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Northern Ireland Audit Office

Report by the Comptroller and Auditor General for Northern Ireland

# Department for the Economy

# Resource Accounts

# 2018-19

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## Introduction

1 In each of the past three years, I have reported on significant concerns surrounding the operation of the non-domestic Renewable Heat Incentive (RHI) scheme. Each of my reports attached to the Department's Resource accounts have outlined significant weaknesses in the scheme and set out the ongoing actions proposed by the Department to address these weaknesses.

2 My initial report in June 2016 was followed by seven evidence sessions of the Public Accounts Committee between September 2016 and January 2017. The Renewable Heat Incentive Inquiry was then established to carry out an in-depth investigation of the operation of the scheme and is likely to report later this year.

3 My report below provides an update on:

- how actions taken by the Department have reduced the total costs of the scheme;
- how the reduction in tariff rates from 1 April 2017 has affected the behaviour of applicants on the scheme;
- actions taken by the Department to increase the number of inspections and deal with any enforcement action; and
- why I have again decided to qualify my regularity audit opinion.

## Total costs in 2018-19

4 In order to protect the Northern Ireland block budget and to bring the scheme back within the allocated budget, the Department imposed significant changes to the tariff paid from 1 April 2017 to all users of the scheme. Legislation was passed through Westminster to extend this revised tariff rate to 31 March 2019. Table 1 below compares the tariff rates payable for a typical 99kW boiler accredited onto the scheme before 18 November 2015.

**Table 1: Change in tariff rates**

| | **Original tariff rate up to 31 March 2017** | **Revised tariff rate 1 April 2017 to 31 March 2018** | **Revised tariff rate 1 April 2018 to 31 March 2019** | **Current tariff rate from 1 April 2019** |
|---|---|---|---|---|
| Heat generated per kWh **up to** 1,314 hours (15 per cent of total hours in the year) | 6.4 p/kWh | 6.7 p/kWh | 7.0 p/kWh | 1.7 p/kWh |
| Heat generated per kWh **over** 1,314 hours | 6.4 p/kWh | 1.5 p/kWh | 1.6 p/kWh | 0 p/kWh |
| Maximum kWh payable | Unlimited | 400,000 kWh* | 400,000 kWh* | N/A |

**Source: Department**
**Based on rates payable for a 99kW boiler accredited before 18 November 2015**
***400,000kWh equates to a 99kW boiler operating approximately 11 hours each day of the year**

5 The implementation of the rates after 2017 have significantly reduced the cost of the scheme to the extent that in 2018-19 the annual cost of RHI was less than the share of the UK budget available by £1.9 million.

**Table 2: Annual costs of the RHI scheme**

| | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|
| | £million | £million | £million |
| Annual cost of non-domestic RHI scheme | 42 | 21.7 | 21.1 |
| Annual cost of domestic RHI scheme | 3 | 2.8 | 2.7 |
| Annual cost of both RHI schemes | 45 | 24.5 | 23.8 |
| | | | |
| Costs covered through NI share of UK RHI budget Annually Managed Expenditure (AME) | 18 | 22.3 | 25.7 |
| **Costs met from the NI Executive Departmental Expenditure Limit (DEL)** | 27 | 2.2 | - |
| **Unused AME budget for RHI** | - | - | 1.9 |

**Source: Department**

6 The further significant reduction in RHI tariffs from 1 April 2019 will further significantly reduce the cost of RHI, well below the Annually Managed Expenditure (AME) budget available. I asked the Department to comment on this underspend and whether it intends to introduce any new Renewable Energy schemes in the future to help utilise this budget. The Department told me that work to consider the required support for renewable energy, in general, is being considered as part of the development of the new draft Energy Strategy for Northern Ireland during the next 18 months.

## Change in behaviour of applicants

7 The significant amendments to the tariffs from 1 April 2017 appears to have been a key factor in a substantial reduction in the overall heat generated under non-domestic RHI since 2016-17. This reduction may suggest that in some cases, heat produced before April 2017 was not actually required for business purposes but rather some of it may have been produced only with a view to increasing RHI payments.

