

## 7 EU Refunds and Levies in the Agriculture Sector

- 7.1** The Department of Agriculture, Food and the Marine (the Department) administer EU funds that focus on supporting the agriculture sector and rural life in Ireland. The EU Common Agricultural Policy provides funding for
- the European Agricultural Guarantee Fund (EAGF) which finances direct payments to farmers (such as the single payment scheme) and measures that regulate or support agricultural markets
  - the European Agricultural Fund for Rural Development (EAFRD) which supports rural development programmes.
- 7.2** The Department was also responsible for the administration of the milk quota scheme in Ireland which ended in March 2015. Milk quota levy receipts were used by the EU to fund the EAGF.
- 7.3** EAGF and EAFRD funding administered through the Department in 2015 comprised
- EAGF funding of €1,210 million
  - EAFRD funding of €382 million.
- 7.4** This report examines
- a refund of €68 million from Ireland to the EU in 2015 for non-compliance with EAGF and EAFRD scheme regulations<sup>1</sup>
  - the payment to the EU by the Department of €71 million in 2015 as a result of Irish milk production exceeding the national milk quota, and the recovery of those funds from milk producers.

### EAGF and EAFRD compliance issues

- 7.5** The Department is obliged under EU regulations to conduct compliance checks as part of its role as the administrator of the EAGF and EAFRD.<sup>2</sup> In the period 2010 to 2015, the Department conducted, on average, 15,500 inspections each year and imposed penalties of €937,000 each year on average. The European Commission (Commission) also conducts routine audits of the application and administration of the funds.
- 7.6** The EU requires each member state to have a land parcel identification system (LPIS) for the administration of grants. The LPIS uses satellite imagery to calculate the area of each land parcel and is the foundation for the administration of land based grants.
- 7.7** The Commission conducted reviews in 2009, 2010 and 2012 of the management of, and control systems for, EAGF and EAFRD funds in Ireland.
- 7.8** After each review, the Commission informed the Department of its view that Ireland had not fully complied with the regulations and that corrective measures were necessary to ensure compliance (Figure 7.1). Each year, the Department contested most of the issues raised.

<sup>1</sup> The EU refers to such refunds as financial corrections.

<sup>2</sup> Each year, 5% of Single Payment Scheme applications must be inspected, including the on-farm inspection of 1% of farms. The Department met these requirements each year and reported annual statistics to the Commission.

- 7.9** To address issues arising, the Department conducted a review of commonage areas in 2009 and an initial LPIS review in 2010. The Department noted that the protracted timeframe to resolve issues raised by the Commission was exacerbated by a change in Commission audit personnel in 2011, which meant that a new audit was required in 2012.

**Figure 7.1 Main Commission findings, by year**

Issues	2009 audit	2010 audit	2012 audit	2013 clearance issues <sup>a</sup>
LPIS - ineligible features not recorded, such as farmhouses and yards	✓	✓	–	✓
LPIS - imagery too old, with some imagery eight years old	✓	✓	✓	✓
LPIS - file updating process and audit trail	✓	✓	✓	✓
Common land registration	✓	✓	–	✓
Eligibility co-efficient	–	–	✓	✓
Administrative procedures	✓	✓	–	–
On-the-spot checks	✓	✓	✓	✓
Application of sanctions and deductions	✓	✓	✓	✓

Source: Analysis by the Office of the Comptroller and Auditor General

Note: a The 2013 'conformity clearance' process collated unresolved issues from 2009, 2010 and 2012

### ***Expenditure disallowance proposed by the Commission***

1 A higher flat-rate disallowance (up to 100%) can be applied when weaknesses are so serious that they constitute a complete failure to comply with EU regulations.

2 Key controls are those physical and administrative checks required to verify substantive elements, in particular the existence of the subject of the claim, the quantity, and the qualitative conditions including respecting time limits, harvesting requirements, retention periods, etc. They are performed on-the-spot, and by cross-checks to independent data such as a land register.

3 Ancillary controls are those administrative operations required to correctly process claims, such as verification that time-limits are respected for the submission of claims, identification of duplicate claims for the same subject, risk analysis, application of sanctions and appropriate supervision of the procedures.

