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Bcc: Mark George[Mark.George@ofgem.gov.uk]; Shaneigh Turner[Shaneigh.Turner@ofgem.gov.uk]
From: Edmund Ward
Sent: 2016-05-20T12:54:10Z
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Subject: RE: Urgent - Explanation needed around Ofgem to issues identified through Site Audits [OFFICIAL]
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Stuart

Thanks for the opportunity to comment and clarify on the points you shared.

See below our responses (in green), and also for reference Deloitte responses (in red) to Michael Woods' earlier email (in blue). [NB: I have not shared these with Michael, but I'd be happy for you to do so].

I also note (as discussed between Teri and Seamus) that the audit rates referred to below were based on a wider summary provided in the (draft) Deloitte Phase 1 report; for reference, the extract is as follows:

Site inspection audit coverage: Site inspection audits selected for FY2015/16 originally covered 0.86% of the full population of sites, with a further 8 sites added at DETI's request in January 2016. However, there has been no adjustment to take account of the 200% increase in applications between September 2015 to February 2016 (compared to the number of applications received for FY2014/15), or the non-compliance issues related to fuel records and heat loss calculation which have been identified in three out of four (75% non-compliance) finalised reports from the FY2015/16 audit plan. Furthermore, site inspections are not performed across all technology types utilised under the NIRHI.

Regarding the joint review, I can report that we had a productive meeting with Deloitte and Ricardo this morning, and we will share initial proposals on an approach to phase 2 next week.

Kind regards
 Edmund

From: Wightman, Stuart [mailto:Stuart.Wightman@economy-ni.gov.uk]
Sent: 19 May 2016 20:35
To: Edmund Ward
Cc: Teri Clifton; Hughes, Seamus
Subject: Urgent - Explanation needed around Ofgem to issues identified through Site Audits

Edmund

Apologies for the very short turnaround, but we urgently need to respond to an early draft of an NI Audit Office Report on RHI tomorrow. The draft report includes the following text raising concerns / questions around the current audit programme and how any issues are identified. Now's the chance to challenge any inaccuracies in the draft report. Can I please ask you to provide a response or correct the text I've highlighted below. Can I please ask for a response asap?

Thanks again, Stuart

OFGEM also carried out physical inspections of the equipment installed to ensure it meets the scheme requirements. However I understand that the rate of inspection in Northern Ireland has been very low at around 0.86 per cent of applications (compared to around 1.86 per cent in Great Britain).

It should be noted that this rate was a result of site audits being planned on the basis of anticipated application rates. Significant and unprecedented increases in application volumes in 2015/16 saw c. 2128 applications received by the end of 2015/16, versus 434 in 2014/15. Some 982 applications were received in the period September-November 2015 alone, and 1,307 in the period September 2015-February 2016, and we would expect these to form part of the audit strategy for 2016/17.

Ofgem carries out audit activity, including via the use of 3rd parties, in line with our administrative arrangements and agreed funding. DETI and Ofgem have regularly discussed the approach to audit as the numbers of applications increased, as part of the developing audit strategy for 16/17 and beyond.

Overall 14 audits were conducted in 2015/16, which is 4% of the 359 applications received in the first 6 months of the year, or 1.5% of the 921 applications received from scheme launch until September 2015. The Department and Ofgem are already engaged in a joint review, which in addition to considering an approach to applications received in 2015/16 will inform the audit strategy for 2016/17 and beyond.

This very low rate of inspection is compounded by the fact that when issues are identified by the inspection process it is very unclear if anything is done about it – particularly by the Department. In 2015-16 of the four scheme inspections that had been completed at the time of this report, compliance issues were identified in three. However the Department is not routinely provided with any detail of these issues by OFGEM and it is unclear how issues arising from inspections are cleared.

