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Dear Fiona,

### **NIRHI – Funding for 2012/13 and future requirements**

Further to our recent correspondence, I am writing to provide you with some further analysis of NIRHI scheme costs to date and to propose an adjustment to the way we calculate future funding. This proposal provides for a reduction of the funding required for 2013/14 as set out in the baseline scope and will, I believe, provide better certainty for both parties and reduce the risk associated with the current funding mechanism.

As you are aware, the Baseline scope set out estimated costs for the operational aspects of NIRHI at the following amounts:

2013/14	2014/15	2015/16
£164,636	£223,809	£341,629

After negotiation the following formula for providing the funding necessary for Ofgem to administer the NI RHI, was arrived at:

**We anticipate costs for NIRHI will be around 3% of total scheme operating costs. As a result, we propose to charge on the following basis that DETI costs = Total RHI operating cost\* Value of NI tariff payments / Value of Total (NI+GB) tariff payments.**

Unfortunately, based on the formula above, the payment to Ofgem for 2012/13, would have been zero. However, thanks to the initial funding you made available, and to the additional £19,000 provided to fund interim manual systems, Ofgem was able to recover close to the actual cost of running the scheme in 2012/13.

Now that we have been operating the NIRHI for five months, we have data which indicates that the agreed formula may not in fact be appropriate in 2013/14 as it could result in Ofgem receiving insufficient funds to administer the NIRHI, which would represent a significant risk both to Ofgem and to DETI.

## Why the formula may not cover Ofgem's costs in 2013/14

- 1) Some resource requirements associated with running a scheme are not proportionate to the number of applications (see Annex 1) as, for example, there are significant fixed costs including baseload tasks and management time liaising with DETI etc.
- 2) Actual numbers of applications to date have been very low, providing no scope going forward to absorb additional non-proportionate costs should these volumes continue.
- 3) Payments lag significantly behind much of the work carried out by the operational team. Payments are not usually made for at least six months after the enquiry and application handling stage. This depresses charges in any year in which the number of applications is growing. The projections are that total RHI application numbers will grow throughout the lifetime of the scheme but because NIRHI started considerably later than GBRHI it is considerably behind GBRHI on the growth curve. Therefore basing charges on this very lagging indicator will mean that DETI would be charged only for a small percentage of the work done on NIRHI in any year, and this proportion would be disproportionately smaller than the GB scheme for which more payments are coming through.

Fuller details of the proportionality issue are provided in Annex 1.

## Alternative funding calculation options

For the reasons set out above, it is not certain that the agreed formula will provide adequate funding for NIRHI in 2013/14 and beyond. The following alternatives to the agreed formula are suggested.

### 1) Full costing

The finance team at Ofgem could provide a full actual costing for NIRHI.

There would be costs associated with this option. Not only would it be necessary to have separate staff or a strict allocation of a proportion of their time to NIRHI, all associated recruitment and other costs would have to be passed on to DETI as would a charge for the work done by the finance and management teams to provide the necessary level of detail on a regular monthly basis. As this is likely to be the more expensive option it has not been investigated in detail.

### 2) A charge based on a fixed and variable portion

A two-tier charge with a set fixed charge and a variable amount in addition based on proportion of **accreditations** would enable us to cover baseload costs even at low volumes. It is suggested that accreditations, rather than payments be used to set the proportion of cost attributable to the GB and NI schemes respectively. This is to avoid the issues noted above associated with using payments which is a lagging indicator. (If accreditations slow for NI however, using accreditations would favour DETI as the ongoing costs of managing periodic data and payments may not be adequately covered.)

## The fixed charge

It is proposed that a fixed charge of 3 per cent of the GB operational budget be made to Ofgem to cover the administration of the NIRHI. The rationale for this is as follows:

### 1) Staffing costs

In the first months of operation, 3.75 per cent of total operational staff time was spent on NIRHI. It is assumed that this is greater than would be needed once we reach steady state. By removing hours spent on actual processing of applications, which will vary with the number of applications received, this figure can be reduced by around 10 per cent. A further reduction has then been applied to allow for steady state efficiencies to provide a simple calculation that a

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fixed 3% of operational costs should be attributed to NIRHI. It is proposed that this be provided as a fixed amount to allow for appropriate planning and budgeting. Provision at this level will also allow for sufficient audit procedures to be put in place.

