NATIONAL AUDIT OFFICE

Report by the
Comptroller and Auditor General

Ministry of Agriculture,
Fisheries and Food

The Sheep Annual Premium Scheme in England

HC 273 Session 1999-2000
10 March 2000

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John Bourn
Comptroller and Auditor General

National Audit Office
11 February 2000

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Executive Summary

1 The Sheep Annual Premium Scheme was introduced in the European Union in 1990 to guarantee sheep producers in member states a common level of support. This report examines the administration of the Sheep Annual Premium Scheme in England. In 1998-99 payments of £142 million were made to sheep farmers in England. This makes it the second largest Common Agricultural Policy scheme administered by the Ministry of Agriculture, Fisheries and Food (the Ministry), after the Arable Area Payments Scheme.

2 Member states must follow the European regulations or guidance on the principles of sound financial control. Failure to do so may result in the European Commission proposing deductions to the reimbursement to member states of payments to farmers under Common Agricultural Policy schemes - known as ‘disallowance’. Member states bear the cost of disallowance as it represents a failure on the part of administrators rather than claimants.

3 Whether the detailed arrangements within a member state comply with the requirements for sound controls in a scheme may only start to become clear once the Commission has conducted an audit. The process of confirming if the results of the audit indicate significant weaknesses leading to disallowance, and at what level, may take several years to complete. Initially the member state may be uncertain as to whether changes in procedures will be required or whether it will be able to convince the Commission that its management of the scheme was satisfactory.

4 The Commission conducted audit visits to England in 1995 and 1996, examining the implementation of the Sheep Annual Premium Scheme for 1993 onwards. By 1998, the European Commission had disallowed expenditure of £27.2 million in England in respect of the Scheme years 1993 to 1995. This equated to just over five per cent of Sheep Annual Premium Scheme (the Scheme) payments in England between 1993 and 1996. The disallowance had its origins in the quality of flock records maintained by farmers and the Ministry’s efforts to balance the demands of scheme control and practical issues such as the timing of on-farm inspections. In the light of this disallowance, it was important to tighten up the administration of the Scheme so that the taxpayer did not continue to lose money.

5 The Ministry has already made significant changes in its implementation of Scheme controls. Disallowance of Scheme expenditure reached a peak in 1994 of £13 million and fell to under £2 million in 1996. By 1998 the Commission indicated that scheme controls were compliant with European regulations in areas of previous weakness. As at January 2000, the final results of review by the European Commission of performance for the 1997 and 1998 Scheme years were not available. However, the Ministry does not expect to incur disallowance in respect of the same problems as in earlier years.

6 The purpose of this report is to analyse the position reached and make further recommendations to safeguard the taxpayer's and farmer's interests. Our recommendations are as follows:

i) The Ministry should seek to clarify the European Commission's concerns at the earliest possible opportunity and establish clearly the potential implications for disallowance. In developing detailed scheme rules to meet the needs of agriculture in England, it should take care not to put the taxpayer at risk of incurring disallowance.

ii) The Ministry seeks to maintain close liaison with the other agriculture departments in the United Kingdom, including the sharing of information about the Commission's views on scheme controls. The Ministry accepts that the changes in the structure of government following devolution mean that it must be careful to ensure that this sharing of information continues.

iii) The Ministry should make every effort to encourage farmers to adopt the recommended standard format for the combined flock and movement record and to ensure that farmers' compliance will satisfy the Commission for the purposes both of scheme control and animal movement requirements.

iv) If trading standards or other bodies continue to provide farmers with movement record books for other purposes, the Ministry must ensure that farmers only use these for Scheme purposes if they meet the Ministry's requirements. In the spirit of modernising government, greater liaison between the authorities with an interest in flock records would be helpful.

v) The Ministry should revise the inspection report forms to explain more clearly those cases in which an inspector concludes that the quality of flock records was satisfactory in spite of differences between the number of sheep counted and the number recorded.

vi) A claim, which is satisfactory in all other respects, is rejected in full if the inspector reports that the flock records are unsatisfactory. It is therefore important that the Ministry satisfy itself as to inspectors' consistency in their assessment of the quality of a farmer's flock records.

vii) Where the penalty is not specified by European regulations, for example in cases of error in flock records, the Ministry might consider whether a system of graduated penalties could lead to more equitable treatment in those cases.

viii) The rules relating to claims from producer groups originate from a now defunct scheme and cause confusion or error by some farmers. These rules serve little purpose and the Ministry should continue to press the European Commission to change them.

ix) It is the Commission's normal practice to target its audits according to risk factors, for example size of expenditure, or issues or regions previously shown to be capable of improvement. The Ministry should periodically re-assess the areas of general weaknesses in member states identified by the Commission in 1997, to minimise the risk of future adverse comment or disallowance.

x) The Ministry has started to build on contacts with administrators in other member states and material available from the Commission. Better information on the conduct and costs of on-farm inspections, for example, should be used by the Ministry as a benchmark for its performance and for sharing experience on aspects of administration not normally covered by the Commission's reviews of Scheme compliance.

xi) The Ministry should assess the effectiveness of the individual criteria within its revised risk analysis model for the selection of claims for on-farm inspection. It should also extrapolate the results from the random sample selected by the model to enable the overall level of error in expenditure under the Scheme to be estimated.

7 The United Kingdom receives subsidy under this Scheme on more animals than any other member state and on 19 million animals out of a European Union total of 73 million. The value of disallowance for the United Kingdom on the sheep scheme was £87.3 million for 1993 to 1996 and was higher than the total for all other member states. The comparative figures are shown in Figure 1.

Figure 1

Numbers of animals paid for and amount of disallowance on the Sheep and Goat Annual Premium Scheme

	Number of sheep and goats on which premium paid in 1998 (thousands)	Disallowance for 1993 to 1996 (£ million)
United Kingdom	19,200	87.3
Spain	18,700	0.9
Greece	10,500	0
Italy	7,900	37.0
France	7,000	4.2
Ireland	4,300	1.8
Portugal	2,500	1.5
Germany	1,700	0.02

The other member states receive premium on only some 1.2 million sheep and goats in total and incurred no disallowance.

Source: National Audit Office analysis

8 Of the 19 million sheep in the United Kingdom on which subsidy is paid under this Scheme, some 11 million (55 per cent) are outside England. Our recommendations above relate mainly to the administration of the Scheme in England by the Ministry, which was the main focus of our examination. But they should also be useful to the authorities in Scotland, Wales and Northern Ireland who exercise some responsibility for the Scheme in those parts of the United Kingdom and where disallowance for 1993 to 1996 amounted to some £60 million (69 per cent) of the United Kingdom total of £87.3 million.

Part 1: Introduction

1.1 This Part provides background information on:

- sheep farming;
- the Sheep Annual Premium Scheme (the Scheme);
- the role of the European Union and the responsibilities of the Ministry of Agriculture, Fisheries and Food (the Ministry); and
- why we examined the Scheme and the methodology we used.

Sheep farming

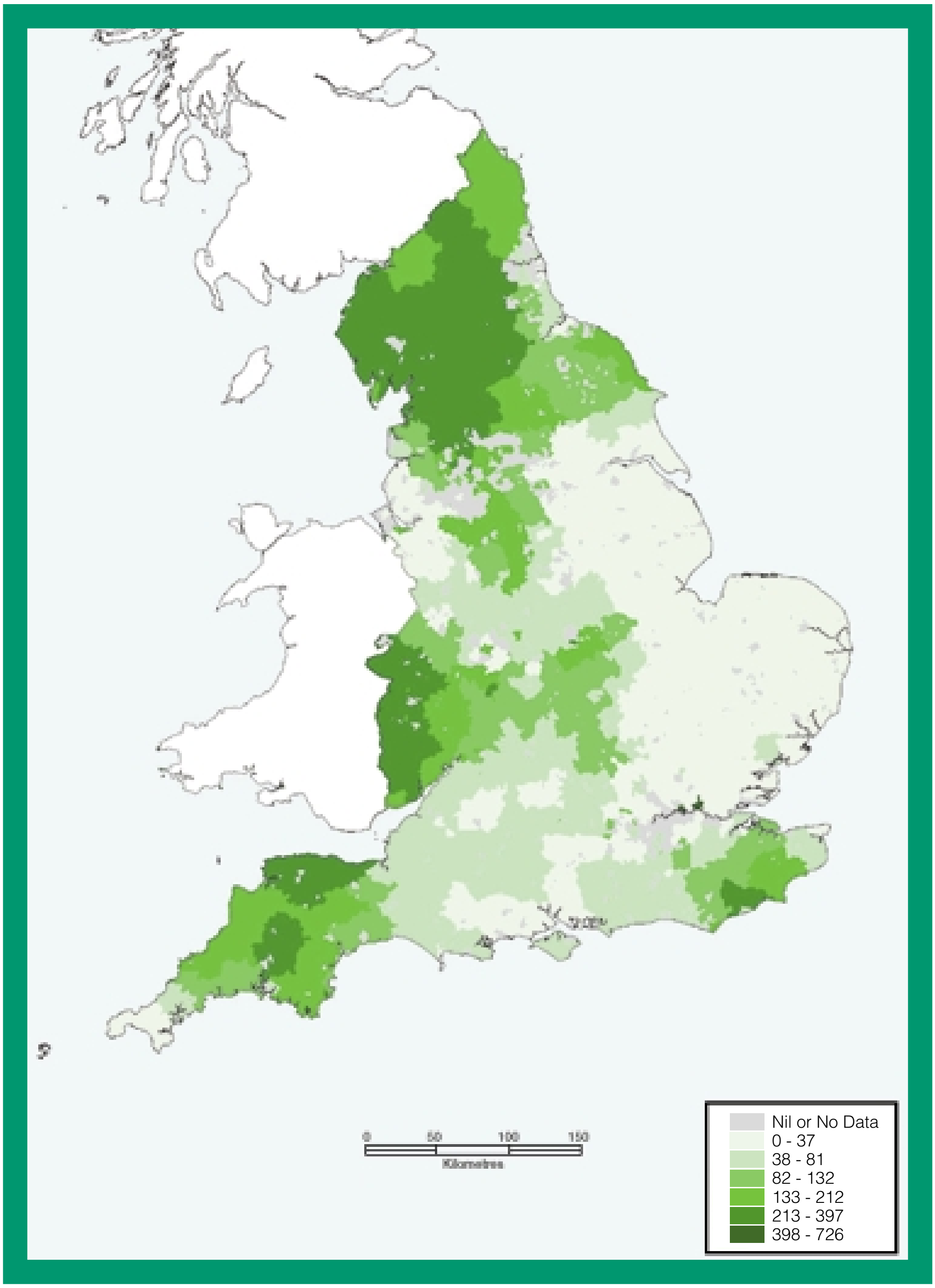
1.2 The United Kingdom is the largest sheep producer in the European Union, with a flock of some 44 million, half of which are lambs under one year old. There are some 20 million sheep in England held by some 45,000 sheep producers. There are wide variations in holdings across England but sheep farming tends to be the dominant type of farming on less agriculturally productive land, particularly in the hill and upland regions (Figure 2). Sheep are produced principally for their meat.

1.3 The current state of the sheep farming industry in the United Kingdom is generally depressed. A strong pound tends to reduce prices and the value of Common Agricultural Policy subsidies for UK producers. The consumption of sheep meat has remained steady since 1995 but the average market price of lambs has fallen sharply: in October 1998 the price was 32 per cent below the level in 1996 (Figure 3). This decline has resulted from a combination of the strength of sterling, reduced exports and the collapse of the sheepskin market. Many hill farmers have been particularly affected by the fall in prices because farms in upland regions are predominantly based on sheep farming.

Figure 2

Number of ewes per 100 hectares in England

The distribution of sheep varies widely across England. Sheep farming is of most importance in the upland regions of northern and western England

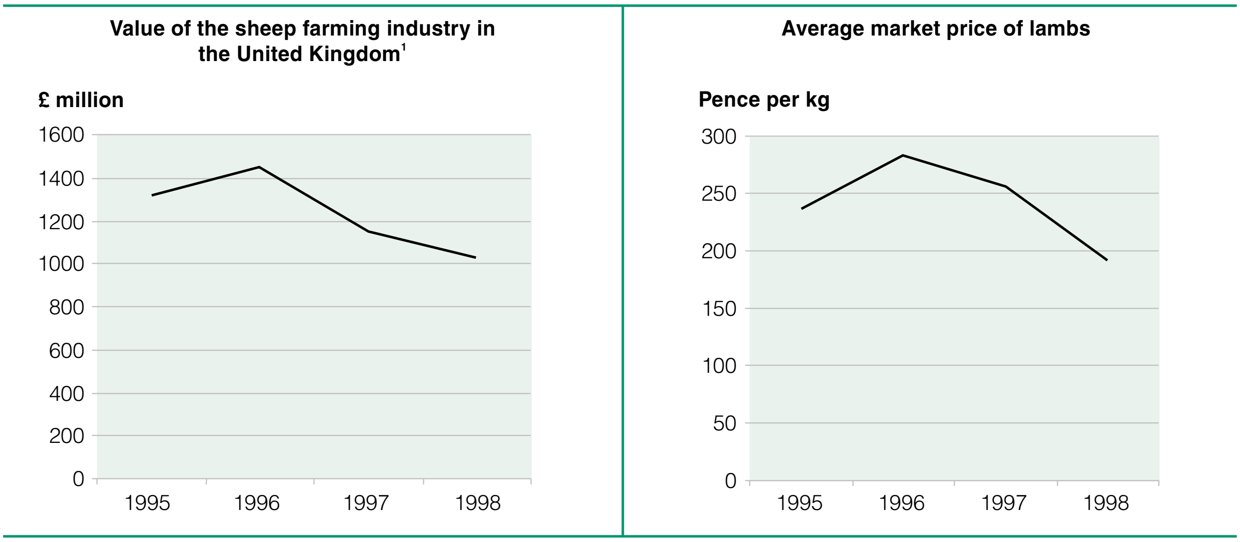


Source: Map produced on behalf of Ministry of Agriculture, Fisheries and Food, by FRCA GI Unit, Leeds. June 1999. Based upon the OS maps © Crown Copyright Reserved MAFF Licence GD272361

Figure 3

Some statistics on the sheep farming industry in the United Kingdom

The farm gate value of the sheep farming industry and the market price of lambs fell between 1996 and 1998



Note 1. Farm gate value - Sale value of sheep plus subsidies under Common Agricultural Policy

Source: National Sheep Association

The Sheep Annual Premium Scheme

1.4 In terms of expenditure, the Sheep Annual Premium Scheme (the Scheme) is the second largest Common Agricultural Policy scheme – after the Arable Area Payments Scheme - administered by the Ministry in England. As with other Common Agricultural Policy schemes, payments to farmers are met initially from money voted by Parliament and then reimbursed by the European Union. The Ministry's objectives in respect of administration of all Common Agricultural Policy schemes are to administer payments fairly and in full accordance with European Union requirements.

1.5 The Scheme was introduced in 1990 as part of a reform of the European Union sheepmeat regime and replaced the Ewe Premium Scheme. The aims of the reform were to ensure a single, harmonised regime for the sheepmeat sector throughout all member states and to guarantee producers a common level of support.

1.6 With effect from 1993, a system of quotas was introduced and imposes a financial ceiling on Scheme expenditure in each member state. In that year the European Union allocated each member state a fixed level of quota based on the level of applications in the previous two years. In 1995 the European Court of Auditors noted that this sought to stabilise the European budgetary expenditure but made the administrative management much more cumbersome. Individual entitlement to Scheme payments is limited to the number of eligible animals for which a producer holds sheep quota. An eligible animal is a live female sheep that either has given birth to a lamb or is at least 12 months old by a particular date (currently 15 May). There are 8.7 million quota units in England. In effect, this is the maximum number of sheep on which payment can be claimed and paid in England under the Scheme.

1.7 Sheep producers receive headage payments for eligible animals. To qualify for payments, producers must follow strict rules for the Scheme laid down by the European Commission and the United Kingdom legislation that contains supplementary details on implementation of the rules. The rules of the Scheme and the key requirements are summarised below. Figure 4 indicates the key dates in the Scheme timetable.

Main features of the Sheep Annual Premium Scheme

- Farmers must keep sufficient sheep to cover the number claimed for at least a period of 100 days after the end of the application period. This is known as the 'retention period' and is when the Ministry carries out on-farm inspections to verify the accuracy of a sample of farmers' claims.

- Farmers can claim individually or as part of a producer group. Producer groups must be in existence at the date of application and continue unchanged throughout the retention period. If these change at other times the groups must notify the Ministry.