DETI and OFGEM have regular meetings at which operational issues or trends are raised as appropriate. It's important to note that there are a large number of eligibility requirements and ongoing obligations relating to the Non-Domestic RHI scheme. While Ofgem and the

Department rightly and properly record and action these where identified and where appropriate, in many cases these do not have a material impact. For example, of the 3 cases where non-compliance was identified, in no case is this anticipated to result in retrospective sanctions with regard to payments made, and subject to compliance actions we would not impact on future payments to these sites to be affected by more than 1%. OFGEM uses the results of its audit programme, not only to take action on individual cases, but to consider the wider approach to non-compliance, and this includes administrative/operational changes (such as via updating guidance or processes) to focus on preventative measures.

Another important control operated by OFGEM to prevent abuse of the scheme is that it will query any increase in heating equipment hours used which is more than 25 per cent higher than had been predicted in the original application. However it is unclear how OFGEM challenges the veracity of the explanations received and in any case the Department does not routinely get to see the explanations.

DETI and OFGEM have regular meetings at which operational issues or trends are raised as appropriate. Individual responses to requests for information are assessed on a case-by-case basis, and Ofgem will not release payments if it has evidence or reasonable grounds such that it is not satisfied that ongoing obligations have been met. Outcomes of this review includes referral of individual installations for further investigations, including by compliance teams or via inclusion in the site audit programme.

Please see below also, some responses from Deloitte to Michael Wood's earlier email regarding the draft Deloitte Phase 1 report:

With specific regard to the draft report I would make the following comments and observations:

1) The report provides no overall opinion or stated level of assurance on the system of control as it applies to the NI Scheme. The reason why the investigation has been commissioned is in response to allegations that have been received that the NI Scheme has been subject to Fraud and Abuse and that Scheme Controls are either insufficient to manage these risks or have not been operating effectively. Given that the risks associated with these allegations are the same risks recognised in Ofgem's Fraud risk Strategy, I would have expected the report on Phase 1 to have provided an overall opinion on the system of control to manage these risks as well as a specific opinion on the controls in regard to the 5 key areas specified in the scope;

- Eligibility;
- Ongoing Compliance;
- Payments;
- Governance; and
- Site inspections.

The report lists the findings (in most cases there are none) in each of these areas but provides no specific level of assurance on controls in each area. It would be useful as part of the work on Phase 1 for the report to set out the key controls in each of these areas and the extent to which these were found to be adequate to manage the stated fraud risks and the extent to which any differences in the NI Scheme impacted on these controls.

First, the reason our report provides no overall opinion / level of assurance is purely because it was commissioned as 'Independent Assurance' Work, for which we have agreed with Ofgem Audit, Risk and Assurance Committee ('ARAC') that we would rate individual findings, but not the overall report. We do provide overall ratings for Internal Audit reviews. Independent Assurance work is typically commissioned on an ad hoc basis by the business, whereas Internal Audit work is delivered under an agreed plan, agreed with ARAC at the start of the year.

We understand your concerns in not receiving this overall rating but would like to provide reassurance that it's not in any way a reflection of the appropriateness and adequacy of Ofgem's system of internal controls relating to NIRHI; it's merely the way we have agreed to present our reports.

Second, we understood there to be allegations of fraud and abuse, but were not privy to the exact nature of such allegations (what they were, who they came from, how many allegations have been received etc.). We have adopted a two-phase approach to first (and we think sensibly) rule out process and control issues from an Ofgem Administration standpoint, before spending the time and money doing site visits to identify potential fraud and abuse that may only be identified from physical inspections.

Finally, we adopt an exceptions-based approach and only report on those areas where we have identified control gaps, or issues related to operating effectiveness of controls (as identified from audit testing). The absence of findings on the remaining scope items means that we have not identified any control deficiencies in these areas. Unless otherwise agreed, we would not typically report on all key controls identified for each scope area and report against the adequacy of these. Additionally, our process understanding did not reveal any differences in the administration of the NI vs GB scheme, apart from those already identified in the report.

