Defra and RPA Reports on Accounts 2013-14

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Department for the Environment Food and Rural Affairs Annual Report and Accounts 2013-14 - The Report of the Comptroller and Auditor General to the House of Commons

Introduction

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 policy and related 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 £3.4 billion in 2013-14 (2012-13 £3.3 billion).

Purpose of this report

This report explains the nature of the Department's historic qualifications and progress made in addressing the issues that led to those qualifications, primarily those encountered during the implementation of the previous CAP. In addition, I have set out the actions being taken by the Department to manage future risks in the context of significant CAP reforms.

Unqualified opinion on regularity - financial penalties arising from European Commission funded schemes

I qualified my audit opinion on regularity as a result of material financial penalties incurred by the Department and accrued in the financial statements, from 2008-09 until 2011-12. The requirement to pay financial penalties ("disallowance"), where Commission funded scheme regulations are not correctly applied, results in a loss to the UK Exchequer, which is recognised within the financial statements of the Department. This loss is outside Parliament's intentions in relation to the proper administration of European funding and is therefore considered irregular. The qualification was removed in 2012-13 as penalties accrued in year were not considered to be material. In 2013-14, the level of penalties accrued in year was again not considered to be material. I have therefore issued an unqualified opinion on regularity on the 2013-14 financial statements in this respect. I will continue to assess the value of penalties accrued in each year, to determine the impact on my opinion on subsequent financial statements.

Unqualified opinion on financial statements - completeness of Single Payment Scheme trade receivables and payables balances

In 2012-13, I limited the scope of my audit opinion, as the Department and Rural Payments Agency (the Agency) was unable to provide me with sufficient audit evidence to support the completeness of trade receivables and payables balances relating to over and underpayments to claimants under the Single Payment Scheme. These amounts are administered and accounted for by the Agency, and consolidated into the Department's financial statements. The Agency has made significant progress in 2013-14 in respect of demonstrating the completeness of these trade receivables and payables balances and I am therefore able to provide a clear opinion on Single Payment Scheme trade receivables and payables balances reported at both 31 March 2014 and 31 March 2013.

Financial penalties reported to 2013-14

Where the Commission takes the view that the detailed scheme regulations have not been applied correctly in processing Commission funded transactions, financial penalties are incurred. These penalties are payable by the Department as a deduction from future Commission funding and are known as disallowance.

In anticipation of these financial penalties, the Department makes a provision in its financial statements for disallowance arising in respect of the Single Payment Scheme, a number of smaller on-going schemes and for Single Payment Scheme predecessor schemes.

The Department accrues penalties when either the Commission confirms a penalty or the Department has decided not to contest it. At this point the value of disallowance becomes certain and I consider it to be irregular. The total value of disallowance penalties accrued or provided for since the introduction of the CAP 2005 in 2008-09, is currently £580 million.

The value of penalties accrued in 2013-14, and therefore deemed irregular expenditure, is £42 million (2012-13: £20 million). This includes £30 million in relation to the Single Payment Scheme. 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 £6.3 billion of expenditure recognised in the Department's financial statements and the £3.4 billion of Commission funded expenditure managed by the Department.

I have therefore not qualified my opinion on regularity on the Department's 2013-14 financial statements.

Future financial penalties

The Department's 2013-14 financial statements include a provision for £84 million in respect of estimated future disallowance penalties (2012-13: £133 million), which remain subject to challenge and so are not yet sufficiently certain to be accrued. This includes £38 million in respect of the 2010 and 2011 Single Payment Schemes which the Department is contesting with the Commission.

Due to the nature of disallowance, penalties are not incurred in the financial year of scheme payments, but in subsequent years. As a result, there are penalties yet to be recognised in the financial statements for historic scheme expenditure, which the Commission is yet to review. The Department's current expectation is that disallowance penalties incurred for schemes under the current CAP, which is due to end in 2014-15, will be fully calculated and settled by 2019-20.

The Single Payment Scheme represents approximately 80 per cent of Commission funded expenditure under the current CAP. The Department currently expects disallowance penalties going forward, in respect of the Single Payment Scheme, at 2 per cent of scheme expenditure; with weaknesses in quality of data and cross checks considered to be the root cause.

The disallowance expectation across all schemes and scheme years is approximately 2.8 per cent. This is in excess of the 2 per cent Single Payment Scheme forecast due to significantly higher rates of disallowance expected to be applied by the Commission to some of the smaller schemes, such as the Fresh Fruit and Vegetables Aid scheme.

As a result of the £84 million provision balance and scheme penalties not yet recognised in the financial statements, I expect the level of penalties accrued will increase going forward, and this may lead me to qualify my regularity opinion in future years. In order to determine the impact on my opinion, I will continue to assess the materiality of the value of penalties accrued in each year.

