



Northern Ireland Audit Office

**Report by the
Comptroller and
Auditor General for
Northern Ireland**

**Department for the
Economy**

**Resource
Accounts**

2017-18

Introduction

- 1 The Department for the Economy (the Department) has responsibility for a range of functions including economic policy, energy, further and higher education, employment and skills programmes, tourism, telecoms, research and statistic services, health and safety at work and mineral development.
- 2 In each of the past two years, I have reported on significant concerns surrounding the operation of the non-domestic Renewable Heat Incentive (RHI) scheme. Both 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. There has been a huge level of public interest in how this scheme was set up and managed by the Department and its potential impact on Northern Ireland public expenditure for many years to come.
- 3 My initial report in June 2016 was followed by seven evidence sessions of the Public Accounts Committee between September 2016 and January 2017 when the Renewable Heat Incentive Inquiry was established to carry out an in-depth investigation of the operation of the scheme. The Inquiry is still ongoing and will report in due course.
- 4 My report below provides an update on:
 - how the actions taken by the Department have reduced the total costs of the scheme and the impact on the block grant for the remainder 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 improve the quality of inspections and enforcement action; and
 - why I have again decided to qualify my regularity audit opinion.

Total costs in 2017-18

- 5 The Department imposed significant changes from 1 April 2017 to the tariff paid to those who had applied to the scheme before 18 November 2015 which included a new tiered tariff rate and a cap on heat output. This brought the tariff paid to those users into line with those who had applied to the scheme after 18 November 2015. This change to tariff rates was imposed (initially only for one year) in order to try to control future costs, address the issue of excessive returns for some users and to reduce the possible incentive for wasting heat.
- 6 As a result, these new rates applied to all accreditations, no matter when they joined the scheme. Table 1 below compares the rates payable for a 99kW boiler accredited before 18 November 2015:

Table 1: Change in tariff rates from 1 April 2017

	Original tariff rate	Revised tariff rate
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
Heat generated per kWh over 1,314 hours	6.4 p/kWh	1.5 p/kWh
Maximum kWhs payable	Unlimited	400,000 kWh*

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

- 7 The revised rate was challenged in a judicial review taken by the Renewable Heat Association (RHANI). The judge in the case ruled in favour of the revised tariff being allowed to stand although RHANI has however stated its intention to appeal the decision. Legislation has now been passed through Westminster to extend the revised rate to 31 March 2019 while the Department consults on a more permanent tariff structure.
- 8 As a result of the new tiered rate commencing on 1 April 2017, the annual cost of the scheme has significantly reduced in 2017-18 as outlined in Table 2 below.

Table 2: Annual costs of the RHI scheme

	2017-18	2016-17
	£ million	£ million
Total cost of RHI scheme in year *	24	45
Costs covered through NI share of UK RHI budget Annually Managed Expenditure (AME)	22	18
Costs met from the NI Executive Departmental Expenditure Limit (DEL)	2	27

Source: Department

*The cost of the RHI scheme in 2017-18 is comprised of £21.7 million (2016-17 - £42 million) for the non-domestic RHI scheme and £2.8 million (2016-17 - £3 million) for the domestic scheme.

Change in behaviour of applicants

- 9 The change in tariffs appears to have been the main reason for a substantial change in the overall heat generated under non-domestic RHI. The total heat generated has fallen by over 33% in 2017-18 compared to the previous year as set out in Table 3 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	2017-18	2016-17	% change
		MWh	MWh	
Agriculture	1,114	288,110	425,470	- 32%
Forestry/wood	186	42,572	79,935	- 47%
Other	828	125,620	178,177	- 29%
Total	2,128	456,302	683,582	- 33%

Source: Department

- 10 The change in the tariff paid coupled with the reduction in heat generated has resulted in the payment of non-domestic RHI almost halving in the year as shown in Table 4 below.

