

**Report of the Comptroller and Auditor General on the
Rural Payments Agency 2009-2010 financial statements**

Rural Payments Agency

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

Introduction

1. The Rural Payments Agency is an Executive Agency of the Department for Environment, Food and Rural Affairs and was established in October 2001. The Agency manages a wide range of Common Agricultural Policy schemes, the most significant of which is the Single Payment Scheme.
2. The Single Payment Scheme was introduced by the European Union as part of the 2003 Common Agricultural Policy reforms which replaced 11 separate crop and livestock based production subsidies with a single payment based on land area.
3. The Rural Payments Agency experienced considerable difficulties in capturing and processing the data required to process payments for the first two years of the scheme and continues to experience difficulties in quantifying the value of payments made to farmers as a result of these difficulties.
4. Where the European Commission takes the view that the detailed European Regulations have not been applied correctly in processing European Union (EU) Scheme transactions there is a risk of financial penalties (referred to as disallowance) of expenditure under the Scheme. In anticipation of these financial penalties the Department for Environment, Food and Rural Affairs retains a provision in its financial statements for disallowance penalties arising in respect of the Single Payment Scheme, a number of smaller on-going schemes and for predecessor schemes. The total provision for penalties held at 31 March 2010 by the Department is £220 million, but this provision is not accounted for in the RPA financial statements. Penalties totalling £160 million were confirmed by the European Commission. This includes £117 million in respect of Single Payment Scheme for scheme years 2005 and 2006. In my opinion the requirement to pay material disallowance penalties to the European Commission is not in accordance with Parliament's intention and this expenditure is therefore irregular. I have therefore qualified my opinion on the Department for Environment, Food and Rural Affairs 2009-2010 resource accounts on the grounds of regularity due to material financial penalties being confirmed. Further details are provided later in this Report and I have reported

separately in respect of the Department's 2009-2010 resource accounts (HC 241).

5. The difficulties experienced by the Rural Payments Agency have led to three value for money reports¹ by the National Audit Office. Following the publication of the second report the Department and the Agency made a number of assurances to the Committee of Public Accounts that the problems of the original implementation were largely addressed and that progress was well underway to rectify mistakes and recover overpayments of Single Payment Scheme trade payables and quantify Single Payment Scheme trade receivables. My latest report in October 2009² demonstrated however that there was still a long way to go and that progress has been slow and costly. In particular, my report highlighted that IT systems were expensive and cumbersome, the high administrative cost per claim, unquantified under and overpayments of claims, and management and governance weaknesses.

Purpose of Report

6. The financial statements on the following pages represent the results of the Rural Payments Agency for the period from 1 April 2009 to 31 March 2010. I have limited the scope of my audit opinion as I was unable to obtain sufficient audit assurance to support the balances relating to Single Payment Scheme trade receivables and Single Payment Scheme trade payables.
7. The purpose of this Report is to explain the background to the qualification of my audit opinion and provide an overview of the progress made since the publication of my second Value for Money follow up report in October 2009 and the qualification of my audit opinion on the Agency's financial statements for 2008-2009.

My obligations as Auditor

8. Under the Government Resources and Accounts Act 2000, I am required to examine, certify and report on the financial statements that I receive. I am required, under International Standards on Auditing (UK and Ireland), to obtain evidence to give reasonable assurance that the Rural Payments Agency's

¹ *The delays in Administering the 2005 Single Payment Scheme in England, HC 1631 Session 2005-06, 18 October 2006. Progress update in resolving the difficulties in administering the Single Payment Scheme in England, HC 10 Session 2007-08, 12 December 2007 A second progress update on the Administration of the Single payment Scheme by the Rural Payments Agency, HC880 Session 2008-2009, 15 October 2009*

² *A second progress update on the Administration of the Single payment Scheme by the Rural Payments Agency, HC880 Session 2008-2009, 15 October 2009*

financial statements are free from material misstatement. In forming my opinion I examine, on a test basis, evidence supporting the disclosures in the financial statements and assess the significant estimates and judgements made in preparing them. I also consider whether the accounting policies are appropriate, consistently applied and adequately disclosed.

Progress since my report on the 2008-2009 financial statements

9. In 2008-2009 I qualified my audit opinion on the financial statements for the Rural Payments Agency on three separate grounds:

- Firstly, I was unable to obtain sufficient audit assurance to support the trade receivable balance arising from Single Payment Scheme overpayments and I therefore limited the scope of my audit opinion in this respect. I have again limited the scope of my audit opinion in 2009-2010 and further details are provided in paragraphs 14 to 16.
- Secondly, I did not consider that the Agency's 2008-09 financial statements complied with Financial Reporting Standard 23 'The effects of changes in foreign exchange rates' and I therefore qualified my opinion on the basis of a disagreement on the application of this standard in the financial statements. The Agency has worked closely with the Department to resolve this issue and have appropriately reflected the effects of foreign exchange transactions in the 2009-2010 financial statements. The Agency has also restated the prior year balances. My opinion is no longer qualified in this respect.
- Finally, I qualified my regularity opinion due to the payment of material disallowance penalties being imposed by the European Commission relating to the Fruit and Vegetable Producer Groups and Operational Funds. The liability for any future disallowance payments rests with Department for Environment, Food and Rural Affairs and therefore any qualification will be recorded on the Department's financial statements and not on the Agency's financial statements. I have qualified my audit opinion on the Department for Environment, Food and Rural Affairs resource account for 2009-2010 due to material disallowance arising from the Agency's administration of European Commission agricultural subsidy schemes. I have reported separately in respect of the Department for Environment, Food and Rural Affairs 2009-2010 resource accounts (HC 241) on this issue.

