



National Audit Office

**REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL**

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A Second Progress Update on the Administration of the Single Payment Scheme by the Rural Payments Agency

Summary

1 In 2005 the Single Payment Scheme (the scheme) was introduced by the Member States of the European Union as part of the Common Agricultural Policy reforms which replaced 11 separate crop and livestock based production subsidies to farmers with a single payment based on land area. European Union (EU) Regulations provided some discretion as to how the scheme could be implemented within individual countries. The Department for Environment, Food and Rural Affairs (the Department) introduced a 'dynamic hybrid' system in England whereby payments are based partly on historical data and partly on a flat rate per hectare. This was the most complex model available and only England, Germany and Finland chose to adopt it, although Germany and Finland are introducing the 'dynamic' element in 2010 and 2011 respectively. Total payments to farmers in scheme year 2008 amount to £1.63 billion.

2 The Rural Payments Agency (the Agency), which administers the scheme on behalf of the Department, experienced considerable difficulties in processing applications and paying farmers in the 2005 and 2006 schemes. These difficulties generated a large backlog of work which it has struggled to clear alongside the annual scheme processing cycle. In the 2005 scheme many farmers were paid the wrong amounts late, causing stress and cash flow problems to one in five farmers. In 2006, scheme administration improved and over 96 per cent of payments were made by 30 June 2007. This met the target set in EU legislation, although many payments were still inaccurate. Such problems can result in disallowance, whereby the European Commission declines to fund a percentage of payments if it concludes that the Agency has not complied with the regulations of the scheme, and also sets penalties if payments are made beyond the targets set in EU legislation. The Department set aside £292 million for potential disallowance and penalties for the first two years of the scheme.

3 This report is our second update on the progress made by the Agency in administering the scheme in England. We reported in October 2006 on the problems experienced by the Agency in administering the 2005 scheme. We also reported in December 2007 on the Agency's progress in administering the 2006 scheme and on its efforts to stabilise future scheme administration. This report examines further progress made, including the recovery of previous overpayments, and the scheme's governance by the Agency and the Department.

Main findings

On remedying the problems with processing claims

4 In early 2007, following a review of the scheme systems by IT specialists, the Agency concluded that it would be better value for money to upgrade the existing IT systems rather than to procure new ones. In April 2007 it set about upgrading the existing systems in order to transform scheme administrative performance by 2010. The upgrades to date have improved the stability of the IT systems and allowed farmers to be paid earlier than in previous years. The Agency paid out over 96 per cent of the 2008 scheme payments to farmers by mid-May 2009, compared to only 80 per cent by the same month for the 2006 scheme.

5 The lack of sufficient progress in aligning the design of the scheme's systems to operational needs has, however, hindered efficient administration. In the absence of reliable records we estimate that the IT costs for the scheme, which includes recovery work, maintenance costs, upgrades in response to policy and other changes, as well as overheads, amounted to £130 million between April 2007 and March 2009. The Agency considers that the high cost reflects the complexity of the scheme in England, but when estimated earlier spending on scheme IT of £220 million is taken into account, we consider the scheme's IT to be very expensive. In addition:

- heavy customisation of the IT systems has resulted in very complex software which is expensive to modify and maintain, and has increased the risk of obsolescence. For example, any further upgrades in response to policy initiatives from the European Commission will be expensive to implement; and
- around a third of the changes made to the finance system have been 'invasive', requiring changes to the source code, although the Agency did not keep an accurate record of all the changes made.

6 The degree of changes to the system has created other problems. The involvement of Agency staff in the original implementation of the system blurred responsibilities with its contractors, leading to a lack of clarity over who is liable if the system goes wrong. In view of the heavy customisation of systems since then, we have been unable to gain adequate assurance over what redress would be available for any potential system failures in future. Despite the changes that have taken place, scheme payments show little sign of increased accuracy, with estimated overpayments of £24.3 million and underpayments of £38.8 million in scheme year 2008.

7 The complexity of the systems has contributed to a very high average cost of £1,743 for administering each claim in 2008-09 – a 22 per cent increase on 2005-06 when the scheme was introduced. Staff costs represent 41 per cent of the cost per claim and the remainder comprises IT and administrative cost overheads. Between 2007-08 and 2008-09 the Agency managed to reduce staff costs by £3.7 million but other scheme administrative costs increased by £8.8 million. The high cost per claim is a reflection of the unforeseen additional costs of £304 million incurred on the scheme by the Agency between April 2005 and March 2009. Once the £27 million cost of bad debts and changes in disallowance are included, the cost per claim in England is even higher. In comparison to the administration cost in England of £1,743 per claim, the cost per claim in Scotland was only £285, although we have not been able to establish what proportion of the difference is due to additional complexity and what proportion due to the way it was implemented.