8 I reported last year on the significant reduction in both heat output produced and the corresponding RHI payments and this trend has continued again in 2018-19 as outlined in Tables 3 and 4 below. This reduction is particularly marked in the forestry/wood sector which would typically have been engaged in generating heat for wood drying.

**Table 3: Heat Output produced in MWh for all applicants**

| Sector | Number of installations | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|---|
| | | MWh | MWh | MWh |
| Agriculture | 1,114 | 425,470 | 288,110 | 240,340 |
| Forestry/ wood | 186 | 79,935 | 42,572 | 35,485 |
| Other | 828 | 178,177 | 125,620 | 106,655 |
| Total | 2,128 | 683,582 | 456,302 | 382,480 |

**Source: Department** ***Based on meter readings to May 2019***

**Table 4: Non – domestic RHI payments for all applicants**

| Sector | Number of installations | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|---|
| | | £million | £million | £million |
| Agriculture | 1,114 | 26.8 | 12.9 | 12.8 |
| Forestry / wood | 186 | 4.7 | 1.6 | 1.5 |
| Other | 828 | 10.5 | 7.2 | 6.8 |
| **Total** | **2,128** | **42.0** | **21.7** | **21.1** |

**Source: Department**

9 I asked the Department to comment on the apparent changes in behaviour shown following the new tiered rate and cap on heat output imposed from 1 April 2017. The Department told me that the introduction of the tiered tariff to all applicants had significantly reduced the incentive to produce unnecessary heat. Before the changes in 2017 the incentive paid for each kWh of heat generated was higher than the cost of production whereas after 1 April 2017, once the applicant reached the top of Tier 1, the incentive paid reduced to significantly below the cost of production.

## Inspections

10 I reported last year that the Department had appointed inspectors to complete 250 site inspections in 2018-19, selected on a risk assessment basis. As well as this the Department had undertaken to complete a series of desk reviews of sites assessed as low risk.

11 Since then the Department has conducted its full risk assessment based on a number of criteria such as heat generation statistics, existence of a previous heating system, number of installations and the date installed. Based on this it was able to produce a list of installations in risk order which was then used to create a list of the first 250 sites to be inspected based on the highest risk.

12 The first site inspections commenced in July 2018 and consisted of a technical examination to ensure that the information initially provided to Ofgem when the installation was accredited was the same as the actual configuration and that it was complying with regulations. In addition there was analytic and other desk based work carried out to support ongoing eligibility and in particular to examine if the heat generated since installation is reasonable for the purpose stated by the applicant.

13 The Department has also used its own team to carry out desk based work on those installations which it assessed to be of a lower risk. This was intended to cover 200 sites in the first year.

14 As at 31 May 2019, 231 of the highest risk sites had been visited for the technical inspection. The Department expects site visits for all of its initial list of 250 to have been completed by the end of June 2019. In addition to this all of the 200 desk reviews on the least risky sites are well progressed.

15 The results of the site visits are added to the desk based analysis for consideration by the Department's compliance team. In some cases these are also passed on to Ofgem for further consideration.

16 One of the main compliance issues that has been identified has been an apparent over production of heat prior to the introduction of the tiered tariff in April 2017. As I reported before, the rate for most applicants before that date incentivised them to generate as much heat as possible, even if it was not required, as the rate of subsidy was higher than the cost of fuel. Once the new tariff was implemented, the incentive to generate heat that was greater than needed disappeared and in many cases the heat actually generated reduced substantially, as set out in tables 3 and 4 above.

17 The generation of heat only for the purpose of earning RHI payments is a breach of scheme rules and therefore the Department has agreed a process with Ofgem of identifying these cases. The outcome for these cases could range from no action (where the applicant provides more information to support the change in heat use) to revocation from the scheme and a clawback of payments already made.