10. As a result of my audit qualifications on the 2008-09 financial statements and the findings in my Value for Money report, the Department for Environment, Food and Rural Affairs commissioned an external review of the Rural Payments Agency. The findings of this review were published on 20 July 2010. This review commenced in August 2009 and cost a total of £1.9 million.

11. The review's recommendations included:

- improvements to the Agency's operations in order to reduce duplication and to bring down the cost of administering a claim;
- the use of a specialist team to improve the quality of the information on which claims are processed;
- changes to the Agency's responsibilities and operating model;
- improvement to the Agency's financial controls;
- reducing the Agency's reliance on temporary staff; and
- improvements to the governance arrangements exercised over the Rural Payments Agency by the Department for Environment, Food and Rural Affairs.

12. The Department for Environment, Food and Rural Affairs and the Agency acknowledged that the Agency did not have sufficient capacity and capability within their finance function and have used contract staff in 2009-2010. During the course of 2009-2010 the Agency incurred additional costs of £1.1 million to support the finance function. This represents 45% of the Agency's total finance costs. Additional costs to support the finance function in the Agency were also incurred by the Department. These totalled £273,000. In addition, the Department has spent £220,000 on external contractors to support the work undertaken to date on identifying the underlying causes of errors in the data held in respect of the Single Payment Scheme.

13. The additional support to the finance function has allowed progress to be made in the current year and this has resulted in improvements in key financial controls and reconciliations. It has also allowed the Agency to implement a number of significant and complex accounting adjustments relating to foreign exchange transactions and to reduce the Agency's exposure to volatility arising from these transactions. There is a risk however that the underlying capacity and

capability of the Agency remains unaddressed as the level of investment in temporary support is not sustainable and their skills and knowledge are not embedded within the Agency's own staff.

Audit opinion

Qualified opinion owing to a limitation of scope in respect of Single Payment Scheme trade receivables and Single Payment Scheme trade payables

14. My report accompanying the Agency's financial statements in 2008-09 and my Value for Money report in October 2009 highlighted significant issues with the data held by the Agency to process the Single Payment Scheme. I recommended that the Department and the Agency resolve this as a matter of urgency. The Department and the Agency are investing considerable resources in attempting to resolve the underlying issues in the data held by the Agency for the Single Payment Scheme and make accurate payments and quantify the value of Single Payment Scheme trade payables and Single Payment Scheme trade receivables which arise due to incorrect payments to farmers. However, this work commenced after the external review of the Agency and is on-going. The Department and the Agency plan to identify the key causes of under and over payments by the end of July 2010, some twelve months after my previous qualification and report and over three years since the NAO's first value for money study on the Agency highlighted the underlying issues. The Department and the Agency will subsequently need to quantify the total value of Single Payment Scheme trade payables and Single Payment Scheme trade receivables and establish a detailed project plan to address the underlying data quality and recover or reimburse amounts owing to and from farmers. Progress to date has been limited. The Agency has not been able accurately assess the value of Single Payment Scheme trade payables and Single Payment Scheme trade receivables in 2009-2010 and therefore I have limited the scope of my audit opinion in this respect.

15. The 2009-2010 financial statements record Single Payment Scheme trade receivables for amounts owed to the Agency of £27 million. The Agency has provided for doubtful debts within this balance of £9.8 million. The net Single Payment Scheme trade receivables balance recorded is therefore £17.2 million. I have been unable to obtain assurance that this balance is reflected in the financial statements at the appropriate amount, that the stated balance reflects the total value of amounts due to the Agency and that these amounts will

ultimately be recovered by the Agency. I therefore have limited the scope of my audit opinion in this respect.

16. The 2009-2010 financial statements also record Single Payment Scheme trade payables in respect of amounts owing to farmers of £30.9 million. There was insufficient evidence to support that this balance was reflected in the account at the appropriate amount and represents the total value of Single Payment Scheme trade payables which will ultimately result in a liability to be paid by the Agency. I have therefore limited the scope of my audit opinion in respect of the valuation, existence and completeness of this balance.

Further actions taken or proposed to be taken by the Rural Payments Agency

17. I have reported previously on the problems with the Agency and my concerns remain extant. Until the Agency has a management team with the skills and experience necessary to address the challenges little progress is likely to be made in improving data quality, ensuring that IT systems work effectively and are fully supported and in reducing the costs of administering the Single Payment Scheme. The proposed approach must obtain value for money for the taxpayer and reflect the budgetary constraints within which the Department and the wider public sector must operate.

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