

Distribution: Sarah Cox, Chief Operating Officer

Report of Factual Findings – Concerns raised over funding and audit sampling methodology within the Northern Ireland Non Domestic Renewable Heat Incentive Scheme

Date: 26 June 2017

## 1. Background and objective

At the request of the Ofgem Chief Operating Officer (COO) we have carried out enquiries and an examination of documentation made available relating to concerns raised by a member of staff within Ofgem E-Serve regarding the Northern Ireland Non Domestic Renewable Heat Incentive (NI ND RHI) Scheme. These concerns have been raised in response to requests for input into the NI ND RHI Scheme Public Inquiry. This was a fact finding project and did not form part of formal HR, disciplinary or legal processes.

The NI ND RHI Scheme was introduced in Northern Ireland (NI) in November 2012 following the introduction of the Great Britain Non Domestic Renewable Heat Incentive (GB ND RHI) Scheme in November 2011. The NI ND RHI Scheme has grown significantly since it was launched in November 2012. A significant spike in applications was noted during the second half of 2015 prior to amendments to the Regulations in November 2015 which introduced a tiered tariff for small and medium biomass technologies and an annual cap for eligible heat payments and in response to the Scheme suspension announcement (effective 29 February 2016) due to insufficient funding.

As at May 2016 the NI ND RHI Scheme cost was 1.44% of the total E-Serve cost as per the E-Serve Finance financial models provided.

Some key statistics relating to the NI ND RHI Scheme provided by RHI Scheme management are detailed in the table below:

Description	2012/13	2013/14	2014/15	2015/16	2016/17
Number of applications received during year	9	119	434	1,567	-
Number of accredited installations at year end (cumulative)	5	87	402	1,258	1,991
Number of applications reviewed (to a point of approval or rejection)	4	79	317	858	783
Value of successful payments during the year (rounded figures)	-	£366k	£3.9m	£18.9m	£43.7m
Agreed Department for the Economy (DfE) funding	£526,077	£164,587	£210,629	£253,102	£430,291*

\*Still subject to final agreement to a change control request for increased Q4 funding

This memorandum contains the findings from our enquiries into the two concerns raised. Our work was based on interviews with staff currently involved in the funding and audit process and examination of supporting documentation.

Refer to Section 2 for a summary of the concerns raised, Section 3 for an overall summary of observations and recommendations and Sections 4 and 5 for further detail on the concerns raised and results of our enquiries.

## 2. Summary of concerns raised

The review related to the following concerns raised in two areas of the NI ND RHI Scheme raised by the Head of E-Serve Finance.

### 2.1 Funding

It has been suggested that the lack of appropriate processes and financial scrutiny over the funding agreements with DfE have resulted in errors, work being undertaken without agreed DfE funding and increased financial risk to E-Serve.

### 2.2 Audit sampling methodology

It has been suggested that there has been a lack of understanding of statistical analysis and the benefits that could be derived from using it.

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### 3. Overall summary of observations and recommendations

Based on the enquiries undertaken and documentation examined we have raised the following observations based on the enquiries performed:

#### 3.1 Funding

##### *Agreeing funding*

There was an apparent lack of a structured and joined up approach to preparing the costing and budgets, and agreeing funding between the Scheme team and E-Serve Finance for 2016/17. Apart from attending the E-Serve led monthly RHI Board meetings which is attended by DfE representatives, E-Serve Finance were not directly involved in any funding negotiations with DfE or any further interactions with DfE finance team representatives. It is not clear whether sufficient input was obtained from E-Serve Finance in the funding negotiations.

The line items and cost groupings in the E-Serve financial model (e.g. Bought-in-Services) are different from those used in preparing the NI ND RHI Scheme bid requirements (e.g. Consultancy) and those used in the change control form signed off by DfE. No mapping between the line items and cost groupings used by the NI ND RHI Scheme management, those in the change control form and the E-Serve financial model was provided. The use of differing line items and cost groupings has resulted in additional work required in re-grouping costs as set out in the E-Serve financial model to align to the line items and cost groupings used in the change control sheet for DfE reporting purposes.

Although E-Serve Finance were requested to provide the go ahead on a change control form during 2015/16 prior to sending it across to DfE; this same practice was not followed for the 2016/17 financial year change control form. This supports the concerns raised that E-Serve Finance was not consulted appropriately during the 2016/17 funding process.

There needs to be greater alignment between schemes and E-Serve Finance in preparing funding requirements and budgets. Adequate procedures should be implemented and enforced during the funding and budgeting processes. Processes should require sufficient levels of input and coordination between the various teams involved. Consideration should be given to whether there needs to be an increased level of interactions between E-Serve Finance representatives and DfE Finance representatives.

##### *Timeliness of funding agreements*

Significant time lags were noted in obtaining agreement on the 2016/17 funding with DfE which was signed off in August 2016. In addition, the change control form for Quarter 4 of 2016/17 has not yet been agreed and as a result the funding for the quarter is yet to be received.

Greater focus and effort should be applied in agreeing funding in a timely manner prior to the start of the year and agreeing any change requests in a timely manner.

##### *Scheme costing*

Costs were allocated based on varying assumptions, which is to be expected for different types of costs; however, these assumptions were not consistently applied in the initial bid requirement calculations provided and the E-Serve financial models for 2016/17. There also appears to be a lack of clarity on the difference between line items and cost groupings used, for example E-Serve IT Operations, E-Serve IT Development and IM&T.

The calculations provided, which supports the £375,895 agreed by DfE, did not include all relevant costs, for example central overheads, all E-Serve Support Team costs and IM&T.

In addition, the fact that NI ND RHI and GB ND RHI costings are combined results in a lack of granularity in the detailed costing for the NI ND RHI. This adds a certain degree of complexity to the budget and funding process as the NI ND RHI Scheme receives funding from DfE and the GB RHI Scheme receives funding from BEIS. This may have been appropriate at the very start of the scheme due to the size of the NI ND RHI Scheme; however, this should be reviewed and assessed in future.