**2) Audit**

The agreed funding mechanism would have allowed for perhaps one audit in 2013/14. The funding methodology proposed now would provide for c9 audits. It is felt that this should be sufficient for up to 123 participants, however you may wish to allocate separate funding if you would prefer a larger sample.

**3) Recruitment**

A 3 per cent charge would allow us to recruit one member of staff for NIRHI, and current experience on the scheme indicates that this will be needed in 2013/14. Five people have been trained to work on NIRHI and we would expect at least two of them to be replaced during the coming year. The 3 per cent charge would meet part of the cost of recruiting one new member of staff.

**4) IT**

For these areas, 3 per cent of the GB budget will allow us to extend efficiency improvements being made to the GB scheme to NI. This will reduce the possible divergence of the schemes.

For the items above, the costs are likely to be in broad proportion to GB, for the items below, there is a potential that the costs for NIRHI may not be in proportion to GB

**5) Complaints and disputes**

Currently running at a low level, these may be sporadic or triggered by particular issues such as technologies or application type, and some of these issues may disproportionately affect NI based on the demographics of the region. A considerable proportion of complaints to date have arisen because of concerns that a particular technology is being unfairly treated. For example, ground source heat pumps were, at one stage, mired in technical and legal issues. Areas with more 'new build', or areas with more land available for ground or water source loops would be more likely to generate complaints of this nature. It seems theoretically possible that such issues might disproportionately affect Northern Ireland. Other complaints triggers have been grant funding issues. At present of the six accreditations for Northern Ireland, three have been car mechanical and other similar small workshops, but numbers are so low it is difficult to draw valid conclusions.

**6) Fraud and compliance**

Fraudulent activities are rare at present so even one case affecting NI would be a significant proportion of all the cases under consideration, potentially far outweighing the proportion of payments for the region. Experience so far is that a case arises for around every 350 applications. We expect NIRHI to have 123 applications in 2013/14 so it should be likely that no cases will arise. However, should one do so it would be out of proportion to the GB scheme.

**7) Legal issues**

Issues specifically in relation to NI have already arisen such as the privacy policy. In the GB scheme there was a considerable bedding in period in which legal issues emerged. It is expected that the same will apply to NI.

In cases 5, 6 and 7 there is some risk that the costs could escalate above the 3 per cent provided for in this new charging mechanism, for the reasons set out above. Should the full 3 per cent not be required, only the amount actually spent would be invoiced to DETI. However, should costs associated with fraud, legal issues or complaints escalate to a level

which could not be accommodated in the available budget Ofgem would revert to DETI for contingency funding.

### The variable charge

If NI applications rise above 3 per cent of the GB total, an additional variable charge will be made. The amount would be calculated by assessing the proportion of accreditations which are NIRHI and charging the corresponding proportion of the GB staffing costs.

The formula would then be as follows:

**The fixed charge for administering the NIRHI will be 3% of total GB operating budget for the year (not including any allocation for development). In addition, should the proportion of applications for NIRHI exceed three per cent of those for the GB scheme, an additional charge will become payable on the following basis: Percentage of NI accreditations / Total (NI+GB) accreditations minus 3%\* total RHI staffing costs.**

**Applying the above formula, the charges for 2013/14 are set out below:**

<b>RHI Operational budget 2013/14</b>	
Operations staff	71,218
Legal staff	9,161
Recruitment	1,920
Training	3,155
Consultancy - volume driven	14,861
Consultancy - other	4,440
IT	26,940
Events	600
Other	2,103
Total	£134,398
Operational budget as set in baseline scope	£164,636
<b>Decrease in budget provision required*</b>	<b>£30,238</b>

\*Assuming accreditations for NI do not exceed 3% of those for GB

### Other issues to consider

#### FOI requests

These are growing in number and it is not clear to Ofgem that DETI expects us to be responsible for managing them. DETI may wish to take on this aspect themselves, or alternatively to fund Ofgem to deal with FOIs. We would be grateful for clarification on this point. Again, the numbers to date are not large (although in one recent week 6 FOIs were received each taking up to six days, so the resourcing implications can be significant) and if the new formula is adopted this we would be happy to deal with these aspects on behalf of DETI within the funding set out above.

I will shortly be visiting so that we can discuss this proposal in more detail, in the meantime if you have any queries do please give me a call on the number above.

