

The Highland Council

27 October 2016

Agenda Item	
Report No	

Renewable Heat Incentive Scheme

Report by Director of Finance

Summary

This report provides an update on concerns expressed by members at Audit & Scrutiny Committee on 29 September, and a subsequent meeting of a member group on 10 October to clarify the remit for this report.

The report only covers issues that can be discussed publicly at this time, and therefore focusses on budget preparation and monitoring detail.

1. Background

- 1.1 At the Audit & Scrutiny Committee on 29 September 2016 it was agreed that a report be submitted to the Highland Council meeting on 27 October 2016 to provide Members with reassurances that the issues highlighted by the Audit Team regarding a shortfall in income received from the Renewable Heat Incentive (RHI) Scheme were being addressed.
- 1.2 The Director of Development & Infrastructure had indicated that a report would be submitted at the end of the current financial year once the RHI Scheme's final position was known. This would clarify the extent of income that the Council has recovered from current claims that are outstanding at the time of writing this report.
- 1.3 Despite the Internal Audit report providing **Reasonable Assurance** members of Audit & Scrutiny Committee raised a number of concerns, some of which required to be considered sooner, and to move forward, an assurance provided that lessons had been learnt and a proper and effective process was now in place.
- 1.4 It was clarified that the Audit opinion was based on current controls and processes, and the report had complied fully with the remit set by the Chairs of Audit & Scrutiny and Resources Committees.
- 1.5 Based on the above, a further meeting was convened on 10 October, open to all Council members, to clarify the remit of this subsequent report to Council.

2. Confidential Information

- 2.1 The report considered by the Audit & Scrutiny Committee had been leaked to the Press, despite its confidential nature, and had been covered in some detail. Currently the Council is in a legal dispute with the former contractor.
- 2.2 Consideration needs therefore to be given to how issues can be reported to Members meantime taking into account the important of factors such as

commercial confidentiality and the on-going legal action. It is essential that this is not prejudiced, and whilst a report could be considered by the Council in private, there is a danger that sensitive financial and legal information might again also be leaked.

- 2.3 The Member Group, at its meeting on 10 October therefore agreed that this report will only contain information that can be shared publicly at this stage. A further report will be made on conclusion of the legal action.

3. Remit of this Report

- 3.1 The Member Group agreed a remit for this report, and following subsequent legal advice this report covers the following areas:-

- (1) The total cost of running the RHI Scheme;
- (2) How the budget target had been set, and why;
- (3) Why the budget target had not been revisited when it became apparent it was no longer achievable;
- (4) The arrangements for revenue reporting of this Scheme to members.

4. Discussion

4.1 RHI Scheme Costs

There is only one officer who works exclusively on the RHI Scheme, the Data Co-ordinator on grade HC06 (current salary band £22,295 - £25,116). As stated in the Audit Report, other members of the Energy Team do spend time on RHI, but their time is not identified in a way that can determine the absolute cost relating to RHI.

- 4.2 The total Energy Team comprises of 8.8 FTE officers and has a total budgeted cost of £0.303m.

4.3 Budget Target Setting and why the Target was not Revisited

The RHI Scheme was a new Scheme, and officers immediately identified the opportunity for the Council to derive significant income that would assist with delivering budget savings targets. Like many Budget Estimates, when there is no previous data on which to base evidence, the income target was derived from professional judgement as to what is a realistic assessment. This was based on the number of sites, boiler capacity, running times, and an estimated timescale for the introduction and implementation of biomass boilers across the Council area. However no working papers have been located to support any calculation.

- 4.4 Appendix 1 provides extracts from Service and Corporate Budget Savings proposals that were agreed by Council over three successive financial years 2012-15. Members should reflect that each Service over this period was set specific savings targets, stated in terms of a percentage against the Service overall budget. Whilst, in the case of RHI Scheme, the income target was ambitious, the judgement of officers was that setting ambitious income targets was preferable to proposing further service savings as an alternative. This was originally a corporate budget saving target rather than a Housing & Property target.