It is not clear whether the figures used in costing delivery of the NI ND RHI Scheme received adequate scrutiny and challenge, for example where E-Serve support team costs, such as Counter Fraud, were not allocated to the NI ND RHI Scheme. Greater scrutiny should be applied to make sure that the Scheme costing is reflective of the best estimate of all costs to deliver the Scheme.

Clarity should be provided over the definitions of cost groupings used. Where there are deviations from standard cost groupings there should be a mapping between the various calculations to clearly illustrate how the deviations were arrived at. Appropriate cost allocation assumptions and bases should be agreed and should be applied consistently by ND RHI Scheme management and E-Serve Finance. In addition, given that the NI ND RHI and GB ND RHI Schemes are separate schemes funded by two different government departments consideration should be given to splitting the two out when calculating the bid requirements and required funding.

The cost groupings used during the funding and budgeting process should take into account any external reporting requirements to the governmental departments to avoid any further administrative work required to re-group costs for reporting purposes.

#### *Standard operating procedures*

There are some standard operating procedures for budgeting and funding available on the wire; however, they are not up to date and they appear to apply to DECC in most respects, rather than DfE. Based on discussions with RHI Scheme management it was noted that they are not aware of all procedures that are available on the wire.

Fit for purpose standard operating procedures should be drafted, communicated and implemented going forward.

#### *Relationship with DfE and reporting*

The MoU between E-Serve and DfE and underlying ways of working are still to be agreed and finalised. The draft MoU with DfE needs to be finalised and the ways of working as described as being in place in the draft MoU should be agreed and implemented. Prior to finalising the MoU input from interested parties that are directly affected by the MoU should be sought on the requirements for the MoU.

Refer to Section 4 for further detail.

### 3.2 Audit sampling methodology

The focus of external advice obtained on audit sampling methodologies until 2017 has predominantly been on the GB ND RHI Scheme rather than the NI ND RHI Scheme. Since the launch of the scheme, sample sizes in the NI ND RHI Scheme was initially informed by looking at a percentage of the GB audits, thereafter for 2015/16 and 2016/17 sample sizes

were determined through agreement with DfE due to the significant increase in accredited installations during 2016/17.

For the majority of the lifetime of the NI ND RHI Scheme a targeted risk based sampling approach has been adopted rather than a statistical sampling approach. Although a targeted sampling approach may be effective where resources are limited and allow flexibility to audit in areas of greatest risk, the sample results are not representative and conclusions cannot be drawn over the overall Scheme.

In addition, based on the statistics provided by NI ND RHI Scheme management it can be seen that an insufficient number of audits was being carried out in order to extrapolate validly the results of statistical samples over the population. Increased funding would have been required in order to carry out a sufficient number of audits to enable statistical quantification of the results.

Scheme management indicated that until recently there has been no proactive involvement **or request from DfE to review the audit strategy and audit sampling method and that DfE's** formal approval of audit strategies was not sought or provided.

The fact that the Scheme has grown significantly over the last two years indicates a need to reassess the efforts of the audit team. The recommendations identified by Grant Thornton during 2017 should be considered by E-Serve together with DfE while finalising the 2017/18 audit strategy. Formal agreement of the 2017/18 audit strategy should be retained for record keeping purposes.

Should a statistical sampling approach be incorporated in the 2017/18 audit strategy, the results should be used to draw conclusions for the overall Scheme together with the financial impact. The results should be reported to DfE regularly in order to feed into future audit planning and potential improvements across the Scheme.

Refer to Section 5 for further detail.

#### 4. Enquiries into concerns raised over funding

The individual raising the concerns has suggested:

- E-Serve Finance were not involved in the funding arrangements and agreements of the NI ND RHI Scheme between E-Serve and DfE.
- As a result of E-Serve Finance's lack of involvement in agreeing funding the Scheme has undertaken work without agreed DfE funding and failed to ensure all costs were included in the request for funding and therefore agreed funding was below the level required to undertake E-Serve's role.
- The Scheme did not provide DfE with regular estimates of committed expenditure and, had this been done it would have allowed the Scheme and DfE to act more quickly in response to increasing costs.

#### Findings

##### *Funding process*

The agreement for E-Serve to administer the NI ND RHI Scheme on behalf of the Department of Enterprise, Trade and Investment (DETI) in Northern Ireland (now the Department for the Economy (DfE)) came about in 2011. The Managing Director of E-Serve and the Head of Scheme Development at that time are no longer employees of Ofgem E-Serve.

Discussions with E-Serve Finance and current RHI Scheme management highlighted that during Scheme development, based on the feasibility study carried out, a decision was taken that as the NI ND RHI Scheme represented approximately 3% of the size of the total UK RHI (including both GB and NI) it should incur costs approximating to 3% of the total UK RHI costs.

The feasibility study confirms that based on the uptake information provided by DETI at the **time and Ofgem's experience with operating the** Northern Ireland Renewables Obligation (NIRO) Scheme, the plan was for the uptake of the NI ND RHI to be 3% of the GB ND RHI Scheme. As part of the feasibility study operational costs were forecast based on the 3% assumption and an uptake rate of 5% for the first four years of the scheme. A recommendation was made to plan for and seek funding based on an uptake rate of 5% due to the potential for the uptake to be greater than expected.