Yours sincerely,

Matthew Harnack

## Annex 1 - Proportionality

Some resource requirements associated with running a scheme are not proportionate to the number of applications

### Costs which *are* probably proportionate

These will include aspects such as:

- IT (including support, hardware and software, licences etc)
- Recruitment
- Technical consultancy
- Travel
- Enquiries
- Overhead

### Costs which are highly likely to be out of proportion

#### 1) Divergence of schemes

As well as impacting on development and IT costs, divergence of the GB and NI schemes will impact on operational costs. Scheme divergence is highly likely, for example, it is not expected that the NIRHI scheme will be revised on the same timescales as the GB scheme. Under the GB scheme there will be changes in 2013/14 to the definition of complex systems. These changes will not be introduced for NI until considerably later. Staff will have to be trained to operate two different systems and monitoring will have to be put in place to ensure this is appropriately handled. While some of the changes to the GB scheme may increase scheme requirements, others, such as the metering changes, are expected to considerably reduce the amount of work needed to accredit an installation. Where these are delayed for NI, as well as the costs of divergence, there will be a resource cost for maintaining the more time consuming procedures for NI, which will make the costs of running that scheme disproportionately greater for NIRHI. A number of regulatory fixes which will simplify the accreditation process are currently being considered by DECC.

#### 2) Differences in application type

Although in theory the larger and more complex an application is, the more time it takes, in practice, particular characteristics can increase the time taken to process an application. For example, farmhouses are not usually business rated so establishing their eligibility for the non-domestic scheme can be very time-consuming. Such premises may be a disproportionate amount of NI work depending on the demographics of the area. Although as previously noted no farms in NI have applied for the scheme yet it is too early to rely on that fact.

#### 3) Reporting and communication

All reports produced for GBRHI have to be replicated for NIRHI. This is not an additional 3% workload for these tasks, it is estimated to be closer to an additional 25%, taking into account that some of the issues will have been resolved in developing the GB report. Reporting currently utilises 4.8 FTEs per annum. We are working on making our reporting more efficient by developing our IT systems.

#### 4) Timesheet reporting

Because it was recognised that not all tasks are proportionate to NIRHI payment levels, it has been necessary to ask all staff working on NIRHI to keep timesheets of the work they do specifically on NIRHI. It is this timesheet reporting which has allowed us to have solid data upon which to base this analysis of the proportion of time being taken on NIRHI. It will also provide security, going forward, that we have accurately portrayed the cost of running the NI scheme to DETI. This is an administrative burden on those staff who have to complete timesheets, on their managers and on those reporting on their activity. Again, these activities are not necessary in relation to the GB scheme.

### 5) Staff allocation

In order to manage the RHI scheme we have to have different staff able to carry out the following tasks:

- Operational management
- Application processing (+leave cover)
- Enquiry handling (+leave cover)
- Level three reviews (+leave cover)

Although these individuals will not need to spend 100% of their time on NIRHI, they will all have to be trained so the training overhead is higher for NIRHI. Because the absolute numbers of staff employed on these tasks is so low, a full extra person has to be trained in each area to provide cover. In the GB scheme, training one extra member of staff will provide cover for many postholders. Therefore the training burden will not be proportionate to that of the GB scheme.

### 6) Management of the scheme

Managing the relationship with DETI may not take the same amount of effort as managing the relationship with DECC, since, for example, we do not have to attend monthly meetings with DETI. Nonetheless it is considerably more than 3% of the work associated with managing the relationship with DECC especially given travel times to DETI etc.

It is these tasks which, along with scheme management and reporting which form the baseload of tasks for RHI which are not, or may not be proportional to the same tasks for the GB RHI scheme.

## Annex 2 - The operational charges in 2012/13

Cost	Detail	Amount
Staffing	Assistance with UAT	2,144
	Writing operational procedures	2,292
	Processing applications	1,790
	Enquiries handling	482
	Providing reports, managing the scheme, liaising with DECC etc	18,094
Total		<b><u>24,802</u></b>
	This included manual processing of applications in the period before the IT system went live. Timesheets indicate that the total operational staff time taken up on NIRHI equated to 3.75% of the GB RHI operational staff costs during the 1 <sup>st</sup> November – 30 <sup>th</sup> March 2013 period. This proportion has been reduced to 3% for the purposes of charging.	
ID checks	For the 8 applications received in year	£16
Total		<b>£24,818</b>