reasons for this); and
 - d. If so, consequently what, if anything, ought to have been done in order to highlight, record or deal with the nature of the Scheme funding.

Departmental Annual Accounts

19. Please explain the purpose of Departmental annual accounts.
20. Provide an explanation of, and commentary upon, the references to the RHI Scheme in the DETI annual accounts for the years ending 31 March 2013 to 31 March 2016 including in particular the following references:
 - a. Item 13 on internal page 68 of the annual accounts for the year ending 31 March 2013 (accounts dated 5 July 2013);

- b. Item 13 on internal page 56 of the annual accounts for the year ending 31 March 2014 (accounts dated 4 July 2014) please address the following questions:
- c. Item 13 on internal page 60, and section 9.3 of the Departmental Resource accounts on internal page 88, of the annual accounts for the year ending 31 March 2015 (accounts dated 3 July 2015); and
- d. Item 13 on internal page 47, and section 9 of the notes to the Departmental Resource accounts on internal page 76, of the annual accounts for the year ending 31 March 2016 (accounts dated 1 July 2016).

In each case, please indicate what you understand to be being communicated in relation to the RHI Scheme by the reference; the significance of the information; and whether you think the reference is appropriate and accurate.

Whistle-blowing and raising of concerns

- 21. Identify any instances of which you are aware of whistle-blowing in relation to the Scheme, or disclosures made in the public interest raising concerns about the Scheme, setting out details of when this occurred, to whom and by whom any relevant disclosure was made and how it was dealt with.
- 22. In particular, provide an account of how you dealt with any disclosures raising concerns about the Scheme made or communicated to you at any time. In relation to each such instance, identify precisely how the concerns were communicated to you.
- 23. From your investigations, indicate whether you consider DETI dealt appropriately with whistle-blowing complaints made to it. Give detailed reasons for your assessment.

General

24. Considering the RHI Inquiry's Terms of Reference, please identify any representations made to you about the RHI Scheme which you regard as significant and about which you consider the RHI Inquiry should be aware. In respect of any such representations please indicate when they occurred, where they occurred, who was involved, and what was said or communicated to you.

25. Considering the RHI Inquiry's Terms of Reference, please identify any conversations or discussions you had about the RHI Scheme which you regard as significant and about which you consider the RHI Inquiry should be aware. In respect of any such conversations or discussions please indicate when they occurred, where they occurred, who was involved, and what was said to you.

26. Provide any further evidence within your knowledge or belief which is relevant to the matters which the RHI Inquiry is investigating as set out in the RHI Inquiry's Terms of Reference.

NOTE:

It is important for the efficiency of the RHI Inquiry that the issues identified above are addressed as fully as possible and by reference, where available, to the dates and locations of specific incidents to which reference is made. The statement should be broken down into paragraphs, which should be numbered sequentially from '1' to the end. The use of appropriate section headings or sub-headings is also encouraged. A template witness statement is provided with this Notice for your assistance and should be used as the format for your response.

INQUIRY INTO THE RENEWABLE HEAT INCENTIVE SCHEME**RHI REF: Notice 286 of 2017****DATE: 27 July 2017*****Witness statement of: Kieran Donnelly, Comptroller and Auditor General for Northern Ireland***

I, Kieran Donnelly, will say as follows:-

Background**Question 1**

1. I have worked in public audit since joining the former Exchequer and Audit Department¹ as a graduate trainee in 1983. I am a member of the Chartered Institute of Public Finance and Accountancy. I have been part of the senior management in the Northern Ireland Audit Office since 1997 and was appointed to the post of Comptroller and Auditor General in September 2009.

Question 2

2. The Comptroller and Auditor General (C&AG) is a corporation sole² and responsible for public audit in Northern Ireland. This has a wide scope, covering the audit of financial statements, regularity, propriety and value for money.³ I, as the Comptroller and Auditor General, and my staff are the external auditors of all Northern Ireland Departments, the Assembly Commission, executive agencies and other central government bodies, including non-departmental public bodies and health and social care bodies.
3. There has been a Comptroller and Auditor General in Northern Ireland since 1921. The Exchequer and Audit Act (Northern Ireland) 1921 established the Exchequer and Audit Department and made provision for the audit of the accounts of the Consolidated Fund, the receipt, custody, and issue of public moneys, and the powers, duties, tenure of office and salary of the Comptroller and Auditor General.
4. The Audit (Northern Ireland) Order 1987 introduced significant changes to modernise public audit and reflect the changes in the role of government. It established the Northern Ireland Audit Office (NIAO), consisting of the office of Comptroller and Auditor General, who is head of that Office and the staff appointed by him under that Order.⁴ The Order made new provision enabling the Comptroller and Auditor General to conduct economy, efficiency and effectiveness examinations in government

¹ The Exchequer and Audit Department became the Northern Ireland Audit Office in 1987

² The Audit (Northern Ireland) Order 1987 schedule 1 paragraph 1. This means that while Northern Ireland Audit Office staff assist in the discharge of my functions, all legal powers, rights and duties are vested in the office of Comptroller and Auditor General

³ The Financial Reporting Council's revised Practice Note 10, Audit of Financial Statements of Public Sector Bodies in the United Kingdom (October 2010) states '*Whereas regularity is concerned with compliance with appropriate authorities, propriety is concerned more with standards of conduct, behaviour and corporate governance. It includes matters such as fairness, integrity, the avoidance of personal profit from public business, even-handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance*'

⁴ 1987 Order article 5

departments and other authorities and bodies. The Order also included provisions designed to strengthen the independence of public audit in Northern Ireland such as the establishment of an Assembly Committee to authorise the Comptroller and Auditor General's estimate and requiring NIAO staff to cease to be civil servants.

5. As Comptroller and Auditor General I am required to audit the financial statements of all Northern Ireland departments and individual public bodies (the 'Auditor' function). I am also is required to authorise the issue of public funds by the Department of Finance from the Northern Ireland Consolidated Fund to departments and others (the 'Comptroller' function).
6. In addition I may carry out audits of particular areas of central government expenditure to establish whether public funds have been used economically, efficiently and effectively – the audits are known as Value for Money audits.
7. I am also a prescribed person for whistle-blower's concerns about the proper conduct of public business, value for money, fraud and corruption in relation to the provision of centrally funded public services and health service bodies.⁵
8. Each year, the Office completes over 150 annual financial audits across the public sector. During the 2011-2016 mandate, the Office published over 70 value for money reports, good practice guides and general reports drawing on its financial audit work, provided support to the Assembly in its scrutiny of the use of public money and dealt with 103 queries from Members of the Legislative Assembly ("MLA") and 271 issues raised by external whistle-blowers.
9. By convention, the Northern Ireland Audit Office has a close relationship with the Public Accounts Committee (PAC) of the Northern Ireland Assembly. This Committee considers my reports and can hold public hearings on the accounts of central government organisations laid in the Assembly although in practice most hearings focus on value for money studies.
10. The Northern Ireland Audit Office currently has 110 staff and is accountable to the Audit Committee of the Northern Ireland Assembly for the Office's expenses. The Audit Committee is required to agree the annual estimate of the use of resources of the Office and lay it before the Assembly and to approve the salary of the Comptroller and Auditor General.