E-Serve Finance have built an Excel based financial model for E-Serve which allows for differences in cost allocations across the schemes funded by DfE (e.g. NI ND RHI) and others funded by the Department for Business, Energy & Industrial Strategy (BEIS) (e.g. GB ND RHI). This was deemed necessary by E-Serve Finance as the size of the NI ND RHI Scheme has grown since the launch and differences between the NI ND RHI and GB ND RHI Schemes. This Excel financial model considers the following:

- Individual scheme funding requirements provided by scheme management in the format prescribed by E-Serve Finance. This is the proposed scheme cost required to deliver the **government department's requirements for the following year, based on relevant assumptions** and should include:
  - Delivery team staff costs: costs to deliver the scheme
  - Bought-in-Services, also referred to as consultancy costs: includes for example any external assurance or legal services

- E-Serve Support team costs: E-Serve overheads re-charged to each scheme, for example E-Serve Finance, E-Serve Counter Fraud, E-Serve Managing Director Office costs, etc.
- Actual staff costs
- E-Serve support team costs and corresponding allocations to individual schemes as agreed at the Associate Director/ Managing Director level
- Corporate/ central overheads to be recharged to individual E-Serve schemes as agreed during the Ofgem wide budgeting process at the Associate Director/ Senior Civil Servant level, for example IM&T, building costs, etc.

Historically, the E-Serve Senior Responsible Officer has been responsible for funding discussions with the relevant government departments. Corporate Finance are not involved in these funding discussions apart from providing E-Serve with the output of Ofgem Corporate Planning. Compiling of the E-Serve financial model and funding discussions with the relevant government department should be coordinated with Ofgem Corporate Planning as certain central/ corporate costs subject to Ofgem Corporate Planning are re-charged and allocated to individual E-Serve Schemes. These costs should be included in the funding that is agreed with the relevant government department. The general intention is to have funding agreed in advance of the work being undertaken.

Once funding and budgets have been agreed the Excel financial model is created with the final figures which then forms the basis for monthly reporting and review for the rest of the financial year.

#### *Standard operating procedures*

There are some standard operating procedures for budgeting and funding available on the wire; however, they are not up to date and they appear to apply to DECC in most respects, rather than DfE. Extracts from applicable policies are detailed below:

- The E-Serve Finance Corporate Planning and Budgets policy available on the intranet states:

*'The Corporate Plan details the allowed spend for Ofgem for the financial year to which it relates and the total Licence Fee income for the period.*

*The Corporate Plan is set initially and translated into Budgets before funding is agreed with sponsoring departments (e.g. DECC). Budgets are used to develop funding requests to sponsoring departments, which will be consistent with those budgets. Budgets should thereby reconcile to funding requests. Once funding is agreed, budgets will be amended to reconcile to the funding agreed.'*

- The E-Serve Finance Funding policy available on the intranet states:

*'We should be providing best estimates of our funding requirements around October of the previous financial year. This allows those funding departments to seek funding themselves.*

*Requests for funding to government departments should be sent by the e-serve SRO [Martin Crouch (Apr 2013)]. Requests should not be submitted until sign-off has been obtained from the F&A team and the legal director.*



*The methodology for requesting additional funding depends on the funding source. In accordance with the MoU additional funding must be requested via the formal 'Change Control' process.*

*Funding will be formally agreed via a letter from the Senior Reporting Officer at DECC.'*

Based on evidence examined the 2016/17 financial year funding requests were sent to DfE by NI ND RHI Scheme management rather than the E-Serve SRO and the legal director was not involved. In addition, there is reference to a MoU and Senior Reporting Officer at DECC. However, there is currently no agreed MoU in place between E-Serve and DfE and there are no specific references to the procedure that should be followed specifically for DfE.

The Head of E-Serve Finance also indicated that a change control process is currently being reviewed by the Strategy and Business Support (SBS) team.

#### *2016/17 funding arrangements*

NI ND RHI Scheme management recognised that 2016/17 funding would involve a significant increase due to the additional work required to deliver the Scheme and expected forecasted costs to exceed 3% of the ND RHI costs (including both NI ND RHI and GB ND RHI).

During January 2016, ND RHI Scheme management put together an initial view of ND RHI costs for E-Serve Finance, covering both NI and GB. This combined figure combined funding that would need to be obtained from DfE for the NI ND RHI Scheme and BEIS for the GB ND RHI Scheme. This initial view was largely based on the 2015/16 Scheme costs. In doing this they arrived at an initial figure of £4,712,227 for the total ND RHI bid requirement. The supporting calculation provided shows a figure of £375,895 for the NI ND RHI Scheme. The Head of Technical & Compliance indicated that these figures were informed by input from DfE on what funding they had available and what they required in terms of scheme delivery for the upcoming year. It was intended to be used for the purposes of having initial working level funding discussions with DfE.

The 2016/17 ND RHI bid requirement was submitted to E-Serve Finance on 6 January 2016 together with relevant assumptions used in costing the delivery of the Scheme. Email correspondence shows that when sending this across to E-Serve Finance the ND RHI Scheme management indicated it did not include any cost allocations for central teams and IM&T. Therefore it can be concluded that the total of £375,895 specific to the NI ND RHI Scheme did not include an element for all central teams and IM&T. In addition, the workstream categories used in this bid requirement were amended by ND RHI Scheme management before sending to E-Serve financial and differ from the workstreams that have been used in the E-Serve financial models for 2016/17.

We were not provided with any evidence indicating that the detailed split between GB ND RHI and NI ND RHI was shared with E-Serve Finance; however, on 12 January 2016 the RHI Scheme management indicated that the NI ND RHI specific funding requirements was to be around £375,000 based on discussions with DfE on scope and requirements.

A draft change control form for the 2016/17 funding for the value of £375,895 was submitted to DfE during June 2016, almost three months into the financial year. A letter accompanying the draft control change form includes reference to the 3% approach, refers to overheads **and confirms the split between 'relevant scheme costs' plus 'NI specific costs' associated with processing spikes in applications, servicing increased volume of participants, and conducting**



a higher volume of site audits. The change control form was signed off by the E-Serve Associate Director RHI and E-Serve Managing Director on 19 August 2016 and by DfE on 23 August 2016 almost five months into the year.

