Department for the Environment, Food and Rural Affairs and Rural Payments Agency Accounts 2014-15

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

Introduction

The Department for Environment, Food and Rural Affairs (the Department) develops and implements policy relating to the environment, food and rural issues. It is also responsible for negotiating European agricultural and rural policy and related funding on behalf of the UK. The Department receives funding from the European Commission (the Commission) to deliver the Common Agricultural Policy (CAP) and other initiatives - some £3.1 billion in 2014-15 (2013-14 £3.4 billion). CAP schemes covering 2005-14 are winding down, with new CAP schemes for 2015-20 commencing during the 2014-15 financial year.

Purpose of this report

This report explains the nature of the Department's disallowance qualification. It looks at the progress the Department has made in addressing the issues encountered when implementing the previous CAP (CAP 2005–14) that give rise to this qualification. I have also set out an overview of the actions being taken by the Department to manage future risks in the context of significant CAP reforms (CAP 2015-20). Further information is provided in my report 'Managing disallowance risk' (HC 306).

Qualified opinion on regularity - financial penalties arising from Commission-funded schemes

Until 2011-12, I qualified my audit opinion on regularity as a result of material financial penalties incurred by the Department and accrued in the financial statements. The requirement to pay financial penalties ('disallowance'), where Commission-funded scheme regulations are not correctly applied, results in a loss to the UK Exchequer that is recognised within the financial statements of the Department. This loss is outside Parliament's intentions in relation to the proper administration of European funding and is therefore considered irregular. I did not qualify my audit opinion on regularity for 2012-13 and 2013-14 as penalties accrued in year were not considered to be material. In 2014-15, penalties accrued in year, at £90 million, returned to material levels. I have therefore qualified my opinion on regularity on the 2014-15 financial statements.

Financial penalties reported to 2014-15

Financial penalties are incurred when the Commission takes the view that the detailed scheme regulations have not been applied correctly in processing Commission-funded transactions. These penalties are deducted from the Department's future funding from the Commission and are known as disallowance.

Due to the nature of disallowance, penalties are not incurred in the financial year of scheme payments, but in subsequent years once the Commission has completed its reviews. As the process of Commission reviews progresses the likelihood of disallowance penalties becomes known and is reflected in the financial statements. I qualify my regularity opinion on the accounts when disallowance penalties are confirmed and therefore reasonably certain. In practice this is when the Commission has notified a penalty which the Department will not contest. This is the same point at which the Department reflects the likely disallowance in the financial statements as an accrual. The value of penalties accrued in 2014-15, and deemed irregular expenditure, is £90 million (2013-14: £42 million). This comprises 2010 to 2013 Single Payment Scheme penalties. I consider this to be material in the context of the £6.3 billion of expenditure recognised in the Department's financial statements and the £3.1 billion of Commission-funded expenditure managed by the Department.

The Department also includes a provision in its financial statements for disallowance penalties which are probable but not yet confirmed. The Department's 2014-15 financial statements include a provision for £65 million in respect of estimated future disallowance penalties (2013-14: £84 million). These penalties remain subject to challenge and so are not yet sufficiently certain to be accrued. This mainly relates to 2014 Single Payment Scheme penalties and cross compliance scheme audits relating to years 2010 to 2012, for which the Department currently expects financial correction of around £30 million and £22 million respectively.

The total cumulative value of disallowance penalties recognised in the Department's financial statements to 31 March 2015 is £642 million, which relates to the 2005-14 Single Payment Scheme, a number of smaller 2005-14 schemes and predecessor schemes. CAP 2015-20 schemes have not yet been subject to review by the Commission, and so levels of likely disallowance are not known.

Future financial penalties

For historic scheme expenditure which the Commission is yet to review, the Department is not able to reliably estimate the disallowance penalties that may arise and, therefore, no liability is included in the financial statements. The Department's current expectation is that disallowance penalties incurred for schemes under the CAP 2005-14, which has now drawn to a close, will be fully calculated and settled by 2019-20. The Commission has recently announced that it intends to complete all of its audits within two years of the end of a scheme year. There is therefore a risk of a bunching effect as outstanding cases of CAP 2005-14 reach conclusion, while new cases from CAP 2015-20 are concluded more quickly.

Managing disallowance risk

I have considered the Department's management of disallowance risk throughout the CAP 2005-14 in my report '*Managing disallowance risk*' (HC 306), published in July 2015. This report provides further information about what the CAP is, how the Department administers it in the UK and how disallowance penalties arise. It also considers the underlying causes of disallowance in England, future disallowance risk and how the Department manages this risk.

The Department and the Rural Payments Agency have made good progress over the last year in their approach to disallowance. They have strengthened governance across organisations administering the CAP, improved understanding of the key drivers of disallowance, developed systems and processes to manage disallowance risk, adopted a more proactive approach with the Commission, and improved management information. Nevertheless, there are persistent problems, chief of which has been deficiencies in mapping capabilities. The Commission has recently introduced new mapping requirements and controls in the current CAP and increased its focus on mapping issues. The Department is addressing this by exploring options for additional investment to reduce disallowance risk.

Common Agricultural Policy reforms

The problems experienced by the Department in implementing CAP 2005-14 reforms undoubtedly contributed to the level of disallowance penalties incurred. The Commission recently reformed the CAP, with the majority of the new regulations coming into force from 2015. The Department has been working with its agencies and other delivery bodies to ensure that the new schemes are successfully delivered. The Department considers CAP 2015-20 to be more complex and subject to more stringent control requirements than CAP 2005-14.

The Department established the CAP delivery programme (the programme) to deliver CAP 2015–20. The programme incorporates the procurement, development and implementation of new systems. Delivery of the programme is critical to the successful provision of CAP reform: to correctly apply scheme regulations to pay claimants accurately and efficiently; and to minimise disallowance penalties going forward.

The programme is currently behind schedule and despite good progress on registrations, customers experienced issues with the initial release of the online service, in particular the portal and land mapping functionality. As at 31 March 2015, the total IT expenditure under the Programme was £97.6 million, of which £69 million was capitalised, against an overall forecast for the life of the project of £155 million set out in the original Full Business Case. As a result of the issues identified, the Department has written-off £5.2 million of this capitalised expenditure, with a review of the Programme's business case and delivery model underway.

It is clear that the Department still has much to do to address the ongoing issues and to ensure it delivers value for money in its implementation of CAP reform. I will be looking at this issue again as part of a value for money report on CAP reform and the Programme, which I intend to publish in 2016.

9 July 2015

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