Question 3

11. The issues in relation to the RHI scheme only really began to come to light from October 2015 onwards. My staff attended the Department of Economy, Trade and Investment ("the Department") audit committee meeting in October 2015 and have told me that it was clear that RHI was becoming a big issue in the run up to closing the scheme. It was clear from the discussion at that Audit Committee that there were beginning to be serious concerns about the funding of the scheme, which was in

⁵ Public Interest Disclosure (Prescribed Persons) Order (Northern Ireland) 1999

excess of the original budgets, and in particular how much of the cost would be covered by Treasury. The Department were unclear at the extent of the costs of the scheme as people were still applying to be part of the scheme (the original scheme had not closed) and there was still a view among senior staff that additional funding would, in all likelihood, be made available from Treasury to meet the costs.

12. On 17 December 2015, as part of planning the 2015-16 audit of the Department's Resource account, my audit team (Tomas Wilkinson, Brian O'Neill and Pauric Higgins) met with Trevor Cooper (finance director) and other departmental staff (Iain McFarlane and David Conliffe). I have seen a copy of our minutes of this meeting which record that as part of the meeting the non-domestic RHI scheme was discussed. Trevor Cooper raised two main issues on RHI:
 - (i) The Department was seeking retrospective approval for £17.7m expenditure incurred in the period 01/04/15 to 26/10/15 when it did not have approval for the scheme from the Department for Finance and Personnel (DFP). This was because the requirement for approval had been overlooked.
 - (ii) It was now likely that the total cost over the life of the scheme would significantly exceed the amount of Annually Managed Expenditure (AME) provided from GB. It had always been assumed by the Department that the amount of AME would be largely unlimited but in fact it had now been made clear that it was being limited to a percentage share of the funding to the GB department. As a result the commitments made over twenty years would exceed the amount of AME – even at that stage ballpark figures of around £20million a year were mentioned, although this wouldn't start to impact until 2016-17.
13. In January 2016, the Office of the First and 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. I also received a copy of this letter at this time from OFMDFM.
14. On 19 January 2016 DFP wrote to me to confirm that it had told the Department that it would not give retrospective approval for the applications approved between April and October 2015 as the scheme was not approved by them during this time. This meant that any spending on these applications would be irregular, now and also in the future.
15. I was also approached in early February 2016 by a member of the Assembly's Enterprise and Trade committee, Conor Murphy MLA, who asked if I was aware of the issues surrounding RHI and sought assurance that this would be an area I would be examining.
16. At this stage it was clear that this was a very serious issue that we would have to investigate thoroughly. There were two main ways we could have progressed this work. One was by a full scale Value for Money ("VFM") study. This would have involved a full detailed investigation into all aspects of the RHI scheme from its inception and would have sought to investigate the reasons behind the overspend of the scheme and

the other allegations now coming forward about abuse of the scheme. This report would have been published and subject to Public Accounts Committee scrutiny once complete. However, typically VFM studies take at least a year to complete and publish and in this case the complexities which were apparent even at this early stage could take longer. I considered that the gravity of the issues meant that it was necessary to publish the key facts much sooner with the potential of a more detailed report at a later date. Therefore I decided in February 2016 to publish a report accompanying the annual accounts which would contain as much information as possible in a factual way and allow for the issues to be made public and subsequently considered by the Public Accounts Committee (“PAC”) at the earliest opportunity.

17. In March and April 2016 my staff commenced work on the report. The work included:
 - (i) The potential cost of the scheme over coming years compared to likely funding available from Treasury. This had to be discussed and prepared by the Department and reviewed by us;
 - (ii) The background to the scheme – business cases, consultant’s reports;
 - (iii) A trawl of information available including online information such as installer websites;
 - (iv) Our own calculations as to the profitability of the scheme under certain scenarios; and
 - (v) Review of the Department’s controls over spending on the scheme, including its interaction with the Office of Gas and Electricity Markets (Ofgem).
18. Our work resulted in a first draft of the report being discussed with the Department in mid-May and then being subject to several revisions as clarifications and more information was received culminating in our final report in June 2016.
19. There had been Assembly elections in May 2016 and at one of the first meetings of the new PAC I was due to present a briefing on potential upcoming reports that could be considered at future sessions of the Committee. Although my report on RHI had not been completed or published by the briefing session on 8 June 2016 I decided that the Committee should receive a full briefing on emerging findings. The Committee agreed that this was a very important matter and asked that it was fast-tracked into their programme of work commencing after the summer recess.
20. From September 2016 to January 2017 we assisted PAC in their inquiries into RHI which included seven evidence sessions.
21. In June 2017 we published a report on RHI, attached to the 2016-17 accounts, providing an update on the information we had provided the previous year.

The NIAO report of June 2016**Question 4**

22. As part of my audits of accounts, I am required to give two opinions – whether the financial statements give a true and fair view and also a regularity opinion. The true and fair view opinion is the same as the audit opinion relating to all accounts in both the public and private sectors and basically confirms that the accounts are free from material misstatements and faithfully represent the financial performance and position of the entity.
23. The regularity opinion is an opinion which is exclusive to public sector audit and requires that I report on whether in all material respects the expenditure and income of the entity:
- (i) have been used for the intentions of the Northern Ireland Assembly when it granted the money; and
 - (ii) have been incurred in accordance with the rules governing the spending of that money.
24. In the 2015-16 and 2016-17 audits of the Department's Resource Accounts my true and fair view opinion has been unqualified. However I qualified my regularity audit opinion for two reasons:
- (i) Firstly, I was of the opinion that the Department was unable to demonstrate that its controls over spending on the non-domestic RHI scheme were adequate to prevent or detect abuse of the scheme. In coming to this opinion I considered the range of evidence including the lack of physical inspections, the apparent abdication of responsibility to Ofgem, the susceptibility of the scheme to fraud and abuse and the emerging whistle-blower allegations. Because of this, I did not have enough evidence to satisfy myself that the expenditure on the scheme had been applied for the purposes intended by the NI Assembly.
 - (ii) Secondly, included within this expenditure is an amount on which retrospective approval had not been granted by the DFP. This was for applications approved in the period from April 2015 to October 2015 when DFP had not given approval for the scheme. Consequently any spending on these applications did not have DFP approval and therefore did not conform to the rules which govern public expenditure and I qualified my regularity audit opinion in this regard.

