

**Report of the Comptroller and Auditor General on the
Rural Payments Agency 2010-2011 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 Agency experienced considerable difficulties in capturing and processing the data required to process payments for the first two years of the scheme. It continues to experience difficulties in quantifying the value of under and over payments made to farmers as a result of these problems.
4. The European Commission sets detailed regulations which must be complied with in administering the scheme. Where the European Commission takes the view that the regulations have not been applied correctly in processing European Union (EU) scheme transactions there is a risk of financial penalties (referred to as disallowance). In anticipation of these penalties the Department for Environment, Food and Rural Affairs retains a provision in its financial statements for disallowance arising from the Single Payment Scheme, a number of smaller on-going schemes and for predecessor schemes.
5. At 31 March 2011 the Department held a provision for penalties of £84 million, but this provision is not accounted for in the Agency financial statements as these are considered to be a liability of the parent Department. The European Commission imposed £160 million penalties during 2010-2011. This included £130 million in respect of the Single Payment Scheme 2007, 2008 and 2009 where flat rate disallowance remains at 2 per cent. Total disallowance penalties paid and payable by the Department for Environment, Food and Rural Affairs are now in excess of £0.5 billion.

6. 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 2010-2011 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 2010-2011 accounts (HC 1003).

Purpose of Report

7. The financial statements on the following pages represent the results of the Rural Payments Agency for the period from 1 April 2010 to 31 March 2011. I have limited the scope of my audit opinion as I was again unable to obtain sufficient audit assurance to support the balances relating to Single Payment Scheme trade receivables and Single Payment Scheme trade payables.
8. 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 qualification of my audit opinion on the Rural Payments Agency's financial statements for 2009-2010 and 2008-2009.

My obligations as Auditor

9. 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 Agency's 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.

Audit opinion

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

10. This is the third year in which the Rural Payments Agency has been unable to provide sufficient audit evidence to support the trade receivables balance arising from Single Payment Scheme overpayments. It is the second year in

which the Rural Payments Agency has been unable to provide sufficient audit evidence to support the trade payables balance arising from Single Payment Scheme underpayments. I therefore have again limited the scope of my audit opinion in this respect.

11. The 2010-2011 financial statements record Single Payment Scheme trade receivables of £24.5 million. The Agency has provided for doubtful debts against this balance of £13 million. I have been unable to obtain assurance that these balances in the financial statements are recorded at the appropriate amount and reflect the total value of amounts due to the Agency. I therefore have limited the scope of my audit opinion in this respect.
12. The 2010-2011 financial statements record Single Payment Scheme trade payables of £54.5 million in respect of amounts owing to farmers. I have been unable to obtain assurance that this balance is recorded at the appropriate amount and represents the total value of Single Payment Scheme trade payables which will ultimately result in a liability. I have therefore limited the scope of my audit opinion in respect of the valuation, existence and completeness of this balance.
13. The value of under and over payments in respect of Single Payment Scheme payments made during 2010-2011 is not material and therefore I have not qualified my audit opinion in respect of Single Payment Scheme payments in 2010-2011.

Progress since my report on the 2009-2010 financial statements

14. During 2010-2011 the Agency invested considerable resources attempting to resolve the underlying issues in the quality of data for the Single Payment Scheme and make accurate payments. It also worked to quantify the value of Single Payment Scheme trade receivables and Single Payment Scheme trade payables.
15. In my report accompanying the 2009-2010 accounts¹ I highlighted that the Agency planned to identify the key causes of overpayments by the end of July 2010. This piece of work was led by Agency staff with the support of external consultants. The costs paid to external consultants totalled £1.5million.

¹ *Report of the Comptroller and Auditor General on the Rural Payments Agency Accounts 2009-2010 HC 141 Session 2009-2010*

16. This work created a model which identified five key factors which could give rise to overpayments. The Agency reviewed all payments to farmers and highlighted a further 6,797 payments with characteristics featuring at least one of the five key factors. These payments are therefore considered at risk of having been overpaid, but currently have no debt recorded and are therefore not reflected in these financial statements. The Agency has not reviewed the 6,797 payments potentially at risk as yet and therefore there is a significant risk that the Single Payment Scheme trade receivables balance is understated. The Agency also developed a model to assess the staff costs required to accurately recalculate a debt in order to prioritise case work and determine whether it was value for money to proceed in individual cases. The validity of this model is dependent on the Agency being able to accurately value a debt and assess the full staff costs attributable in processing and recovering the debt.
17. The Agency sought to reduce the level of uncertainty in respect of the Single Payment Scheme trade payables and Single Payment Scheme trade receivables balances recorded in its 2010-2011 financial statements. The Agency planned to review the 150 largest recorded underpayments and the 150 largest recorded overpayments as at 31 December 2010. This exercise required case workers to recalculate a payment from first principles. The Agency used a spreadsheet developed internally to calculate these values.
18. During the period January to April the Agency was able to recalculate the value of 179 under and over payments. This identified 56 overpayments with a value of £2.2 million and 101 underpayments with a value of £8.1 million. These amounts are reflected in Note 18 as validated balances. In addition, 22 cases reviewed identified that there was neither an under or an over payment and therefore these balances were removed.
19. The examination of the 179 cases was very time consuming. The Agency has estimated that these cases took on average 3 to 4 days for a caseworker to complete. In addition, the review process of this work takes approximately 1 day per case. This work equates to around 800 working days or 4 full time equivalent staff working for a year. The Agency estimates that a review of a less complex case could be completed in less than two days.
20. The European Commission Regulations² include provisions regarding the recoverability of debts identified more than four years after payment. The