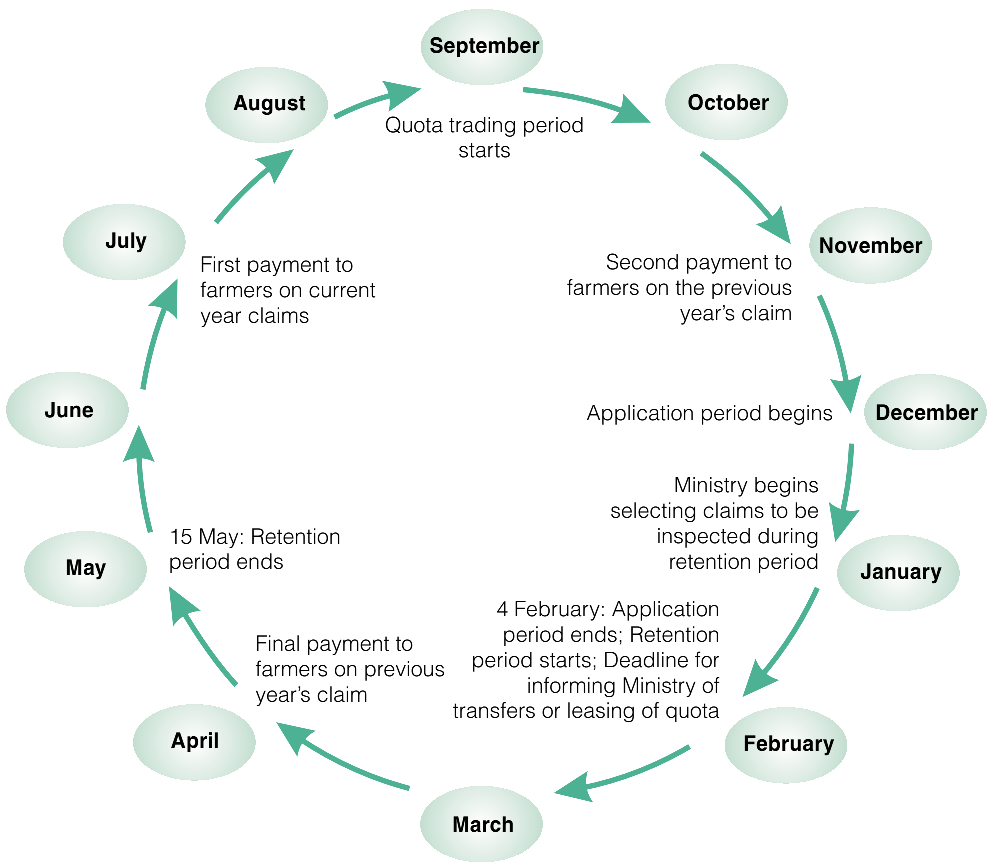
- Farmers can claim for less than their quota but must claim for, or lease out to another eligible producer, a minimum percentage of their quota during each Scheme year.

- Farmers must provide details of where their sheep are kept throughout the retention period.

- Farmers must keep an up-to-date record of their flock that includes a running total of their eligible sheep and identifies purchases, and other eligible additions, deaths and sales.

Figure 4

Key dates in the Sheep Annual Premium Scheme

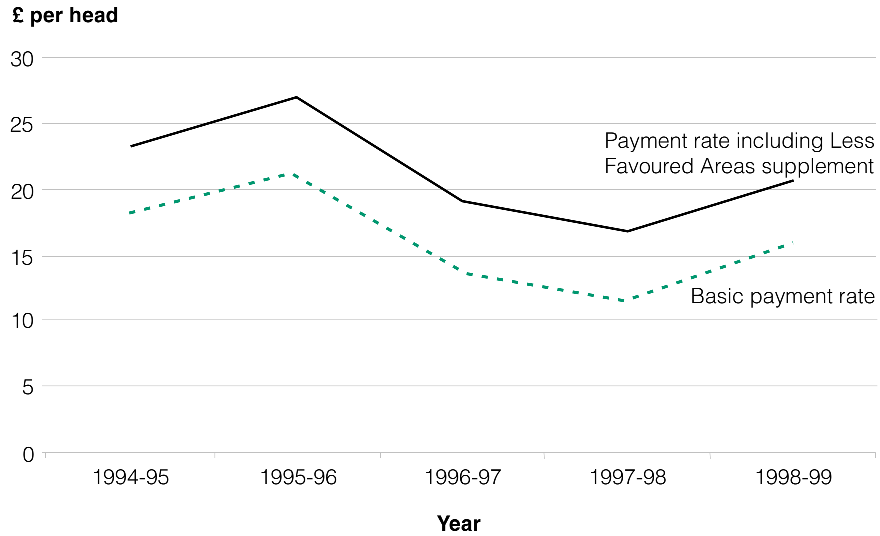


Source: National Audit Office

1.8 The European Union sets the payment rates under the Scheme each year. These are based on the average market price of sheepmeat and goatmeat across member states. In 1998, sheep farmers received a basic payment of £16 for each eligible sheep for which they held quota. The European Union also funds additional compensation to protect and sustain sheep farming in regions where it is especially important to the local economy. Therefore, in "disadvantaged" or "severely disadvantaged" regions designated by the Commission - together comprising "Less Favoured Areas" in the United Kingdom - producers receive a supplementary payment of approximately £5 per eligible quota animal. Figure 5 shows how payment rates have fluctuated since 1994-95. The increase in the basic payment rate in 1998-99 reflects a fall in the average market price of lambs.

Figure 5

Sheep Annual Premium Scheme payment rates 1994-95 to 1998-99



Source: National Audit Office

1.9 In February 1998, the European Commission published its proposals for the future reform of the Common Agricultural Policy. The proposals, known as *Agenda 2000,* were adopted in the spring of 1999. The package focused on the beef, arable and milk sectors and will lead to cuts in support prices and increases in direct subsidy payments in these sectors. There will be increased emphasis on environmental and rural development measures. No changes were proposed to the Sheep Annual Premium Scheme, which would continue in its present form for the foreseeable future.

Industry views on the benefits provided by the Scheme

The Sheep Annual Premium Scheme has a vital part to play in helping maintain sheep in the hills. This provides for the maintenance and management of these areas as well as producing an income for farmers and local communities. The Less Favoured Area Supplement is a vital part of this equation.
Hill Farming Initiative

The Sheep Annual Premium Scheme provides production support directly to the producers with no involvement by processors, auctioneers or any third party. The support is accordingly not subject to any dilution and the further subsidy available in Less Favoured Areas is well justified.
British Meat Federation

1.10 In 1998, the Ministry received some 34,000 claims and made Scheme payments to farmers of £142 million, including £18 million to farmers in Less Favoured Areas. The payments covered 8.2 million eligible sheep. Our analysis of claims in 1998 showed that:

- 30 per cent (10,200) of claims were from producers in Less Favoured Areas, and accounted for 43 per cent (3.6 million) of the sheep paid for.
- The average number of sheep paid per claim was 241 but individual claims ranged from 10 to nearly 12,000 sheep.
- The average payment to a producer was £4,200. The smallest claim was for £160 and the largest was over £200,000.
- Nearly half of the payments were for less than £2,000; nearly three-quarters were for less than £5,000. Less than three per cent were for over £20,000 (Figure 6).

Figure 6

Profile of Scheme payments made to farmers for 1998

Value of claims (£)	Number of claims	Percentage of claims (%)
Less than 2,000	16,056	47.2
2,000 – 4,999	8,967	26.3
5,000 – 9,999	5,378	15.8
10,000 – 19,999	2,650	7.8
20,000 – 49,999	909	2.7
50,000 – 99,999	52	0.2
100,000 and over	9	0.03
Total	**34,021**	**100**

Source: National Audit Office

The role of the European Union and the Ministry's responsibilities

1.11 The European Union determines the payment rates and regulatory framework for the Scheme across all member states. The European Commission, specifically Directorate General VI - Agriculture, carries out a programme of audits of the Scheme in order to monitor compliance with European regulations and to ensure specific targets such as payment deadlines are met. The Commission has the power of disallowance, that is to penalise financially individual member states which it considers are not meeting the regulations or exercising adequate financial control.

Figure 7

Responsibilities for the Sheep Annual Premium Scheme

European Union

Determines Scheme regulations, sets payment rates and monitors systems and controls in member states.

The European Commission reimburses Scheme payments made to farmers. Reimbursement is conditional upon the Ministry implementing the Scheme in accordance with European Union Regulations and sound financial control

The European Commission undertakes annual audits to monitor compliance with European regulations and assess the implementation of Scheme controls. Weaknesses in controls can result in the European Commission reducing the amount of reimbursement — known as disallowance

Ministry of Agriculture, Fisheries and Food

Responsible for administering the Scheme in England in compliance with European Union regulations and for making payments to farmers.

Headquarters division in London (CAP Schemes Management Division) has overall responsibility for accreditation and scheme compliance across all schemes to satisfy European Union requirements for the Ministry's role as a paying agency.

Implements policy

Livestock Schemes division and one regional office - Northallerton - have specific responsibilities for:

- liaising with the European Commission;
- formulating national regulations and designing guidance for farmers;
- preparing operational instructions; and
- ensuring regional offices adopt best practice.

Processes claims

Scheme claims are processed by the Ministry's nine regional offices. Staff in each office:

- input farmers' claims onto the database;
- perform a series of checks on each claim; and
- authorise claims for payment, taking into account any reductions.

Cases of suspected fraud are referred to the Ministry's Legal Department for investigation.

Carries out field inspections

Ministry staff perform on-farm checks on 10 per cent of Scheme claims. Field inspectors:

- perform a count of the number of sheep; and;
- check that the farmer maintains a flock record in accordance with European regulations.

Inspection results are returned to processing staff before claims are authorised for payment.

Source: National Audit Office

1.12 The Ministry is responsible for managing and administering the Scheme in England and for ensuring its detailed rules for the Scheme comply with European Union regulations. Within the framework set out by the European Union, member states do have some discretion in the organisational arrangements for the Scheme. Figure 7 sets out the main responsibilities for the administration of the Scheme. In addition the Intervention Board is responsible, as the United Kingdom funding body, for receiving and accounting for European Union Common Agricultural Policy Guarantee funds and, as the Co-ordinating Body, for promoting the harmonised application of Common Agricultural Policy Scheme administration in the United Kingdom.

1.13 The Ministry has in place the following structure to meet its responsibilities:

- A headquarters division in London, the Livestock Schemes Division, has overall policy responsibilities for the Scheme in the United Kingdom, formulating national regulations and liasing, through the Ministry's Beef and Sheep Division, with the European Commission on behalf of the Ministry and other departments in the United Kingdom responsible for administration of the scheme.

- Another headquarters division, the CAP Schemes Management Division, has overall responsibility for issues relating to the Ministry's role as a "paying agency" - a body, recognised by the European Commission, as being responsible for authorisation, execution and accounting for payments involving European Union Funds. This division is also responsible for scheme compliance across all Common Agricultural Policy Schemes and for co-ordinating and monitoring activities within the Ministry, including the regional offices, which are relevant to the paying agency function.

- Nine regional offices, which process and check claims and authorise payments to farmers. The head of the regional organisation has overall responsibility for the effective implementation of all Common Agricultural Policy schemes administered by the Ministry and for managing regional resources in the light of competing priorities to achieve targets.

- One of the nine regional offices, located in Northallerton and called the National Scheme Management Centre, is responsible for the management of the Scheme. The Centre develops Scheme guidance; monitors the implementation of the Scheme by the other regional offices; and ensures best practice is adopted.

- Another of the nine regional offices, at Carlisle, is responsible for the management of the quota system and has general responsibilities for field inspections across all schemes. For those two aspects, Carlisle's responsibilities for guidance, monitoring and best practice are equivalent to those held by Northallerton, and the two regional offices work together closely.

1.14 The agriculture departments in Scotland, Wales and Northern Ireland have parallel responsibilities for Scheme administration in each country. The respective administrations are responsible for implementing an appropriate system of controls, meeting payment details and submitting information as the basis for returns to the European Commission. The Commission proposes disallowance for the United Kingdom as a whole although the calculations may be based on the Commission's findings in one part or more of the United Kingdom. As the United Kingdom Co-ordinating Body, the Intervention Board is responsible for co-ordinating responses to all Commission proposals on disallowance in the United Kingdom. Senior officials, from whichever paying agency incurred the relevant expenditure on which disallowance is proposed, take the lead in negotiations with the Commission and at hearings of the European Union Conciliation Body, supported by the Intervention Board as Co-ordinating Body.

1.15 Following devolution, the main responsibilities for administering the Scheme remain unaltered. The respective administrations in England and Scotland have produced a Concordat setting out responsibilities for agricultural matters and establishing an agreed framework for co-operation. The Ministry and National Assembly for Wales are currently in the process of agreeing an equivalent statement of co-operation. The Ministry will retain overall responsibility for the pursuit of United Kingdom policies and in formulating responses to European Commission requests. To date, the position whereby disallowance falls to the Intervention Board's budget remains unchanged.

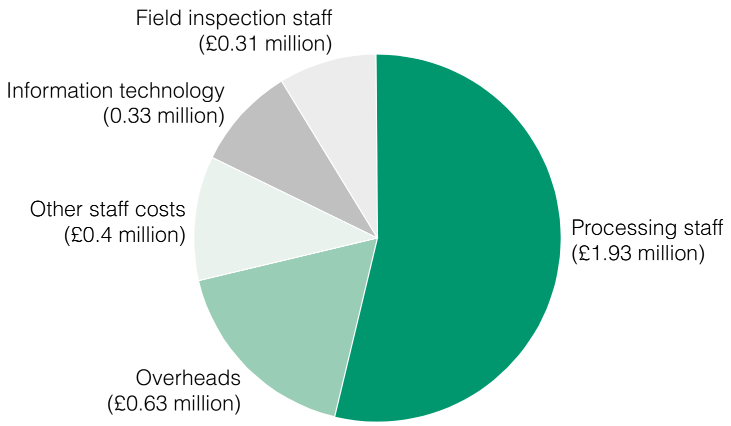
Staffing and cost of administration

1.16 Each of the Ministry's nine regional offices covers an area of England and is responsible for processing Scheme claims and authorising quota transactions. Farmers are required to submit claims to the regional office in which the majority of their holding lies. The Ministry employs about 240 staff in regional offices to process and check farmers' claims under Common Agricultural Policy livestock schemes, including the Sheep Annual Premium Scheme. Another 200 staff at regional offices carry out on-farm inspections of all Common Agricultural Policy schemes administered by the Ministry, including inspections of at least 10 per cent of Sheep Scheme claims each year as required by the European regulations.

Figure 8

Cost of administering the Scheme in England in 1997-98

Total administration costs: £3.6 million



Source: National Audit Office

1.17 Member states are responsible for meeting the cost of administering Common Agricultural Policy schemes and the European Union does not reimburse this. In 1997-98, the cost for the Ministry amounted to some £3.6 million for the Scheme. This equated to an average £106 per claim. The staff costs of processing Scheme claims in regional offices amounted to some £1.9 million, and the cost of carrying out on-farm inspections was £0.3 million (Figure 8). The remainder of the expenditure related to costs of policy staff, information technology and overheads.

Why we examined the Sheep Annual Premium Scheme

1.18 The United Kingdom has the highest number of sheep quota animals in the European Union, nearly half of which are in respect of England. The Ministry in England has overall responsibility for national regulations and liaison with the European Commission. Since 1993, the European Commission has so far disallowed expenditure of £88 million on the Scheme in the United Kingdom, of which £27 million related to England. It was appropriate therefore to examine whether the lessons from this had been learnt.

1.19 Disallowance had its origins in the extent of on-farm inspections and the quality of flock records which were the focus of some attention by the European Commission in the mid 1990s. The tracing of animals has become of increasing importance not only in the event of animal disease but also because of consumer interest in the sources of food we eat. Flock records held by farmers remain a key element of on-farm inspections and scheme control as well as compliance with animal health regulations. The quality and accuracy of those records if inadequate can lead to rejection of the farmer's claim under the Scheme.

1.20 We therefore examined :

- why disallowance was imposed by the European Commission and the action taken by the Ministry in response (Part 2)
- the conduct of on-farm inspections and checking flock records (Part 3)
- the application of penalties (Part 4)

1.21 The report focuses on the Ministry's administration of the Scheme in England and not the remainder of the United Kingdom (paragraph 1.14). In Part 2 we have compared some elements of the operation of the Scheme in England with other parts of the United Kingdom. In addition we have sought to make:

- comparisons with other member states (Part 5).

1.22 As the European Union is responsible for setting the rates of payments and regulations for the Scheme, we did not examine its impact on farmer income and farming practices. Our methodology for carrying out the examination, which is described in more detail in Appendix 1, included:

- visits to four of the Ministry's regional offices to examine administration of the Scheme, and to accompany the ministry's field inspectors to observe on-farm visits;

- an examination of 10 per cent of farmers' claims chosen for field inspection in those regions – to assess the consistency with which field inspections were conducted and penalties applied;

- analysis of management information on the Scheme from all regions, including the application of penalties on irregular claims;

- visiting Scotland, Wales, Northern Ireland and the Republic of Ireland to discuss aspects of administration of the Scheme covered by this report;

- review of reports by the European Commission and the European Court of Auditors on the Scheme;

- a one-day focus group with six farmers in the Northeast from a variety of backgrounds in sheep farming and obtaining the views of a number of sheep industry organisations on the administration of the Scheme;

- advice from an experienced sheep farmer on our findings and a farmer's perspective of the Scheme.

