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From: Forbes Alex (Heat and Business Energy)
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[Risk Appetite and Audit Strategy.docx](#)

Hi all

We discussed tabling an item on risk tolerance re non-compliance at Jan's Ops board. I've pulled together an initial draft – grateful for any comments and corrections.

At the moment it covers the Non-domestic scheme only – should it extend to the dRHI?

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Audit Strategy 2017-18: Risk Appetite

Summary: Ofgem and BEIS will work together over the coming weeks to agree the Ofgem audit strategy for 2017-18. To inform this work, the board is invited to provide a steer on its risk appetite in relation to non-compliance.

Risk Appetite Statement (RAS)

The board reviewed the RAS in February last year. In respect of non-compliance, it describes the extent to which we will tolerate identified non-compliance. It does not describe our risk tolerance in terms the approach to identifying where non-compliance may be taking place.

Current approach

The current audit programme is well developed. The Grant Thornton review in 2015 recognised that it had evolved in response to emerging risks and made a number of recommendations to help focus the audit approach in a way that helped identify the most significant types of non-compliance. Grant Thornton did not review whether alternative approaches to audit would be appropriate, nor did they provide advice on audit sample size.

In 2016-17, Ofgem will audit 225 sites. Around 60% of sites audits will be selected on the basis of risk, with the remaining 40% selected through a statistical sampling method. On the basis that there will be around 16,000 accredited installations at the end of 2016-17, this equates to 1.4% of sites being audited over the course of the year. If this rate continues, around 1 in 4 sites will be audited over the lifetime of their participation on the RHI scheme.

Sites that are subject to audit are provided with 10 days' notice in order to ensure that the plant is accessible and to give the participant an opportunity to gather all appropriate paperwork. Sites are unlikely to be audited more than once during their lifetime on the scheme.

The RHI Project board has previously considered these issues in relation to biogas plant. The board accepted the recommendations in Katie Halter's paper on biogas compliance including:

- Introducing a ring-fenced programme to target the majority of biogas operators early in the scheme participation, and on a regular basis over the lifetime of their participation (estimated cost c£50,000 per year).
- Increased auditing for higher risk groups, such as schemes with previous issues.
- Increasing the number of no notice audits, including pre-accreditation site audits.

Options/Questions

For the purpose of this discussion, it is assumed that the board will wish to continue to take a proportionate, risk-based approach.

Q: Where is the board's risk appetite in terms of audit coverage?

As above, fewer than 1.5% of sites are currently audited each year. For context, NI was criticised for an audit programme that covered around 1% of accredited sites.

At around £1000 per audit, this equates to around 6% of Ofgem's ND RHI admin budget and less than 0.05% of annual forecast expenditure to scheme participants. Around £50k has been recovered in the year to date as a result of audit findings.

We recommend that the board reviews the level of audit coverage.

(Any comparators?)Q: Where is the board's risk appetite in terms of audit approach?

As part of the NI stuff, the NIE commissioned PWC to conduct around 300 unannounced visits to sites.

Ofgem conducted its first 4 unannounced audits before Christmas. Initial feedback is that non-compliance or fraud is thought to have been identified at 2 of the audited sites.

There are obvious advantages to unannounced audits, with the potential to identify non-compliance that may otherwise be hidden where a participant is alerted in advance to an imminent audit.

Set against this is the increased cost of an unannounced audit (approx double, c£2000) and the likelihood that participants would not be able to provide all paperwork. Unannounced audits would likely therefore work best as an addition to the current approach rather than as a replacement.

Cost v Scope

Varying audit coverage and type has obvious cost implications: indicative costs are set out in the table below.

Proportion of sites audited in year*	Current audit approach	10% No Notice	20% No Notice	25% No Notice	50% No Notice
1.50%	£247,500	£272,250	£297,000	£309,375	£371,250
2%	£330,000	£363,000	£396,000	£412,500	£495,000
2.50%	£412,500	£453,750	£495,000	£515,625	£618,750
3%	£495,000	£544,500	£594,000	£618,750	£742,500
4%	£660,000	£726,000	£792,000	£825,000	£990,000
5%	£825,000	£907,500	£990,000	£1,031,250	£1,237,500

*on basis of 16500 accredited sites

Need to include a recommendation? Or let the board have free reign?

Next steps

Following the board's steer on the questions above:

- We will Review and revise the RHI Risk Appetite Statement with a view to bringing to a future board;
- Ofgem will develop a draft 2017-18 audit strategy for BEIS comment and agreement.