Question 5

25. As part of the preparation of my report in June 2016, I asked the Department to provide a response to various questions. In response to a query about why the Department failed to seek approval from DFP to continue the Scheme before the original approval expired the Department told me this was the result of a combination of staff changes and an administrative oversight⁶. It also told me that key information was not passed on from departing staff to their successors and the necessary administrative

⁶ Report by the C&AG on the Department's resource accounts 2015-16, paragraph 11.

arrangements required to trigger an application for re-approval were not in place and that a lack of effective project management also resulted in a failure to recognise the expiry of approval.

26. Other key points of interest to the Inquiry are:

- a. Finance Division would normally have had the lead responsibility for obtaining re-approval, but the Energy Division in the Department should also have been aware of the need for re-approval. Therefore in my opinion both bear responsibility for the failure to submit an application in good time. There should have been a system in place to ensure that the requirement to get re-approval was highlighted in advance.
- b. DFP's correspondence with the Department was clear that the approval for the scheme expired on 31 March 2015. DFP were under no obligation to prompt or remind the Department in relation to the need for re-approval to continue the Scheme after 31 March 2015 – it is up to the spending Department to make the application.
- c. The responsibility of obtaining approval to extend the Scheme ought to have been begun by the Department in accordance with the terms of the original letter of approval from DFP sent to the Department on 27 April 2012. The letter explicitly stated that approval was only given for the period 1 July 2012 to 31 March 2015 and that any decision to continue the Scheme beyond 2015 would require further/separate DFP approval. The letter of approval did not contain any specific guidance about when the application for re-approval should be submitted, however, given that an application for re-approval could be expected to contain a review of the Scheme to date, an up-to-date business case and economic appraisal, then the Department would have realistically needed to begin preparing the application several months prior to the 31 March 2015 deadline. For example, the original submission from the Department took slightly over two months to gain approval from DFP – this would suggest that the Department should have submitted their application for re-approval in January 2015 at the latest.

Question 6

27. In the report I identified various weaknesses in the scheme, in that it:

- (i) 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;
- (ii) did not take the opportunity in 2013 to mirror the GB scheme and introduce some cost control measures at that time;
- (iii) did not take account of changes to underlying costs since 2012 and therefore was over-generous in incentivising renewable heat;
- (iv) couldn't be changed quickly when it became apparent that demand was rising quickly;

- (v) 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;
 - (vi) has at least facilitated the possibility of funding that is at best not in line with the spirit of the scheme and at worst possibly fraudulent;
 - (vii) was not properly monitored and controlled by the Department who solely relied on the work being done by OFGEM; and
 - (viii) did not identify the risks of overspending at an earlier stage even though AME allocations had been previously advised.
28. These weaknesses had, or potentially could have, resulted in unnecessarily generous payments to all applicants, abuse of the Scheme by applicants and a significant risk to the Scheme's budget, and by extension the Departmental budget and Northern Ireland Block Grant.
29. Unlike the Scheme in GB, there were no **cost controls** in place to either discourage heat waste or limit the overall spend on the Scheme prior to November 2015. The principal weaknesses in this area were
- (i) Tiering of payments, introducing a reduced rate after heating equipment had been used for a set period of time would have discouraged heat waste by essentially acting as a cap on usage. The failure to introduce this meant that a key control was not in place;
 - (ii) Degression was a mechanism brought in in GB (introduced April 2013) to amend the tariff paid to applicants in response to changes in demand. This system ensured that the scheme was regularly reviewed to ensure it remained affordable. Between 2012 and 2015 the tariff rates paid in GB fell by around 50% while over the same period in NI the rates actually increased. The Minister of State in the Department of Energy and Climate Change wrote to the Minister in the Department on 29 November 2013 outlining the changes to the GB scheme to control costs, including the introduction of degression. However the Department decided not to legislate for the degression mechanism as its priority at that time was to find ways to increase demand. Once demand started to increase sharply then the Department was unable to react quickly because of legislative restraints.
30. I was also concerned about the weakness of the Scheme's **operational controls**. The concerns included:
- (i) When applications were made to the scheme through Ofgem the approval process was purely desk based with no physical inspections taking place at that time;
 - (ii) Once installations have been established and have commenced operation then Ofgem will include them within the overall pool of completed installations from which they draw a sample for a detailed physical inspection. However the numbers inspected, particularly prior to 2017, were very small;

- (iii) When issues were identified by Ofgem there appeared to be little done to resolve the issue – applicants were sometimes suspended but not removed from the scheme (2 applications were however revoked in 2017);
- (iv) In 2015-16 the Department was not provided with any detail of issues being identified by Ofgem; in fact until September 2016 the Department did not know the names/addresses of the applicants to the scheme as these were all held by Ofgem; and
- (v) A further important control was that Ofgem would query any increase in hours of use over 25% higher than the original application – however it was unclear that Ofgem would challenge explanations received.

31. Finally the weakness of the operational controls put in place by Ofgem was exacerbated by poor **management controls** at departmental level. There was a lack of engagement by the Department, whose officials seemed content to leave monitoring of the Scheme almost entirely to Ofgem. Prior to November 2015, there is no evidence to indicate that the Department had sufficient oversight of Ofgem’s work in order to ascertain that the Scheme was being appropriately administered or that compliance issues were being properly addressed. Despite receiving weekly reports from Ofgem, the Department remained poorly informed about important aspects of the Scheme. For example, the Department was not provided with any detail relating to the few applications in which Ofgem had identified compliance issues, nor was it aware to whom payments were being made and how many of the applicants were claiming for multiple boilers. The Scheme was not represented in the Department’s risk register, there was not a senior project manager in place with responsibility for the Scheme, nor was a formal project management framework used. Such arrangements would have mitigated the loss of organisational knowledge caused by the high turnover of staff in the Energy Division that contributed to missed deadlines.

Question 7

32. My report found that the controls that should have been in place would have been those which would have addressed the weaknesses above including:
- (i) Tiering of rates;
 - (ii) Degression;
 - (iii) A greater level of inspection, both at application stage and during the operation of the boilers;
 - (iv) More hands-on control by the Department so that they would have been aware of issues as they happened;
 - (v) More knowledge by the Department of the scheme and of its benefits/profitability;
 - (vi) Stronger project management arrangements including a senior responsible officer and risk register;

- (vii) Better built in controls to the scheme e.g. the regulations were too vague in certain areas such as what constituted an eligible use of heat etc;
- (viii) A mechanism to require pre-approval before installation of boilers would have allowed the Department to ensure affordability before allowing installation to take place; and
- (ix) Regular reviews of the regulations for the scheme should have been undertaken.