- 7.10** In cases where compliance issues are identified, the Commission may seek a refund of grants previously paid. This is calculated by assessing the risk to the total funds or by applying flat-rate disallowances as follows

- 25% disallowance when the control system is completely absent or gravely deficient and there is evidence of widespread irregularity<sup>1</sup>
- 10% disallowance when key controls are completely ineffective in determining the eligibility of the claim or preventing irregularity<sup>2</sup>
- 5% disallowance when all key controls are applied, but not in the number, frequency or depth required by the regulations
- 2% disallowance when the key controls are adequately performed, but one or more ancillary controls have completely failed to operate.<sup>3</sup>

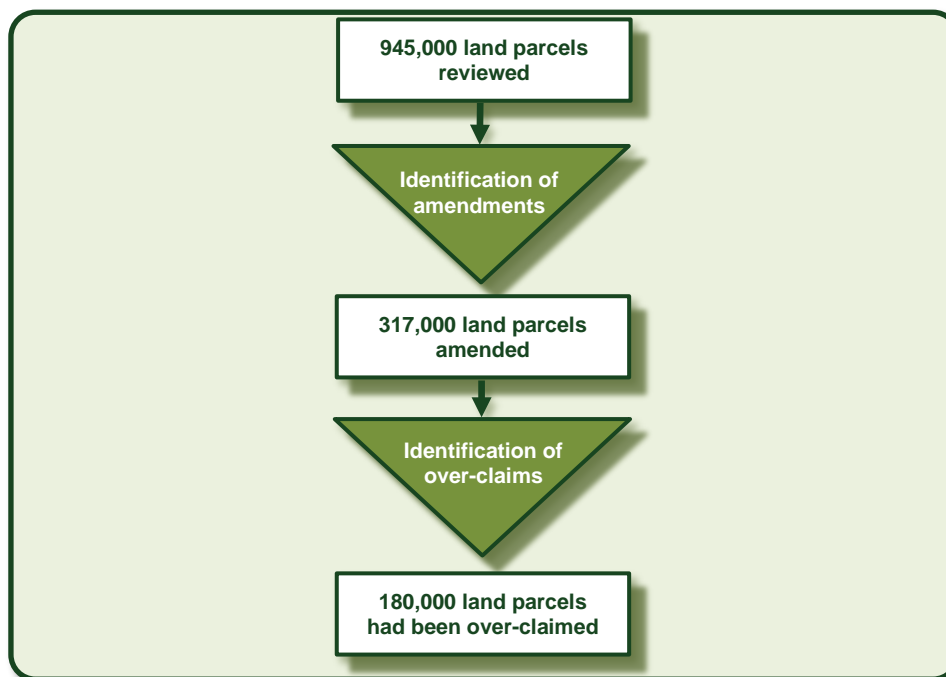
- 7.11** In May 2013, the Commission notified the Department that the exclusion of certain expenditure was proposed and in July 2013 indicated that a flat-rate disallowance of 5% – equivalent to around €450 million – was being considered for the period 2008 to 2012. It considered the weaknesses in the Irish implementation of EU regulations to be “persistent and of a recurrent nature”, as deficiencies noted in the 2009, 2010 and 2012 audits had not been fully remedied.

- 7.12** EU regulations allow member states to provide a reasoned calculation of the risk to EU funds rather than pay a flat-rate disallowance. The Department pursued this option and, in August 2013, the Commission set out its requirements for a review of the level of risk to EU funds, with the Department to complete the review by mid-December 2013.

### Review of land parcels by the Department

- 7.13** To identify the risk to EU funds, the Department conducted a desk-based review of each of the 945,000 land parcels on the LPIS. This examination was enabled by high-resolution imagery acquired by Ordnance Survey Ireland in 2012. The review found 40,000 cases (comprising 180,000 land parcels) where an individual had over-claimed for their holding (Figure 7.2).

**Figure 7.2 Analysis of land parcels, 2013 review**



Source: Department of Agriculture, Food and the Marine

- 7.14** The Department finished the review in December 2013 and completed its analysis in February 2014, estimating the risk to EU funds at €33.4 million for 2009 to 2012.

### Negotiation of expenditure disallowance

1 A 5% rate was applied to expenditure on common land in 2010. The Commission subsequently agreed that the figure of €182 million was overstated by €28 million due to double counting of some figures.