2) The report includes two findings, the issues raised appear to be significant but receive Medium to Low ratings respectively. The report would need to include more information on the assessment of the consequences of these risks for the system of control and in particular if they increase the risks highlighted in the allegation: For example:

Finding 3.1 this finding highlights that a total of 6 on site inspections were carried on the NI scheme applications in 2015/2016 which represents 0.86% of the NI Population compared with 1.8% for the GB scheme. The report does not however, consider the impact of this on the effectiveness of the onsite inspections as a control over risks in the NI Scheme and the extent to which this figure is in line with the % of installations that would need to be inspected to provide a reasonable level of assurance on the NI Scheme. One of the allegations being that there is ineffective oversight of the scheme.

For Finding 3.1, we have highlighted that insufficient audit inspections would increase the risks of fraudulent behaviour / non-compliance with NIRHI not being identified. Having more audit coverage is a detective control to identify fraud (and be preventative in a sense that it can deter bad behaviour). Phase 2 would definitely include a consideration of the number of site

audits needed to provide appropriate and sufficient coverage, based on the number of live Participants and the exact nature of the allegations (to tailor the audit approach to match the risk areas identified).

We are also mindful that some allegations may be related to Policy, rather than process.

The finding goes on to state that three out of the four finalised reports for 2015/2016 identified non compliance issues related to fuel records and heat loss calculations (75%). There is no explanation of whether or not these non compliance issues are significant, the amount if any of grant at risk or how these findings affect the overall risks of fraud and abuse in the NI scheme. It states that all issues were investigated and managed by the compliance team but does not state if the issues were resolved without affecting eligibility or if these findings are as a matter of course formally shared with DETI.

[Addressed above]

3) The second finding in the report, highlights the differences between the categorisation of Medium installations between NI and GB schemes. It recommends that management perform a review of process differences between GB and NI and the impact on Standard Operating Procedures (SOP) within the Scheme controls. The finding needs to make clear the impact of any differences, on how the NI scheme is controlled whether or not as a result there has been insufficient coverage on NI installations as part of onsite inspections. Further understanding the impact of any differences in SOPs and how they affect the control over the risks in the NI scheme is something that would need to be undertaken as part of Phase 2.

This finding is merely an administrative point that the SOP's should reflect the differences in process and controls for GB and NI. In this instance, it should cover the differences in definitions of small, medium and large biomass sites and only impacts the Periodic Data Team's desktop review process; it is separate to onsite inspections entirely. From our sample testing, differences in definition did not impact the operating effectiveness of controls because the full review was carried over the correct sites based on size. We acknowledge the importance of SOP's reflecting processes and controls however and hence it has been raised in our report.

In considering the current draft report and the scope for Phase 2 of the review, it is critical that at the end of Phase 1 and 2 we have a completed piece of work that has investigated the allegations of Fraud and Abuse and not simply a systems audit review and a series of site inspections. To ensure the investigation meets its objectives it is important that the scope of the work undertaken in Phase 2 is such that Deloitte are in a position to express an opinion of whether or not the allegations have been found to be true or not. It is also important that this opinion is based on a sufficient substantive programme of inspections, that it considers and reports against the Fraud / Abuse / Gaming Risks that are recognised in the Ofgem Fraud risk strategy and are at the centre of the allegations that have been received i.e. gaming the scheme, fraud, generation of unnecessary Heat etc. In the context of the draft report on Phase 1 it is important that it clearly states that there are clear controls to mitigate these risks and its opinion on the adequacy and effectiveness of these controls.

Deloitte agreed that they would perform a comprehensive and independent review irrespective of the allegations of fraud. As we were not privy to exactly what the allegations are, we performed a detailed review over the end to end process in administering the scheme (and hopefully this will have covered off on any process and / or control gaps that would increase the risks of fraud happening). We did not consider or cover Policy, which DETI is responsible for (as discussed today).

[Internal Only]

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