Corporate overheads and the GWE cost allocation for E-Serve were distributed to the E-Serve Managing Director and E-Serve Finance on 18 April 2016 by Corporate Finance. It is not evident on whether there were further interactions between E-Serve Finance and RHI scheme management between the point of receiving this detail and the point of completing and submitting the draft change control form to DfE in June 2016 to confirm the value of corporate overheads to be included.

The Head of E-Serve Finance indicated that on several occasions he requested a copy of the funding agreed with DfE but only received it around October 2016; however, no evidence supporting this could be obtained. At the point of receiving the agreed funding/ change control form for £375,895, it became apparent to E-Serve Finance that corporate overheads had not been included and this was raised with ND RHI Scheme management. The Head of E-Serve Finance indicated that during discussions with ND RHI Scheme management they advised that the corporate overheads were omitted when preparing the draft change control form. No documentary evidence of this was provided.

As part of this review E-Serve Finance recalculated what the NI ND RHI Scheme costs would have been had corporate overhead and IT related costs been included. This recalculation identified that the agreed funding was £40,140 below what it should have been. The overall totals are reflected in the table below and the breakdown of these totals is provided in Appendix I.

2016/17 bid requirement calculated by Scheme and figure agreed by DfE	2016/17 bid requirement recalculated by E Serve Finance for purpose of this review	Variance
£375,895	£416,035	£40,140

An analysis and examination of the bid requirement and funding figures for the NI ND RHI Scheme in 2016/17 and of the underlying evidence was performed to:

- Identify whether expected costs were included when the initial bid requirement was calculated by NI ND RHI Scheme Management.
- Identify whether expected costs were included when the E-Serve financial model was prepared in May 2016 for the 2016/17 financial year.
- Compare the basis of cost allocation used for the NI ND RHI Scheme and the GB ND RHI Scheme.

A summary of the observations is noted below and further detail of this analysis supporting these observations is provided in Appendix I and Appendix II.

*General observations*

- The use of terminology used between the NI ND RHI Scheme and E-Serve Finance is not consistent and the difference between these cost groupings is not defined and clear to all relevant individuals, for example:
  - Bought-in-Services (used by E-Serve Finance) versus Consultancy (used within the Scheme)

- o IM&T versus E-Serve IT Oncost (Operations and Development) and which costs fall within each of these cost groupings. It was also noted that the E-Serve IT team are now referred to as Digital Solutions and Services rather than E-Serve IT.
- Costs are allocated based on varying assumptions, which is to be expected for different types of costs; however, these assumptions were not consistent between the initial bid requirement calculations and the E-Serve financial models for 2016/17.
- The line items and cost groupings in the E-Serve financial model are different from those used in preparing the NI ND RHI bid requirements and those used in the change control form signed off by DfE. The table below illustrates the differences identified:

NI ND RHI Scheme management	Change control form signed by DfE	E Serve financial model prepared at the start of the year and used for reporting
<ul style="list-style-type: none"> <li>• Team                             <ul style="list-style-type: none"> <li>- Staff</li> <li>- Other</li> <li>- Consultancy</li> </ul> </li> <li>• Central                             <ul style="list-style-type: none"> <li>- Staff</li> <li>- Consultancy</li> </ul> </li> <li>• IT                             <ul style="list-style-type: none"> <li>- IM&amp;T</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Staff</li> <li>• Other</li> <li>• Consultancy</li> <li>• IM&amp;T</li> </ul>	<ul style="list-style-type: none"> <li>• Delivery team                             <ul style="list-style-type: none"> <li>- Staff</li> <li>- Bought-in-Services</li> <li>- Other</li> </ul> </li> <li>• Support teams                             <ul style="list-style-type: none"> <li>- E-Serve IT Oncost – Operations</li> <li>- E-Serve IT Oncost – Development</li> <li>- Legal Services Oncost</li> <li>- Finance</li> <li>- Counter Fraud</li> <li>- HR</li> <li>- SBS</li> <li>- <b>MD's office</b></li> </ul> </li> <li>• Add ons                             <ul style="list-style-type: none"> <li>- Consultancy contingency</li> <li>- IM&amp;T</li> <li>- Overhead</li> <li>- GWE Contribution</li> </ul> </li> </ul>

There is no mapping between the line items and cost groupings used by the NI ND RHI Scheme management, those in the change control form and the E-Serve financial model.

In addition, this has resulted in additional work required in re-grouping costs as set out in the E-Serve financial model to align to the line items and cost groupings used in the change control sheet for DfE reporting purposes.

- There appears to be lack of clarity and definition around the classification of IT related costs between IT, IM&T and E-Serve IT Oncost. The below table illustrates how these costs have been categorised by the NI ND RHI Scheme in their bid requirement calculation and the E-Serve financial model as at May 2016:

Category	Amount to be included in 16/17 bid	E Serve financial model as at May 2016
IM&T	Bank & ID Project GB Regs Package Cap implementation Process changes Infrastructure support Operational support	A total figure of £750,000 for E-Serve is agreed between IM&T and E-Serve. This includes hardware, software and resources.
IT	Development staff cost Development consultancy cost	Not applicable
E-Serve IT Oncost Operations	Not applicable	IT team staff role allocation specifically for operations as allocated by the IT team
E-Serve IT Oncost Development	Not applicable	IT team staff role allocation specifically for development as allocated by the IT team
Delivery team cost	Strategic process and IT spend	Strategic process and IT spend

*Observations over the bid requirement calculated by the NI ND RHI Scheme*

- The staff cost figure calculated by the NI ND RHI Scheme management was calculated using standard employee costs per grade. Input from E-Serve Finance in order to calculate the staff cost based on actual staff costs was not obtained in calculating the £375,895, which was subsequently agreed and signed off by DfE.
- It is not evident that all E-Serve support teams and central/ corporate overheads were considered in arriving at the £375,895 bid requirement which was subsequently agreed and signed off by DfE.