Question 8

33. The estimated cost of running a biomass boiler at around 4.01 pence per kWh was provided by the Department and based on experience of the use of wood fired boilers by the College of Agriculture, Food and Rural Enterprise (CAFRE). We accepted the figures as reasonable. The figure was broken down as outlined in Table 1 below:

Table 1: Cost of running a biomass boiler

	Pence/kwh
Pellet cost (based on £150/tonne and assuming 4,800kw/tonne at 92% efficiency)	3.36
Average increased use of electric (based on electric rate 12p/kwh)	0.30
Average boiler servicing cost	0.25
Average remedial repairs	0.10
Total cost	4.01 pence/kwh

Source: Department and Annex A of 2015-16 C&AG Report

Question 9

34. I concluded that the potential for unacceptably high rates of return should have been identified and prevented when the Scheme in Northern Ireland was being designed, because that potential was a direct consequence of the flawed design of the Scheme. The unacceptably high rates of return for claimants are directly related to the tariff rates offered to them and the fact that there was no upper limit on what could be claimed. Consequently, the importance of setting an appropriate tariff rate and enabling that rate to be easily adjusted as future demand changed were critical issues that should have been understood and addressed during the design of the Scheme.
35. When the scheme was being established, it should have been identified that the tariff being proposed was higher than the cost of fuel and therefore there would be an incentive to continue to burn fuel just to claim additional subsidy. This should have shown the need for tiering of the rate and should have been identified by both the consultants and in the preparation of business cases.
36. The preparation of business cases and any economic analysis should have involved looking at a number of scenarios and also sensitivity analysis to see if higher usage rates increased returns. Instead it appears that only one usage rate assumption (20% i.e. 33.6 hours per week) was used to show that this gave a return around 12% but no further analysis was done.

Question 10

37. When we first presented the draft findings of our report to officials in middle management at the Department (Stuart Wightman, Alison Clydesdale and Seamus Hughes) in early May 2016 it seemed to us that there was little surprise at the findings relating to over-incentivisation under the scheme. It appeared that officials at this level had been aware of the issues surrounding the lack of tiering for some time although they appeared a little surprised at the extent of profits to be made under the scheme.
38. At more senior levels it is unclear when they became aware of the issues. At audit committees in the first part of 2016 the focus from top management was on cost control and the fact that degression had not been introduced. The lack of tiering and excessive returns was not mentioned.
39. At the Department's audit committee in April 2016 one of my staff (Tomas Wilkinson) who attended recalls mentioning the lack of tiering but being told by Andrew McCormick that it was in fact the lack of degression that was the main issue. At the same meeting he recalls it also being mentioned by John Mills (Grade 5 in Energy branch) that even if returns had been excessive the key point was that the money had been available from GB and if the scheme had not been taken up then there would have been a loss of income to NI as a whole. Therefore the returns had to be high to stimulate the demand which for most of the scheme was low. Andrew McCormick corrected John Mills by saying that value for money was of paramount importance.
40. Andrew McCormick has said at PAC (28 September 2016) that the first time the excessive return and incentive to create unnecessary heat became clear to him was when he saw our report in May 2016. In particular he said that the fact that the subsidy rate being paid per unit of heat was higher than the cost of the fuel used to create the heat was not known to him until that point.
41. In terms of when officials ought to have known about the over-incentivisation and the potential to generate heat just to get an income, in my opinion there were a number of opportunities:
- (i) At the start of the process when the second business plan was prepared in February / March 2012 using the post consultation figures provided by the consultants it was clear that the subsidy rate was now more than the cost of producing the heat but the same sentence from the original business plan was again repeated – that there was no need for tiering as the cost of fuel to create heat was more than the subsidy for that heat. This was plainly incorrect and if it had have been identified at that stage then corrective action might have been taken.
 - (ii) The calculations in 2012 and 2013 as to what might represent a reasonable return were based on a utilisation rate of around 20% - at these levels a reasonable rate of return of 12% was achievable. However the calculations did not look at how the rate of return would vary at higher levels of usage – this was critical as if they had done then it would have identified the excessive returns at higher levels.
 - (iii) The emails from the whistle-blower from September 2013 until 2015 clearly indicate the issues regarding over incentivisation and creating the incentive to produce heat just to generate an income. The emails suggest the response from

some staff was a disbelief that people would do that (waste heat to generate income).

- (iv) If the business plan to DFP had been prepared properly at the right time (March 2015) it is possible it may have identified the issues and they could therefore have been addressed before the big increase in demand later that year.
- (v) Officials should have been more in touch with the market for renewable heat – installers and applicants were well aware of the returns to be achieved. There is some evidence that returns available were available on suppliers' websites.

Question 11

- 42. Paragraph 58 of my 2015-16 report states "I would expect the Department to ensure any recommendations are acted upon and any necessary action is taken. I will closely monitor the outcomes of the reviews instigated by the Department."
- 43. The report I appended to the Department's 2016-17 Resource Accounts provides both a comprehensive commentary on the actions taken by the Department in response to the concerns raised in my original report and also details the outcome of my close monitoring of the reviews instigated by the Department. To briefly summarise:
 - (i) From 1 April 2017 the Department has extended the tiered rate that applied to applications post 18 November 2015 (i.e. after the spike) to apply to all users of the scheme. This is for one year only but has the possibility of being extended. This has significantly reduced the returns from the scheme, especially to users with higher heat outputs. The projected cost of the scheme in 2017-18 has been considerably reduced – the Department estimate the cost of the scheme to the NI block grant in 2017-18 is projected to reduce to £2 million compared to £30 million at the time of my report last year.
 - (ii) The Department engaged PricewaterhouseCoopers (PwC) on 29 July 2016 to carry out a review of 295 installations. This review found issues with more than half of these installations and details in respect of some of these have been passed to Ofgem.
 - (iii) PwC also concluded that the control framework fell short of that required to effectively manage the risks posed by the NI Scheme identifying various weaknesses in the operational controls and that the Northern Ireland Scheme mirrored the GB Scheme, but for the critical omissions of a tiered tariff to discourage heat waste and the absence of a suspension or degression mechanism to act as a cost control.
 - (iv) The Department also engaged PwC in the autumn of 2016 to undertake a review of the actions by departmental staff over several years in the establishment and operation of the scheme. This review took place for some months but had to stop before a report was completed when the Inquiry was established.
 - (v) A task force was established within the Department in January 2017 made up of 20 full time staff with expertise in a range of issues to try to deal with issues including the new 2017-18 regulations, longer term regulations, enforcement and 100% inspection. Its purpose is to bring the scheme back in line with policy, budgetary and governance arrangements.