Part 2: Disallowance

2.1 Disallowance is one measure of how well member states have performed in implementing controls on Common Agricultural Policy schemes in order to safeguard European and national funds. Member states, not farmers, must bear the cost of any disallowed expenditure, as it normally represents a failure on the part of the administrators not of the claimants. This part of the report addresses the following questions:

- What is disallowance?
- How much disallowance has been incurred?
- Why was disallowance incurred?
- How quickly was action taken to address European Commission findings?
- How does England compare with other parts of the United Kingdom?

What is disallowance?

2.2 As with other Common Agricultural Policy schemes, reimbursement by the European Union of payments to farmers is conditional upon the Ministry managing the Scheme in accordance with European regulations. In addition, the Ministry must exercise financial control and comply with rules relating to the operation of an accredited paying agency. Paying Agencies in each Member State submit accounts to the Commission in respect of Common Agricultural Policy Scheme payments for the year ending 15 October. These are examined by external auditors who are required to give an opinion as to whether the accounts provide a true, accurate and complete record of the amounts charged to the Guarantee Section of the European Agricultural Guidance and Guarantee Fund. The accounts are then ‘cleared’ by the Commission, on the basis of this certification, by 30 April following the end of the financial year. Disallowance for making payments after regulatory deadlines is generally included in the 30 April decision.

2.3 Disallowance for non-compliance with other scheme regulations is the subject of later, ad hoc decisions, following audits by the Commission in the following two-year period. If these audits identify weaknesses in the control system or that member states have not carried out adequate checks to ensure the regularity of payments, the Commission may propose disallowance. The amount of expenditure disallowed does not necessarily mean that equivalent amounts have been fraudulently claimed or incorrectly paid to farmers.

2.4 In the first instance, the Commission tries to assess the amount of disallowance based on examination of individual cases, on an extrapolation of findings from a sample of individual cases, or on an evaluation of the actual risk of loss to European Union funds. When it is not possible in these ways to identify the actual amount at risk, but the Commission concludes that a member state has not carried out sufficient checks on claims or there are other control weaknesses, flat-rate deductions to reimbursement are imposed. These are usually at a rate of 2 per cent, 5 per cent, 10 per cent or 25 per cent. In exceptional cases, higher rates up to 100 per cent can be applied and if a member state makes no attempt to apply the requirements of a scheme, then no expenditure is reimbursed.

How much disallowance has been incurred?

2.5 Between 1993 and 1996, the United Kingdom incurred disallowance of £87.9 million on Common Agricultural Policy scheme expenditure administered by the agriculture departments. This amounts to less than one per cent of such expenditure in the United Kingdom covering the Scheme years 1993 to 1995.

2.6 The amount of disallowance on the sheep scheme has been the highest. Of the £87.9 million disallowed for 1993 to 1996, £87.3 million was on the sheep scheme. Of this, £27.2 million (31 per cent) related to England (Figure 9). The Ministry made some £527 million of payments to farmers in the Scheme over that period and disallowance thus equated to 5.2 per cent of total payments. In January 2000, the Commission indicated that it proposed a final disallowance of some £0.05 million for the 1993 to 1995 Scheme years, but did not break the figure down between parts of the United Kingdom. The Ministry informed us that in accordance with rules adopted by the European Union in 1995, it does not envisage disallowance in respect of the 1996 Scheme year. The Commission's work in respect of the 1997 and 1998 Scheme years was not yet finalised as at January 2000. However, the Ministry had received no negative audit criticisms from the Commission in respect of those years and the Ministry thought it unlikely that disallowance would be proposed. From 1999-2000 the Ministry has set a target that the level of disallowance due to non-compliance with European Union regulations in England should not exceed 0.5 per cent of the value of Common Agricultural Policy payments across all schemes.

Figure 9

Sheep Annual Premium Scheme 1993-98 - disallowance imposed by the European Commission on the United Kingdom

European Union Accounting Year	Disallowance for England (£ million)	Disallowance for Scotland, Wales, Northern Ireland (£ million)	Total disallowance United Kingdom (£ million)
1993	6.6	8.8	15.4
1994	13.0	18.4	31.4
1995	6.0	24.2	30.8[1]
1996	1.6	8.1	9.7
1997 and 1998	Not yet determined		
Total	**27.2**	**59.5**	**87.3[1]**

Source: Ministry of Agriculture, Fisheries and Food

Note: 1. Includes £0.6 million not attributable to individual parts of the UK

Why was disallowance incurred?

2.7 Disallowance was imposed because of weaknesses in the Scheme controls in England relating to expenditure charged to European accounting years 1993 to 1996. By far the most significant cause (£26 million out of £27.2 million) was failure in 1993 to 1995 to meet the European Commission' s requirements for performing on-farm inspections during the retention periods (Figure 10). The remainder was for other control weaknesses, such as inadequate checking of producers' eligibility to receive the Less Favoured Areas supplement for 1993 and 1994.

Figure 10

Reasons for disallowance in England

	1993 (£ million)	1994 (£ million)	1995 (£ million)	1996 (£ million)	Total (£ million)	Proportion of total disallowance (%)
Insufficient inspections in the retention period	5.8	12.6	6.0	1.6	26.0	95.6
Inadequate control of the Less Favoured Areas supplement	0.4	0.4	-	-	0.8	2.9
General control weaknesses	0.3	-	-	-	0.3	1.1
Failure to reconcile animal numbers between payment stages	0.1	-	-	-	0.1	0.4
Total	**6.6**	**13.0**	**6.0**	**1.6**	**27.2**	**100**

Source: National Audit Office analysis

2.8 A key requirement of the Scheme is that for a period of 100 days after the closing date for applications, farmers must retain at least the same number of sheep as in their claim. It is one of the measures whereby the Scheme seeks to pay subsidy only to permanent sheep farmers. The period is known as the 'retention period'. For 1993, 1994 and 1995, the Ministry provided for two application and two retention periods for each year - one most suitable for upland farmers and one for lowland farmers. Following an audit visit to England in 1995, the European Commission expressed its concern that there was a risk that the same animals could be claimed for in both application periods by different farmers. While there was no evidence that this was in fact occurring, the Commission sought assurance that the systems in the UK were sufficiently robust to address the risk and justify the option chosen. With effect from 1996, a single retention period was introduced.

2.9 Member states are required to carry out on-farm inspections of 10 per cent of Scheme claims. The European Union legislation gave member states two options for when these might be carried out:

- conducting on-farm inspections of 10 per cent of Scheme claims during the retention period; or

- performing up to half of the required inspections of 10 per cent of claims outside the retention period, provided farmers kept continuous flock records, which would enable confirmation that the number of sheep claimed for had been held throughout the appropriate period.

2.10 The Ministry chose the second option. The provision of two retention periods and conduct of some inspections outside the retention periods was regarded by the Ministry as providing flexibility to meet both the demands of Scheme control and practical issues. The advantages were that resource requirements for inspections would be more evenly spread throughout the year and the inspection of hill farms could be conducted at times of the year when the visits would be more convenient to the farmer and the inspector. For example in many upland areas of the UK, gathering ewes which are in-lamb or are accompanied by young lambs for counting was regarded as having potential risks for the health and welfare of animals.

2.11 On flock records in the United Kingdom, the Commission's view was that reliance could not be placed on them. In particular, the Commission found that farmers were not required to keep flock records in a prescribed and uniform format and they did not keep records to an adequate standard. For example, the Commission's audit in 1996 found that only one of nine farms visited by them had records to the required standard. As a result, the Commission's view was that the United Kingdom was not entitled to conduct inspections outside the retention period. The Commission had previously given warning of this following a visit to Northern Ireland in 1994.

2.12 While accepting that the quality of flock records on farms was variable, the Ministry considered that these inconsistencies were not sufficient to require that all inspections should be conducted in the retention period. The Ministry also considered that the Commission's recommendation that flock records should be kept in a standard format was not a prerequisite of the Scheme and a mandatory standard flock record would be an administrative burden that should not be imposed on farmers. The European Commission did not accept the Ministry's viewpoint and in June 1996 proposed disallowance in respect of 1993 and 1994.

2.13 In proposing disallowance the Commission take into account whether problems and weaknesses are localised. In England, the Commission in effect examined all regions by seeking complete information on the number and timing of inspections, knowing that the Ministry had set a target for only half the minimum number of inspections to be carried out in the retention period.

2.14 Figure 11 shows the rate of disallowance imposed on each region in England for 1993 and 1994. The level took into account the proportion of sheep covered by inspections carried out during the retention period as an indicator of the effectiveness of financial control, even though this was not an explicit requirement of the European regulations. All regions incurred disallowance on grounds of general control weaknesses. Crewe, and the two regions with the largest value of sheep payments, Carlisle and Northallerton, incurred disallowance of 10 per cent in at least one of the two years. For 1994, Crewe had improved both its inspection rate and coverage of sheep in retention to above 5 per cent and therefore disallowance was reduced to 5 per cent. However, Carlisle and Northallerton again incurred disallowance of 10 per cent because their inspection rates in retention had fallen to 4.2 and 4 per cent respectively, covering the same or a lower proportion of sheep than in 1993.

Figure 11

Rates of disallowance imposed on England, based on regional office performance

Higher rates of disallowance were incurred where lower levels of inspection had been achieved

	1993 %	1994 %	Reasons
Carlisle Northallerton	10 10	10 10	Did more than half their inspections during retention in 1993, less than half in 1994. In both years, percentage of sheep covered by inspections in retention were less than 5%.
Crewe	10	5	Level of inspections during retention in 1993 was only 1.8%, covering 1.4% of sheep. In 1994 level of inspections during retention was 6.6%, covering more than 5% of sheep.
Exeter	5	5	Did more than half but not all its inspections in retention in both years.
Worcester Nottingham	5 5	2 2	Did more than half but not all their inspections in retention in 1993. EU target met in 1994, but disallowance for general control weaknesses in England.
Bristol	2	5	Did all inspections in retention and met EU target in 1993. Did not do all its inspections in retention in 1994.
Cambridge Reading	2 2	2 2	All inspections in retention in both years, thus met EU target. Disallowance incurred for general control weaknesses in England.

Source: European Commission reports

2.15 For 1995, all regions apart from Worcester achieved at least an inspection rate of seven per cent during retention, and better coverage of a proportion of sheep claimed. Although some of the general control weaknesses still existed in England, the Commission considered there had been a significant improvement and a rate of two per cent was imposed for all regions except Cambridge and Reading where inspection rates were entirely acceptable and no disallowance was imposed.

Key findings on how much, and why, disallowance was incurred

- The Ministry chose the option of conducting up to half the required inspections outside the retention period in order to give some flexibility in the timing of inspections.
- The European Commission's view was that the quality of flock records could not be relied on to justify that option. 96 per cent (£26 million) of the total disallowance (£27.2 million) on the Scheme in England since 1993 was imposed for this reason.
- Disallowance was imposed at levels that reflected regional performance in the proportion of inspections that were carried out in the retention period and in the proportion of sheep covered. One region in 1993 and two others in 1994 did not even achieve the Ministry's target for field inspections during the retention period. The position throughout England improved significantly in 1995 and 1996.
- The desire to implement scheme controls which comply with European regulations but which fit the nature of agriculture in England or the United Kingdom and avoid unnecessary administrative burdens on farmers is understandable. However, it led to additional cost to the taxpayer.

How quickly was action taken to address European Commission findings?

2.16 The Ministry aims to minimise the level and threat of disallowance by meeting the requirements of European Union regulations. Where the European Commission identifies weaknesses in controls, the Ministry aims to address them promptly. Indeed, the Commission itself will take into account the speed with which a member state acts to make improvements, when determining whether to impose disallowance or at what level.

2.17 The main findings of the Commission during their audit in 1995 and the Ministry's response to each of them are given in Figure 12. On the whole the Ministry responded to the Commission's concerns and acted promptly to avoid disallowance and this has been recognised by the Commission in subsequent reviews. Some changes implemented by the Ministry had a significant impact on farmers, such as the move to a single application and retention period for the 1996 Scheme year and the increased emphasis on flock records leading to the Ministry applying penalties with effect from 1996.

Figure 12

Action taken by the Ministry to address weaknesses in scheme controls identified by the European Commission in 1995

Issues identified by the European Commission	Action taken by the Ministry	Timing of action
Sheep not kept at location declared on claim form	Sheep not found during inspection at location notified on claim are treated as ineligible animals and subject to penalties	1995
	Claim form amended to require detailed information on location of sheep.	1996
Dual retention period	Single retention period introduced.	1995
Method of selecting claims for inspection	Computerised risk analysis model introduced for selection.	1995
Notice given before inspections	Targets set to limit notice given prior to inspection.	1996
	Claim form amended to obtain sheep gathering dates – important for inspections of hill flocks	1997
Inadequate control of producer groups	Further information provided on controls and checks	1995
Annual numbers paid for did not reconcile between payment stages.	Extensive manual exercise to reconcile numbers.	
	IT system amended to collect information following European Commission instruction in 1997	1998
Inadequate control of Less Favoured Areas supplement	Controls strengthened by introducing cross-check to area aid applications to confirm eligibility	1996
Inspection statistics inaccurate	Manual exercise undertaken to identify number of inspections in 1993 and 1994. Computerised database introduced to monitor field inspections	1995
Flock records	Formal record keeping requirements introduced to comply with European rules.	1996
	Stricter enforcement of record keeping requirement	1997
	Regional offices required to meet 10 per cent inspection target in retention.	1997

Source: National Audit Office

2.18 On the Commission's concerns over flock records, however, there was some delay in bringing about improvements. The Ministry was aware of the European Commission's concerns about the standard of flock records and the timing of inspections at least from the early 1990s. In 1991 for example, the Commission identified inspection rates and flock records as an area of concern following the clearance of the accounts for the Sheep Annual Premium Scheme's predecessor, the Ewe Premium Scheme, which led to disallowance of £5.6 million (four per cent of Scheme payments). In 1994, the Commission again focused on the standard of flock records, during its audit in Northern Ireland. It concluded that the quality of flock records was so poor that, in most cases, they served no useful control purposes. Although this visit was in Northern Ireland, the Commission explained that its concerns were applicable to the whole of the United Kingdom and indicated that failure to conduct the minimum 10 per cent inspection rate during the retention period would give rise to problems in the clearance of accounts process.

2.19 The European Commission's decisions on disallowance derive from the process described in paragraphs 2.2 and 2.3. This may involve audit visits or enquiries to a sample of, or all, member states. Audits on the Scheme, for example, may involve visits to selected member states and a sample of regions during the retention period of a particular year. However, the findings from such visits may lead to doubts or enquiries about earlier years or other regions and to subsequent follow-up visits by the Commission. The timing of the Ministry's actions has reflected the process by which the member state can respond to criticisms and provide evidence seeking to satisfy the Commission before disallowance is imposed. This process can take several years after the initial audit by the Commission until the extent of unacceptable weaknesses in systems, the amount of funds at risk and hence the final amount of disallowance is confirmed, as reflected in the position described in paragraph 2.6. While this can lead to some uncertainty in member states as to the likely outcome from their performance in earlier years, it reflects the robustness with which the Commission seeks to pursue apparent weaknesses and to protect the European taxpayer.

2.20 The European Commission's audit of the 1993 and 1994 Scheme years, which focused on England, took place in May 1995 and the Ministry was notified of the perceived weaknesses over flock records in July 1995. The timing of the audit meant that it was too late for the Ministry to take any action to improve the level of inspections. For example in respect of the 1995 Scheme year, the two retention periods had already ended in March and May 1995. The Commission provided the Ministry with an early warning of their concerns in order that the Ministry could address the concerns before the 1996 Scheme year. At this stage, however, the level of disallowance was not known and the Ministry sought to defend its approach to field inspections. Against a background of uncertainty as to whether disallowance would be imposed and what the Commission's intentions were, the Ministry was cautious about making significant changes to its working practices and imposing significant additional burdens on the industry and there was further delay. Not until January 1997 did the Commission announce formally that disallowance would be imposed for the 1993 Scheme year. A chronology of the negotiation process for the disallowance imposed to date is provided in Appendix 2.

Current position

2.21 In 1996 new legislation, The Sheep and Goats (Records, Identification and Movement) Order, was introduced in the United Kingdom. This set out the requirements for flock records, together with guidance to farmers on how to compile them, which directly addressed the Commission's concerns about earlier years and the new requirement from 1995. This legislation applied to the 1996 Scheme year, and the Ministry began to apply penalties where records were not deemed to be satisfactory.