Table 4: Non – domestic RHI payments for all applicants

Sector	Number of installations	2017-18	2016-17	% change
		£'000	£'000	
Agriculture	1,114	12,922	26,758	-52%
Forestry/wood	186	1,641	4,713	-65%
Other	828	7,155	10,864	-34%
Total	2,128	21,718	42,335	-49%

Source: Department

- 11 The change in the tariff for accreditations pre 18 November 2015 also appears to have driven significant changes in the behaviour of applicants for those boilers. Of the 1,685 boilers accredited before then which remain on the scheme only 349 (21 per cent) appear to have been used for more than 40 per cent of the available hours in the year compared to 926 (55 per cent) last year.
- 12 The extent that boilers applied for before 18 November 2015 were used in 2017-18 and the amount of subsidy received per boiler, compared with 2016-17 is set out in Table 5 below.

Table 5: Number of hours run by boilers in year for installations before 18 November 2015

Percentage of total annual hours operated in year	Total annual hours run by one boiler in year	Number of boilers in 2017 -18	Number of boilers in 2016 -17	Typical RHI payment for one 99kW boiler in 2017-18 at this level of usage	Typical RHI payment for one 99kW boiler in 2016-17 at this level of usage *
0-10%	Up to 876	221	81	£2,905	£2,819
10-20%	876 - 1,752	356	192	£8,716	£8,456
20-30%	1,752 - 2,628	399	219	£10,017	£14,093
30-40%	2,628 - 3,504	360	269	£11,317	£19,730
40-50%	3,504 - 4,380	231	267	£12,618	£25,267
50-60%	4,380 - 5,256	86	242	£12,764	£31,004
60-70%	5,256 - 6,132	24	213	£12,764	£36,641
70-80%	6,132 - 7,008	6	129	£12,764	£42,278
80-90%	7,008 - 7,884	1	65	£12,764	£47,915
90-100%	7,884 - 8,760	1	10	£12,764	£53,552
		1,685	1,687		

Source: Department

* This figure is based on the midpoint of the range of hours and a 99kW output boiler and the subsidy rates prior to 18 November 2015.

- 13 The revised tariff rate also introduced a cap on heat output of 400,000kWh meaning that any heat generated over 400,000kWh would not be paid. 400,000kWh equates to a 99kW boiler operating approximately 11 hours each day of the year. Table 6 below shows the effect the introduction of this cap on heat output has had on the heat generated by 99kW boilers accredited before 18 November 2015.

Table 6: Number of kWh operated by 99kW boilers in year for installations before 18 November 2015

kWh operated in year by 99kW boiler	Number of 99kW boilers in 2017 -18	Number of 99kW boilers in 2016 -17
Less than 400,000kWh	1,567	1,028
More than 400,000kWh	118	659
	1,685	1,687

Source: Department

- 14 It is clear from the above information that the behaviour of applicants appears to have changed significantly following the introduction of the new tiered rate and cap on heat output for all applicants from 1 April 2017. This may have been because applicants were no longer able to avail of the higher subsidy rates and as a result, there was no longer any incentive to generate heat if this was only being done in order to claim additional subsidies.
- 15 It has been suggested that boiler users may have used wood boilers only to the 400,000kWh maximum and then switched to other heating methods. However I consider this to be unlikely as the cost of generating heat through wood pellets appears to have been considerably cheaper over the last year compared to either oil or gas and therefore there would have been no reason to change heating (approximate costs in 2017-18 per the Department: wood pellets - 3.2 pence per kWh; gas - 5 pence per kWh; and oil - 4 pence per kWh).
- 16 I asked the Department to comment on the changes in behaviour shown and the Department told me that the introduction of the tiered tariff to all applicants had significantly reduced the incentive to produce unnecessary heat as previously the incentive paid for each kWh of heat generated was higher than the cost of production whereas as now once the applicant reaches the top of Tier 1, the incentive paid reduces to significantly below the cost of production. The Department welcomed this as not only was it an important cost control but it also helped contribute to the key objective of the Scheme to reduce carbon emissions.

Inspections

- 17 The Department is currently revising arrangements with Ofgem who administer the NI non domestic Scheme on its behalf. This includes revising how Inspections and Compliance activities are carried out. During 2017-18, the Department and Ofgem carried out a “pilot” of a new inspections process to help inform the way forward. The pilot involved inspecting 33 sites (65 installations) to assess compliance of the installations against the Scheme regulations and guidance. As part of this exercise, the independent inspectors analysed the use of heat, compared the amount of heat produced to recognised benchmarks and calculated an internal rate of return for each installation.
- 18 The inspectors found a range of compliance issues as follows:
- Incorrect installation of heat meter flow and temperature sensors;
 - Incomplete documentation and record keeping;
 - Erroneous heat loss assessments;
 - Undeclared other sources of finances; and
 - Excessive heat generation.
- 19 The inspectors gave each site a rating: good, satisfactory, weak and unsatisfactory. No installations were deemed to be good, 4 satisfactory, 17 weak and 10 unsatisfactory. Two reports remain outstanding.