- (vi) New procedures have been put in place with Ofgem to ensure there is regular engagement and communication. Also the number of inspections by Ofgem has been increased, although they are still at a relatively low level.
- (vii) The Department has published details of almost all recipients of RHI grants.
- (viii) The Department had intended to procure a suitably qualified independent external organisation to undertake a detailed on-site inspection of all non-domestic RHI installations. This review had been expected to start in early summer 2017. However the initial procurement process has not been successful. The Department has now decided that a pilot programme of inspections in partnership with Ofgem should be undertaken. It is still considering the extent of this pilot programme which is expected to take place in the second half of 2017.

Financial implications

Question 12

44. In the immediate period prior to the change in the scheme regulations on 18 November 2015 there was a huge increase in demand. From September 2015 to 17 November 2015, 980 applications were received to the scheme. The estimated costs of these are set out in Table 2 below.

Table 2: Number of applications from September 2015 to 17 November 2015

	Number of applications	Annual cost	Cost over 20 years
		£million	£million
September 2015	99	2.3	47
October 2015	429	10.9	250
to 17 November 2015	452	11.5	235
Total	980	24.7	532

Source: Department

45. The costs associated with applications in this particular period are therefore projected at £24.7 million per year and a 20 year cost of around £532 million. These projections are based on a number of assumptions:
- (i) The costs are based on the regulations in place in 2016-17 as opposed to the revised regulations for 2017-18. If these were used then costs would be reduced significantly;
 - (ii) Projections for heat generated in the future are based on figures from the Department in June 2016; experience since then may change those projections if they were updated now;
 - (iii) A dropout rate has not been included; and
 - (iv) An inflation rate of 1.6% has been assumed in relation to the 20 year cost.

Question 13

46. The estimated cost to the block grant over the five years to 2020-21 was set out in Table 8 of my report on the 2015-16 accounts and was based on figures provided to

my audit team by the Department. The total cost figure in the table is the total cost of all RHI payments based on projected usages (calculated by the Department based on information available at the time, the tariff rates available at the time, allowing for inflation and assuming no dropout rate).

47. Against these figures is the amount projected to be provided by HM Treasury as a percentage of the allocation for RHI in GB – allocated as Annually Managed Expenditure (AME). This was projected by the Department based on the latest information in June 2016 and published government figures. It was not considered prudent to extend the projections beyond 2021 as the figures would become too uncertain.
48. The table from our report in 2016-17 is reproduced below:

Table 3: Projected deficit in AME funding from 2016-17 to 2020-21

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

Source: Department (June 2016) and C&AG report July 2016

49. The difference between the total cost and the amount provided in AME i.e. the deficit in the table above, has to be met out of Northern Ireland budgets and was estimated at £140 million over this 5 year period.

Question 14

50. I set out below my reasoned assessment of the financial implications of the Scheme for public funds in Northern Ireland (and in particular for the Northern Ireland Block Grant) in a number of hypothetical scenarios to assist the Inquiry:
- If the scheme had not been amended in November 2015 it seems reasonable to assume that while significant numbers would have applied to the scheme there would not have been as pronounced a 'spike' as occurred around that time as applications would have been spread over a slightly longer time period. However there is evidence that there was considerable awareness in a number of sectors of the financial benefits of the scheme and it is very likely that demand would have continued to rise considerably and would very quickly have had a huge impact on the NI budget and would have become clearly unaffordable if it had been allowed to continue.
 - If the scheme had remained open, and the closure in February 2016 had not occurred then it is likely that there would have been additional applications to the scheme after February 2016 which would have increased the cost to the NI block grant beyond the amounts shown in the table at paragraph 13. It is impossible to predict exactly how many might have applied to the scheme post February 2016 and therefore to project this with any accuracy.

- c. If the Scheme amendments brought into effect in November 2015 applied, the closure of the Scheme to new applicants in February 2016 also took effect, and the further tariff changes made in April 2017 applied for one year only, at which point the tariff reverted to those set out in the November 2015 amendments, then the savings in 2017-18 would be one year savings only and the figures post 2017-18 would revert to the figures we previously reported (based on Departmental projections). In this scenario the outturn would be projected at Table 4 below:

Table 4: Financial projections if tariff changes in April 2017 were for one year only

	16-17	17-18	18-19	19-20	20-21	Total
	£'000	£'000	£'000	£'000	£'000	£'000
	Actual	Projected	Projected	Projected	Projected	Projected
Total cost	45,000	24,000	54,800	55,700	56,600	236,100
AME allocation	18,000	22,000	25,700	28,900	34,300	128,900
Deficit	(27,000)	(2,000)	(29,100)	(26,800)	(22,300)	(107,200)

Source: Department

The deficit to be met from the NI budget would continue until the closure of the scheme in 2036-37. This is based on the assumptions by the Department in June 2016 i.e. the usage rate up to that point continuing, no drop-out rate, 1.6% inflation and assumptions about movements in AME.

- d. If the Scheme amendments brought into effect in November 2015 applied, the closure of the Scheme to new applicants in February 2016 also took effect, and the further tariff charges made in April 2017 apply for the remainder of the Scheme, then based on the projected cost under the new rates in 2017 and inflation increases of 1.6% the amount to be funded from the NI budget would be projected to disappear from 2018-19 as the cost would be met in full from the AME allocation. This is shown in Table 5 below:

Table 5: Financial projections if tariff changes in April 2017 apply for the remainder of the scheme

	16-17	17-18	18-19	19-20	20-21	Total
	£'000	£'000	£'000	£'000	£'000	£'000
	Actual	Projected	Projected	Projected	Projected	Projected
Total cost	45,000	24,000	24,384	24,774	25,170	143,328
AME allocation	18,000	22,000	24,384	24,774	25,170	114,328
Deficit	(27,000)	(2,000)	-	-	-	(29,000)

Source: Department/NIAO calculations

This is based on the Departmental projections in June 2017 (and used in my 2016-17 report on the Department for the Economy accounts). There would continue to be no deficit until 2036-37. In fact under this scenario, there would be unused AME funding available for the scheme.

More recent work by me/NIAO in relation to the RHI Scheme**Question 15**

51. Since my report of June 2016 I and my team have provided support and briefing for seven PAC hearings from September 2016 – January 2017, where my report findings were considered.
52. I have also audited the 2016-17 Department for the Economy Resource Accounts and again qualified my audit opinion in relation to the non-domestic RHI scheme and attached a report to these accounts which provided an update on the important issues relating to the scheme.
53. As part of my 2016-17 audit, my staff met and discussed the scheme with the RHI Taskforce team, tested a number of applications and subsequent RHI grant payment and ensured the accounts contained sufficient disclosure in relation to the scheme.