2.22 Whereas in the years up to and including 1996, the Ministry allowed a 14-day period of grace, farmers now have to produce a flock record that conforms to European regulations at the time of the inspection, except where there is good reason such as records being held by the farm accountant. The farmer's claim can also now be rejected in its entirety if their flock record does not meet statutory requirements. The application of penalties is considered further in Part 4.

2.23 After its audit in April 1998 the Commission indicated that the Scheme controls were compliant with European regulations and the Ministry's management of the Scheme was satisfactory. The Ministry does not expect to incur any disallowance on the Scheme from 1997 onwards on the same grounds as in earlier years, although as reflected in paragraph 2.6, final decisions by the Commission were not available by January 2000. However, the risk of disallowance is ever present. In 1998 the Commission was pressing for an obligatory standard format for flock records. In response the Ministry consulted relevant industry organisations and started issuing a new recommended standard format for January 2000.

Key findings on the timing of action taken by the Ministry

- Audits by the Commission in one region or part of a member state, as in the case of Northern Ireland in 1994, can lead to doubts about compliance in other regions, which it may follow up. The Commission may also follow up findings from its audits of some years earlier.
- The Ministry aims to act promptly when the European Commission suggests there are weaknesses in controls. The speed with which a member state acts can avoid or reduce disallowance of expenditure.
- Whether the arrangements adopted by member states to meet local needs comply with the Commission's expectations may only become clearer once the Commission has conducted an audit.
- In 1995, the European Commission's audit in England identified potential weaknesses in Scheme controls operating for 1993 and 1994. In several cases, the Ministry was able to introduce changes that satisfied the Commission that it was developing controls that adequately addressed risks.
- However, there were delays in meeting the Commission's concerns regarding flock records kept by farmers. These concerns were identified in the early 1990s, repeated following its audit in Northern Ireland in 1994 and confirmed in 1995.
- By that time, the retention period for 1995 had already passed, the timing of inspections could not be changed and disallowance was incurred for the 1993, 1994 and 1995 Scheme years. For 1996 and 1997, regional offices were required to conduct all of their sheep inspections within the retention period.
- The Ministry introduced new legislation in 1996 to meet the European requirements that farmers in all member states be obliged to maintain flock records.
- Any Commission audits of the Sheep Scheme are likely to include the United Kingdom since its work is targeted at the most significant member states in terms of expenditure.

How did England compare with other parts of the United Kingdom?

2.24 Disallowance was imposed on Scotland and Wales for similar control deficiencies as in England, such as the dual retention period and the Commission's view that the quality of flock registers did not justify conducting inspections outside the retention period (paragraphs 2.11 and 2.12). Although the amount of Scheme payments is lower in Scotland and Wales, Figure 13 shows that the total disallowance incurred since 1993 as a proportion of expenditure was higher in both countries than in England and that in 1995 the amount of disallowance was also higher.

Figure 13

Sheep Annual Premium Scheme: disallowance imposed on each part of the United Kingdom since 1993

	Disallowance imposed by the European Commission[1] £ million					Disallowance as a proportion of Scheme payments 1993-1996 (%)
	1993	1994	1995	1996	Total	
England	6.6	13.0	6.0	1.6	27.2	5.1
Wales	3.5	12.8	9.1	3.8	29.2	5.8
Scotland	4.8	4.8	14.9	4.3	28.8	7.8
Northern Ireland	0.5	0.8	0.2	0	1.5	1.1
Total	**15.4**	**31.4**	**30.2**[2]	**9.7**	**86.7**[2]	

Notes: 1. The disallowance shown is for 1993 to 1996 accounting years but reflects performance in 1993 to 1995

2. In addition, a further £0.6 million disallowance was imposed for the UK as a whole in respect of Less Favoured Area supplements

Source: National Audit Office analysis

2.25 As for England, levels of disallowance of 2, 5 or 10 per cent were imposed depending on the seriousness of weaknesses in each region. Higher rates of disallowance were proposed for regions in Scotland and Wales. In 1995 for example (Figure 14), they had made less progress than regions in England in increasing the levels of inspections and of sheep counted in the retention period. Northern Ireland, on the other hand, incurred a much lower level of disallowance (Figure 13). The level of disallowance in Northern Ireland for 1993 to 1995 reflects the fact that although it conducted more than the required rate of inspections during the retention period, the proportion of sheep inspected was much lower than the percentage of claims inspected.

2.26 The improved position in respect of performance in 1996 and later years indicates the progress made in the United Kingdom generally. For example, the National Assembly for Wales told us that a risk selection system was introduced in Wales in 1996 and the inspection targets were met in both 1997 and 1998. Monitoring of field inspections and training had been enhanced, creating a tighter control environments. A new flock records book was being issued to farmers in early 2000 to assist and encourage their standard of record keeping and to follow through the process of tightening controls.

Inspection rates and level of disallowance for 1995

Figure 14

	Average inspection rate during retention period	Proportion of total sheep covered by inspection	Disallowance
England	8%	14%	Nil on 2 regions 2% on 7 regions
Scotland	6%	3.3%	5% on 1 region 10% on remainder
Wales	8%	5.5%	5% on 2 regions 10% on 1 region

Source: European Commission papers provided to member states

Key findings on comparisons with other parts of the United Kingdom countries

- In the United Kingdom the amount of disallowance relative to the amount of payments under the Scheme was higher in Scotland and Wales than in England although the reasons for imposing disallowance were similar.
- The Ministry was able to make earlier progress than Scotland and Wales to increase levels of inspection and the proportion of sheep counted during the 1995 retention period.

Recommendations on disallowance

- The Ministry should seek to clarify the European Commission's concerns at the earliest possible opportunity and establish clearly the potential implications for disallowance. In developing detailed scheme rules to meet the needs of agriculture in England, it should take care not to put the taxpayer at risk of incurring disallowance.

- The Ministry seeks to maintain close liaison with other agriculture departments in the United Kingdom, including the sharing of information about the Commission's views on scheme controls. The Ministry accepts that the changes in the structure of government following devolution mean that it must be careful to ensure that this sharing of information continues.

Part 3: On-farm inspections and checking flock records

3.1 European Union regulations require member states to ensure that there is an effective system of controls to detect infringements of the Scheme provisions. The Ministry is concerned to ensure that the rules are complied with and that farmers receive the payments to which they are entitled. The Ministry has implemented a system of manual and computerised checks to verify the accuracy and completeness of claims and to identify irregularities. On-farm inspections enable physical checks on the farmer's claim, and are a key method for ensuring compliance with the requirements of the Scheme. An inspection, or the risk that one may be made, also acts as a deterrent against irregular or fraudulent claims.

Our focus group of six farmers thought that:

The Ministry administers the Scheme in an efficient and timely manner. The design of claim forms had been improved and they thought them relatively easy to complete. Ministry staff provide prompt, helpful advice. However, some small farmers fear that an innocent enquiry might reveal a problem with their claim and might hesitate to seek advice.

3.2 This Part of the report examines:

- How are farms selected and inspected?
- How are flock records checked and results reported?

How are farms selected and inspected?

3.3 European regulations require the selection of 10 per cent of claims for on-farm inspection each year, to target those claims which pose the greatest risk in terms of irregularity. In 1997, the Commission indicated that member states should evolve risk analysis to reflect the results from checks in earlier years and to include a random element in the selection process. The Ministry selects at least nine per cent of claims for inspection, using a computerised risk analysis model, and up to one per cent of claims manually on the basis of information provided by field inspectors, and tip-offs from farmers and the public.

3.4 The Ministry's risk analysis model takes account of various factors, such as the size of the claim; the results of inspections in previous years; the farmer's claim history, including any reductions or rejections; and significant changes compared to previous claims. It also includes a random factor. In 1999, the Ministry redesigned the model to address the position in 1998 which showed a large number of farms were being reselected each year despite previously satisfactory results.

3.5 In 1998 the Ministry met its target for inspecting at least 10 per cent of claims during the retention period from February to May. Field inspectors carried out a total of 3,600 on-farm inspections, of which some 3,500 covering 10.3 per cent of claims were conducted during the retention period. Inspectors counted some 2.3 million sheep in total, more than a quarter of all eligible sheep in England. The value of claims inspected amounted to £40 million out of a total payment value of £142 million.

3.6 Inspectors are required to count sheep and check flock records during the on-farm visits. Neither of these are straightforward tasks. There are many practical problems in finding and counting sheep, often unforeseeable, including poor weather conditions, and difficulties with hill flocks. Farmers are required to permit inspections to be carried out as a condition of eligibility. They accepted the need for checks and controls despite the inconvenience that this can sometimes cause. Their co-operation in attending the count can be invaluable in reaching, gathering and identifying eligible sheep.

The industry's views on inspections

"There could and should be greater awareness of practical farming issues eg counting at lambing time and disturbance of ewes", **National Sheep Association.** *"Timings of inspection in lambing which can pose a welfare problem"*, Hill Farming Initiative. *"MAFF are aware of this problem"* (number of inspections during or just after lambing) *"and have been very helpful and understanding in most cases. However, at the end of the day the Scheme rules require MAFF to carry out inspections at this time"*, **National Farmers' Union**. For example, the Ministry asks farmers to state their expected lambing period on their application forms so that inspectors can try to avoid carrying out inspections at this time: *"field inspections are generally handled sensitively and most MAFF inspectors are courteous and appreciative of the practical difficulties that farmers can experience when inspections are made at short notice"*.

When asked what was the most important quality required of an inspector, **our focus group of six farmers** said "someone who can count sheep". The group thought the experience and knowledge of the field inspector was a crucial factor in the conduct of inspections and the treatment of animals. Field inspectors should have a sound knowledge of farming practices and be able to identify easily different breeds, sexes and ages of sheep.

3.7 We examined the Ministry's conduct of field inspections by observing five different field inspectors over a period of four weeks while they were carrying out inspections in February and March 1999. In all we witnessed some 30 inspections. Of course, the presence of the National Audit Office was likely to encourage an inspection of high quality. However, the physical pressures of a sheep count, the conditions encountered, and the presence of a farmer who was likely to refer to any departures from normal practice, meant that there were limits on the ability of an inspector to influence our views on how well the inspection was carried out. We were satisfied that field inspectors carried out their work conscientiously and checked thoroughly for compliance with the rules of the Scheme.

How are flock records checked and results reported?

3.8 In addition to counting the sheep, the inspector's main task on the farm is to check that the farmer is maintaining the correct flock record and supporting documentation and to record the results of inspections. Our attendance at inspections suggested that the time taken checking the records at the farm - perhaps up to one hour - was a particularly tense period for the farmers, as they regarded this as a key determinant of their entitlement to payment. And often the farmer was more confident about the honesty of their claim and the number of sheep held than whether their clerical skills would meet Ministry expectations. If the records were unsatisfactory in some way the claim could be rejected in its entirety, despite the farmer having the required number of eligible sheep for the claim and having sought to comply with the Scheme rules. Just as there are more sheep in member states than are eligible for the Scheme or than the quota allocated, individual farmers have more sheep than are eligible for payment. This means the task of counting sheep to check the farmer has at least the number claimed for and reconciling the number counted to the flock records is not straightforward.

Our focus group of six farmers suggested:

- Scheme guidance had improved but did not stress enough the importance of providing key information and the implications of not doing so. The guidance could be more explicit in setting out the key requirements; for example, the importance of maintaining adequate flock records and that the failure to do so would result in rejection of the whole claim.

- There were inconsistencies in the approach of field inspectors to examining flock records; in particular, reconciling the number of animals counted on inspection to last entry on the flock record.

On-farm inspections of flocks

Sheep are herded into one corner of the field and then allowed to run past the inspector at a steady rate.

If the inspection coincides with the animals' daily feed, the farmer will lay out a line of feed that allows the inspector to count the sheep as they are feeding.

If a large number of sheep are kept in one field the inspector may count the sheep as they pass through a gate to a neighbouring field.

Sheep inspections are sometimes carried out during lambing when the farmer has brought sheep in from the field.

Checking the records

3.9 The European Union's requirement on livestock producers to keep information on livestock movements and on numbers of animals on which subsidy is payable dates back to a Directive of 1992. There has been national legislation in the United Kingdom since at least the early 1960's requiring similar information on animal movements. Since 1992, the Ministry has been advising farmers that failure to keep adequate records could result in the loss of sheep premium payments. With effect from 1 January 1995, member states were required to ensure compliance by farmers with the 1992 European Union directive in respect of sheep.

3.10 The European Commission regulations on livestock records state that on-farm inspections will include a check that the number of sheep present on the holding and eligible for the Scheme corresponds to the number of such animals on the flock register; and that on the basis of the register, animals for which aid applications have been submitted in the 12 months prior to the inspection, have been kept throughout the retention period. Farmers' flock records must also conform to European Union and United Kingdom regulations in respect of identification and registration of animals for animal health purposes. In February 1996, the Ministry introduced the Sheep and Goats (Records, Identification and Movement Order) 1996 order, commonly known as SAGRIMO. The main objectives of this legislation were to enable better checking of claims for sheep premium by requiring farmers to maintain a continuous record of sheep which are eligible for subsidy; and to help the fight against animal diseases across the European Union by requiring farmers to maintain a common system for recording animal movements. Therefore, while the quality of flock records is no longer an issue for the timing of on-farm inspections, as it was for 1993-1995, (Part 2), it remains important both for checking claims and for compliance with wider European Union and United Kingdom legislation.

3.11 Animal health issues, and the benefits of being able to track animal movements in the event of disease, have attracted increasing attention. In the case of BSE and cattle traceability, this has led to a requirement for cattle to be tagged, passports issued, movements recorded in detail and a computerised database to be established. Such details are not yet required for sheep. The practical issues of sheep traceability are different, not least because there are some three times as many sheep than cattle in England.

The industry's views on the identification and recording of sheep

"Along with the whole industry, we have fought against individual ID of sheep, whilst supporting the tagging with a flock identifier of all sheep before they leave the farm of origin. We do not support the idea that all movements of these tagged animals should be recorded. It is more than adequate to record movements as per the present regulation, that is by batches with the same temporary mark."
Livestock Auctioneers' Association.

"It is generally considered that the current level of record keeping was adequate, but that any increase, bearing in mind the fact that people were having either to keep more sheep or else find part time employment, would be unnecessary and in any case unsustainable."
The National Sheep Association.

"We fully support MAFF's efforts to improve standard flock records. We recognise the importance of accurate flock records and we will...continue to raise awareness on this issue." However, they are fundamentally opposed to the introduction of a national flock register at least until a workable electronic identification system is a possibility. **The National Farmers' Union.**

"There would be advantages to a national flock register but it...would be a burden too many."
Hill Farming Initiative.

3.12 In 1996 and each year since, the Ministry has provided guidance to farmers not only informing them of the legal requirements of a continuous flock record and but also including suggested formats. The Ministry did not make the format prescriptive because it did not want to increase the administrative burdens on farmers. Farmers may have different needs and approaches to record keeping according to the nature and size of their farm. For example, small mixed farms may need only limited records necessary to meet Ministry, local authority or revenue department requirements. Specialist breed farms, or those supplying particular markets, may need very detailed records to satisfy those customers. Larger farms, including those employing a farm or estate manager, may have relatively sophisticated computer files.

3.13 In some regions, trading standards agencies, local authorities or private companies produce record books which farmers may use to record sheep movements. In some cases these are useful to farmers for the purposes of the Scheme, provided the format also meets the requirements of the Ministry regulations. However, if these books provided by local authorities are produced for different purposes or reflect out of date requirements, the farmer may be misled into thinking that his flock record will satisfy a Ministry inspection. In response to the difficulties faced by farmers in maintaining flock records, the Ministry is developing a new suggested format for a combined flock and animal movement record and started issuing this in January 2000.

3.14 The Ministry provides guidance notes each year to field inspectors highlighting changes to scheme rules or inspection forms and issues arising from the previous year's inspections. These include advice on the checking of farmers' records. Against these guidelines we assessed the approach of field inspectors to checking flock records and the judgements they need to apply, and the quality of field inspectors reports. As well as attending on-farm inspections, we examined a random sample of 10 per cent of field inspections during our visits to four regional offices. In total we examined 157 inspection reports from the 1998 Scheme year. This work revealed:

- In some cases farmers do make unintentional errors and omissions in the records they keep. Depending on the nature of the error or omission, inspectors may allow farmers to amend their records ("minor updating") to ensure that they conform precisely to Scheme rules. We found that in similar situations, such as an arithmetical error in the record, one inspector might allow this to be amended and accept the records as satisfactory, while another might take a different view and recommend rejection of the claim. In 1999 the Ministry amended their guidance to give explicit examples of the circumstances in which minor updating is allowed.

- In exceptional circumstances, for example where records are with the farm accountant or with a local authority, farmers are allowed to present their records at the regional office within two working days. In our sample of 157 inspections, we identified four cases where inspectors returned to the farm several days later in order to examine the records, though there was no indication of special circumstances.