- 4.5 Members should note that over this three year period, the actual budget

estimate was increased. Over the same period responsibility for this budget passed from the then Housing & Property Service to Development & Infrastructure, however the core Energy Team remained consistent. Rather than revise the budget target downwards, the Team took a view that income could actually be increased, and this is what was submitted and agreed as a budget proposal.

- 4.6 Subsequent experience, which is covered below, would suggest that whilst the Income target was initially optimistic, it is now realistic in terms of existing and additional sites. The Service set itself overly ambitious budget targets to avoid further cuts in services, but the original professional judgement regarding the level of income achievable was realistic. What proved to be over ambitious was the timescale that this was achievable over.
- 4.7 Budget preparation involves an assessment of financial risks. Officers have to weigh up a number of factors which may include all or some of the following:- cost or income estimates, volume or consumption estimates, factors within the Council's control and those not, seasonal variations, and work required to ensure success including staffing resources. This particular Budget Saving had significant risks as all the above factors played an element in the successful achievement of the target income. Given the number of variable factors, some deviation against the target should have been expected and monitored closely.
- 4.8 The arrangements for revenue reporting this Scheme to members
As stated at paragraph 4.5 responsibility for the Energy Team transferred during the period under review. As a result the Committee reporting arrangements changed to reflect this. What is apparent however is that income from RHI was included within a wider Income budget for the purposes of Committee reporting, and not separately identified. Appendix 2 shows the dates and financial information reported to the respective committees.
- 4.9 Budget monitoring is a partnership between the Service and the Finance Team. Whilst the normal process is to prepare outturn forecasts based on year to date income and expenditure, the nature of RHI income meant that ledger data was little use in terms of trying to project the overall financial position, and the Finance Team were heavily reliant on the Service to provide accurate estimates.
- 4.10 Monthly meetings were held to discuss the financial position, but the usual process with all services is largely informal and not documented. What is clear from the Committee reports however is that a significant amount of income was estimated to be received late in the year, or in the following year, and it was therefore assumed that the budget target would be achieved.
- 4.11 Members will be aware that accounting principles require income and expenditure to be accounted for in the year to which it relates, even if the transaction is not completed in the financial year. A significant proportion of the income therefore formed the basis of a year end accrual. The previous Internal Audit report highlighted concerns about the lack of supporting evidence to substantiate the accrual. Due to the late submission, the information was accepted at face value to meet the accounts closedown deadlines.
- 4.12 There is a lack of commentary in the budget monitoring reports explaining the

reasons for any variances between the income budget figures and the year-end estimated position. However the variances were not particularly material to justify a detailed commentary in a Committee report. However in 2013/14 the year-end forecast was changed four times, and this should have been sufficient to justify an explanation to the Committee.

- 4.13 The first meeting of the FHR Committee was on 22/8/12 with the final meeting on 26/2/14. The Committee was then dissolved in April 2014 and no further budget monitoring reports were provided for the financial year 2013/14, including the last quarter and final outturn position. This is of particular significance as there was a significant increase in the budget of £0.74m that year, half of the income wasn't received, and this was the year in which income problems appeared.
- 4.14 The budget monitoring reports for 2014/15 do not indicate any issues with achieving the budget. The final outturn report showed that the surplus was £16k less than budgeted. Table 1 in Appendix 2 shows that the variance shortfall was £436,755 for this year. However, as detailed at Section 4.1.7 of the audit report, a grant of £335,069 relating to the Home Energy Efficiency Programmes for Scotland Area Based Scheme was received and this meant that the true financial position with regard to the RHI income shortfall was not reported clearly. This is a weakness in the final report for that year.
- 4.15 It was only in 2015/16 (February and August 2016) that the problem of a failure to achieve a budget target was reported to members. So for the two previous years there was either no report or an offsetting grant that masked the true position.
- 4.16 Following consideration by Resources Committee there is now greater reporting and scrutiny of all service and corporate savings, since 2015/16.