Question 16

54. My report attached to the 2016-17 DfE Resource accounts (<https://www.niauditoffice.gov.uk/sites/niao/files/media-files/CAG%20Report%202016-17%20Final.pdf>) provides an update on the important issues arising since last year.
55. My audit qualifications relating to RHI in 2016-17 are the same as in 2015-16. The first qualification again relates to costs incurred on the 788 applications to the scheme approved in the period from April to October 2015 when there was no DFP approval in place. In 2016-17 expenditure on these applications amounted to £18.8 million and because these applications were accepted during a period in which there was no DFP approval, the total expenditure in relation to them continues to be irregular.
56. On the second RHI qualification issue, as was the case last year, I did not consider that the systems in place to prevent or detect abuse of the scheme were adequate and was unable to obtain enough evidence to be assured that expenditure on the non-domestic RHI scheme amounting to £42.3 million in 2016-17 had been incurred for the purposes intended by the Assembly.
57. My report provided updates in relation to total costs in 2016-17, the PwC report relating to physical inspections of 295 boilers, the use of multiple boilers, excessive returns achieved during 2016-17, changes in arrangements with Ofgem, progress in setting up 100 per cent inspections, the significant impact of tariff changes on behaviour and the financial impact of changes in tariff rates in 2017-18.

Possible wider contributory factors**Question 17**

58.
 - a. In my opinion there were a number of factors which contributed to the difficulties in the RHI scheme:
 - (i) Groupthink – there were a number of areas in which there was evidence of decisions being made as a group and a lack of challenge. This included

the confusion over whether there was unlimited AME being allowed to go unchallenged for a considerable time in the Department, despite there being evidence to the contrary⁷;

- (ii) A belief that getting the money available for the scheme actually spent and meeting renewables targets was of paramount importance rather than value for money [see comment made at Audit committee set out in answer to Question 10];
 - (iii) A lot of the effort by staff was in the establishment of the scheme. Once established the operation of the scheme was largely left to Ofgem while the energy team focussed on the establishment of a domestic RHI scheme. Consequently issues such as the need for a review of the scheme and degradation were not addressed.
 - (iv) Failure to use well established procedures to manage risk. In fact in this case the risk was not identified and therefore was not managed.
 - (v) Similar issues have surfaced in the department in the past e.g. in its Report on the Bioscience and Technology Institute in 2012 the PAC identified poor project management, the lack of proper risk identification and a failure of leadership. In the Bytel project report in 2015, which also related to DETI, similar failings were again found around poor project management, a lack of technical expertise and a need to change the culture within DETI. In particular it was noted that the Bytel issue might not have come to light had it not been for the actions of whistle-blowers.
- b. There appears to be a lack of commercial sense and scepticism which could have looked at how the scheme might be abused and sought to have controls in place to prevent that. This sense of naivety is demonstrated by the whistle-blower's comment in her email on 9 June 2014 to Laura McCoy and Fiona Hepper where she said that the flat rate (i.e. without tiering) meant that there was no incentive to be efficient with heat and there were buildings with heat on all year round with the windows open but that "you did not believe that people would do this". There was also a lack of technical skills within the Department to properly understand the scheme and to monitor it once it had been established.
- c. As referred to above, many of the underlying concerns giving rise to the problems with RHI had already been well rehearsed in the previous reports from PAC and NIAO on Bytel in 2015 and the Bioscience and Technology institute in 2012. At the PAC session of 9 November 2016 the Chair of PAC read out extracts from the PAC report on Bytel and it was clear that many of the conclusions from that report in 2015 could equally apply to RHI. These issues included:
- (i) poor project management;

⁷ As set out in paragraphs 63 and 64 below

- (ii) disregard for value for money;
 - (iii) inadequate responses to whistle-blower allegations;
 - (iv) flawed design of scheme;
 - (v) lack of technical expertise; and
 - (vi) poor governance arrangements.
- d.
- (i) I have no particular comments to make in respect of failures in casework systems.
 - (ii) In the NICS generally risk management has improved considerably in recent years and is largely embedded. However, where we have identified problems is in situations where either well established procedures have been set aside or the risk fails to be identified. In this case no specific risks had been identified in relation to RHI. This was despite the fact that although spending may have been relatively low in the first few years considerable commitments were being built up. In particular the risk of overspending was not identified and therefore was not managed. This has not been adequately explained and the risk may have been thought not to exist because of the mistaken belief of unlimited AME. A proper risk analysis should also have identified risks of potential abuses as well as the risk of over incentivisation.
 - (iii) Internal audit will typically set up their work to look at areas of higher expenditure and higher risk. There was no specific risk for RHI and spending in the initial years was not high so therefore it was not identified as a priority for review. In hindsight the potential costs of the scheme and the commitments that were being built up should have triggered a review. When the issue was eventually identified a full Internal Audit investigation was done on RHI which reported in Summer 2016 with an unacceptable result and identifying similar results to our work.
 - (iv) Within the NICS generally there have been issues relating to the investigation of fraud generally and there have been several recommendations made by PAC. In response to this a central fraud investigation unit has been established in DFP which now has specialists who can carry out investigations. The success of this approach is difficult to assess at this early stage in the unit. In relation to this specific case the Department was slow to react and deal with whistle-blowers who initially came forward. Investigations have been hampered by lax regulations which have meant that it is difficult to identify and prove fraud.

Scheme funding**Question 18a**

59. One of the main ways of classifying public expenditure in Northern Ireland (and across the UK) is to divide it into either **Delegated Expenditure Limit (DEL)** or **Annually Managed Expenditure (AME)**.
60. **DEL** funding relates to day-to-day running costs and expenses for government bodies – that is spending that can be controlled by government (and therefore budgeted for), rather than spending which is demand-led (and therefore can only be estimated). It is allocated to the Assembly on the basis that the funds are not linked to a specific purpose and the devolved administration can manage the fund as it sees fit. DEL funding is normally set for multi-year periods as part of Spending Reviews and in total is known as the Block Grant. Changes in the level of the Block Grant which makes up DEL funding are determined using the non-statutory Barnett formula. DEL funding can be spent on the running of services that the Assembly oversees such as schools or hospitals, as well as the everyday cost of resources such as staff.
61. **AME** funding is used to meet the costs of items that are essentially demand-led and therefore unpredictable, cannot be constrained in advance and are not easily controlled, such as welfare payments, tax credits or public sector pensions. Consequently, levels of AME spending are normally forecast rather than strictly budgeted amounts. For most categories of AME spending, HM Treasury provides the amount required to fulfil defined policies and obligations (e.g. social security benefits), and the budget provided is adjusted annually (up or down) without affecting the Northern Ireland block grant – in essence the risk of the amounts required exceeding the budget is borne by HM Treasury, not the NI Executive.