18 Other compliance issues include:

- Inability of some participants to provide required information such as maintenance records or incomplete fuel records;
- Inaccurately reported meter readings;
- Errors in heat loss assessments submitted by the applicant;
- Undeclared carbon trust loans[1]; and
- Lack of evidence of appropriate planning permission or building control approval.

19 Of the 231 site visits that had been completed, the Department has told me that it is working its way through its assessment of them and that this assessment can take several months. At this stage its experience has been that around 80 per cent of cases it looks at have potentially serious compliance issues, mainly in relation to past over production of heat. Of these the Department expects that it will be able to resolve most cases through discussion and other actions short of revocation although it estimates that around 10 per cent will enter the Department's revocation process with potential clawback of grant already paid. Only 3 have so far been revoked from the scheme as a result of the latest inspection process, but the Department has told me that it expects this to increase over the coming months.

20 The Department has also told me that its intention is to complete the programme of site inspections and desk reviews before the end of June 2021. I am pleased that progress is now being made in carrying out the reviews, but would point out that the key measure of success will not be in simply carrying out the reviews, but in the ability to take action where problems are identified. I asked the

[1] Carbon Trust Loan is an interest free loan between £3,000 and £400,000 to businesses in Northern Ireland, investing in energy-saving projects, supported by Invest Northern Ireland. The loan is repayable within four years.

Department to comment on its plans to follow up on issues raised by its inspection process. The Department told me that due to the range and complexity of issues being identified and the need to treat participants in a consistent and proportionate manner, a suite of detailed approaches have been developed to support evidence based decision-making on compliance issues, capable of withstanding legal scrutiny.

**Future tariffs**

21 Independent experts employed by the Department carried out extensive reviews of the tariffs and concluded that the reduced tariffs were still over generous and further changes to the scheme were required to comply with State Aid rules and an agreed rate of return of 12 per cent per annum. Following a public consultation in 2018, engagement with the European Commission and the completion of a business case approved by the Department of Finance, legislation was passed through Westminster agreeing the preferred option for the future of the scheme, which included:

- A new tariff structure (see Table 1) for all small and medium sized biomass boilers to apply from 1 April 2019 for the remainder of the scheme which the Department has calculated to give a rate of return of 12 per cent in line with the adopted State Aid decisions;
- The new tariff structure will result in the subsidy paid to the owner of each individual boiler on the scheme receiving a maximum of approximately £2,000 for a 99kW boiler or £4,000 for a 199kW boiler each year for the remainder of the scheme; and
- The introduction of a voluntary buy-out opportunity for participants on the scheme that wish to avail of it. This provides a one-off payment equivalent to a 20 year, 12 per cent rate of return which is in line with the initial intent of the scheme, less any payments received to date.

22 The Northern Ireland Affairs Committee is currently conducting a short inquiry into the new tariff structure and its report will be published in due course.

**Judicial Review – RHI regulations**

23 As set out in note 19 to the accounts, there is currently a Judicial Review against the introduction of the 2019 amended RHI regulations and an appeal against the introduction of the 2017 Regulations. If the appeal against the 2017 regulations was to be successful then this could result in an additional cost to the Department of around £19 million for the two years of 2017-18 and 2018-19. However on the basis of their legal advice the Department are anticipating that the case will be successfully defended. It is likely that these legal cases will continue for some time.

**Qualified audit opinion**

24 I am required under the Government Resources and Accounts Act (Northern Ireland) 2001 to report my opinion as to whether the financial statements give a true and fair view. I am also required to report my opinion on regularity, that is,

whether in all material respects the expenditure and income have been applied to the purposes intended by the Northern Ireland Assembly and the financial transactions conform to the authorities which govern them.

25 I have qualified my audit opinion again this year for the same reasons as the last three years:

- ongoing weaknesses in controls in the non-domestic RHI scheme; and
- expenditure incurred without the necessary approvals in place.