*Observations over the costing as per the May 2016 E-Serve financial model for NI and GB*

- In preparing the total delivery team staff and other costs, 6% of total costs was allocated to the NI ND RHI Scheme and 94% to the GB ND RHI Scheme. It does not take into account individual staff role allocations and the associated costs between GB and NI.
- The delivery team bought-in-services/ consultancy costs for the GB ND RHI Scheme **includes a line item for 'Deloitte NI Independent Assurance work'** for a value of £7,396. Based on the allocation used only 5% of this cost was allocated to the NI ND RHI Scheme; however, as it was NI specific the total value should have been included the NI ND RHI Scheme costs.
- The delivery team bought-in-services/ consultancy costs includes a line item for Ricardo audits for a value of £21,637 (sum of £10,473 and £11,164). This cost was split between the NI ND RHI and GB ND RHI Schemes with 5% to NI ND RHI and 95% to GB ND RHI. It has not been specified whether these audits relate to GB or NI installations.
- E-Serve IT costs, covering both Operations and Development, and IM&T costs were not included as line items in the agreed financial model as at May 2016. The Associate

Director indicated that **these costs formed part of the 'Overhead' line item; however, no evidence to support this was provided.**

- E-Serve Support Team costs listed below were not allocated to the NI ND RHI Scheme for the 2016/17 financial year:
  - E-Serve Counter Fraud
  - HR
  - SBS
  - Legal Services Oncost Bought-in-Services

Costs for these teams were allocated to the GB ND RHI Scheme. Applying the assumption that the NI ND RHI Scheme is a percentage of the UK ND RHI, then NI ND RHI should have been allocated a portion of the cost of these support teams. Therefore this assumption was not applied consistently.

#### *Monthly tracking of actuals versus budget*

Monthly meetings are held between E-Serve Finance and Scheme management to discuss actuals and forecasts against the budget. During these meetings any updates on staffing and forecasts will be discussed and amendments made to the E-Serve financial model for that particular month.

During the end of 2016/17 E-Serve Finance identified that the NI ND RHI Scheme were going to exceed agreed funding by around £100,000. Refer to Appendix III for a month on month view of actuals and forecasts for the 2016/17 year.

An analysis of the E-Serve financial models and internal management reporting over the course of 2016/17 identified the following:

- Staffing related costs increased from November 2016 onwards which is when the percentage of staff costs allocated to NI ND RHI was increased to 7%. This was done at the request of the Associate Director RHI given that the work to deliver the scheme had increased. Scheme management did allocate time between NI and GB on an individual basis based on their best view. This was not incorporated into the E-Serve financial models, rather a straight 6% or 7% of total staff costs was applied.
- Despite the corporate overhead not being included in the agreed funding and not being reflected in the E-Serve financial model agreed during May 2016, corporate overhead was charged to the NI ND RHI Scheme.
- Despite no budget being included in the E-Serve financial **model for 'E-Serve IT Oncost – Development'**; **it was confirmed by the** Head of Development & Architecture that roughly 30 days of work specific to NI ND RHI was carried out. This was supported by the Management Committee Playback Report maintained by the E-Serve IT Development team. This was not charged to the NI ND RHI Scheme based on instructions from the Scheme as their view was that these costs were not relevant IT development costs. No record of this could be provided. If this is in fact the case it means that DfE was potentially undercharged for development costs specific to the NI ND RHI Scheme.
- In papers prepared by E-Serve Finance for the Management Committee GB ND RHI and NI ND RHI is combined to provide a view of ND RHI. This raises questions over whether the Management Committee were being provided with an appropriate level of detail over

Scheme performance given that the NI ND RHI and GB ND RHI Schemes are separate schemes funded by different government departments.

Due to an increase in costs in delivering the scheme since the end of Quarter 3 and during Quarter 4 due to various factors, such as increased scrutiny over the administration of the NI ND RHI Scheme and increased number of audits, additional funding has been requested for Quarter 4 2016/17. This has not yet been signed off by DfE and as a result the funding for the quarter has not yet been received.

During the process of preparing for the additional funding request, the Head of Operations was provided with an External Change Request Authorisation Form from the interim Associate Director to be completed, which is required to be signed by a representative from Development, IM&T, Legal, Head of Finance and Administration – E-Serve, the Scheme SRO and the E-Serve Managing Director. The Head of Operations confirmed that she was not aware that this was a requirement when requesting additional funding.

#### *Relationship with DfE*

There are Administrative Arrangements in place between Ofgem and DfE. In addition, subsequent to a review over the administration of the NI ND RHI Scheme by PwC in 2016, it was recommended that a Memorandum of Understanding between Ofgem and DfE be drafted. The MoU has been drafted in addition to the Administrative Arrangements and provides a general framework for governance and reporting, including for example working relationships, KPIs and items requiring DfE approval. It is currently with DfE for comment.

The Head of E-Serve Finance has indicated that he has not been consulted on the drafting of the MoU which includes elements of financial reporting. The Head of Operations indicated that once feedback on the draft MoU has been obtained from DfE and the document is finalised they will be communicating relevant points to interested parties, e.g. E-Serve Finance.

#### *Informing DfE of their financial commitment in respect of the scheme*

Regulations were amended in February 2016 giving power to DfE to suspend the NI ND RHI Scheme where it does not or is likely to not have sufficient budget to meet the cost of support payments to participants. The scheme was suspended on 29 February 2016.

For each applicant that is accredited to the Scheme there is a commitment for 20 years of payments. During the PAC meeting in October 2016 it was asked whether details of the committed expenditure were provided to DfE. In response it was stated that information that DfE could use to calculate the figure was provided to DfE.

Reports provided to DETI, now DfE, were obtained. These reports do not provide a view of the total financial commitment in respect of the Scheme.

The Head of E-Serve Finance indicated that attempts were made by himself to provide figures for the financial commitment in the Scheme. Record of these attempts were not provided by the individual who raised the concerns.