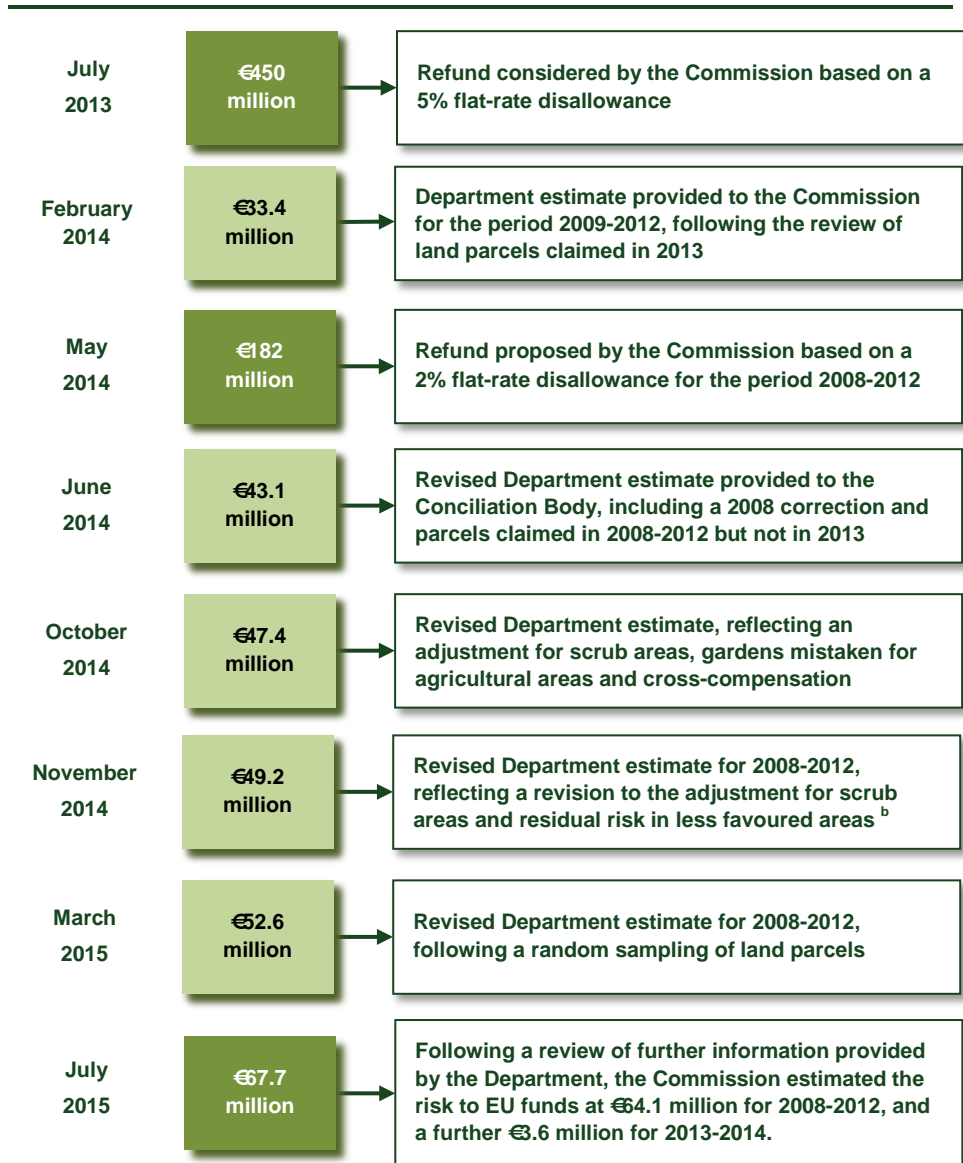
2 An ineligibility coefficient is applied where some of the land has ineligible features, for example scrub. Cross-compensation occurs where reductions in the area of one land parcel were balanced with unclaimed but eligible areas in another land parcel owned by that farmer.

- 7.15** In May 2014, the Commission advised the Department of its proposed disallowance of €182 million, based on a flat-rate disallowance of 2% of expenditure in the period 2008 to 2012.<sup>1</sup> The Commission did not accept the estimate of ineligible expenditure provided by the Department as

- field visits to verify findings were not part of the 2013 review by the Department
- deficiencies in relation to the 2008 claim year had not been quantified
- there were inconsistencies in the reported level of errors in relation to common land
- it did not agree with the application of ineligibility coefficients (of more than 80%) and cross-compensation<sup>2</sup>
- five of seven land parcels visited in 2014 by the Commission identified incorrect exclusions (the sample was chosen from 27 parcels where a desk-based review identified potential issues).