5. Conclusions and Recommendations

- 5.1 Due to the need to maintain confidentiality this report has focussed predominantly on the Budget Preparation and Budget Monitoring aspects of the Internal Audit report on RHI Income.
- 5.2 The Income Budget set initially for RHI Income was, like many others, intentionally set at an ambitious level to incentivise the Service to meet its overall savings target in three successive financial years. The target was ambitious, but should have been reviewed and challenged as more information came to light. In reality the target was increased annually.
- 5.3 Current evidence would suggest that the Budget Target is now realistic. However the Service was too optimistic in terms of timescale.
- 5.4 The change to the Council's structure, and reporting for RHI Income, does appear to have created a void in reporting at a critical time. If reports had followed the pattern of previous years then this situation would have been highlighted to members earlier. Any change in Committee reporting structure should not lead to any failure to report.
- 5.5 The Service needs to be able to evidence budget estimates and provide supporting documentation for both budget and annual accounts. This has not

happened in this instance, and whilst the overall target is now realistic, information provided for budget monitoring and year end accounts was unsatisfactory.

5.6 The Finance Service needs to adopt a risk based approach to budget monitoring, and reflect on the material factors that could impact on the delivery of a balanced budget. The estimate for RHI Income carried a significant number of variables that should have alerted the Finance Service that this was a “high risk” budget.

5.7 The Finance Service needs to be clear that mitigating factors, such as additional one-off grant, is not allowed to mask the underlying financial position. The full financial picture needs to be highlighted to members, where material, rather than what happened in this case where the grant was offset against a budget shortfall.

5.8 **Key Recommendations**

- Budget targets need to be reviewed regularly and any material variations and concerns reported to members
- Budget submissions should be realistic and capable of being delivered within the timescale set
- Financial reports should be submitted to every committee cycle
- Services must be able to evidence and substantiate data provided to Finance for budget and accounting purposes
- The Finance Service needs to adopt a risk based approach to budget monitoring
- All material variances require to be reported to Committee, and cannot be offset in any way

6. **Implications**

6.1 There are no specific Resource, Risk, Equalities, Climate Change/Carbon Clever, Gaelic or Rural Implications that require to be highlighted in addition to the financial issues covered in the above report.

6.2 Failure to respect the Confidentiality of reports may expose the Council to financial or other loss.

Recommendation

The Council is asked to consider the issues raised in this report.

Designation: Director of Finance

Date: 17 October 2016

Author: Derek Yule

Background Papers: Confidential Report to Audit & Scrutiny Committee 29.9.16

Appendix 1

Project	Ref.	Description	Date Agreed	Year	Savings £m	Budget £m
Income Generation	9	Revenue from further opportunities to be identified through the project	HC 09/02/12	2012/13	0.100	0.100
Asset Management	AMP/3	Additional income - Rent, FIT, RHI etc (provisional pending clarification by Govt and submission of Business case)	HC 070213	2013/14	0.720	
Income Generation	2	Transferred from unachieved 12/13 IG saving CIP/IG/2 Charges for Pre-planning advice & certificate of lawfulness	HC 070213	2013/14	0.020	0.840
Asset Management	AMP/3	Additional income - Rent, FIT, RHI etc (provisional pending clarification by Govt and submission of Business case)	HC 070213	2014/15	0.240	1.080

Reporting of budget position to Committee

Table 1 - Income position reported in May 2016 (extract from Internal Audit Report)

Financial year	Budget	Actual income received	Net accrued income (1)	Total per financial ledger	Variance shortfall
2012/13	100,000	71,603	22,452	94,055	5,945
2013/14	840,000	392,452	91,049	483,501	356,499
2014/15	1,000,000	487,142	76,103	563,245	436,755
2015/16	1,000,000	622,822	33,675	656,497	343,503
Total	£2,940,000	£1,574,019	£223,279	£1,797,298	£1,142,702

For the first two financial years, 2012/13 and 2013/14, the budget rested within the Housing and Property Service and the revenue budget monitoring reports were provided to the Finance, Housing and Resources (FHR) Committee. Following Service re-structuring, this responsibility moved to the Development & Infrastructure Service which reported to the Planning, Development and Infrastructure (PDI) Committee.

