Report on Accounts 2012-13

Department for Environment, Food and Rural Affairs

Report of the Comptroller and Auditor General to the House of Commons

Introduction

1. The Department for Environment, Food and Rural Affairs (the Department) develops and implements policy relating to the environment, food and rural issues. It is also responsible for negotiating European agricultural and rural funding on behalf of the UK. The Department receives funding from the European Commission (the Commission) to deliver the Common Agricultural Policy (CAP) and other initiatives, some £3.3 billion in 2012-13 (2011-12 £3.7 billion).

2. I have reported previously on the problems experienced by the Rural Payments Agency (the Agency), an executive agency of the Department, in implementing the Single Payment Scheme (the Scheme). The Scheme was introduced by the European Union as part of the 2003 Common Agricultural Policy reforms which replaced 11 separate crop and livestock based production subsidies with a single payment based on land area.

Purpose of this report

3. The financial statements on the following pages represent the results of the Department for the period from 1 April 2012 to 31 March 2013. This report explains the nature of Scheme related qualifications in 2012-13 and progress made by the Department and Agency in correcting the problems experienced in the past.

4. I have limited the scope of my audit opinion as I was unable to obtain sufficient audit assurance to support the completeness of balances relating to Scheme trade receivables (amounts due from claimants) of £6.7 million and Scheme trade payables (amounts due to claimants) of £16.0 million which are recorded in the Department's financial statements. These amounts are administered and accounted for by the Agency, but consolidated into the Department's financial statements.

5. In 2011-12, I qualified my opinion on the financial statements on the grounds of regularity. The requirement to pay material financial penalties ("disallowance") where Scheme regulations are not correctly applied results in a loss to the UK Exchequer which is outside Parliament's intentions in relation to the proper administration of European funding. Due to delays by the Commission in assessing the level of financial penalties, and a subsequent significant reduction in penalties finalised in 2012-13, I have not qualified my regularity opinion on the 2012-13 financial statements in this respect.

Limitation of scope in respect of the completeness of Scheme trade receivables and Scheme trade payables

6. The 2012-13 financial statements reports Scheme trade receivables of £6.7 million (2011-12: £14.9 million) and Scheme trade payables of £16.0 million (2011-12: £56.8 million). During 2012-13, the Agency has prioritised validation of the balances reported in the financial statements (valuation and existence), but has not yet undertaken the more extensive work necessary to address whether these balances reflect all amounts due to, and payable by the Department (completeness).

7. I have obtained sufficient evidence to support the existence and valuation of Scheme trade receivables and Scheme trade payables as reported in the 2012-13 financial statements. I am therefore able to provide a clear opinion on these aspects of the Scheme trade receivables and Scheme payables balances.

8. I have been unable to obtain assurance that these balances in the financial statements reflect all amounts due to, and payable by, the Agency. I have therefore limited the scope of my audit opinion in

respect of the completeness of Scheme trade receivables and Scheme trade payables balances. I qualified my opinion in this respect in 2011-12.

Progress on Scheme trade receivables and Scheme trade payables since my report on the 2011-12 financial statements

9. In April 2012, the Department implemented a 3 year Strategic Improvement Plan with the aim of stabilising itself in preparation for CAP reform, which includes the validation of Scheme trade receivables and Scheme trade payables balances. Validation involves the identification and correction of corrupt data, recalculation of claim values and checking of data held in operational, accounting and payments systems. By 31 March 2013 this work was partially complete with 39% of the balances reported at 31 March 2012 validated.

10. The Department has also taken further action to write off balances where they represent irrecoverable overpayments to claimants or where it is not value for money to pursue recovery. In addition to the data cleanse under the Strategic Improvement Plan and write offs, there have been further movements on Scheme trade receivables and Scheme trade payables, including payments, provision for doubtful debts, corrections and new balances.

11. Scheme trade payables have fallen to £16.0 million (2011-12 £56.8 million), of which £11.3m relates to the 2012 scheme year and is either awaiting payment or related to a historic unvalidated balance. The balance relating to the current year represents 0.9 per cent (2011-12 2.7 per cent) of current year Scheme expenditure, which is an appropriate level for the nature of the Agency's operations and the reduction since 2011-12 further demonstrates improved processing by the Agency.

12. As a result of the improvements in data quality, and a reduction in the value of unvalidated debts, I was able to obtain evidence over the existence and valuation of Scheme trade receivables and Scheme trade payables. There remains a risk of further movements in the value of reported balances as the Agency completes its validation processes; however my testing has provided sufficient evidence that Scheme trade receivables and Scheme trade payables balances as reported in the financial statements for 2012-13 exist and are accurately valued.

