

**Report of the Comptroller and Auditor General on
the Department for Environment, Food and Rural
Affairs 2010-2011 accounts**

Department for Environment, Food and Rural Affairs

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

Introduction

1. The Department for Environment, Food and Rural Affairs develops and implements policy relating to the environment, food and rural issues. It is also responsible for negotiating European agricultural and rural funding on behalf of the UK. The Department receives funding from the European Commission to deliver the Common Agricultural Policy and other initiatives.
2. I have reported previously on the difficulties experienced by the Rural Payments Agency, an executive agency of the Department, in implementing the Single Payment Scheme. 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's difficulties have resulted in the European Commission proposing financial penalties. Where the European Commission takes the view that the detailed European Regulations have not been applied correctly in processing European Union Scheme transactions there is a risk of financial penalties (referred to as disallowance) of expenditure under the Scheme.
4. These penalties are payable by the Department for Environment, Food and Rural Affairs as a deduction from future Commission funding. In anticipation of these financial penalties the Department retains a provision in its accounts for disallowance penalties arising in respect of the Single Payment Scheme, for a number of smaller on-going schemes and for Single Payment Scheme predecessor schemes.

Purpose of report

5. The financial statements on the following pages represent the results of the Department for Environment, Food and Rural Affairs for the period from 1 April 2010 to 31 March 2011. I have qualified my opinion on the 2010-2011 accounts on the grounds of regularity. The requirement to pay

material disallowance penalties results in a loss to the UK exchequer which is outside Parliament's intentions in relation to the proper administration of European funding.

6. In addition, 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 of £11.5 million and Single Payment Scheme trade payables of £54.5 million which are recorded in the Department's accounts.
7. The purpose of this Report is to explain the background to the continuing qualifications of my audit opinion. The report also provides an overview of progress made by the Department since I first qualified the accounts of the Department in 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 Department for Environment, Food and Rural Affairs 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. I am also required to satisfy myself that, in all material respects, the expenditure and income of the Department for Environment, Food and Rural Affairs have been applied to the purposes intended by Parliament and conform to the authorities that govern them.

Progress since my report on the 2009-2010 financial statements

9. I am qualifying the 2010-2011 accounts on the same basis as I qualified the 2009-2010 accounts. Namely, on the grounds of material irregular expenditure as a result of disallowance penalties and a limitation of scope in respect of the balances relating to Single Payment Scheme overpayments (trade receivables) and Single Payment Scheme underpayments (trade payables).

Disallowance penalties

10. During 2010-2011 Defra accepted disallowance penalties of £175 million and these are reflected in the 2010-2011 accounts. This includes penalties of £145 million in respect of the administration of the Single Payment Scheme in England in 2007, 2008 and 2009. The residual penalties confirmed relate to Fruit and Vegetables (£24 million) and Rural Development Programme for England 2007 and 2008 (£6 million). I have therefore qualified my audit opinion on the Department's accounts on the grounds of regularity. The European Commission disallowed £160 million in 2009-2010 and of £92.2 million in 2008-2009.
11. The Department's 2010-2011 accounts include a provision for a further £84 million in respect of estimated disallowance penalties. This sum includes a total of £53 million in respect of the Single Payment Scheme in England for 2010. The total value of disallowance penalties paid and payable by Defra is now in excess of £0.5 billion. This is a cash loss to the UK Exchequer.
12. The Department for Environment, Food and Rural Affairs continues to contest the amounts of disallowance that will be applied and will seek arbitration on the amounts prior to accepting the settlement.

Limitation of scope on Single Payment Scheme trade receivables and Single Payment Scheme trade payables

13. The 2010-2011 financial statements record Single Payment Scheme trade receivables of £11.5 million (£17 million in 2009-2010). This is stated after providing for doubtful debt of £13 million (£9.8 million in 2009-2010). The 2010-2011 financial statements also record trade payables in respect of underpayments made to farmers of £54.5 million (£30.9 million in 2009-2010). There was insufficient evidence to support that these balances are reflected in the financial statements at the appropriate amount and represent the total value of Single Payment Scheme trade receivable and Single Payment Scheme trade payables owing to or from the Department.
14. I consider that the total value of these balances in 2010-2011 is material to the Department for Environment, Food and Rural Affairs and I have therefore limited the scope of my audit opinion on both the Department's

and the Rural Payments Agency's financial statements in respect of the valuation, existence and completeness of these balances. The value of under and over payments in respect of payments made during 2010-2011 is not material and therefore I have not qualified my audit opinion in respect of Single Payment Scheme payments.

15. I have reported separately on this issue in my report accompanying the Rural Payments Agency 2010-2011 financial statements (HC 1231).

Progress made by the Department in resolving the Rural Payments Agency's difficulties in administering European Funds

16. Disallowance penalties have been incurred as a direct result of weaknesses in the management and administration of the Rural Payments Agency. The difficulties experienced by the Rural Payments Agency have led to three values for money reports¹ by the National Audit Office. My latest report in October 2009² demonstrated 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 administrative cost per claim was high, there are unquantified under and over payments, and management and governance weaknesses.

17. During 2010-2011 there have been a large number of changes within the Rural Payments Agency. Three Chief Executives were in post during 2010-2011. A new Chief Executive was appointed in January 2011, the Senior Leadership Team has been replaced and the number of senior roles in the executive team increased from five to nine (including the Chief Executive). Since the 1 April 2011 the Chief Executive has appointed six individuals to these roles. The appointment of a permanent member of staff for two of these roles is still on-going (Operations director and IT director). The Chief Executive and the Senior Leadership Team are developing a five-year Strategic Improvement Plan. The Agency has stated that this will consider the key priorities for the Agency. It aims to publish this plan in the autumn.

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*

18. I have reported separately in my report accompanying the Rural Payments Agency 2010-2011 financial statements on the extent of the progress made by the Agency during 2010-2011. (HC 1231).

Further actions taken or proposed to be taken by the Department for Environment Food and Rural Affairs

19. The appointment of a new senior leadership team in the Rural Payments Agency provides a catalyst for the Agency to address the underlying operational issues with urgency and rectify the underlying causes which lead to my qualifications. It is important that the Department ensures that the five-year Strategic Improvement Plan addresses the significant issues relating to finance, operation and governance and places Defra and the Rural Payments Agency in the best place to implement the new Common Agricultural Policy for 2014 onwards.

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