² Article 73 ((EC) No. 796/2004)

Agency's interpretation of this Article has led it to write off £3.3 million of debts from 2005 and 2006 where these have not been verified to the level necessary to generate an invoice. This equates to 12 per cent of the 2009-2010 gross Single Payments Scheme trade receivables balance reflected in the accounts. The Agency obtained HM Treasury approval for these write-offs. The Agency has informed us that they will apply this Regulation in subsequent years. These amounts are a direct loss to the UK Exchequer and I therefore consider these amounts to be irregular expenditure.

21. This is the third year in which I have limited the scope of my audit opinion in this respect. The Agency needs to urgently address the operational issues which prevent them being able to accurately assess these balances and ensure that the losses borne by the UK Exchequer are minimised.

Other actions taken by the Rural Payments Agency

22. The difficulties experienced by the Rural Payments Agency have led to three value for money reports ³ by the National Audit Office. My last report in October 2009⁴ 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. The report noted that progress to resolve these issues had been slow and costly.

23. The Department for Environment, Food and Rural Affairs commissioned an external review of the Agency in response to these reports, and my qualification of the financial statements, which was published in July 2010⁵. The Agency subsequently identified six priority projects which would address the recommendations I made, the Public Accounts Committee findings and the recommendations of the external review. These projects were:

- 2010 Single Payment Scheme Delivery;
- Debt and data;
- Disallowance defence;

³ *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*

⁴ *A second progress update on the Administration of the Single payment Scheme by the Rural Payments Agency, HC880 Session 2008-2009, 15 October 2009*

⁵ *2013 Review of the Rural Payments Agency available at <http://archive.defra.gov.uk/foodfarm/farmmanage/singlepay/index.htm>.*

- Financial controls;
- Corporate services efficiency and effectiveness; and
- ICT Continuity.

24. The Public Accounts Committee considered my Report and requested that the Department provide quarterly updates on progress in implementing recommendations. The Department has provided six quarterly updates to the Public Accounts Committee. These provide an update against the six priority projects and the latest Report highlights that the focus should be on allowing the new senior leadership team to establish an overarching plan.

25. During 2010-2011 there have been a large number of changes within the Rural Payments Agency. The Chair of the Audit and Risk Committee resigned with effect from 30 November 2010. This was due to his concerns regarding the capacity of the Agency and the Department to address the significant issues in the Agency. A new Chair of the Audit and Risk Committee was appointed with effect from 1 March. However, the Audit and Risk Committee was not operational between November 2010 and March 2011.

26. During 2010-2011 there have been three Chief Executives in post. A permanent 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 permanent members of staff for two of these roles (Operations director and IT director) is still on-going. Furthermore, the Chief Executive and the Senior Leadership Team are developing a five-year Strategic Improvement Plan, which will consider the key priorities for the Agency. It aims to publish the plan in the autumn.

27. I have previously reported on weaknesses in core financial controls within the Agency. The Agency addressed this area as one of the six priority projects and I am pleased to note improvements in this area. For example, bank reconciliations are now completed and reviewed in a timely fashion and the annual accounts preparation has improved. However, the Agency and the Department for Environment, Food and Rural Affairs continue to acknowledge that the Agency does not have sufficient permanent capacity and capability within their finance function. It continued to use external consultants in a

number of areas during 2010-2011. During 2010-2011 the Agency incurred additional costs of £2.9 million paid to external consultants to support the finance function (£1.1 million in 2009-2010). This represents 45% of the Agency's total finance costs. The current Finance Director of the Department for Environment, Food and Rural Affairs will take up the role as the Agency's permanent Finance Director in July 2011. I welcome the appointment of a permanent member of staff to this role.

28. I have also previously reported that key IT systems which support the Single Payment Scheme would no longer be supported after December 2011. The Agency addressed this issue as one of the six priority projects. In April 2011, the Cabinet Office provided approval for the Agency to procure continuity of support and maintenance for these business critical systems.

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

29. The appointment of a new senior leadership team in the Rural Payments Agency provides an opportunity for it to urgently address the underlying operational issues and rectify the causes which lead to my qualifications. It is important that the five-year Strategic Improvement Plan addresses the significant issues relating to finance, operation and governance, allows the Agency to resolve its current difficulties and places it in the best place to implement the new Common Agricultural Policy for 2014 onwards. 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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