



Briefing

Grant Thornton review of the NDRHI Audit Strategy – Action Plan

This paper provides a summary of the actions that will be taken forward following a review of the NDRHI Audit Strategy by Grant Thornton	From	Amy Powell-Tuck
	To	Management Committee
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1. Summary

- 1.1. In October 2014 Grant Thornton were commissioned to carry out an external review of the Non-Domestic Renewable Heat Incentive Audit Strategy.
- 1.2. As part of the ITT they were asked to provide two reports; Tranche 1 to review the current audit strategy and review whether it is consistent with good practise; Tranche 2 to provide recommendations for improvement and advice regarding future sample sizes.
- 1.3. An update was given to MC on the 2th January following the finalised Tranche 1 report. This paper provides an update on the finalised Tranche 2 report and the actions that will be taken forward following the review.
- 1.4. The recommendations in this paper have been incorporated into the draft Audit Strategy for 2015/16 which is due to be discussed by Chris Poulton / Dan Osgood on the 20th March.

2. Ofgem’s response

- 2.1. The recommendations presented in Grant Thornton’s reports were not unexpected by the Audit team. As previously mentioned in the Tranche 1 update, a number of the actions are already in the process of being implemented / in place.
- 2.2. We intend to take the majority of the recommendations forward including the dual approach to site selection (statistical/targeted).
- 2.3. Only two recommendations are not being taken forward (detailed in the table in the appendix). This is a result of regulatory restrictions / unnecessary further categorisation.
- 2.4. The draft Audit Strategy is currently being reviewed internally and incorporates the Grant Thornton recommendations being taken forward.
- 2.5. The draft Audit Strategy outlines the confidence level, expected error rate and materiality values we intend to use to establish the sample size going forward for the statistical audits.
- 2.6. The Appendix provides a summary of all recommendations and our responses to them.

3. Appendix – summary of recommendations

Section [Ofgem category]	Priority [Ofgem priority]	Grant Thornton Recommendation / Observation	Take forward? (Y/N)	Ofgem response
Audit approach [sample size]	High	In order to harness the benefits of both statistical and targeted sampling techniques we would recommend the audit approach is split into two separate parts. The first part would be a representative statistical sample to give a view of overall compliance rates for the entire population, allowing results to be extrapolated and overall conclusions to be drawn on the scheme as a whole. The second part would focus on targeted sampling based on the audit team's experience, allowing audit resource to focus on the areas of highest risk. Further details of how this approach would work in practice are set out in Section 3 and 4 of this report.	Y	We agree with this recommendation and will take it forward as part of the Audit Strategy for 2015/16. We will use installations approved in the previous financial year to form the 'population' for the statistical group. The following values have been proposed in the draft Audit strategy: Confidence level- 95%, Materiality- 3%, Expected error rate: 0.75%, giving a sample size of 175 statistical audits. In addition, at least 100 targeted audits will be completed. These values have yet to be approved by senior stakeholders.
	-	In the first year of implementation, management will need to decide whether they wish to perform one statistical sample over all of the historic payments, or whether they wish to split the historical data and perform separate statistical samples on separate scheme years.	Y	We have decided to perform one statistical sample over all the historic payments.
	-	We recommend that management determine their approach to re-auditing sites that have previously been audited.	Y	We will look into completing a review of this by March 2016.
Sample size [Site selection]	Medium	We recommend that evidence that the site selection criteria is reviewed and approved by senior stakeholders is retained.	Y	On-going- senior stakeholders are already involved with informing risk categories. We will reformat the site selection form to include a signature line to evidence this.
Audit types	Medium	Given the limited scope of desktop reviews and internal resource required to perform the checks, we recommend that these reviews are restricted to installations where a concern has been raised with the meter readings, fuel records and inhibitor use, rather than performing a fixed percentage of desktop reviews each year.	Y	Agreed- the desktop strategy will be reviewed as part of the wider audit strategy. Site selection logs can be modified so that the operational team can assist in recommending relevant sites. We also expect to review the scope of the desktop audits to account for the introduction of biomass sustainability requirements in October 2015.
	High	We recommend that pre-accreditation audits continue going forward and form part of the targeted audit sample.	Y	Pre-accreditation audits are a useful tool for complex / large installations or where there is a lack of certainty from the reviewer as to whether they are being given an accurate representation of the installation set up. Each recommendation is carefully considered by the audit team and a referral form is used to get clarity regarding the points

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				that are unclear. A number of audits will continue to be set aside as part of the targeted sample in order to accommodate pre-accreditation audit requests.
Categorisation of findings-observations	Medium	We recommend 'observations' are reviewed to identify the risks associated with each one and determine which observations need to be recorded as part of the audit process.	Y	On-going. Planned completion by the end of 2014/15, with a view to incorporating this into BAU going forward.
	Medium	It would be useful to categorise 'observations' into three categories; 'further information required', 'best practice point' and 'for Ofgem information only'. This will help determine and prioritise follow up actions.	Y	On-going. Planned completion by the end of 2014/15, with a view to incorporating this into BAU going forward.
Categorisation of findings-potential errors	Low [High]	The potential error percentages should be reviewed by the Audit and Compliance team to ensure these are consistent with current understanding on a cyclical basis (e.g. annually).	Y	On-going. Planned completion by the end of 2014/15, with a view to incorporating this into BAU going forward.
	High [Low]	We would recommend that overpayments calculated by the PDS team are compared to the values used for audit purposes to determine whether the potential errors reported are appropriate.	Y	On-going, but further review required. Closer collaboration with the compliance team means processes are in place to understand and record the values recouped / action taken in order to inform this.
	High	A library of potential error percentages which records the rationale/source for each figure should be updated to ensure corporate memory is retained.	Y	On-going. Planned completion by the end of 2014/15, with a view to incorporating this into BAU going forward.
	High	If any potential errors associated with non-compliances are revised following an annual review, we recommend that both the new and the old potential error should be logged in a central library. For the year following a change in potential error, we would recommend that when the results are reported, a footnote is included to illustrate the impact resulting from the 're-grading'. This will allow comparability year on year.	Y	On-going. Planned completion by the end of 2014/15, with a view to incorporating this into BAU going forward. Reporting the result following a 're-grading' should be achievable and can be explored further.
Categorisation of findings-non-compliances	High [Low]	We recommend that each non-material non-compliance should be reviewed and classified as 'major', 'moderate' or 'minor' to ensure consistent treatment under Ofgem E-Serve's assurance framework. From our discussions with the Audit team we do not anticipate many non-material non-compliances to be categorised as 'major' or 'moderate'.	N	We will consider further the benefits of any additional sub-categorisation, while taking into account the new risk categorisation already agreed with DECC's Audit and Risk Committee (ARC).

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<p>Response to non-compliances</p>	<p>Medium [Low]</p>	<p>We recommend that the Audit team review any non-material, non-compliances where no further action is taken, to establish whether these should continue to be monitored as part of the audit programme.</p>	<p>N</p>	<p>We will consider this further but also recognise that in some areas scope to do this has been limited by regulations. For example, not keeping fuel records contravenes the regulations and is therefore is recorded as a non-compliance. However regulatory changes are expected to come into force that should help to reduce the key non-material non-compliances ('meter component installed incorrectly' and 'lack of fuel records').</p>
<p>Calculation of impact</p>	<p>Medium [High]</p>	<p>We would recommend that the NDRHI quarterly reports are enhanced by quantifying the monetary impact of each non-compliance category reported.</p>	<p>Y</p>	<p>Agreed- This should be easy enough to implement</p>