- 7.16** EU regulations provide an opportunity for member states to commence a mediation process using the EU Conciliation Body, the results of which are not binding on the Commission. The Department initiated this process.
- 7.17** In June 2014, the Department submitted a case to the Conciliation Body, arguing that the LPIS review fully established the risk to EU funds. In December 2014, the Conciliation Body reported that while it was not possible to negotiate an agreement between the Department and the Commission, conciliation did not seem out of reach and encouraged further discussion between the Department and the Commission.
- 7.18** In July 2015, the Commission proposed a settlement of €64.1 million for the period 2008 to 2012. A further correction of €3.6 million in relation to low eligibility coefficients was proposed for the period 2013 to 2014.<sup>1</sup> The proposal was accepted by the Department. The settlement was deducted from EU funding to Ireland in 2015. The settlement negotiation process is summarised in Figure 7.3.
- 7.19** Measures introduced to address the issues that led to the disallowance include
- a review of commonage areas that commenced in 2009
  - the acquisition of high-resolution imagery in 2012 resolving concerns about the age of imagery
  - the 2013 review which updated the LPIS for ineligible features that had not been recorded
  - the introduction by the Department in 2012 of more precise guidance for inspectors when calculating eligibility coefficients
  - the introduction of revised procedures to improve the audit trail.

<sup>1</sup> The Department state that eligibility coefficients are the only unresolved issue from the 2008 to 2012 Commission reviews.

Figure 7.3 Negotiation of disallowance amount <sup>a</sup>

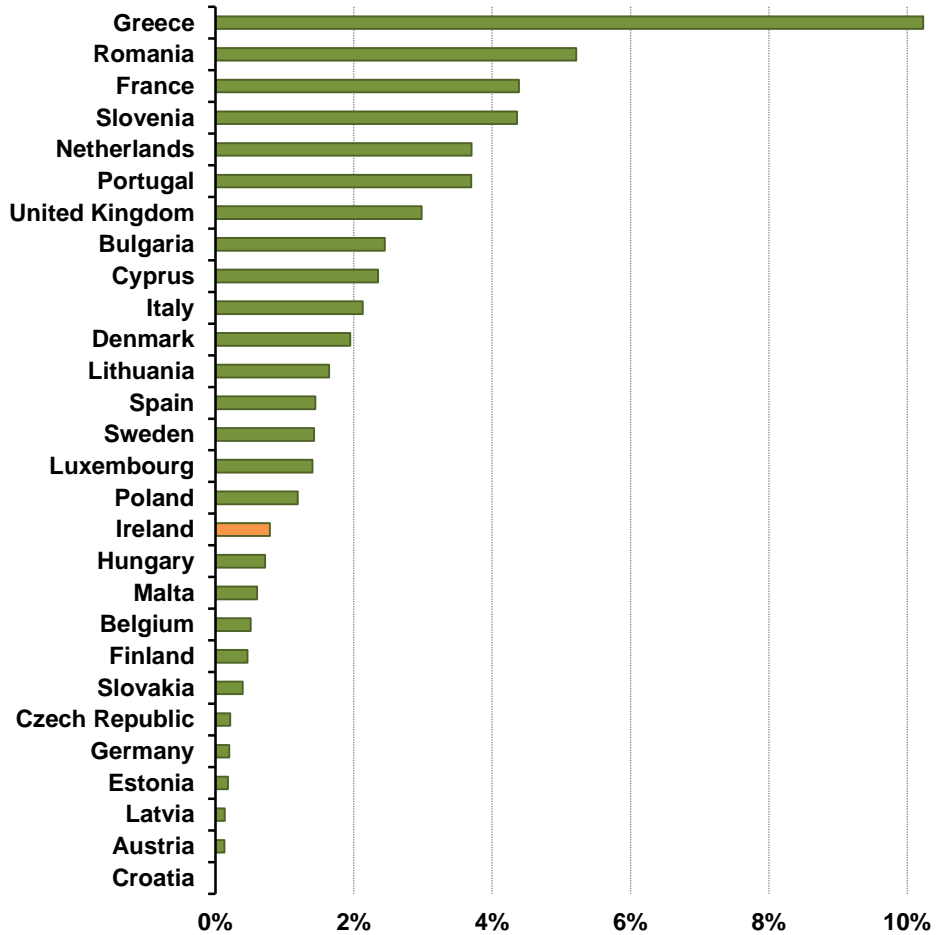
Source: Office of the Comptroller and Auditor General

- Notes:
- a Quoted figures exclude €0.95 million recovered from farmers and refunded to the EU, following the 2013 review. This refund was subtracted from the settlement agreed in 2015.
  - b A less favoured area is where agricultural production or activity is more difficult because of natural handicaps, such as steep slopes or low soil productivity.