- Inspectors are required to examine the flock record back to 1 January of the current year. We found that some checked back to the previous year even though instructions did not specifically require them to do so. In one case we observed that, while the record in the current year was satisfactory, subject to minor updating, checking back to the previous year revealed that the farmer was not in fact keeping a proper continuous flock record and the claim was rejected on this basis.

Reporting the results of inspections

3.15 Every inspection visit must be the subject of a report setting out the inspector's findings and conclusion. Where inspectors find significant errors in the flock record, they have to indicate this in the report, and the claim is likely to be rejected. The inspector should tell the farmer if non-compliance with Scheme rules has been found and ask for explanations. The farmer is invited to sign the summary report form and may add any observations. In all cases, an internal report by the inspector is also completed setting out details of any infringements and the conclusion to be drawn. These are then submitted to the processing section responsible for dealing with the farmer's claim. Based on the information in the reports, processing staff will reduce or reject the claim if any infringements have been found. It is therefore important that inspection reports provide clear and complete information to enable processing staff to process the claim correctly. In 1995 the Commission was considering whether to introduce rules for a standard report on field inspections. This has not been introduced but indicates the increasing attention being paid to administrative details in operating the Scheme.

3.16 We provided the full results of our examination to the Ministry. A key issue we found was the reconciliation of the number of eligible animals counted on inspection to the latest entry in the flock record. The Ministry's guidance to field inspectors states that under normal circumstances inspectors should carry out a complete count of the entire flock to give a sound basis on which to check the running total in the flock record. However, we found in 46 of the 157 (29 per cent) inspection reports examined, the latest flock record total differed from the number of sheep counted. We accept, based on our own attendance at inspections, that there are valid reasons to explain differences between the numbers recorded and counted:

- There may be occasions when eligible sheep or ewe lambs in excess of the farmer's claim figure are grazing on land away from the holding. In these cases, the inspector is permitted to verify the number of animals claimed by headcount and verify the remainder by reference to the farmer's movement records.

- Ewe lambs that are 12 months old by the end of the retention period are eligible under the Scheme. SAGRIMO states that ewe lambs should not be brought into the continuous flock record until they reach this age or have given birth. However, many farmers include ewe lambs before they reach the eligible age for the sake of completeness of recording. Some inspectors allowed this to be treated as a technical error.

- In difficult weather conditions (for example, fog) or on inspections where animals are spread across mountainous terrain, it is not possible for the inspector to be completely confident that he has seen and counted every animal. On such occasions, as long as the farmer's claim figure has been verified, it may not be possible to reconcile the number counted to the flock record.

3.17 In 10 of the cases we examined the size of the differences between numbers counted and numbers recorded was sufficiently large to call into question the accuracy of the flock record, but the inspector's report did not explain the discrepancy and considered the records to be satisfactory. These cases did not throw doubt on the eligibility of the claim, since the number of sheep counted were greater than the number claimed. However, given that processing staff are required to process the claim based on the information in the inspection report, and the penalty for inadequate flock records is the rejection of the claim, inspectors might be expected to indicate the reasons for the differences which allow them to report the inspection as satisfactory. Where possible, inspectors should be required to confirm the accuracy of the flock record by reconciling the latest running total with the number of eligible sheep in the flock.

Key findings on checking flock records and reporting results

- Farmers are now required to keep continuous flock records, that conform to European and United Kingdom legislation, for both Scheme control and animal health purposes. Identification and recording of movements of livestock are of increasing importance and in 1998 for European Commission was pressing for an obligatory format for flock records.
- Farmers are provided with guidance from the Ministry on the contents of flock records to meet these requirements, but the format is not mandatory largely in order to avoid adding to administrative burdens on farmers. Some trading standards or other authorities produce flock movement or record books which farmers may use for a variety of purposes.
- Checking flock records presents some problems due to the wide variation in their nature or format, changes in recent years in what is required of inspections and valid differences between numbers of sheep counted and recorded, of eligible sheep and sheep quota numbers, of ewes and ewe lambs. Guidance to inspectors is issued each year.
- A whole claim can be rejected if the flock record is reported as not satisfactory by the field inspector. Our examination of inspection reports suggested that it was not always clear why the inspector considered the records to be satisfactory. Clearer reporting of reasons for their judgements might assist in ensuring a consistent approach.

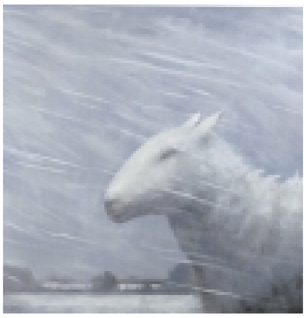
Recommendations on on-farm inspections and flock records

- The Ministry should make every effort to encourage farmers to adopt the recommended standard format for the combined flock and movement record and to ensure that farmers' compliance will satisfy the Commission for the purposes both of Scheme control and animal movement requirements.

- If trading standards or other bodies continue to provide farmers with movement record books for other purposes, the Ministry must ensure that farmers only use these for Scheme purposes if they meet the Ministry's requirements. In the spirit of modernising government, greater liaison between the authorities with an interest in flock records would be helpful.

- The Ministry should revise the inspection report forms to explain more clearly those cases in which an inspector concludes that the quality of flock records was satisfactory in spite of differences between the number of sheep counted and the number recorded.

Part 4: The application of penalties



4.1 Where irregularities are found in farmers' claims, financial penalties are applied to discourage fraud and abuse of the Scheme and to protect the taxpayer from the threat of disallowance of national expenditure by the European Commission. It is important that penalties should be imposed consistently and fairly upon farmers. We examined the circumstances in which irregularities arise, the penalties that have been applied and the reasons for applying penalties in the 1998 Scheme year.

Why were claims reduced or rejected?

Irregularities

4.2 Irregularities may range from simple unwitting errors by the farmer to deliberate acts of fraud. Some relate directly to the financial value of the claim, such as overclaims on the number of sheep; while others may occur where a condition of the Scheme has not been properly fulfilled – for example, the failure by a farmer to keep satisfactory flock records. An individual claim may sometimes exhibit a number of different irregularities. Not all irregularities result in reductions to claims and financial penalties. The Ministry is able to correct small errors of a clerical nature (such as ensuring the claim is signed, provided this is done before the closing date for application) within the rules of the Scheme and pay claims in full as appropriate.

Financial penalties

4.3 European Union regulations set out specific penalties for certain types of irregularity that must be imposed on the farmer's claim but others are determined by each member state. Penalties that are determined by European regulations include cases where the number of sheep counted by an inspector is less than the farmer has effectively claimed, and cases where the farmer has submitted an application form after the closing date. A graduated scale of penalties is applied in these cases and the member state has no discretion in applying these penalties. Figure 15 sets out the range of penalties applicable where there are insufficient sheep to cover the claim.

4.4 For some types of irregularity the European regulations are less specific and the member state is responsible for determining the penalty. In England, for example, the Ministry has determined that where flock records are deemed inadequate the claim will be rejected in its entirety. (The same is true of the rest of the United Kingdom.)

Figure 15

Penalties applied in cases where there are insufficient sheep

Type of irregularity	Penalty to be applied
Insufficient sheep to cover claim Claims are reduced when the number of eligible animals kept throughout the retention period is lower than the number of eligible animals claimed – and the reason for the difference is not force majeure or losses from natural circumstances notified to the Ministry.	**If the difference between the number claimed and the number found is not more than five per cent:** payment is made only on the number of animals found and the payment rate per sheep is also reduced by the percentage difference between number claimed and number found.
Claims can be reduced for a number of reasons including: ■ Insufficient animals found at inspection; ■ Failure to notify the Ministry of losses and no replacements held; and ■ Animals not at notified location.	**If the difference is between five per cent and 20 per cent:** payment is made on the number of animals found and the payment rate is reduced by twice the percentage difference between number claimed and number found. **If the difference is more than 20 per cent:** the whole claim is rejected.

Source: Ministry of Agriculture, Fisheries and Food

Level of irregularities

4.5 In 1998 the Ministry received some 34,000 applications under the Sheep Annual Premium Scheme. Of these, 21,300 claims (63 per cent) were cleared as satisfactory and paid in full. In another 10,000 cases (30 per cent), the number of sheep paid for was lower than that shown on the claims. Claimants are allowed to record on their claim all the eligible sheep they intend to keep throughout the retention period even if they do not hold quota for them. However, they are paid only on the number of animals for which they hold quota, and need to meet the requirements of the Scheme only in relation to the quota number. The computerised processing system in these 10,000 cases automatically reduced the number of animals claimed to the quota number. These are not irregularities.

4.6 Of the remaining claims, 2,078 (6.1 per cent) were reduced and 407 claims (1.3 per cent), were rejected in their entirety because of errors, irregularities and the application of penalties. Some claims contained more than one irregularity and regional offices identified some 2,700 separate irregularities on these

2,078 claims. The bulk of the reductions and rejections, 2,324 (94 per cent) were identified by in-office checks but 161 cases (6 per cent) were at least partly due to unsatisfactory results from field inspections.

4.7 The value of these 2,485 reductions and rejections in the 1998 Scheme year was £2.65 million (Figure 16). This included 743 cases where the existence or allocation of quota was recorded as resulting in reduction or rejection of claims. In 203 of these, the claimant had no eligible quota. This may arise where leases of quota between farmers have failed to register in time for eligibility under the Scheme, or farmers applied for subsidy hoping to be successful in their applications for quota from the National Reserve. Excluding these 743 quota cases, over half of the £1.5 million reduced or rejected arose from only 65 claims, where the reduction was for more than £5,000. 85 per cent (1,497 out of 1,742) of the reductions involved less than £1,000.

Number and value of reductions and rejections for the 1998 Scheme year

Figure 16

Size of reduction (£000s)	Reductions and rejections excluding quota problems		
	Number of claims reduced	Number of claims rejected	Value of reductions and rejections (£000s)
<1	1,373	124	236
1 – 2	55	32	127
2 – 5	64	29	298
5 – 10	27	7	230
0 – 20	12	8	261
20 – 50	6	4	262
50 – 100	1	-	62
Sub-total	1,538	204	1,476
Cases relating to quota problems	540	203	1,177
Total	**2,078**	**407**	**2,653**

Source: National Audit Office analysis

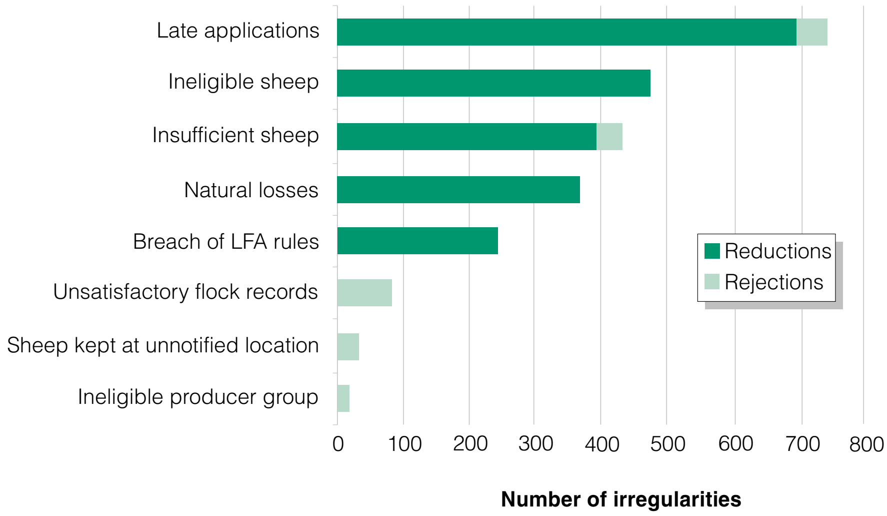
Reasons for application of penalties

4.8 Excluding insufficient quota, we found that the highest number of cases in England where penalties led to reductions or rejections were for late applications (Figure 17) :

- Claim forms specify clearly the final date for receipt of claims and this has been unchanged from 1996 to 1999. Where farmers submitted their forms after 4 February 1998, their claims were subject to a reduction proportional to the number of days that they were late (694 cases). Applications received after 1 March were rejected (45 cases). The European requirement for a deadline to be set for applications reflects the position that data are required in order to establish payment rates and for budgetary control.

Figure 17

Main reasons for reductions and rejections of claims for 1998 in England



Source: National Audit Office analysis

4.9 The other main reasons for the application of penalties were:

Claims reduced or rejected

- Ineligible animals. For example, farmers may claim on ewes under 12 months old if they are expected to lamb before the close of the retention period. Deductions were applied to claims on animals that had not in the event given birth (475 cases reduced).

- Farmers owning fewer sheep than they claimed for. There were 390 cases where the number of sheep counted was up to 20 per cent fewer than the farmer had quota for, and the claim was reduced. In 44 cases, the difference was more than 20 per cent and the claims were rejected.

- Losses of sheep, such as deaths, during the retention period which resulted in the number of remaining animals falling below the farmer's quota or claim (368 cases reduced).

- Breaches of the Less Favoured Area rules - (245 cases reduced and 7 cases rejected).

Claims rejected

- Unsatisfactory flock records (84 cases). 43 of these cases occurred in just two of the nine regional offices, Bristol and Reading.

- Sheep kept at a different location than on the farmer's application form and the change had not been notified to the Ministry (32 cases).

- Producer group problems (18 Cases). (Cases of claim reductions as a result of such problems are classified under the appropriate categories of errors such as quota holdings).

Key findings on why claims were reduced or rejected

- Just over 2,000 claims were reduced or rejected for the 1998 Scheme year. Over 90 per cent of these were identified by in-office checks and included cases due to events after the application date and cases where information provided by the farmers themselves led to reductions to claims.

- Apart from quota allocation problems, late applications were the biggest cause of claim reductions and the highest numbers of complete rejection of claims were due to unsatisfactory flock records.

Were penalties applied consistently?

4.10 Our file examination for inspections, a sample of cases and interrogation of databases indicated that the Ministry applied penalty reductions and rejections in accordance with the rules of the Scheme and as determined by the European Union. We noted that the category of unsatisfactory flock records is one where the

Ministry has the discretion to determine the penalty. It is a severe penalty to deny compensation to a farmer who has submitted an honest claim but who, perhaps because of a clerical error, has made a mistake or failed to keep their records correctly. Our attendance at on-farm inspections and review of inspectors' reports indicated the problems in examining the quality of flock records. Therefore we examined this category in more detail. We also examined cases involving 'producer groups', which our contact with farming associations indicated as a cause of problems.

Unsatisfactory flock records

4.11 In 1998, 84 claims amounting to £278,000 were rejected in their entirety because of unsatisfactory flock records. Examples of the kinds of error which inspectors in these cases identified as constituting sufficient grounds for considering the farmer's flock record unsatisfactory and which led to the Ministry rejecting the claim included:

- failure to keep the record up to date;
- discontinuity in the record – for example, the failure to include one or more sales or purchases of eligible animals, or to record all deaths and losses;
- absence of a continuous running total of eligible animals although this could be calculated; and
- discrepancy between the latest running total and the number of animals the inspector had counted. As indicated in Part 3, this did not consistently lead to inspectors reporting the results as unsatisfactory and should not necessarily do so.

4.12 Flock records now have to satisfy animal health objectives as well as the Scheme. Penalties may be applied to farmers who do not keep satisfactory records for whatever reason since their claim form (Appendix 3) contains the undertaking to keep the records required under the Sheep and Goat (Records Identification and Movement) Order 1996. The Ministry may reject a claim in its entirety even if a farmer has made an unwitting clerical error or omission, owns and has retained all of the animals for which he has quota (and counted as correct by the inspector), and in all other respects submitted an honest application.

4.13 Our attendance at on-farm inspections confirmed the difficulties in examining the quality of flock records. For example, in cases where there is no suggestion that the farmer has claimed for more sheep that he is entitled to, and the knowledge that rejection of the whole claim is the penalty, inspectors will need to weigh all the evidence carefully before coming to a decision. This can be finely balanced, with the judgement influenced by individual circumstances, though operational instructions are revised every year to take account of new case examples. The two similar cases described below, both of which were submitted to the Northallerton regional office, give examples of the impact of decisions about the quality of flock records.

- An upland farmer submitted a claim for payment on 1331 sheep. This represented the number of animals on which quota was held; though the number of eligible animals owned by the farmer was larger than this. (Entitlement to Scheme payments is limited to the number of eligible animals for which the farmer holds sheep quota.) The field inspector counted 1502 eligible sheep, 69 more than recorded in the farmer's flock record (1433). The inspector considered that the flock record was inadequate and the Ministry rejected the claim, after considerable deliberation, on the grounds that the records were deficient in a number of areas. These included an arithmetical error by the farmer some months before in attempting to maintain an accurate running total following a count. While no abuse of the Scheme was intended and the farmer had the 1331 sheep needed to qualify for payment of the amount claimed, the lack of complete records resulted in the farmer losing £27,000.