- 20 In addition to the pilot inspections, Ofgem carried out additional audits on 30 installations and identified issues in 24 installations (80 per cent). The audits carried out by Ofgem were in relation to specific concerns brought to their attention from a variety of sources and the findings were broadly similar to those listed in paragraph 18 above.
- 21 It is clear from the Department's inspections and Ofgem's audits that problems exist in a significant number of installations. The independent inspectors undertaking the pilot made a number of recommendations, including that all sites should be inspected within a maximum of three years and I asked the Department to comment on whether or not this is achievable.
- 22 The Department told me that it has just appointed inspectors to a framework with the intention of completing up to 250 site inspections in 2018-19, selected on the basis of a risk assessment. In addition, the Department will undertake a series of desk top reviews of sites, which will include reviewing the amount of heat generated and paid for. This approach will be reviewed in March 2019 and adjusted as required. The Department is aiming to complete the programme of inspections and desk reviews within a 3 year period as recommended by the independent inspectors.
- 23 While I note the intention to inspect/review all sites within the next 3 years, I am concerned at the slow rate of progress that has been made to date. It is also vitally important that full enforcement action is taken where inspections identify any issues which may potentially include removal from the Scheme. I asked the Department to comment on the pace of inspections and also on its plans to take enforcement actions arising from the inspections, if required.
- 24 The Department told me that the inspection process now in place, based on a revised methodology developed through the pilot process, and with the selection of sites based on a risk assessment, should help to rebuild public confidence in Scheme compliance. Regarding enforcement activity, the Department told me that based on the work carried out by themselves and Ofgem, three installations have been revoked from the Scheme and a number of further compliance cases are ongoing which could result in further removals from the Scheme where appropriate.

Qualified audit opinion

- 25 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.
- 26 I have qualified my audit opinion again this year for the same reasons as the last two years:
- ongoing weaknesses in controls in the non-domestic RHI scheme; and
 - expenditure incurred without the necessary approvals in place.

- 27 While there has been some improvement in cost control in 2017-18 because of the introduction of the revised tariff, 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.
- 28 I have again 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.
- 29 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 2017-18 in relation to these 788 applications amounted to £7.9 million (£18.8 million in 2016-17 / £11.9 million in 2015-16) 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.
- 30 The above irregular expenditure incurred on the non-domestic RHI scheme in 2017-18 of £7.9 million represents 36 per cent of the total expenditure incurred on the non-domestic RHI scheme of £21.7 million in 2017-18. 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.

Other issues: Invest NI irregular expenditure

- 31 I have also qualified my regularity audit opinion in relation to £2.1 million expenditure incurred by Invest Northern Ireland in 2017-18 under the Skills Growth Programme as DoF refused to provide retrospective approval for grant expenditure which had been committed to during the period 1 January 2016 to 5 April 2018. As the Department has overall responsibility for ensuring that approvals are obtained and provides funding to Invest NI through grant in aid, my regularity opinion has also been qualified in respect of this expenditure as it does not conform to the authorities which govern it. This issue is discussed in more detail in the Department's governance statement.

Conclusion

- 32 The Department has made some progress in addressing the many issues arising from my previous reports on the non-domestic RHI scheme. The introduction of the new tariff rates from 1 April 2017 has resulted in a reduction of costs in the year and has been a key factor in changing the behaviour of applicants. I am however concerned at the slow rate of progress made by the Department in inspecting all sites, although I acknowledge that there is an intention to inspect all sites within the next three years. It is important that these inspections progress at a faster pace and where problems are found, proper enforcement is carried out.
- 33 Whilst recognising that progress has been made on the non-domestic RHI scheme, I continue to have significant concerns about the operation of this scheme and some of the weaknesses in controls that continue to exist. I understand that the Department intends to consult on further changes to the scheme and I will closely examine the actions taken by the Department once this process has been completed.

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