8 Many of the contracts for the ongoing support of the Agency's scheme IT systems are due to end in 2009. The Agency is exploring options to procure extended support, and it has estimated that this would cost £12 million for the next two years. The Agency is very dependent on external support, with over 100 IT contractors based permanently in its offices as part of a contracted IT service. This dependence, combined with the need to renew the support contracts quickly, and the difficulty in finding other potential contractors who could support the bespoke systems, will undermine the Agency's ability to get value for money.

On the accuracy of processing claims and the recovery of earlier overpayments

9 Overpayments to farmers since 2005 are likely to be between £55 million and £90 million, and the Agency has already repaid an estimated £85 million to the European Commission for potential overpayments. The Department had notified the Committee of Public Accounts in February 2008 that overpayments were estimated to be £37 million, although the Chief Executive of the Agency reported to Ministers in the same month that the actual figure was around £60 million. The Departmental Accounting Officer has written to the Chairman of the Committee of Public Accounts to clear up this misunderstanding. The Agency estimates that significant further overpayments are likely to have been made since February 2008.

10 We concluded that seeking to correct earlier errors in processing claims and thus to establish the extent of overpayments has cost the Agency approximately £119 million (staff costs and associated overheads). As yet, however, there is still no clear picture of the degree of inaccuracy in the data. The work to correct 34,500 cases in 2007 took over a year to complete and did not identify all errors. In the absence of proper documentation or quality control, not all original payment errors were corrected, necessitating a further tranche of corrections on 27,757 cases in 2008 and early 2009. During the summer of 2009, National Audit Office and Agency testing of outstanding overpayment debts showed high error rates, such that the Comptroller and Auditor General qualified his opinion on the Agency's financial accounts because of significant uncertainty over remaining debts.

11 In addition to poor oversight of correction work, a number of Agency management failures, such as a lack of an effective strategic approach, poor co-ordination of different teams and a wider lack of capacity, have resulted in slow progress in overpayment recovery. By the end of May 2009, the Agency had invoiced less than half of the farmers believed to have been overpaid, and it had only recovered £25 million of overpayments. The Agency considers it unlikely that it will recover £4.6 million, including in 13 cases where overpayments were each over £50,000. Even straightforward mistakes have taken a long time to resolve. The Agency made duplicate payments of over £50,000 to 19 farmers in August 2006, but made no recoveries until April 2008 (apart from £2,000 from one farmer in December 2007), and in July 2009 £106,000 was still outstanding.

12 The Agency has been slow to notify farmers of overpayments, and the lack of information in the letters sent out, and uncertainties over the calculations made, have led to further queries. In our survey, 58 per cent of farmers invoiced for overpayment felt that the Agency's approach to recovering overpayments had been 'unreasonable'.

On the governance of the scheme

13 In January 2008 the Department and the Agency made a number of assurances to the Committee of Public Accounts that the problems with the original implementation of the scheme were largely resolved and that progress was well underway to rectify mistakes and recover overpayments. We consider that this report demonstrates that there is still a long way to go and that progress has been slow and costly.

14 According to Departmental oversight performance reports and the evidence of achievement against Ministerial targets, the Agency has made strong progress in the last year. Thirteen out of 15 assessments between October 2008 and March 2009 for the relevant five targets were 'green'. However, some of the assessments against individual targets are not an accurate reflection of performance, and collectively the targets do not cover all the key aspects of the Agency's activities.

15 The slow progress in identifying and recovering overpayments has not been helped by a lack of experienced senior officials to support the Chief Executive. The Agency has experienced a high turnover of senior staff, including two changes of Chief Operating Officer during 2008. The Departmental and Agency Boards responsible for overseeing performance and the Agency's Audit and Risk Committee have not had sufficient information on which to challenge progress effectively. In September 2009 the Department announced it would undertake a wide-ranging review of the operational capability of the Agency.