Housing and Property Service reports

The budget information was included within the Non-Housing Revenue Account report which provided details of expenditure and income by activity. Table 2 below details the reported expenditure and income (shown in brackets) figures provided against the heading for Energy & Sustainability. In considering the income figures below it should be noted that this is the total income for this activity and includes more than the RHI income. Therefore, this does not match up exactly to the information provided in Table 1.

Table 2 – Reporting to Finance, Housing and Resources Committee

Committee Date	Period to	Annual Budget £000	Actual YTD £000	Y/E Estimate £000	Comments
22/08/12	30/06/12	841 0	75 0	841 0	
03/10/12	31/07/12	830 0	71 0	858 (60)	Year-end variances of £35k and (£60k) reported.
28/11/12	30/09/12	830 0	111 0	865 (60)	Year-end variances of £28k and (£60k) reported
30/01/13	30/11/12	830 0	167 (15)	848 (60)	Year-end variances of £18k and (£60k) reported.
10/04/13	28/02/13	832 (38)	193 (124)	844 (184)	Year-end variance of £12k and (£60k) reported. No explanation provided re income and why this now has a budget or the reason for the increase in the y/e estimate.
05/06/13	30/04/13	859 (864)	24 43	859 (864)	-
28/08/13	31/03/13	234 (124)	267 (207)	267 (207)	Final out-turn for 2012/13 £33k overspend and (£83k) additional income. No explanation provided as to the reasons for this.
	30/06/13	889 (894)	44 (32)	889 (894)	-
09/10/13	31/08/13	889 (914)	107 (96)	932 (1,004)	Year-end variances of £43k and (£90k) reported
27/11/13	30/09/13	887 (914)	218 (103)	930 (1,004)	Year-end variances of £43k and (£90k) reported.
22/01/14	30/11/13	887 (914)	241 (175)	940 (805)	Year-end variances of £53k and £109k reported. No information as to the reason for the anticipated shortfall in income.
26/02/14	31/12/13	887 (914)	378 (245)	978 (974)	Year-end variances of £91k and (£60k) reported.

Development & Infrastructure Reports

This information was reported for the Service under the heading “Property – Energy & Sustainability” and shows the net income/ expenditure information. Again, this cannot be matched exactly to the information at Table 1.

Table 3 - Reporting to the Planning, Development & Infrastructure Committee

Committee Date	Period to	Annual Budget £000	Actual YTD £000	Y/E Estimate £000	Comments
14/05/14	N/A	-	-	-	No budget monitoring report.
20/08/14	30/06/14	(239)	538	(239)	-
05/11/14	30/09/14	(874)	(382)	(874)	No information provided as to the reason for the increase in the budgeted surplus.
18/02/15	31/12/14	(874)	(19)	(874)	-
03/06/15	N/A	-	-	-	No budget monitoring report.
19/08/15	31/03/15	(874)	(858)	(858)	Out-turn report for 2014/15, underachieved budget surplus by £16k.
	30/06/15	(101)	1,986	(101)	
04/11/15	30/09/15	(101)	2,362	(101)	
17/02/16	31/12/15	(100)	1,133	78	See Note 1.
11/05/16	N/A	-	-	-	No budget monitoring report.
17/08/16	31/03/16	(854)	(245)	(245)	See Note 2. Out-turn report for 2015/16, underachieved budget by £609k.
	30/06/16	(1,636)	1,017	(1,636)	-

Notes:

- 1 Section 4.2 of the covering report stated *“Energy and sustainability will not achieve their targeted surplus. The income target for Renewable Heat Incentive is £1m, however this will not be achieved in the current financial year leading to a budget shortfall.”* This was the first time that a shortfall in income was reported.
- 2 Section 3.4.1 of the covering report stated *“As previously reported, Energy and Sustainability would not achieve their targeted surplus. Income shortfalls on both Renewable Heat Incentive (£0.348m) and Feed-in-Tariff (£0.056m) account for two-thirds of the overspend. The remaining one-third are in respect of costs incurred in rectifying issues with the biomass boilers and also the removal of the wind turbines at schools.”*