## 5. Enquiries into concerns raised over audit sampling methodology

The individual who raised the concerns has suggested:

- A lack of understanding of statistical sampling and the benefits that could be derived from using it by the NI ND RHI Scheme
- Had the Scheme undertaken statistical analysis of random samples they would have been better placed to identify a significant risk of non-compliance in a timely manner to be used in support of additional funding from DfE for increased audits and/ or more checks during accreditation.

### Findings

In order to protect funds paid out under the RHI Scheme from fraud and to make sure that payments are only made to those entitled an ongoing cycle of audits of installations was implemented. The first ND RHI audit strategy was developed in 2011/12 specifically for the GB ND RHI Scheme setting out the sample size and site selection criteria.

Deloitte was commissioned in 2011 to investigate the most appropriate methodology for audit sampling based on industry best practice, and to produce data on appropriate sample sizes based on their findings. Deloitte recommended the Monetary Unit Sampling (MUS) method as the preferred method for RHI audit sampling. It provides a direct linkage between the financial value of the payments and the sample items selected, applying materiality (an **'acceptable' level of error**) and **confidence levels as a measure of how reliable a statistical result is**, for example a 95% confidence level for payments not to be overstated by more than 2% would require a sample size of 150. The MUS approach also weights each **installation's chance of selection to reflect the volume of heat generated and the tariff for the technology type and size**. It would allow a straightforward evaluation of sample results and their extrapolation to the entire population.

A further refinement involved segmentation of the audit population into sub populations sharing similar characteristics in order that each sub population could be sampled and evaluated separately. This would allow audit effort to be focused on installations considered to present the greatest risk of error.

Subsequent to the GB ND RHI Scheme launch, the method recommended by Deloitte was adapted to reflect the number of applications within the sub populations received and to account for audit findings identified and their material impact on payments, while still remaining within the available site audit budget. The targeted nature of the audits meant that results could not be confidently extrapolated to provide a view of the overall population.

Subsequently a review was conducted by Grant Thornton in 2014/15, the results of which were incorporated into the 2015/16 audit strategy. Similarly, Grant Thornton proposed the use of MUS. The only difference being splitting the audit programme into both statistical (175 were recommended) and targeted (100 were recommended) audits. Grant Thornton provided a spreadsheet to aid with the selection of monetary unit (statistical) samples. The Head of Technical and Compliance confirmed that this Grant Thornton review was focused on the GB ND RHI Scheme only.

Until 2016/17 when the audit strategies for the NI ND RHI and GB ND RHI Schemes were separated, the audit strategy was considered to be a joint strategy for both the NI and GB ND RHI Schemes; however, the 2015/16 audit strategy is the first time the NI ND RHI



Regulations are specifically referenced and there is no reference to the specific audit strategy and sampling methodology applied for the NI ND RHI Scheme.

The ND RHI Assistant Audit Manager indicated that the tool provided by Grant Thornton for statistical sampling was not used for the NI ND RHI Scheme but rather the sample selection was targeted based on risk criteria. Sample size for the NI ND RHI Scheme was based on circa 1.7% of GB ND RHI audits for 2013/14; 3% of GB ND RHI audits until 2015/16 and then as per agreement with DfE.

The following table provides a breakdown of the number of audits undertaken versus the number of accredited installations as provided by RHI management:

Description	2012/13	2013/14	2014/15	2015/16	2016/17
Planned audits	-	5	12	6	57
Actual audits	-	5	12	14	57
Accredited NI installations at year end	5	87	402	1,258	1,991
Percentage of NI installations	-	5.7%	3.0%	1.1%	2.9%
Percentage of GB population	-	2.3%	3.2%	6.9%	25.3%

The table above is reflective of the varied sample sizes since Scheme launch. During 2016/17, together with the agreement of DfE, the number of audits planned and undertaken increased significantly reflecting the significant increase in accredited installations.

In September 2016, DfE commissioned a review over the NI ND RHI Scheme policy, design and administration. This review was carried out by PwC and highlighted recommendations relating to the audit strategy and audit sampling methodology. Scheme management indicated that prior to the outcome of this review there was limited interest from DfE in the **audit strategy and audit sampling method and it appears that DfE's approval of audit strategies was not sought or provided.**

In response to the PwC recommendations, a review by Grant Thornton was undertaken during March 2017 in order to provide input into the 2017/18 audit strategy which is still to be finalised and signed off by DfE. As per the draft report provided, this review has recommended a combination of (i) statistical sampling on the basis of MUS, (ii) targeted sampling based on intelligence and (iii) referrals from the Counter Fraud team.

The below table is an extract from the draft Grant Thornton report which is based on the NI ND RHI Scheme. It is an illustration of estimated sample sizes which considers a confidence level of 95% and multiple materiality and expected error rates. The detail is based on the sum of the annualised payment figure for all installations based on data provided by Ofgem to Grant Thornton in March 2017.

Materiality	Expected error rate	Estimated sample size
2%	1%	577
3%	1%	220



Materiality	Expected error rate	Estimated sample size
4%	1%	131
5%	1%	93
6%	1%	72
3%	0.5%	143
3%	0.75%	175
3%	1.5%	385
3%	2%	850

Extrapolation of the sample results is not statistically valid based on the small sample sizes selected.