- An upland farmer submitted a claim for 1002 sheep. As for the previous case, this represented the number on which quota was held, though the number of eligible animals the farmer owned was larger. The field inspector counted 1001 ewes and 205 ewe lambs – a total of 1206 eligible sheep again thus confirming that the farmer had at least the quota number, as required. However, the farmer's record showed a latest running total of 1,080 sheep, suggesting an inaccuracy in the record. The inspector nevertheless decided that the result was satisfactory. The claim for more than £20,000 was paid in full. This contrasts with the case above where the correct number of sheep was held but errors in the flock record were regarded as sufficient for complete rejection of the claim.

There were differences between the two cases, which influenced the decision taking. In the first case the records were defective in a number of areas, and the producer was penalised. In the second case the producer had been unable to count all of his ewe lambs because they were ungathered and out on an open moor, but had made the best, if somewhat imprecise, count of ewe lamb numbers that he could and recorded it in a format acceptable for the purposes of claiming under the Scheme. The inspector's judgement was that, given the circumstances, no more could have been expected of the claimant at the time that the inspection took place. These examples illustrate the difficulty in reaching conclusions, despite precedents and training.

4.14 The objective of the Scheme is to guarantee producers a common level of support (paragraph 1.5). To achieve that, producers of eligible sheep are paid compensation subject to quota restrictions on the number of animals. In both the above cases, the farmer was entitled in principle to support in those terms, but there were doubts about the accuracy of his record keeping for all his sheep. The potential severity of penalty in these cases contrasts with the situation with animals kept at unnotified locations. Farmers are required to notify the Ministry in writing before moving sheep to locations not referred to in their claim form. The Ministry has determined that animals kept at an unnotified location are not eligible for subsidy payments but the entire claim is rejected if the number of animals kept at an unnotified location exceeds 20 per cent of the quota held. In England in 1998 there were 32 cases of rejection involving unnotified location. We noted that in Scotland, while there were cases of unnotified location, the farmer had been reminded about the rules regarding notification but no penalties had actually been applied.

4.15 Penalties are now more severe than in the earlier years of the Scheme as the Ministry recovers Scheme payments back to the 1998 Scheme year if inspections reveal weaknesses in flock records suggesting less than perfect records in previous years. Errors found in a farmer's records in the year 2000, for example, could lead to the recovery of monies paid to the farmer over a three-year period.

4.16 The general approach is to apply penalties which are reflective of the breach committed by the farmer. This has to be looked at on a case by case basis in the absence of a standard formula for application of proportionate penalties. Graduated penalties, rather than total rejection of claims, provide scope to penalise farmers where they have made errors and have not claimed more than their entitlement. Such a system, involving a sliding scale of penalties depending on the significance of the mistake, enables farmers to keep substantially more of their claims in such cases. We noted that, at least in the cases of unsatisfactory flock records, it appeared that the Ministry could adopt this approach if it wished to. The Sheep and Goat (Records, Identification and Movement) Order 1996 provides that, where a producer fails to comply with the requirements, the

Ministry may withhold or recover on demand ‘the whole or any part of’ any premium payable. This phrase appears to have been specifically included in the Order to allow graduated penalties to be introduced.

The industry’s views on the severity of penalties

“In general penalties are applied fairly and in accordance with the Scheme rules. However there are occasions where we feel that “the penalty does not fit the crime.” e.g. where MAFF themselves have made a mistake and have to recover payments from producers - not only do they recover the payments they also charge interest on the payments.” **National Farmers’ Union**.

In relation to penalties applied to changes in a holding’s Less Favoured Area status, the **National Farmers’ Union** noted: *“We have seen cases where a farmer has purchased some extra land and has changed his LFA status because of one hectare and has then had all of his Sheep Annual Premium disallowed. This is a disproportionate penalty.”*

“It is accepted that financial penalties may be required but only if there is full justification and leniency is shown when problems have been experienced in gathering or identifying deaths on the moors.”
Hill Farming Initiative.

“There should be very severe financial penalties for transgression of the Scheme, more specifically where claim application forms are found to be for number in excess of animals actually held.”
British Meat Federation

Our **focus group of six farmers** suggested that in some aspects, penalties were felt to be too severe and did not “fit the crime”. Claims could be rejected when the error had resulted from a mis-interpretation or lack of awareness of Scheme rules and there had been no intent to defraud or cheat the Ministry. Rejections for inadequate flock records or the failure to notify the location of flocks were considered to be extremely harsh as the farmer can often prove he has sufficient eligible sheep to cover the claim.

Producer group and quota errors

4.17 In 1998, ‘producer groups’ submitted 12,985 claims (38 per cent of all applications). Producer groups arise where sheep are jointly owned by two or more people in a legally binding arrangement recognised by the Ministry. Each member of the group must hold quota in the same proportion as their share of the business and each must sign the claim form. If a member of the group dies, or the structure of the business changes, the quota held must also change to reflect the new arrangements and the group must notify the Ministry. The rules are set out in the guidance notes for farmers but in practice they make clerical errors - for example they may fail to change their respective quota holdings after changes in the ownership structure of a farm. In such cases, claims may be penalised even though in all other respects their applications are correct and the number of animals claimed would be eligible for payment had the group not made this administrative mistake.

Examples of producer group and quota problems that we found include the following:

A claim for 100 sheep in the Northallerton region involved one producer owning 90 per cent and another producer owning 10 per cent of the flock. The claim included nine ewe lambs that were expected to lamb by the end of the retention period. In the event only seven gave birth and therefore only 98 sheep were eligible for payment. One of the producers now owned only 9.8 animals - less than the minimum 10 animals required under the Scheme rules. After prolonged consideration of whether the entire claim was now invalid, the Ministry paid on 89 animals at a reduced rate. The minority partner who could have expected £160 from 10 animals received nothing.

A claim for 319 animals was submitted to the Carlisle regional office by a producer group consisting of a husband, his wife, and their son. The husband and wife owned 319 quota units and they had leased 106 units to their son in 1995 for the maximum allowable period of 3 years. From 1995 to 1997, they claimed as a partnership, each owning a third of the flock. But they overlooked the fact that the lease expired at the end of 1997, and their son therefore had no quota to support his share of the claim. Although an inspector counted 360 eligible animals, the regional office only paid on 213 animals. This represented two thirds of the claim, in accordance with the share of the business nominally owned by the husband and wife. This mistake cost the group £1,600.

4.18 The number of claims involving reductions, rather than rejections, because of producer group errors is not separately analysed. However, of the 4,000 claims from producer groups that were reduced, a significant proportion of those were likely to have been due to producer group errors.

4.19 In addition, we noted the following:

- The National Farmers Union told us that there is still confusion amongst farmers over the meaning of the term ‘producer group’ and many have been caught out by changing the makeup of the producer group without changing the apportionment of the quota.

- Ministry staff told us that errors by farmers arising from producer group rules cause them considerable extra work because of the complexities of the cases and the additional correspondence work required.

- Schemes similar in operation to the sheep scheme, such as the Suckler Cow Premium Scheme, do not provide for producer groups: quota is held by the business, not the individual.

- The producer group arrangements were introduced originally as part of the predecessor scheme to Sheep Animal Premium, when they enabled individuals, particularly in families, in producer groups to obtain better quota allocations. They were of more relevance to the United Kingdom where flock sizes are larger; in other countries, such as the Republic of Ireland, producer groups do not exist in the sheep scheme. Following introduction of the quota rules in 1993, the producer groups appear to serve little useful purpose.

Key findings on the application of penalties

- In addition to loss to an individual farmer, reduction or rejection of claims results in the United Kingdom failing to benefit from receipt of European money to the fullest possible extent.
- In general farmers accepted the need for penalties; and the Ministry applied penalties in accordance with the rules of the Scheme. In those types of cases where European regulations determine the level of penalty, such as late claims and claims for more sheep than the number eligible, there is a graduated scale.
- There were certain types of case, especially unsatisfactory flock records, where the Ministry has discretion and had determined that the penalty should be complete rejection of the claim. This must have presented difficult judgements for inspectors, as the claims were not for more than the farmer's entitlement but were due to farmer error or omission in administrative skills.
- The severity of penalty - complete rejection of the claim - for unsatisfactory flock records seemed inconsistent with the fact that the format of flock records is non-mandatory. Although flock records may contain errors that do not relate to the quota of animals on which the farmer receives payment, the claim may be rejected; 84 cases were rejected on the grounds of flock records in 1998.
- The Ministry now applies penalties to previous years if flock records in one year are found to be unsatisfactory.
- The quota arrangements control the level of expenditure under the Scheme but provide a number of administrative problems. A significant number of farmers have lost income in 1998 and previous years as a result of misunderstandings about the rules of producer groups leading to the application of penalties.

How many prosecutions have there been?

4.20 In cases where regional office staff suspect that irregularities may be due to fraud or wilful negligence by the farmer, cases are referred to the Ministry's Investigation Branch in London for closer scrutiny. After this review, cases are passed on to the Ministry's lawyers to decide whether the suspected offender should be prosecuted. Prosecution is undertaken only where there is sufficient evidence to prove beyond reasonable doubt that a criminal offence has been committed; and that it is in the public interest to prosecute. The Ministry's lawyers may conclude that it is not in the public interest to prosecute, for example, when the conviction would be likely to result in a small penalty, or where the financial value of the irregularity is small.

Example 1

A claim was submitted in respect of 52 sheep for which sufficient units of quota were held. On the inspector's first visit to the holding the farmer was not in and the inspector could not find any traces of sheep on the farm. When the inspector rang to inform the farmer he wished to inspect the ewes the farmer said he had sent the ewes to slaughter. At an interview held by the Investigations Branch of MAFF the farmer confessed he did not have any sheep at the time of the claim or subsequently. The farmer was prosecuted and found guilty of knowingly submitting a false claim to obtain premium. He was fined £1000 with £2000 costs. The penalties could have been higher if the farmer had not pleaded guilty at the first opportunity and given an apology.

4.21 Between 1992 and 1998 regional staff referred 42 cases of suspected fraud or serious negligence concerning the Scheme to the Ministry's Investigation Branch (Figure 18). The most common cause of investigation related to farmers making overclaims on the number of animals in their ownership, (as in example 1). Other irregularities included: forgery of forms; receipts or invoices; irregular record keeping; breaches of retention rules; disputes over ownership of sheep; and fraudulent claims for quota. Of the cases investigated 53 per cent of the irregularities were discovered through field inspections, 29 per cent through office checks and around 14 per cent through tip-offs.

Figure 18

Sheep Scheme investigations and prosecutions in England 1992-98

Over half of investigations concern farmers having fewer sheep than claimed

Reason for investigation	Number investigated	Number of prosecutions	Outcome of prosecution
Insufficient sheep	24	4	Total fines of £10,000 with costs of £4,900
Forgery	8	1	Fined £700 and costs £650
Irregular records	3	1	Fined £1525 and costs £5148
Two farmers claim on one flock	3	0	—
Breach of retention rules	2	1	Conditional discharge and costs £600
Sheep not owned by claimant	1	1	Fined £400 and costs £100
Ownership of sheep in dispute	1	0	—
Total	**42**	**8**	

Source: National Audit Office analysis

4.22 Four-fifths of reported cases were not recommended for prosecution, mainly because there was insufficient information to prove a criminal offence had been committed. (See example 2). In cases where the Ministry lawyers decided not to prosecute, lack of reliable evidence was usually the main reason. Other factors included the length of time that had elapsed since the alleged offence and whether or not a prosecution would be in the public interest. The Committee of Public Accounts 25th report of 1998-99 on the Arable Area Payments Scheme recommended that the Ministry review its criteria for prosecution and the experience of other Departments in using prosecution as a deterrent.

Example 2

A farmer and his wife submitted a claim for 966 ewes. An inspection during retention found only 794 on the farm. The farmer claimed the shortfall in numbers was due to sheep being stolen and losses from natural causes. The thefts were reported to the police after the inspection. The investigation unit was unable to prove that the farmer had put in a false claim and so a prosecution was not sought.

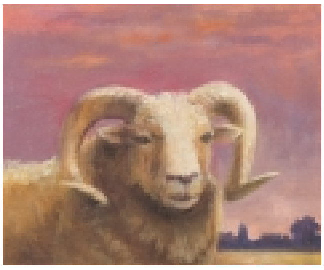
Recommendations on the application of penalties

- A claim, which is satisfactory in all other respects, is rejected in full if the inspector reports that the flock records are unsatisfactory. It is therefore important that the Ministry satisfy itself as to inspectors' consistency in their assessment of the quality of a farmer's flock records.

- Where the penalty is not specified by European regulations, for example in cases of error in flock records, the Ministry might consider whether a system of graduated penalties could lead to more equitable treatment in those cases.

- The rules relating to claims from producer groups originate from a now defunct scheme and cause confusion or error by some farmers. These rules serve little purpose and the Ministry should continue to press the European Commission to change them.

Part 5: Comparisons with other member states



5.1 The European Union regulations for the Sheep Annual Premium Scheme apply across all member states, and therefore there is some scope for comparison. For example, information covering all member states is provided by the European Commission from time to time on the number of animals claimed; quota usage; and the number of claims subject to on-farm inspections and the number of such claims reduced or rejected as a result. In addition, the European Commission produced in 1997 to 1999 detailed reports on the results of its work in clearance of accounts for 1993 to 1995. These included the results from its examination of the sheep scheme in a sample of member states. In addition, a report by the Comptroller and Auditor General of the Republic of Ireland published in late 1998 and a visit to that Office and to the Department of Agriculture in Dublin enabled us to make some additional comparisons between parts of the United Kingdom and the Republic of Ireland.

5.2 The cost of administration is borne by the member state. In 1995, the European Court of Auditors acknowledged that the management and checking of the Scheme was likely to entail considerable administrative cost. However, neither the member states it had visited at that stage, nor the European Commission, collected full information on such costs. Our contacts with the Audit Offices in other member states suggests that while the quality and availability of information on the cost of administering Common Agricultural Policy schemes is improving, it is still difficult to obtain for the purposes of comparison.

5.3 This part of the report examines:

- How many sheep are paid for under the Scheme and what is the take-up of quota?
- How much disallowance has been imposed?
- What comparisons of data and results from on-farm inspections can be made?
- Were inspections unannounced and how many late claims were there?

How many sheep are paid for and what is the take up of quota?

5.4 The United Kingdom holds the highest number of sheep (19 million) in the European Union on which premium is paid under the Scheme (Figure 19). The figures for England were 8.2 million, Scotland 4.2 million, and Wales some 5.2 million.

Figure 19

Numbers of sheep and goats on which premium paid in 1998

Country	Thousands
United Kingdom	19,177
Spain	18,720
Greece	10,541
Italy	7,908
France	7,046
Ireland	4,347
Portugal	2,527
Germany	1,712
Netherlands	685
Austria	175
Sweden	155
Denmark	75
Belgium	62
Finland	53
Luxembourg	4
Total	**73,187**

Note: Only Greece, Spain, France, Italy and Portugal have significant numbers of goats eligible for the Scheme

Source: European Commission working document provided to member states. Some figures are estimates

5.5 There are 8.7 million sheep quota units allocated to England representing the limit on the number of eligible sheep which may be paid for under the Scheme. The payments to farmers in England in 1998 covering 8.2 million sheep therefore represented a shortfall of 0.5 million against its sheep quota for the Scheme. This shortfall arises from a number of sources:

- Where farmers fail to use or lease out more than 30 per cent of their quota in any one year, quota may be withdrawn from them and taken into the National Reserve for allocation to new farmers, for example;

- Some farmers claim for payment at slightly lower levels than their quota. This may occur for example, if they do not own the correct number of sheep; or to keep a margin of safety for any errors or losses of sheep which would bring the number held below the number claimed for and put their whole claim into jeopardy;

- Farmers whose claims are reduced or rejected on the grounds of irregularity will not be paid on their quota and to that extent the number of sheep paid for will be less than the quota available. However, the quota will be counted as "used" even though payment was not made on the full amount.

5.6 In 1997, the European Commission produced a working document on the quota usage across member states for 1993 to 1995 (Figure 20). This showed that the United Kingdom in 1995 had unused 482,000, 2.5 per cent, of its quota rights compared with a total nine per cent for all member states. And although it has the highest number of quota units of all member states, five countries had higher numbers of unused quota. As indicated above, these figures for unused quota exclude that on which payment was not made because of the application of penalties.