Question 18b

62. The RHI scheme has been demand led from the beginning and was intended to be funded as AME. However, as set out below, in the case of the RHI scheme in Northern Ireland there was a limit to the amount of AME funding that would be paid from HM Treasury, though there was some confusion within the Department as to how this would be applied⁸. It was later clarified (in the January 2014 letter referred to below) 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.
63. The first indications that this was not normal AME was in April 2011. In an email on 15 April 2011 from Jon Parker in HM Treasury to Alison Clydesdale in the Department, officials stated that RHI spending was not being treated as standard AME, where the Exchequer takes on all risks of overspend, but instead there would be a risk-sharing arrangement. The email pointed out that the NI share of funding would be around 3 per cent of the GB funding and if RHI spending in one year exceeded the profile set in

⁸ Andrew McCormick evidence to PAC 28 September 2016, page 20

the Spending Review, then the Department would need to repay this in future years and would incur a Departmental Expenditure Limit (DEL) penalty likely to be of the order of 5 per cent. This informal information was not confirmed by HM Treasury at that time. However, departmental officials (Alison Clydesdale and Peter Hutchinson), 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.

64. A more definitive note of the budgetary position was in a letter from the Minister of State in the Department of Energy and Climate Change (DECC) on 7 January 2014 to the minister for the Department which set out that the NI allocation of AME funding would be based on a Barnett formula share (3 per cent) of the GB RHI budget.
65. I am not aware of any other grant incentive scheme in Northern Ireland which is funded under comparable risk-sharing arrangements from AME funds.
66. There should have been proper cost controls from the beginning to ensure that if applications started to increase more than expected the scheme could be stopped or amended quickly. Somehow the myth had spread within the Department that the amount of AME was unlimited and therefore this was not such a concern⁹. Degression would have been the key cost control, but tiering of rates and a facility to suspend the scheme at short notice would also have helped.

Departmental Annual Accounts

Question 19

67. The purpose of Departmental annual accounts is to present a clear picture of the Department's aims, activities, functions and performance, linking performance delivered over the past year with expenditure during the same period. It is through this mechanism that each department demonstrates how much of its voted resources it has used, what it has used its resources for and explains the outcomes it has achieved with them. Department annual accounts consist of two parts – the Annual Report and Financial Statements.
68. The Annual Report outlines the performance of the Department during the year and consists of the Performance Report, Governance Statement, Directors' Report, Remuneration and Staff Report and Audit and Accountability Report.
69. The financial statements outline the financial performance of the Department during the year and consist of numerous statements and notes which show how the money voted to a Department has been spent and what assets and liabilities are held at the end of each reporting period.

⁹ Andrew McCormick evidence to PAC 28 September 2016, page 37

Question 20

70. To assist the Inquiry, I provide a commentary below on certain references to the RHI Scheme in the Department's annual accounts for the years ending 31 March 2013 to 31 March 2016. In each of the cases the figures and comments have been subject to audit in the relevant year and I believe that the information is still appropriate and accurate:

- a. Item 13 on page 68 of the annual accounts for the year ending 31 March 2013 (accounts dated 5 July 2013) - The Department had estimated that in 2012-13, expenditure on the RHI scheme would be £1,500,000. Actual expenditure incurred on the scheme during 2012-13 only amounted to £470,000.

Page 69 of these accounts refers to the fact that there was a lower than anticipated uptake resulting in a difference of £1,030,000 between the estimate and the outturn.

- b. Item 13 in page 56 of the annual accounts for the year ending 31 March 2014 (accounts dated 4 July 2014) - The Department had estimated that in 2013-14, expenditure on the RHI scheme would be £1,650,000. Actual expenditure incurred on the scheme during 2013-14 amounted to £1,650,000.

- c. Item 13 on page 60, and section 9.3 of the Departmental Resource accounts on page 88, of the annual accounts for the year ending 31 March 2015 (accounts dated 3 July 2015) - Page 60 outlines that the Department had estimated that in 2014-15, expenditure on the RHI scheme would be £5,768,000. Actual expenditure incurred on the scheme during 2014-15 was £2,157,000 more than what the Department had originally estimated and amounted to £7,925,000. Page 61 outlines that demand for grants provided through the Renewable Heat Incentive Scheme exceeded what was originally forecast in year. Page 88 – this refers to the future financial obligations at 31 March 2015 of £198.8 million that the Department must meet in relation to the Renewable Heat Incentive Scheme. It states that these amounts are guaranteed for the duration of the scheme and the commitments will be funded from Annually Managed Expenditure. This was still fair to say as the commitment at this stage could still have been managed within NI's share of the AME pot going forward. In preparing these accounts for the year ended 31 March 2015, the Department re-assessed what the commitment at 31 March 2014 should have been and re-stated this commitment figure to £28.7 million at 31 March 2014.

- d. Item 13 on page 47, and section 9 of the notes to the Departmental Resource accounts on internal page 76, of the annual accounts for the year ending 31 March 2016 (accounts dated 1 July 2016) - Page 47 outlines that the Department had estimated that in 2015-16, expenditure on the RHI scheme would be £30,400,000. Actual expenditure incurred on the scheme during 2015-16 was £4,703,000 more than what the Department had originally estimated and amounted to £35,103,000. Page 48 outlines that this overspend is attributed to a spike of applications received prior to the scheme closure.

Page 76 – this refers to the future financial obligations at 31 March 2016 of £1,135 million (2015-16 - £198.8 million) that the Department must meet in relation to the Renewable Heat Incentive Scheme. There is no mention of it being funded from within AME.