Value for Money Conclusion

16 The Department and the Agency have brought forward payments due to farmers under the single payment scheme but the cost of administration – at an average of £1,743 per claim – is very high and there are no signs of it coming down. Efficiency has not improved, the IT systems are expensive and cumbersome, and the information in those systems is still inaccurate. The additional £304 million staff costs, the £280 million set aside for disallowance and penalties, and the £43 million anticipated irrecoverable overpayments, shows scant regard by the Department and its Agency for the proper

management of public funds, and the ongoing administration of the scheme does not represent value for money. Without any alternative system to fall back upon, the Agency appears to have little choice but to continue with the existing IT systems in the short term. The relative inexperience of the senior management team in the Agency and difficulties in establishing an accurate assessment of progress have hindered the scrutiny of expenditure and the development of any alternative approaches. The fault does not lie with the Agency alone as the Department has not adequately engaged with the issues we highlighted in our earlier reports about this scheme. The review announced by the Department in September 2009 is a late response to longstanding issues.

17 In January 2008 the Department assured the Committee of Public Accounts that the Agency was resolving the problems with this scheme and that good progress was being made in recovering overpayments. These assurances proved optimistic and the Department still does not have sufficient grip on the issues being faced by the Agency. Until the Department and the Agency address the ongoing weaknesses in managing the scheme, there is a high risk that costs will continue to rise, and that the errors and inaccuracies will increasingly become embedded within the data. The Comptroller and Auditor General qualified his audit opinion on the Agency's financial accounts for 2008-09 because of significant uncertainty over the overpayments still outstanding. Without prompt action, continued uncertainties over its financial records leave the Agency at risk of further qualifications in the future.

Recommendations

18 This is our third review of the single payment scheme. Over the period 2007 to 2009, the Department and the Agency have brought forward payments to farmers, but they have not adequately addressed the earlier recommendations from the Committee of Public Accounts and they still have not gained adequate control of the scheme. We consider the underlying problems to be the following:

- underestimation of the scale of work required to remedy the problems in determining the amounts due to farmers each year and the sums to be recovered. The high turnover of senior staff has allowed the culture of over-optimism in reporting that we originally identified to persist;
- inadequacies in record keeping and management information make it difficult for the Agency's Board and the Department to measure progress accurately;
- there is scant regard to protecting public money. The cost of administering each claim remains very high and there has been little effective action by the Department or the Agency to streamline costs or to develop any alternative approaches to reduce the dependency on the existing IT systems;
- at Departmental level the focus was on monitoring the service to farmers provided by the Agency, and the implementation of policy initiatives from the European Commission without sufficient regard to known key risk areas, such as overpayments and the complexity of the IT systems; and
- a lack of detailed engagement with the operational issues faced by the Agency and personal ownership of them within the Department.

19 To address these problems, we recommend the following action:

i Stabilise the current position

- Determine what is needed to keep existing systems operational and consider the business case for investment in a new IT support system. Establish how much it will cost to maintain the existing IT systems for the next five years, and quantify the cost of having to respond to potential European Commission policy changes, as well as the risk of significant system failures because of a lack of support.
- Tidy up the data. Experience shows that the Agency is unlikely to do this in an acceptable timeframe. Therefore the Department should commission an external organisation to work with the Agency to compile an accurate record for each claimant.
- Establish the full extent of overpayments and determine action within three months of this report. Where overpayments cannot readily be offset against future scheme payments, contract out the debt recovery arrangements and notify farmers likely to have been overpaid accordingly.

ii Develop alternative options that could be used to process payments instead

- As part of its current review, the Department should determine the potential costs and benefits of introducing a longer term contract or service level agreement with an organisation to develop and operate a suitable payment system. The agreement would need to specify clear performance standards and that the organisation would be responsible for the cost of system changes in response to any future policy changes by the European Commission.

iii Resolve the management issues

- The Department should work urgently with the Agency to resolve management capability issues.
- Consider separating out other services that the Agency currently administers, such as the British Cattle Movement Service, to free up time for senior managers to address the difficulties with the IT systems and the inaccuracies in the data. Management of the other services could be transferred to other agencies sponsored by the Department.
- Put in place a target regime for the Department and the Agency that focuses on the key risks associated with this scheme. Clear targets and metrics for the Department and its accredited organisation would help to support a more robust and formal service agreement.
- Agree the detailed actions, budgets and deadlines necessary to resolve the problems with the IT systems and the data quality so that progress can be measured effectively.
- Keep a proper audit trail of each action taken.