Unused quota in 1995 in all member states

Figure 20

	Quota rights (thousands)	Quota rights unused Number (thousands)	%
United Kingdom	19,492	482	3
Spain	19,398	1,585	8
Greece	11,023	967	9
Italy	9,575	1,921	20
France	7,842	599	8
Ireland	4,956	216	4
Portugal	2,690	315	12
Germany	2,432	664	27
Netherlands	930	229	25
Austria	206	48	23
Sweden	180	32	18
Denmark	104	23	22
Finland	80	17	21
Belgium	70	10	14
Luxembourg	4	4	100
Total	**78,982**	**7,112**	**9**

Source: European Commission document circulated to member states

Key findings on take-up of quota

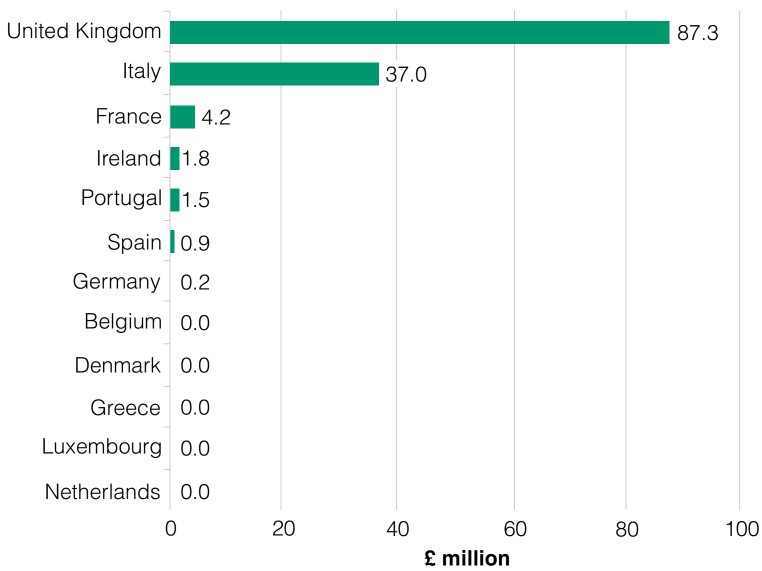
In 1998, the Ministry paid premium on 8.2 million animals, some 0.5 million fewer than the quota attributable to England. Part of this represents the application of penalties, but the remainder is classified as unused quota. This represents a loss to sheep farmers, in general largely within their own control, and to amounts which may be claimed from European funds. In 1995, the percentage of quota rights unused in the United Kingdom was under three per cent, compared with nine per cent across all member states.

How much disallowance has been imposed?

5.7 Since 1993 the European Commission has disallowed expenditure of £132 million across all member states on the Sheep and Goat Annual Premium Scheme. Figure 21 shows that the amount of disallowance incurred by the United Kingdom (£87.3 million) was the highest and more than double that incurred by the next highest member state (Italy) in that period. This indicates that disallowance has not been incurred at the same levels throughout the larger sheep and goat producing countries. Spain, for example, which is the second largest member state in terms of number of sheep and goats under the Scheme (Figure 19), has incurred less than £1 million of disallowance; and Greece, which is the third largest, none at all since 1993. These figures, like those in Figure 1, exclude a relatively small amount of disallowance imposed by the European Commission for missing any payment deadlines under Common Agricultural Policy Schemes.

Figure 21

Sheep Annual Premium Scheme: disallowance of expenditure for each member state 1993 to 1996



Source: Ministry of Agriculture, Fisheries and Food

Note: Austria, Finland and Sweden are excluded from the table which compares totals for 1993 to 1996, as they did not join the European Community unit 1995.

5.8 The amount of disallowance incurred by a member state is greater where more than one region or regional office has demonstrated failings, or where significant improvement had not been made in respect of continuing weaknesses identified in earlier years. In essence this, combined with the level of expenditure, explains the higher value of disallowance in the United Kingdom since 1993. As described in Part 2, all regions in England, and Scotland and Wales had sought to achieve only half of their inspections during the retention period for 1993 and 1994 and most were not able to improve on that target in 1995 to reach the level expected by the Commission after its 1995 audits. This compares, for example, with Spain where the national level of inspections exceeded the required percentage within the retention period and where only some regions inspected less than 10 per cent of claims in 1993 and 1995. In France, although the Commission identified a number of regions where the percentage of inspections was significantly under target, again this did not apply to all regions.

5.9 The Commission's view is that the Scheme by its nature is a difficult one to control due to terrain, seasonal moving of sheep, and the large numbers of animals involved. The Commission's audits in 1994 to 1996, covering Scheme controls or expenditure in 1993 onwards paid special attention to the Scheme due to weaknesses it had reported in 1991 and due to the changes to the Scheme being introduced:

- a new quota system, and new definition of eligibility of ewes, with effect from 1993;
- a requirement from 1994 for formalised systems of selecting claims for inspection; and
- from 1996 an obligation on farmers to maintain flock movement records.

The audits in 1994 to 1996 covered all member states but looked particularly at the countries where there was the most significant expenditure on the Scheme: Spain, France, Italy and the United Kingdom.

5.10 The reasons for imposing disallowance in respect of the Scheme for each member state included:

- **Italy**: For 1993 and 1994 unrepresentative sampling of claims; discrepancies between premium and veterinary statistics in one region; high levels of irregularity in certain areas which were not addressed by conducting higher levels of inspection; unsatisfactory flock records; and inadequate notification of place of retention. Eligibility doubts, from inspectors incorrectly including male and young female sheep; absence of flock marking where several flocks kept together.

- **France**: Inadequate numbers of on-farm inspections 1993 to 1995; unsatisfactory control over fattening operations (concerning milk-producing sheep) 1992 to 1995.

- **Spain**: In some areas the level of on-farm controls in 1993 and 1995 failed to meet the legal requirements and inspection levels were not increased when irregularities were found. Flock movement registers were not introduced as required from 1 January 1995.

- **Ireland**: Differences in the number of animals paid between the advance and final payment stages for 1993.

- **Portugal**: Insufficient level and inappropriate timing of inspections; ineffective administrative controls; inadequate control of milk production; superficial risk analysis; failure to introduce flock registers from 1995 (and still not introduced in 1998).

5.11 The Commission's summary report on the results of its clearance of accounts work for 1993, published in April 1997, also indicated a number of other areas of weakness not necessarily attributed to individual member states.

- Ownership of animals: difficulties of determining ownership at the time of inspections. Although not a requirement, some form of marking sheep would be a valuable control.

- Limited checking of documents to confirm whether animals had been on farm since the beginning of the retention period.

- Difficulty in determining the age of sheep in large flocks; failure of claimants to be sufficiently specific in declaring flock location and absence of sanctions where movements in retention not notified.

- Poor attempts at risk assessments and failing to introduce a random element into the selection process; or to grasp that risk analysis should evolve from the basis of previous results.

Key findings on disallowance imposed on member states

- The disallowance of £87 million in the United Kingdom on the sheep scheme was the highest of all member states for 1993 to 1996.
- Some member states have incurred little or no disallowance under the Scheme, where for example the failure to carry out sufficient inspections occurred in fewer regions or occurred in a single year only.
- A summary report by the Commission from its audits of 1993 to 1995 identified other general areas of concern, including progress in implementing the new approach to risk analysis and random sampling to select claims for inspection.

What comparisons of data and results from on-farm inspections can be made?

5.12 On-farm inspections take place in each member state of the European Union and the European regulations result in similar routines in all member states. Figure 22 contains some data for 1998 on sheep inspections in England, Scotland, Wales, Northern Ireland and the Republic of Ireland provided to us by the respective departments of agriculture.

Figure 22

Comparison of sheep inspection data for 1998 - the United Kingdom and the Republic of Ireland

	England	Scotland	Wales	Northern Ireland	Ireland
Proportion of Scheme claims subject to field inspection	10.6%	17.3%	11.6%	20%	24%[1]
Number of sheep counted on field inspection	2.3 million	0.93 million	0.78 million	0.58 million	1.4 million
Sheep counted as a proportion of total sheep claimed under the Scheme	26.7%	21.6%	14.3%	42.5%	27.7%
Average size of flock subject to inspection	626	393	470	264	138
Average inspection time (hours)	3.8	5.0	3.1	3.3	2.5
Proportion of inspections that led to reductions to the claim	4.9%	4.7%	5.1%	3.1%	6.5%

Note: 1. Reduced to 14 per cent in 1999.

Source: National Audit Office analysis

5.13 Figure 22 and additional information we obtained indicate:

On numbers inspected

- Significantly higher proportions of claims were subjected to inspections in Scotland, Northern Ireland and the Republic of Ireland in 1998. European regulations require a minimum of 10 per cent. Where field inspections reveal significant irregularities the member state is required to inspect a higher percentage. Prior to 1993, all claims were subject to inspection in the Republic of Ireland. This level was reduced gradually from 33 per cent in 1995 to 14 per cent in 1999 for reasons of greater efficiency and effectiveness. These reductions reflect the assessment of risk and the aim of more thorough and effective inspection of a smaller percentage of claims, including the use of unannounced inspections.

- The number of sheep counted was the highest in England by a wide margin. This reflects the amount of quota allocated to England – 8.7 million out of some 19 million for the United Kingdom. In addition, claims for inspection are selected using a risk analysis model, which includes an element that in part targets a sample of the largest claims.

- Targeting larger claims means that the proportion of sheep counted in each country was always higher than 10 per cent. For example, even if Northern Ireland had carried out only the minimum percentage of claims to be inspected, the proportion of sheep counted in 1998 might still have been in the region of 21 per cent compared with 26.7 per cent in England.

- Differences in the average of size of flocks subject to inspection obviously also reflects the numbers of claims received and numbers of sheep. For example, Ireland receives nearly 10,000 more claims than the whole of the United Kingdom but these cover some 4 million sheep compared with just over 19 million in the United Kingdom.

On time spent

- Variations in the average hours spent on an inspection may reflect a range of practical issues such as distance travelled, size of farms, flock sizes. The higher average time in Scotland may be due to geographical factors. In addition, inspectors in Scotland have a wider remit, covering checks on animal health.

- In England, the higher average size of the flocks inspected could be expected to account for higher average times. However, the average number of sheep counted per minute of inspection time is the highest in England, at 2.7 compared with 0.7 in the Republic of Ireland (the lowest) and 2.5 in Wales (the second highest). In that respect, England compares favourably with other countries.

- Counting sheep is not the only significant element of time spent. For example, the average inspection time in England reflects the time spent, where it is attributable to individual inspections:

    - travelling. The longer times – in 1998 82 inspections out of 3,500 in England took more than 10 hours – are generally due to the distances to and from farms;

    - at the farm, counting sheep and checking flock records;

    - dealing with paperwork in office;

    - on aborted or inconclusive visits to farms, for example where the farmer was not available or the sheep could not be gathered on the first attempt;.

Key findings on comparisons of on-farm inspection data

- The requirements to subject a minimum percentage of claims to inspection, but to target risk and larger claims, result in varying numbers of sheep counted.

- Compared with other parts of the United Kingdom in 1998 and the Republic of Ireland, England inspected the lowest proportion of claims (10.6 per cent) but counted the second highest proportion of sheep (26.7 per cent).

- Comparison of average inspection times between countries is not conclusive. Variations can arise from the size of farms, number of sheep and distances travelled. There is no evidence that the time spent in England is out of line with that elsewhere in the United Kingdom and the Republic of Ireland.

Reductions and rejections of claims

5.14 The figures provided on the proportion of inspections that led to reductions in claims in Figure 22, showed that, compared with the United Kingdom, the Republic of Ireland identified higher percentages of incorrect or irregular claims, although it had the lowest average inspection time. Nearly all its inspections in 1998 were unannounced and this may be a factor in the identification of errors or irregularities.

5.15 Detailed figures for 1998 were not available to compare the value of reductions to claims in England with others in Figure 22. But because of the significantly larger average flock size in England, and number of sheep counted, the value of reductions might be more significant than elsewhere. For example, on the Arable Area Payment Scheme in England our earlier work has shown that, while the highest proportion of errors were found on medium sized claims the value of errors were as great or greater in high value claims.

5.16 We also compared the proportions of reductions and rejections of claims in 1998, arising from all types of checking, in England with the other parts of the United Kingdom and also with the Republic of Ireland (Figure 23). Of the five countries, England was second only to Wales in the total percentage of Scheme claims reduced or rejected. Apart from Northern Ireland where the proportion of rejected claims in 1998 was greater than that of reduced claims, more claims are reduced than are rejected. As for the data on field inspections, these statistics do not indicate whether different countries are relatively more successful in identifying irregularity or whether claimants in some areas are more likely to submit irregular claims. Nor do they indicate whether England is more or less severe in its application of penalties.

Figure 23

Percentage of claims reduced and rejected in 1998 in the United Kingdom and the Republic of Ireland

	England	Scotland	Wales	Northern Ireland	Ireland
Proportion of Scheme claims reduced (%)	6.1	3.3	10.7	0.6	4.3
Proportion of Scheme claims rejected (%)	1.3	1.7	0.9	1.1	0.4
Value of reductions and rejections	£2.7m	£0.1m		£0.5m	

Source: National Audit Office

5.17 European Commission papers provided to member states in 1998 contain information on the number of claims in 1996 which were subject to on-farm inspections by member states and the number of such claims reduced or rejected as a result. Taking the seven member states with the highest number of claims and the highest value of payments shows:

- the number of claims reduced or rejected as a result of field inspections in 1996 as a percentage of number of claims inspected ranged from 3 per cent in the Republic of Ireland to 42 per cent in Italy (Figure 24);

- of those seven member states, only the Republic of Ireland identified a lower number of reductions and rejections than the United Kingdom, although France and Greece identified the same or a lower percentage.

Reduction and rejection of claims as a result of on-farm inspections in 1996 in seven member states

Figure 24

		Total Reductions and Rejections	
	Number of Inspections	**Number**	**%**
Italy	34,500	14,600	42
Greece	27,900	1,800	6
Spain	12,800	1,500	12
Portugal	4,700	1,000	21
France	7,200	700	10
United Kingdom	5,100	500	10
Ireland	15,400	400	3
Others	8,100	900	11
Total	**115,700**	**21,400**	**18.5**

Source: European Commission papers

5.18 The number of reductions to claims is more than the rejections. This merely indicates that partial compliance with Scheme regulations occurs more often than complete failure. Some 70 to 80 per cent of total rejections and reductions in 1996 in five of the seven member states with the highest number of claims, including the United Kingdom, were reductions (Figure 25). This suggests some similarity in the seriousness of cases identified. For Italy, the figure was 60 per cent, so that of the claims identified for reduction or rejection, it identified proportionately more to be rejected outright than other member states. The Republic of Ireland identified proportionately fewer rejections. The position in Italy probably reflects the fact that in 1996 it targeted claims in a region where compliance problems were known to exist.

Figure 25

Reductions as a proportion of total reductions and rejections in seven member states in 1996

	Number of Reductions	Number of Rejections	Reductions as a proportion of total %
Italy	8,700	5,900	60
Portugal	700	300	70
France	500	170	75
Greece	1,340	450	75
United Kingdom	400	100	80
Spain	1,200	300	80
Ireland	360	40	90

Source: European Commission papers

5.19 In 1996, both Italy and the Republic of Ireland inspected more than 30 per cent of claims. Italy reduced or rejected 42 per cent of claims inspected, and the Republic of Ireland only 2.6 per cent. This suggests that checking more than the minimum requirement of 10 per cent of claims does not necessarily result in identifying more cases of irregularity.

5.20 A report by the Comptroller and Auditor General for Ireland found that in 1998, apart from cases selected as a result of penalties in earlier years, a lower percentage of claims selected on the basis of risk assessment resulted in the application of penalties than those selected randomly. This suggested that not all elements of risk analysis were helping to increase the detection rate, although the report indicated that the value of irregularities, which were not available, would need to be taken into account in reviewing the comparative results.

5.21 Comparing the United Kingdom position with the total for all member states in Figure 24, the percentage of claims reduced or rejected as a result of on-farm inspections in the United Kingdom (10 per cent) is lower than the total of 18.5 per cent. But the Commission's figures we examined did not contain the value of reductions or rejections. Since field inspections select claims on the basis of risk and are targeted in part on large value claims, we could not compare the success of inspections in respect of money saved. In any event, the percentage, or value of claims reduced and rejected would not indicate whether the causes of variations lie in the extent of irregularity in each country or in the quality of field inspections.

Key findings on reductions and rejections of claims

- The proportion of inspections (4.9 per cent) which in 1998 led to claim reductions were not significantly different in England than in other parts of the United Kingdom. In the Republic of Ireland, where nearly all inspections were unannounced in 1998, 6.5 per cent led to reductions in claims.
- The percentage of claims reduced or rejected was higher in England (7.5 per cent) than elsewhere in the United Kingdom apart from Wales (11.6 per cent).
- In 1996, 10 per cent of inspections in the United Kingdom resulted in reductions or rejections of claims. This compared with the total for all member states of 18.5 per cent.
- The higher level of on-farm inspections in Republic of Ireland and Italy in 1996 (over 30 per cent of claims) did not result in similarly high percentages of reductions and rejections.
- The value of reductions to claims as a result of on-farm inspections can be useful to compare the relative success of this method of checking, and of the various elements of risk analysis models used in selecting claims.
- Sharing of such information with other member states and the Commission might identify scope for reducing the cost or extent of inspection, while maintaining the deterrent effect, appropriate coverage of expenditure and targeting risk.