Completeness of Single Payment Scheme trade receivables and payables balances

The Agency experienced considerable problems in capturing and processing the data required to process payments for the first two years of the Single Payment Scheme. As a result, in 2012-13, I was unable to obtain evidence to support whether the reported trade receivables and payables balances included all unsettled overpayments and underpayments to claimants. I therefore limited the scope of my audit opinion around the completeness of trade receivables and payables balances relating to the Single Payment Scheme on both the Department's and Agency's financial statements.

In preparation for the new CAP schemes being introduced from 2015, in April 2012, the Agency implemented a 3 year "Strategic Improvement Plan" with the aim of stabilising the Agency in preparation for CAP reform. This included a risk-based assessment and review of claimant overpayments and underpayments, in order to demonstrate the completeness of the Single Payment Scheme trade receivables and payables balances recorded in the financial statements.

Based on the work performed by the Agency and the testing I have performed, I have obtained sufficient evidence to support the completeness of Single Payment Scheme trade receivables and payables balances as reported in the 2013-14 accounts. I am therefore able to provide a clear opinion on the balances reported at both 31 March 2014 and 31 March 2013. Further details are set out in my report on the Agency's 2013-14 accounts (HC229).

Common Agricultural Policy reforms

The problems experienced by the Department in implementing the 2005 CAP reforms led to the issues around Single Payment Scheme trade receivables and payables and have undoubtedly contributed to the level of disallowance penalties since its introduction in 2005. However, the Commission is planning major changes to the way CAP works to create a more effective policy for a more competitive and sustainable agriculture industry and vibrant rural areas. The Department has been involved in the negotiations on the reform, with the key aims of improving the simplicity, affordability and effectiveness of the CAP for farmers and authorities. There are a number of significant risks to implementing CAP reform; the Department will need to ensure that the lessons learned from the previous CAP implementation are applied to the current reforms.

Although CAP reform will be introduced in 2015, with most payments under the current CAP fully disbursed in 2014-15, the Department will continue to meet commitments entered into under the current schemes beyond this date. The Department has been working with its agencies and other delivery bodies to ensure the successful delivery of the new schemes, which are more complex and based on regulations which are not yet fully confirmed.

To do this, the CAP Delivery Programme (the Programme) was established by the Department. The programme was initially owned by the Chief Operating Officer; however a dedicated Senior Responsible Officer, with experience of major project delivery, has now taken up post. The project owner is supported by a Board, led by the Accounting Officer, which includes representatives from all bodies responsible for delivering CAP. Delivery of the Programme is critical to the successful provision of CAP reform: to correctly apply scheme regulations to pay claimants accurately and efficiently; and to minimise penalties.

The Programme incorporates the procurement, development and implementation of new systems that will be delivered through an agile approach, involving outsourcing to multiple IT providers. In 2013-14, the total IT expenditure was £35m, of which £26m was capitalised, against an overall forecast for the life of the project of £155m. The IT system will be brought into use over a number of releases with the first release due in July 2014 and expected completion in early 2016.

The Department has commissioned external consultants to undertake a high level review of the impact that the implementation of the Programme will have on disallowance under the reformed CAP. This review forms the first stage of providing the Department with an understanding of the risks likely to have the greatest impact on the rate of disallowance, and will provide an understanding of where the greatest effort to minimise the impact should be directed going forward.

In addition, the Department is currently undertaking a number of business improvements and re-alignment initiatives. Further to the achievement of efficiency savings, these will seek to supplement the Programme to achieve effective delivery of the reformed CAP.

Sir Amyas C E Morse **8 July 2014**
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Rural Payments Agency Annual Report and Accounts 2013-14 - The Report of the Comptroller and Auditor General to the House of Commons

Introduction

The Rural Payments Agency (the Agency) is an Executive Agency of the Department for Environment, Food and Rural Affairs (Defra) and was established in October 2001. The Agency manages a wide range of Common Agricultural Policy (CAP) schemes, the most significant of which is the Single Payment Scheme (the Scheme).

The Scheme was introduced by the European Union as part of the 2003 CAP reforms, which replaced 11 separate crop and livestock based production subsidies with a single payment based on land area.

The Agency experienced considerable problems in capturing and processing the data required to process payments for the first two years of the Scheme. It has since made significant progress in resolving difficulties in quantifying the value of under and over payments made to farmers and other Scheme claimants as a result of these problems. These are included in the Statement of Financial Position as Scheme trade receivables (representing past overpayments and so amounts due from Scheme claimants) and payables (representing past underpayments and so amounts due to Scheme claimants) balances.

As a result of these difficulties, in 2012-13, I was unable to obtain evidence to support whether the reported Scheme trade receivables and payables balances included all unsettled overpayments or underpayments (completeness).