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Individuals interviewed:

- Edmund Ward, Head of Compliance and Technical RHI
- Teri Clifton, Head of Operations RHI
- Peter Rice, Head of E-Serve Finance
- Gareth John, Associate Director RHI
- Paul Heseltine, Associate Director, Finance and Risk Management

Glossary of terms

Term	Definition
COO	Chief Operating Officer
DECC	Department for Energy and Climate Change
DETI	Department of Enterprise, Trade and Investment
DFE	Department for the Economy
D RHI	Domestic Renewable Heat Incentive
GB	Great Britain
GB ND RHI	Great Britain Non Domestic Renewable Incentive
IM&T	Information Management & Technology
MoU	Memorandum of Understanding
MUS	Monetary Unit Sampling
NAO	National Audit Office
ND RHI	Non Domestic Renewables Heat Incentive (includes GB and NI)
NI	Northern Ireland
NI ND RHI	Northern Ireland Non Domestic Renewable Incentive
NIRO	Northern Ireland Renewables Obligation
RHI	Renewable Heat Incentive
SBS	Strategy and Business Support
SOP	Standard Operating Procedure

## Appendix I

The table below provides a breakdown of the 2016/17 funding requirements for NI ND RHI as follows:

- a) This column sets out the funding requirements submitted by NI ND RHI Scheme management to E-Serve Finance and agrees to the total funding agreed and signed off with DfE.
- b) This column sets out the NI ND RHI Scheme costs as per the May 2016 financial model prepared by E-Serve Finance and agreed with NI ND RHI Scheme management.
- c) This column provides an estimate of what the NI ND RHI Scheme costs should have been after taking into account corporate overhead and IM&T, recalculated by E-Serve Finance for purposes of this review.

Area (taken from the E Serve financial model used across E Serve)		a) Scheme bid 16/17	b) May 2016 Scheme costs	c) Recalculated Scheme costs
Delivery team	Staff	230,772	203,402	243,811
	Bought-in-Services/ Consultancy	53,575	69,964	62,749
	Other	30,269	13,719	14,012
Support Teams	E-Serve IT Oncost – Operations	Note 1	0	11,509 *
	E-Serve IT Oncost – Development		0	23,489 *
	Legal Services Oncost	Note 2	1,028	909
	Finance		3,437	3,460
	Counter Fraud		0	6,242 *
	HR		0	7,061 *
	SBS		0	4,009 *
	MD's office		21,339	21,427
Add ons	Consultancy Contingency	Note 2	10,218	10,218
	IM&T	Note 1	0	7,500 *
	Overhead	Note 2	36,782	36,782
	GWE Contribution		15,166	15,166
<b>Total</b>		<b>375,895</b>	<b>375,056</b>	<b>416,035</b>

\*Assumes 5% of the total ND RHI costs

Note 1: A sum of £47,000 was included for IT/ IM&T. This included a Bank and ID Project, Operational Support and Infrastructure Support.

Note 2: A sum of £12,620 for Central team staff and £1,658 for Central team consultancy costs was included. Based on the supporting calculation this did not account for all Support teams and central/ corporate costs.

## Appendix II

The following table provides detail on the basis of cost allocation used in calculating the £375,895 agreed with DfE and as per the E-Serve financial model in May 2016 for both NI ND RHI and GB ND RHI.

Line item/ cost grouping (as per the E Serve Financial model)		Basis of allocation used to support the £375k prepared by NI RHI Scheme management	Basis of cost allocation to NI ND RHI as per the E Serve financial model as at May 2016	Basis of cost allocation to GB ND RHI as per the E Serve financial model as at May 2016
Delivery team	Staff	Individual staff allocated between NI and GB <b>schemes based on management's best view at the time of preparation</b> multiplied by a standard employee cost per grade. Actual staff costs were not taken into account in arriving at the £375,895.	6% of total delivery staff cost (increased to 7% from November 2016 onwards)	94% of total delivery staff cost (decreased to 93% from November 2016 onwards)
	Bought-in-Services/ Consultancy	Estimated cost of: - 50 Ricardo audits (£49,700) - Tech support for operations and regulatory changes (£3,375) Strategic process and IT spend (£500)	Specific NI ND RHI other costs (Compliance and audit, applications bank and ID checks, Cantata software licences, SUN licences and payment support, Institute of Customer Service, Qlikview software licences)  5% of all ND RHI costs (including scheme development, bank charges, Deloitte NI Independent Assurance work of £7,396, ICF International biogas site visits, call credit API maintenance fee, Cantata software licences, Ricardo audits of £10,473+£11,164)	Specific GB ND RHI other costs 95% of all ND RHI costs (including scheme development, bank charges, Deloitte NI Independent Assurance work of £7396, ICF International biogas site visits, call credit API maintenance fee, Cantata software licences, Ricardo audits of £10,473+£11,164)
	Other	5% of total ND RHI recruitment, training, travel and subsistence, bank charges and stationery costs  Specific NI costs including bank and ID checks,	6% of total delivery team other costs (increased to 7% from November 2016 onwards). This includes: - Training and teambuilding, assumes £750 per employee per year	94% of total delivery other cost (decreased to 93% from November 2016 onwards)

Line item/ cost grouping (as per the E Serve Financial model)		Basis of allocation used to support the £375k prepared by NI RHI Scheme management	Basis of cost allocation to NI ND RHI as per the E Serve financial model as at May 2016	Basis of cost allocation to GB ND RHI as per the E Serve financial model as at May 2016
		software licences, payment costs, Institute of Customer Services	<ul style="list-style-type: none"> <li>- Vouchers, assumes £50 per employee per year</li> <li>- Recruitment, assumes 20% staff turnover</li> <li>- Travel and subsistence</li> <li>- Meeting rooms and accommodation costs,</li> <li>- Office and IT equipment, assumes £150 per employee</li> <li>- Communications, nothing included</li> </ul>	
Support Teams	E-Serve IT Oncost – Operations	Refer to IM&T below	Not applicable as no cost allocated	IT team staff cost allocated on an individual basis between schemes; any bought-in-services are pro-rated according to IT team staff allocations
	E-Serve IT Oncost – Development			
	Legal Services Oncost	Central team staff: 3% of UK RHI 2015/16 figures at time of preparation and a further 3% saving. The 2015/16 costs used as a base included Counter Fraud Staff and Other (cost centre for 7150), Legal Services Staff and Other (cost centre 7115) and MDs Office Staff and Other (cost centre 7105).	Legal team staff cost allocated on an individual basis between schemes; any bought-in-services are pro-rated according to legal team staff allocations	Legal team staff cost allocated on an individual basis between schemes; any bought-in-services are pro-rated according to legal team staff allocations
	Finance	Central team consultancy: 3% of UK RHI 2015/16 figures at time of preparation and a further 3% saving. The 2015/16 costs used as a base included Legal Services Consultancy (cost centre 7115) and MDs Office Consultancy (cost centre 7105).	1% of total E-Serve Finance team cost	25% of total E-Serve Finance team cost
	Counter Fraud		Not applicable as no cost allocated	25% of total Counter Fraud team cost Counter Fraud Independent Advisor
	HR		Not applicable as no cost allocated	28% of total HR team cost
	SBS		Not applicable as no cost allocated	15% of total Counter Fraud team cost
	MD's office		2% of total MD office cost	15% of total MD office cost