Whistle-blowing and raising of concerns

Question 21

71. At the end of the first PAC evidence hearing in September 2016, the Permanent Secretary of the Department approached me to say that he had just been made aware of correspondence from a whistle-blower dating back to 2013 which appeared to indicate that staff within the Department would have been aware of the issues of over-incentivisation for a considerable time. As a result of this he was proposing to extend the investigative work of PwC to look into the actions of Departmental staff. Subsequent to this further correspondence was identified. My team would not have been aware of this when my report on the accounts was published in July 2016. All of the correspondence with the whistle-blower that I am aware of is detailed in Table 6 below:

Table 6: Correspondence from whistle-blower

Date	Description
August 2013	26 August 2013 - Email received by DETI minister Foster from the co-founder of a local company (Janette O'Hagan, Heatboss) looking to meet to see how the company could align energy efficiency with the sustainability delivered by RHI.
September 2013	<p>3 September 2013 - Email received by DETI minister Foster from the whistle-blower (Janette O'Hagan) that many of the company's potential customers are no longer worried about becoming more efficient as it pays them to use as much heat as they can and that the incentive to use more is leading to misuse in some cases.</p> <p>5 September 2013 - A letter was sent from DETI minister Foster to this whistle-blower (Janette O'Hagan) asking that a meeting be set up with the DETI Energy team.</p>
October 2013	<p>8 October 2013 - A meeting was held between the whistle-blower (Janette O'Hagan) and the Departmental Energy Team (Fiona Hepper, Peter Hutchinson, Joanne McCutcheon) to discuss the impact of RHI on energy efficiency levels and potential opportunities to align RHI and energy efficiency levels. At this meeting, the whistle-blower says that she pointed out that:</p> <ul style="list-style-type: none"> • as there was no tiering in Northern Ireland, there was no incentive for applicants to the scheme to be efficient; • it was more likely that the heating would be kept on in buildings all year round, with the windows open everywhere; and • it was in the interest of businesses to be wasteful with what is strictly not a renewable energy source. <p>The whistle-blower kept her own minute of this meeting on 8 October 2013 and these notes outline that in response to the above points raised, the Department staff (Fiona, Peter and Joanne) had told her that they did not believe this was the case and people would not do this.</p>

June 2014	<p>9 June 2014 -Email from the whistle-blower (Janette O'Hagan) to Department Personal Secretary (Laura McCoy) and onwards to Fiona Hepper:</p> <ul style="list-style-type: none"> • requesting an update on when tiering will be introduced as 'what is been seen on the ground in Northern Ireland is that buildings are using more energy than before because it pays them to do so;' • "The flat rate means that there is no incentive at all to be efficient so the heat in buildings is all year round with the windows open everywhere. When we had spoken, you did not believe that people would do this, but please believe me that it's happening with almost everyone we approach."; and • "It's got to the stage where it simply cannot be ignored any longer." <p>11 June 2014 - Department replied (Davina McCay, Sustainable Energy Branch) to Janette O'Hagan outlining that "we intend to review elements of the non-domestic RHI, including tariffs within the next few months."</p>
March 2015	<p>11 March 2015 - Email from the whistle-blower (Janette O'Hagan) to Davina McCay (Department Sustainable Energy Branch):</p> <ul style="list-style-type: none"> • requesting an update on any progress on a review of the RHI tariffs; and • outlining that a company installing a biomass boiler would get payback in 2 years if the heat was running 24 hours a day for 7 days a week.
March 2015	<p>12 March 2015 - Department replied (Seamus Hughes) to the whistle-blower (Janette O'Hagan) outlining that tiering may be introduced at a later date as a budgetary control measure.</p>
March 2015	<p>12 March 2015 - Email from the whistle-blower (Janette O'Hagan) to Department (Seamus Hughes and Stuart Wightman):</p> <ul style="list-style-type: none"> • outlining need for tiered funding so people don't just waste fuel for the sake of earning money on the RHI payments; and • commenting that this was raised with the Energy team back in 2013 and was told in 2013 that the Department didn't think businesses would abuse the system, but this is happening time and time again.

Source: Department

72. Other whistleblowing allegations which I am aware of are included in Table 7 below. These allegations have been made to NIAO, DfE, PAC or MLAs and have already been provided by me to the Inquiry team.

Table 7: Whistle-blower allegations

Whistle-blower	Date	To	Comments
Anonymous	28/01/2016	OFMDFM*	Department Internal Audit informed NIAO of allegations of abuse of the scheme. Ofgem were informed of allegations by Department.
Anonymous	07/10/2016	Jim Allister MLA Oliver McMullan MLA (PAC member)	Letter passed on to NIAO from two sources with allegations against [REDACTED] NIAO asked the Department to investigate on 10/10/16. Department passed allegations onto Ofgem. On 24 October 2016 Andrew McCormick wrote to me to say

			that Ofgem had told him that they had already looked into this issue and despite the fact that their inspectors had found 'no evidence of the building described as agricultural workshop/storage being used as a workshop or for animal pens as described in the non-domestic questionnaire' they had concluded there was no further action necessary. Department did not accept this conclusion and passed it back to Ofgem to consider along with similar instances discovered by PwC. Andrew McCormick confirmed again on 13 January 2017 that investigations were ongoing. These have still not been concluded.
Personal information redacted by the RHI	09/12/2016	NIAO	Telephone call received – suggesting pipe installed from business premises [redacted] to heat a nearby [redacted] Church Hall. Department informed on 12/12/16.
Anonymous	10/12/2016	DfE*	Referred to NIAO on 16/12/16 – relates to allegations about a Housing Association who allegedly staged photographs to show that boilers had been connected.
Paul Brannigan	14/12/2016	PAC	Relating to [redacted] advertising "FREE heat plus a significant financial reward."
Personal information redacted by the RHI	17/12/2016	Robin Swann MLA (Chair PAC)	Alleged that DFP Supply Officer should not have approved initial scheme.
Anonymous	January 2017	NIAO	[redacted] Church – heated all week to a temperature of 68F even when no services. DfE informed in January 2017.
Irish News article	6/01/2017	N/A	Department were also asked by NIAO to investigate the fire at premises in Fermanagh on 06/01/17 where eight boilers were destroyed.
Anonymous	27/01/2017	PAC	Referenced a farmer [redacted] abusing the scheme.

Source: NIAO

*These issues were passed to us as part of a general requirement in Managing Public Money that all suspected frauds are reported to the C&AG

Question 22

73. All disclosures received by NIAO were sent to the Department for further investigation. The Department subsequently passed these onto Ofgem and are awaiting confirmation of final outcome.

Question 23

74. The Department's agreement with Ofgem is that Ofgem are to investigate any instances of non-compliance. I am content that the Department has passed the above allegations to Ofgem, however, in most of the above instances, Ofgem's investigations have still not been completed.
75. The regulations surrounding the non-domestic RHI scheme are generally weak and open to interpretation which has hampered the ability of Ofgem and the Department to deal with the issues. As investigations continue it is still too early to make a definitive judgement on how the issues have been handled.

General

Question 24

76. I am not aware of any other representations made to me which have not already been reported to the RHI Inquiry.

Question 25

77. I am not aware of any such conversations other than have already been reported to you.

Question 26

78. There is not further evidence of which I am aware which has not already been reported to you.

Statement of Truth

I believe that the facts in this witness statement are true.

Signed:



Dated: 27 July 2017