The Agency has made significant progress in 2013-14 in respect of demonstrating the completeness of these receivables and payables balances. As a result I have been able to obtain sufficient appropriate evidence to support the reported figures in the financial statements and issue an unqualified audit opinion. This report provides further detail on these matters.

In addition I have reported on other matters of relevance to the Agency's administration of the CAP.

Completeness of Scheme trade receivables and Scheme trade payables

Notes 9 and 11 to the 2013-14 financial statements report Scheme trade receivables of £5.1 million (2012-13: £6.7 million) and Scheme trade payables of £8.2 million (2012-13: £16.0 million).

In preparation for the new CAP schemes being introduced from 2015, in April 2012, the Agency implemented a 3 year "Strategic Improvement Plan" with the aim of stabilising the Agency in preparation for CAP reform. This comprised a series of 45 projects across 6 main themes.

Through the Strategic Improvement Plan the Agency identified customers with no recorded unsettled over or underpayments who were at highest risk of having been over or under paid. The Agency aimed to review these customers' balances within the "Cleanse the AP/AR Ledger" project. The project was approved in March 2013 and was closed in March 2014.

I have reviewed the appropriateness of the risk assessment process, confirmed the accuracy of applying the risk assessment to identify customers at higher risk of having unsettled balances and confirmed the accuracy of the Agency's reassessment of these customers' balances.

Alongside this testing I have considered the findings of my audit of scheme payments made in previous years. This testing has demonstrated a significant and sustained improvement in the accuracy of payments made by the Agency during the last three years. Consequently there has been a reduction in the risk of there being material unrecorded, unsettled over and underpayments that the Agency should be recognising as Scheme trade receivables and payables balances.

I have also considered the cause of Scheme trade receivables and payables balances created in the current year, and confirmed they are not indicative of wider systematic issues that have not been identified and addressed, and which could result in further unrecorded over and under payments.

As a result of my testing, and considering the results of the Agency's own work, I have obtained sufficient evidence to support the completeness of the Scheme trade receivables and payables balances as reported in the 2013-14 accounts. I am therefore able to provide a clear opinion on the Scheme trade payables and receivables balances reported at both 31 March 2014 and 31 March 2013.

Other matters of relevance to the administration of the CAP

Disallowance

Since the introduction of the Scheme, Defra has accrued or provided for £580 million of financial penalties ("disallowance") from the European Commission because it did not correctly apply Scheme regulations.

Defra is responsible for these financial penalties, for which £41.8 million was accrued in 2013-14, as the designated UK Authority for CAP funds. I consider such losses to the Exchequer to be irregular. However, whilst I consider this level of cost to the taxpayer significant, I do not consider this to be material in the context of the £6.3 billion of expenditure recognised in the Department's financial statements and the £3.4 billion of European Commission funded expenditure managed by the Department. I have therefore not qualified my opinion on regularity on the Department's 2013-14 financial statements.

The Agency is not responsible for paying disallowance penalties and they are therefore not recorded in the Agency's accounts. Accordingly my opinion on the Agency's accounts is not qualified in this regard.

The Agency and Defra currently forecast disallowance penalties, in respect of the Single Payment Scheme, at 2 per cent of scheme expenditure; with weaknesses in quality of data and cross checks considered to be the root cause.

The disallowance forecast across all schemes and scheme years is around 2.8 per cent. This is in excess of the 2 per cent Single Payment Scheme forecast due to significantly higher rates of disallowance expected to be applied by the Commission to some of the smaller schemes, such as the Fresh Fruit and Vegetables Aid scheme. Further details are set out in my report on the Defra 2013-14 accounts (HC10).

Strategic Improvement Plan

The Agency's Strategic Improvement Plan was closed at the end of March 2014 following completion of 42 of the 45 projects. The remaining 3 projects are due to be completed in 2014-15 and managed through usual governance arrangements. Early closure of the plan reflects significant progress by the Agency in stabilising its operations in readiness for new CAP schemes and systems.

CAP Reform

The problems experienced by the Agency and Defra in implementing the 2003 CAP reforms have undoubtedly contributed to the level of disallowance penalties since its introduction in 2005.

The European Commission is planning major changes to the way CAP works, with the aim of creating a more effective policy for a more competitive and sustainable agriculture industry and vibrant rural areas. The Agency has been working with Defra and other delivery bodies to ensure the successful delivery of the new schemes, which are expected to be more complex and based on as yet unconfirmed regulations.

To do this, the CAP Delivery Programme was established by Defra to procure, develop and implement new systems and processes to support the new schemes. The development of these new systems and processes is key to the successful delivery of future CAP schemes and minimising disallowance going forward. The Agency is working with the Programme team to develop the specifications and procure the replacement systems that will deliver CAP reform obligations, to mitigate the risk of errors similar to those which arose from the introduction of CAP 2005. Further details are set out in my report on the Defra accounts (HC10).

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