Line item/ cost grouping (as per the E Serve Financial model)		Basis of allocation used to support the £375k prepared by NI RHI Scheme management	Basis of cost allocation to NI ND RHI as per the E Serve financial model as at May 2016	Basis of cost allocation to GB ND RHI as per the E Serve financial model as at May 2016
		Not evident whether this was included		
Add ons	Consultancy Contingency	Not applicable as no cost allocated	2% of total contingency allocated to E-Serve	27% of total overhead allocated to E-Serve
	IM&T	10% of: - Operational support to ND RHI - Infrastructure support to ND RHI - Bank & ID project costs	Not applicable as no cost allocated	20% of total IM&T cost allocated to E-Serve
	Overhead	Not applicable as no cost allocated	1% of total overhead allocated to E-Serve	25% of total overhead allocated to E-Serve
	GWE Contribution	Not applicable as no cost allocated	1% of total GWE cost allocated to E-Serve	25% of total GWE cost allocated to E-Serve

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### Appendix III

The table below represents the NI ND RHI monthly actuals and forecasts for the remaining year from the financial models provided by E-Serve Finance for each month during the 2016/17 financial year (Scheme Single Sheet)

Area		May 2016	June 2016	July 2016	Aug 2016	Sep 2016	Oct 2016	Nov 2016	Dec 2016	Jan 2017	Feb 2017	Mar 2017
Delivery team	Staff	219,514	217,375	222,887	226,094	223,428	220,295	212,669	212,253	227,072	233,731	232,128
	Bought-in-Services/ Consultancy	62,749	61,631	63,318	59,752	69,561	52,763	57,427	63,681	56,871	115,532	86,500
	Other	13,539	14,070	14,464	14,619	14,165	14,044	13,008	11,004	10,565	9,961	8,616
Support Teams	E-Serve IT Oncost - Operations	0	0	0	0	0	0	0	0	0	0	0
	E-Serve IT Oncost - Development	0	0	0	0	0	0	0	0	0	0	0
	Legal Services Oncost	909	2,142	2,795	3,524	7,059	10,086	10,999	22,648	35,288	34,417	27,548
	Finance	3,460	3,462	3,396	3,380	3,261	3,227	3,059	2,925	2,930	2,941	2,919
	Counter Fraud	0	0	0	0	0	0	0	0	0	0	0
	HR	0	0	0	0	0	0	0	0	0	0	0
	SBS	0	0	0	0	0	0	0	0	0	0	0
	<b>MD's office</b>	21,427	19,481	19,486	19,303	20,406	19,544	20,004	20,168	20,521	20,830	20,822
Add ons	Consultancy Contingency	10,218	18,888	3,672	0	0	0	0	0	0	0	0
	IM&T	0	0	0	0	0	0	9,375	9,375	9,375	9,375	9,375
	Overhead	36,782	36,782	36,782	36,782	36,782	36,782	36,782	36,782	36,782	36,782	36,782
	GWE Contribution	16,506	16,850	16,780	16,865	17,794	12,505	12,332	13,022	6,769	8,024	5,599
<b>Total</b>		<b>385,104</b>	<b>390,682</b>	<b>383,581</b>	<b>380,319</b>	<b>392,456</b>	<b>369,246</b>	<b>375,654</b>	<b>391,858</b>	<b>406,173</b>	<b>471,593</b>	<b>430,299</b>



## Statement of Responsibility and Use of Report

We take responsibility for this report which is prepared on the basis of the limitations set out below.

This Report has been prepared solely for your exclusive use and solely for the purpose of providing an assessment of the concerns raised over funding and audit sampling methodology used within the NI ND RHI Scheme.

The matters raised in this report are only those which came to our attention during the course of our internal audit work and are not necessarily a comprehensive statement of all the weaknesses that exist or all improvements that might be made. Recommendations for improvements should be assessed by you for their full impact before they are implemented. The performance of internal audit work is not and should not be taken as a substitute for **management's responsibilities for the application of sound management practices**. We emphasise that the responsibility for a sound system of internal controls and the prevention and detection of fraud and other irregularities rests with management and work performed by internal audit should not be relied upon to identify all strengths and weaknesses in internal controls, nor relied upon to identify all circumstances of fraud or irregularity. Auditors, in conducting their work, are required to have regards to the possibility of fraud or irregularities. Even sound systems of internal control can only provide reasonable and not absolute assurance and may not be proof against collusive fraud. Internal audit procedures are designed to focus on areas as identified by management as being of greatest risk and significance and as such we rely on management to provide us full access to their accounting records and transactions for the purposes of our audit work and to ensure the authenticity of these documents. Effective and timely implementation of our recommendations by management is important for the maintenance of a reliable internal control system.

The report and the work connected therewith are subject to the Services Agreement between the Gas and Electricity Market Authority and Deloitte LLP for Internal Audit and Assurance Services dated 25 June 2015. The report is produced solely for the use of Ofgem for the purposes of its internal audit programme. Its contents should not be quoted or referred to in whole or in part without our prior written consent except as required by law. Deloitte LLP will accept no responsibility to any third party, as the report has not been prepared, and is not intended for any other purpose.

Deloitte LLP  
London  
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