26 While costs have again reduced in 2018-19 because of the introduction of the revised tariff in 2017, I was still unable to obtain sufficient evidence that the controls over the spending on the non-domestic RHI scheme were adequate to prevent or detect abuse of the scheme as issues are still being identified as part of the ongoing inspection process.

27 I have also qualified my regularity audit opinion because of a lack of required approvals being received by the Department in relation to a significant proportion of the spending on the non-domestic RHI scheme. At the commencement of the scheme in November 2012, the Department of Finance and Personnel (DFP – now the Department of Finance (DoF)) had given approval for expenditure under the scheme up to 31 March 2015. DETI (DfE was previously known as DETI) was due to seek re-approval of the scheme from DFP from 1 April 2015 but this was overlooked and DFP approval was not granted until 29 October 2015.

28 During this seven-month period in 2015-16, there were 788 boiler applications to the scheme, out of a total of 2,128 boiler applications (37 per cent). The ongoing costs incurred during 2018-19 in relation to these 788 applications amounted to £8.1 million (£7.9 million in 2017-18) and as stated above, because these applications were accepted onto the scheme by DETI during a period in which there was no DFP approval, the total expenditure in relation to them continues to be irregular.

29 The above irregular expenditure incurred on the non-domestic RHI scheme in 2018-19 of £8.1 million represents 38 per cent of the total expenditure incurred on the non-domestic RHI scheme of £21.1 million in 2018-19. It is likely that a similar proportion of the non-domestic RHI expenditure will continue to be irregular each year until 2037-38 when the scheme closes unless the Department is able to obtain retrospective approval from DoF. To date, the Department has not formally sought retrospective approval for these 788 applications, but will consider it following the implementation of the long term tariff structure.

**Payments to North South bodies**

30 I have also qualified my regularity opinion in relation to expenditure in 2018-19 of £13.6 million to Tourism Ireland Limited and £4.4 million to InterTradeIreland (total of £18 million) as due to absence of a DfE Minister, it was not possible to secure North South Ministerial Council (NSMC) approval for the 2018 and 2019 Business Plans for these two North/South bodies. While DoF has agreed that these payments are legal in the absence of approved Business Plans, I have

decided to qualify my regularity opinion as the expenditure has been incurred without the necessary approvals in place.

**Presbyterian Mutual Society**

31 The Presbyterian Mutual Society (PMS) went into administration at the height of the financial crisis in 2008. In total £225m of loans were made by the former Department of Enterprise (DETI) to bail out PMS. Of this amount, £50 million, is at the end of the list of creditor priorities and is unlikely to be repaid. The remaining £175 million is being repaid through annual instalments over 10 years and is due to be settled in full by November 2020.

32 Joint Supervisors (who are licensed Insolvency Practitioners) manage the affairs, of the Society. The property investment portfolio consists of 14 sites of retail and office properties predominantly located in the north of England and in Scotland. At 31 March 2019, the total amount to be repaid is £98 million and final settlement of the loan due in November 2020) is dependent on the 14 properties being sold. Independent insolvency advisors employed by the Department to assess the Joint Supervisors' plans have indicated that they expect the loan to be repaid in full, however, given their strategy of selling these properties by November 2020, there is no certainty over the total repayment of the loan until these sales have taken place. I note the Department's disclosure in relation to this loan at notes 12 and 19 to the accounts and I shall continue to closely monitor progress and may report on this matter in the future.

**Conclusion**

33 The Department continues to address issues arising from my previous reports on the non-domestic RHI scheme, but significant challenges remain. I welcome the fact that the inspection process has now got substantially underway although the proof of success in this work will be the extent to which proper enforcement action can be taken, in line with the Scheme regulations, where serious issues are identified.

34 Whilst recognising that progress has been made on the non-domestic RHI scheme, I continue to have concerns about the operation of this scheme. I will continue to monitor the results of the ongoing inspection process and any further actions taken by the Department to address the concerns I have previously raised.

K J Donnelly

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**Comptroller and Auditor General**
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