Planned action to address the completeness of Scheme trade receivables and Scheme trade payables

13. The Agency aims to address completeness, and conclude its validation of known Scheme trade receivables and Scheme trade payables balances, through the financial statements Payable/Accounts Receivable (AP/AR) Cleanse project. The final project scope was approved in March 2013.

14. The Agency recognises the importance of continuing its work to improve data quality and to cleanse important data sets for land, customer and financial information. The AP/AR Cleanse project is scheduled to conclude the validation of Scheme trade receivables and Scheme trade payables and address completeness of these balances by the end of March 2014. Further work will be required to confirm that current plans, including the AP/AR Cleanse project, will fully address my remaining qualification on the completeness of these balances.

Financial Penalties arising from European Union Schemes

15. Where the Commission takes the view that the detailed European Regulations have not been applied correctly in processing European Union (EU) Scheme transactions there is a risk of financial penalties or disallowance under the Scheme. These penalties are payable by the Department as a deduction from future Commission funding. In anticipation of these financial penalties the Department makes a provision in its financial statements for disallowance penalties arising in respect of the Single Payment Scheme, for a number of smaller on-going schemes and for Single Payment Scheme predecessor schemes.

16. The Department finalises penalties when either the Commission confirms a penalty or the Department will not contest it. At this point the value of disallowance becomes certain and I consider it to be irregular as it represents a shortfall in EU funding, which will be met by the UK taxpayer and

which has arisen through ineffective controls operated by the UK managing body (maladministration). This has resulted in the Defra financial statements having been qualified since 2008-09, on the basis of material irregular expenditure in relation to the finalised disallowance penalties in year.

17. As a result of administrative delays within the Commission, during 2012-13, the Department finalised disallowance penalties of £20.2 million (2011-12 £46.3 million), which are reflected in the Statement of Comprehensive Net Expenditure. Whilst I still consider this level of cost to the taxpayer significant, I do not consider this to be material in the context of the £3.3 billion of Commission funded expenditure managed by the Department. I have therefore not qualified my audit opinion on the Department's 2012-13 financial statements on the grounds of regularity.

18. The Department's 2012-13 financial statements also include a provision for £133.0 million in respect of estimated disallowance penalties (2011-12 £125.4 million), which are subject to challenge and so are not yet finalised. The total value of disallowance penalties finalised or provided for since the introduction of the CAP 2005 in 2008-09 is currently £600.1 million. As the main cause of the reduction in penalties provided and finalised during 2012-13 was due to delays within the Commission rather than underlying improvements in compliance with EU scheme rules, it is likely that the level of penalties finalised will increase again in future years. I will continue to assess the materiality of the value of penalties finalised in year to determine the impact on my opinion on subsequent financial statements.

Common Agricultural Policy reforms

19. As I have reported previously, the problems experienced by the Department in implementing the 2003 CAP reforms have undoubtedly contributed to the disallowance penalties since the Scheme's introduction in 2005. However, the Commission are planning major changes to the way CAP works to create a more effective policy for a more competitive and sustainable agriculture and vibrant rural areas. The Department is actively involved in the current negotiations on the reform, with one of their aims being to improve the effectiveness of the CAP for farmers and authorities.

20. To do this, the CAP Delivery Programme (the Programme) was established. The programme is owned by the Chief Operating Officer for Defra, supported by a Programme Board led by Defra's Accounting Officer, and includes representatives from all bodies responsible for delivering CAP. The Programme incorporates the procurement, development and implementation of new systems during 2013-14. Development and implementation of these will present a number of challenges, including the requirement that data cleansing is completed on time, in order to ensure that accurate and complete data is transferred to the new systems.

21. Delivery of the CAP Delivery Programme is critical to the successful provision of CAP reform; to correctly apply Scheme regulations to pay claimants accurately; and to minimise penalties. Successful implementation of the reform will involve development and delivery of new Schemes which will present a number of significant challenges. Defra will need to work with its agencies and other delivery bodies to ensure successful delivery of the new Schemes which are expected to be more complex, based on unconfirmed regulations and subject to an uncertain implementation date. In addition, the IT element of the programme will be delivered through an agile approach which involves outsourcing to multiple IT providers. The Department has recognised a number of significant risks relating to the Programme. It will need a strong relationship between the Programme team and other important stakeholders, and appropriate governance arrangements, to ensure that these risks are adequately managed and that the Department learns the lessons from the implementation of CAP 2005.

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