Were inspections unannounced and how many late claims were there?

Targets for notice given to farmers

5.22 The European rules require that inspections should be unannounced: advance warning should be limited to the strict minimum necessary and should not exceed 48 hours except in certain circumstances. An inspection with little or no notice reduces the opportunity for farmers to correct irregularities, for example buying in or borrowing sheep to match the numbers on which a claim has been made. The Ministry aims to carry out as many unannounced field inspections as possible and sets targets for the amount of notice inspectors should give to farmers. These differ according to whether the farms are located in Less Favoured Areas. These are generally upland farms where notice is often required, as flocks may have to be gathered. For example, the target for inspections with less than three hours notice is five per cent in the upland regions, but 60 per cent in lowland.

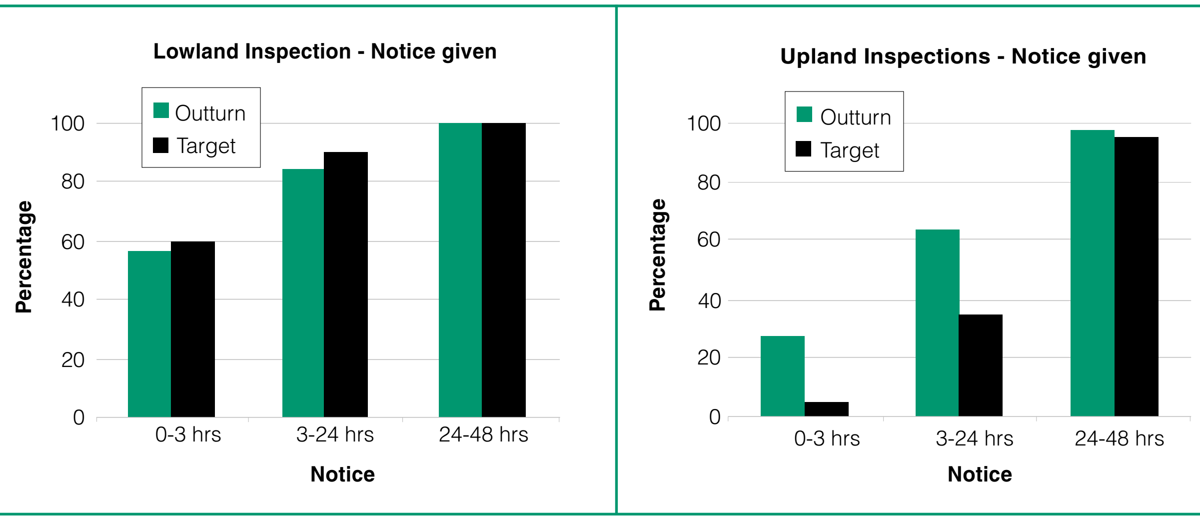
5.23 In 1998 we found that in England:

- Only 14 lowland inspections and 26 upland inspections were carried out with more than 48 hours notice (less than one per cent and two per cent respectively);
- The Ministry improved on its targets for the level of notice in upland regions (Figure 26), with nearly 30 per cent of inspections being carried out with less than three hours notice against the target of five per cent.
- In lowland areas, the Ministry fell slightly short on the much tougher targets for inspections with less than three hours notice, with an overall outturn of 58 per cent against a target of 60 per cent.

Figure 26

Notice of inspection given to farmers in England in 1998

The Ministry exceeded its targets for unannounced inspections in upland regions, but fell slightly short on the much tougher targets for lowland inspections.



Source: National Audit Office Analysis

5.24 In Ireland, an analysis of sheep inspections carried out in 1997 showed that penalties were recommended in 6.3 per cent of unannounced inspections compared to 2.1 per cent of inspections where notice was given. Our review of data for England in 1998 shows that the percentage of inspections which found unsatisfactory results at the farm were 5.6 per cent in total, but 8.3 per cent for inspections where notice was between 0 to 3 hours.

Key findings on giving notice of inspections

- The Ministry aims to carry out all inspections with less than 48 hours notice given to farmers. In 1998, only 40 out of some 3,500 inspections fell outside that target and the number of inspections with less than 48 hours notice met the European Union requirement.
- The Ministry also sets internal targets for the percentage of inspections to be carried out with less than 3, less than 24, and less than 48 hours notice. This too is in line with the European requirements that the minimum possible notice be given.
- There is some indication from data for England in 1998 and from an analysis in Ireland of results in 1997 that unannounced on-farm inspections identify a higher percentage of unsatisfactory results, than those where more than three hours notice is given.

Late claims

5.25 It is a European requirement that farmers submit their claims by the deadline set by the member state. The number of late claims reported to the Commission by the United Kingdom for 1996 was 1,079. This was the second highest number and percentage of claims in the seven member states with the most claims (Figure 27).

Number of late claims in 1996 in seven member states

Figure 27

	Late Claims	
	Number	**% of total claims**
Italy	5,812	6.4
United Kingdom	1,079	2.9
Ireland	880	1.9
Greece	499	0.3
Spain	271	0.3
France	213	0.4
Portugal	172	0.5

Source: European Commission documents circulated to member states

5.26 Our work in examining the application of penalties in England in 1998 (Part 4) indicated that, excluding quota problems, the highest number of reductions and rejections were for late applications (694 cases). This appeared to be a category where the irregularity was clear but attempts might be made to reduce the numbers. Guidance in England is quite explicit that farmers must submit claims by a deadline in order to be eligible for the Scheme. Since eligibility requires sheep to be retained for 100 days starting on the same date as the closing date for applications, there should be no reason for farmers to miss the deadline since they must at that stage know how many sheep they will be claiming for.

Key findings on late claims

- For 1996, the number of late claims reported to the Commission by the United Kingdom was the second highest, in number and percentage, of the seven member states which are the highest spenders under the Scheme.
- Figures for 1998 show that late claims by farmers in England produced the highest number of reductions and rejections to claims, other than quota problems.

Recommendations arising from comparisons

- It is the Commission's normal practice to target its audits according to risk factors, for example size of expenditure, or issues or regions previously shown to be capable of improvement. The Ministry should periodically re-assess the areas of general weaknesses in member states identified by the Commission in 1997, to minimise the risk of future adverse comment or disallowance.

- The Ministry has started to build on contacts with administrators in other member states and material available from the Commission. Better information on the conduct and costs of on-farm inspections, for example, should be used by the Ministry as a benchmark for its performance and for sharing experience on aspects of administration not normally covered by the Commission's reviews of Scheme compliance.

- The Ministry should assess the effectiveness of the individual criteria within its revised risk analysis model for the selection of claims for on-farm inspection. It should also extrapolate the results from the random sample selected by the model to enable the overall level of error in expenditure under the Scheme to be estimated.

Appendix 1: Study methodology

Analysis of management information

1 We obtained from the Ministry a number of different data sets:

- applications and payments made in each regional office;
- quota data including the amount of quota held by each farmer and quota transactions in 1998;
- claims selected for inspections and the criteria under which each was selected; and
- administrative data on field inspections carried out and their results.

2 Using an Access software package, we sorted and interrogated the individual data sets to provide more management information. For example:

- We established the number and value of reduced and rejected claims and produced an analysis of the range of values and main reasons for reduction and rejections.
- We used the data on field inspections to compare the notice given to farmers of an inspection against the targets set in lowland and upland areas.
- We collated regional information to calculate the number of sheep counted in England, average flock size subject to inspection, average inspection time and proportion of inspections which led to reductions to claims.

3 Using information common to two data sets, we linked the data on payments to farmers and on quota held. This data is held on different computer systems at the Ministry, which are linked together. We interrogated the combined data set to check that farmers did not receive payment on more animals than quota held. We also checked that the farmer's quota holding was for the appropriate category – Less Favoured Area or lowland.

4 At our visits to regional offices, we carried out a small sample of cross checks to test that the data held centrally was accurate.

Visits to regional offices

5 We visited four of the Ministry's nine regional offices. We agreed with Ministry staff that the four regional offices provided a representative cross-section in terms of the type of farming and the relative importance of the Scheme in different regions. The four offices visited were:

- Carlisle: largest regional office in terms of number of Scheme claims and is predominantly an upland farming region. The Sheep scheme is the most important scheme in the region.
- Northallerton: second largest regional office in terms of the number of Scheme claims and has a mixture of upland and lowland farming. The region has a wide mixture of arable and livestock farming.
- Bristol: mid-ranking regional office in terms of Scheme size and also has a wide mixture of land use and farming.
- Cambridge: smallest regional office in terms of Scheme size and is an exclusively lowland region. The region is dominated by arable farming.

The four regions gave a wide geographical coverage of England. In addition, Northallerton is the National Scheme Management Centre for the Scheme and Carlisle is the lead region for quotas and field inspections.

6 The visits lasted one week at each regional office and comprised:

- interviews with Ministry staff to establish their approach to processing Scheme claims and managing the field inspection programme. We reviewed the structure and staffing of processing sections;
- a review of Scheme controls to address key risk areas. We established which checks are built into the computer system;
- an examination of a random 10 per cent sample of claims which had been selected for field inspections in 1998 (see below);

- an examination of small samples to test specific risk areas - such as the application of penalties.

Sample examination of field inspection files

7 In the four regional offices that we visited, we selected a random sample of 10 per cent of all claims that had been field inspected in 1998. We examined in total 157 files and collected data that was not available from the Ministry's information systems. The objectives of the analysis were to:

- assess the quality of farmers' records as reported by inspectors;
- assess the judgements applied by field inspectors and regional offices in their treatment of records;
- examine other administrative aspects of the inspection process, such as the accuracy with which reports were completed and processed.

8 In particular, we compared the number of animals counted with the number of animals recorded in the farmer's continuous flock record. If the farmer's records were up to date, these two numbers could be expected to agree. Where they were significantly different, we looked for some explanation by the field inspector. We also noted any other factors about the case which were relevant – such as whether the field inspector was able to count all the animals; or whether any net losses or purchases of animals recorded by the inspector reconciled with earlier information provided by the farmer on the claim form.

Accompanying field inspectors on visits

9 We also spent one week at each of the four regional offices accompanying field inspectors on inspections on farms. The objectives of this were to:

- gain an understanding of different types of inspection and the wide variations between different parts of the country;
- appreciate the practical difficulties of sheep inspections and the problems faced by field inspectors;
- observe the approach of field inspectors to managing their workload and carrying out inspections; and

- observe the standard of flock records and the Ministry's approach to checking them.

Consultation exercise and expert advice

10 We received comments from five organisations in the sheep farming industry on the operation of the Scheme in general and the Ministry's administration of it. Their views assisted in our understanding of the Scheme and some are reflected at various points in this report. We are grateful for their contributions. They were:

British Meat Federation

Hill Farming Initiative

Livestock Auctioneers' Association

National Farmers Union

National Sheep Association

11 We held a one-day focus group of six farmers from a variety of sheep farming backgrounds in the NorthEast of England. The aim was to discuss issues such as the guidance provided by the Ministry; the helpfulness of Ministry staff; the conduct of field inspections; the quota trading system; and the Ministry's application of penalties to supplement the views obtained from the consultation exercise.

12 We employed John Sayer, a retired sheep farmer, to provide expert advice on our findings and give a farmer's perspective on the Scheme.

Comparisons with other member states

13 We sought to compare the position in England against that in the rest of the United Kingdom and in the Republic of Ireland on issues such as:

- general information on the nature of sheep farming as it affects the administration of the Scheme or on-farm inspections;

- the number and value of Scheme payments;

- the level of disallowance;

- information on the conduct and results of field inspections.

We achieved this by means of a questionnaire and short visits to each country. In Scotland we accompanied inspectors on two on-farm inspections; and in the Republic of Ireland we visited an area office of the Department of Agriculture and Food and met a group of inspectors. We also met with representatives of the Office of the Comptroller and Auditor General in Dublin to discuss their work on Premium and Headage Grant Applications reflected in a report published in October 1998.

14 The results from this work are reflected at various points in our report where comparative information was available or useful.

15 We also reviewed reports for the Scheme year 1996 provided by the European Commission to member states in 1998. This enabled comparison of, for each member state, number of quota units allocated and used; number of sheep paid for; numbers of field inspections carried out and percentage of inspections leading to reduction or rejection of claims. In addition, we visited the European Court of Auditors to discuss their 1995 report on the administration of the Sheep and Goat Premium Scheme.

Appendix 2: Chronology of negotiations between the Ministry and the European Commission on disallowance

Key stages in the disallowance process	Scheme years	
	1993 and 1994	**1995 and 1996**
European Commission audit visit	15-19 May 1995	25-29 March 1996
European Commission notification of concerns	12 July 1995	20 January 1997
Ministry response	23 August 1995	4 June 1997
Meeting to discuss issues raised by European Commission	5 December 1995	27 June 1997
European Commission publish formal audit report	12 March 1996	18 July 1997
Ministry response	24 May 1996	20 October 1997
European Commission notification of proposed disallowance	20 June 1996	
Ministry response	3 October 1996	
Meeting to discuss audit report	11 October 1996	23 October 1997
European Commission announces disallowance to be imposed	31 January 1997 (for 1993)	14 September 1998
	23 December1997 (for 1994)	
Ministry decide not to appeal	18 March 1997 (for 1993)	
	23 January 1998 (for 1994)	

Appendix 3: Contents of the Sheep Annual Premium claim form

Claimant details

Name, address, telephone number "holding" (farm etc) reference number
Location of flock (Any subsequent changes must be notified to Ministry in writing).
Leased in animals details i.e. from whom sheep are leased, to avoid duplicate claims.
Gathering of flocks, expected date and month to assist in timing of inspections.

Claim

Number of eligible animals

Number, if any, of ewe lambs which will be under 12 months old on 15 May and expected to lamb by that date (end of retention period).

Start and finish of lambing period.

Producer information e.g.
- If a sheep milk producer (lower rates are payable)
- If a shepherd or employing a shepherd (shepherds who are also may producers may run their own sheep with his employers flock. Information necessary for control purposes)
- If intend to make another claim under the Scheme (for example, a producer may be a member of a producer group and a sole producer)

Producer group information e.g. details of joint ownership, membership of group, percentage share of flock and of number claimed.

Declarations, Undertakings

Undertaking to keep continuously at least 10 eligible sheep.

Special undertakings re:
- producer groups where flock jointly owned
- Less Favoured Area producers
- shepherd and employer where sheep cannot be separately identified
- milk producers claiming for fattened lambs.

Declaration that:
- received and read copy of Notes for Guidance, claimant's responsibility to be aware of rules
- believe qualify for payment
- all particulars and statements are correct

If breach will
- repay premium on demand; pay interest from date of payment to that of repayment

Flock records
- will keep records required under legislation plus vouchers, receipts or other documents to validate accuracy and will allow any officer authorised by Ministry to see flock records and documents

Inspection
- will allow inspection at any reasonable hour by an officer authorised by the Ministry. Will gather sheep so can be counted, and give reasonable assistance
- Recognise that such inspections may be unannounced and may occur more than once during the year

Undertaking
- Will keep on the holding listed, or elsewhere as notified, throughout the retention period, at least the same number of eligible sheep for which holds sheep quota

Warning about liability to prosecution and penalties

Signature and Date

Glossary

Disallowance	the amount repayable by a member state to the European Commission in the event of control weaknesses. It does not affect payment to farmers.
Eligible animal	a live female sheep over one year old at, or expected to produce a lamb before, the end of the retention period
Holding	the land owned or occupied by a farmer on which he holds sheep
National reserve	a pool of sheep quota from which the Ministry can allocate quota to applicants in certain priority categories. Applications to the reserve can be made once a year normally in the late spring. All member states are required to operate a national reserve.
Penalties	reduction in, or loss of all, premium payable to claimant due to infringement of the scheme rules
Producer	a person who assumes the risks and/or organises the rearing of at least 10 eligible ewes which he or she either owns, or leases, and receives the proceeds of sale for the lambs produced. This Report normally refers to a farmer, although technically producer is the appropriate term.
Producer group	a group or association with reciprocal rights and obligations between eligible producers. Includes groups where members own sheep jointly. Partnerships, including family partnerships, where sheep are jointly owned must claim as a producer group.
Quota	Each producer was given an allocation of quota at the start of the Scheme, based on previous claim history. They can acquire or dispose of quota through transfer or lease, or certain producers can apply to the national reserve.
Quota unit	represents the right to premium on an eligible ewe if all other conditions of the Scheme are satisfied.
Retention period	the minimum period during which a farmer must retain the sheep on which premium is to be paid, that is from midnight on 4 February to midnight on 15 May.