**International comparison**

**7.20** In the period 2008 to 2015, Ireland had a relatively low rate of disallowance (Figure 7.4).

**Figure 7.4 EAGF and EAFRD disallowance rates in EU countries, 2008 to 2015**



Source: Department of Agriculture, Food and the Marine

**7.21** In the period 2008 to 2015, the average disallowance each financial year was 2.4% on an EU-wide basis. Ireland has performed better than most, with an average disallowance in the region of 0.8%. A disallowance imposed by the Commission can have significant cost. For example, in 2014, a disallowance of more than €1 billion was imposed on France, related to the period 2009 to 2013. Like Ireland, most of the correction related to weaknesses in its LPIS, with flat-rate disallowances ranging from 2% to 100%.

### ***Other costs***

**7.22** The review conducted by the Department required internal and external staff resources and utilised new software. In addition, the Department obtained legal support in advance of the conciliation process. The Department has indicated the total cost of the review to be €3.2 million, comprising

- €960,000 of internal staff costs
- €450,000 for new software
- €840,000 for the revised imagery
- €920,000 for the services of a contractor to review imagery
- €10,500 for legal services engaged as part of the conciliation process.

### ***Recovery of overclaims***

**7.23** In its submission to the Conciliation Body, the Department noted that a flat-rate disallowance made it very difficult for member states to recover over-payments. Funds of €0.95 million were recovered from land owners as a result of the 2013 review.

**7.24** The Department did not pursue farmers for further overpayments. It has advised that key factors in its decision were

- the complexity of the administrative and technical verification processes involved and the likelihood of significant appeals and challenges
- the normal practice in other member states where the national exchequer pay such financial corrections.

### **Conclusions**

**7.25** The Department was involved in a protracted process with the Commission, in an attempt to resolve the deficiencies noted by the Commission in its review of agriculture funds in 2009, 2010 and 2012. Ultimately, this resulted in the EU imposing a disallowance on Ireland.

**7.26** The Department actively engaged with the Commission on the issue of how much should be repaid. It succeeded in reducing the repayment from €182 million to €64.1 million for the period 2008 to 2012, with a significantly reduced rate of disallowance, of €3.6 million, for 2013 and 2014.

## Milk quota and levy

- 7.27** A milk quota system was introduced in the European dairy sector in April 1984, to address overproduction in the dairy market and a related increase in the cost of market intervention measures to support dairy prices. National milk production quotas were allocated to each member state. In Ireland, the quota was divided between individual milk producers based on their production in 1983.<sup>1</sup> The quota of a milk processor is the total of the quota of individual producers supplying that processor.<sup>2</sup>
- 7.28** In 2003, the EU decided to abolish milk quotas in 2015. The decision to end the quota system was influenced by growing demand for dairy products on the world market, which EU producers were unable to benefit from without incurring a levy. The milk quota regime was abolished on 1 April 2015.
- 7.29** A milk producer was liable for a surplus levy (commonly referred to as a 'super levy') only when the producer exceeded his/her quota, the processor of that milk exceeded its production quota and the Member State exceeded its quota. The quota was based on the quantity of milk produced and adjusted to reflect the butterfat content of the milk.
- 7.30** The levy and quota were set by agreement between EU ministers. In 2015, the levy was 28.66 cents per litre of milk in excess of the quota.

**7.31** In 2015, the Irish national quota was 5.78 million tonnes, up from 5.40 million tonnes in 2008.<sup>3</sup> Measures introduced in 2008 to initiate a "soft landing" for the sector included

- a 2% increase in the quota for 2009
- a 1% increase in the quota each year for the period 2010 to 2014
- an amendment in 2010 to the butter fat correction factor which was equivalent to a 1% increase in the quota
- quota trading schemes to increase producer flexibility.

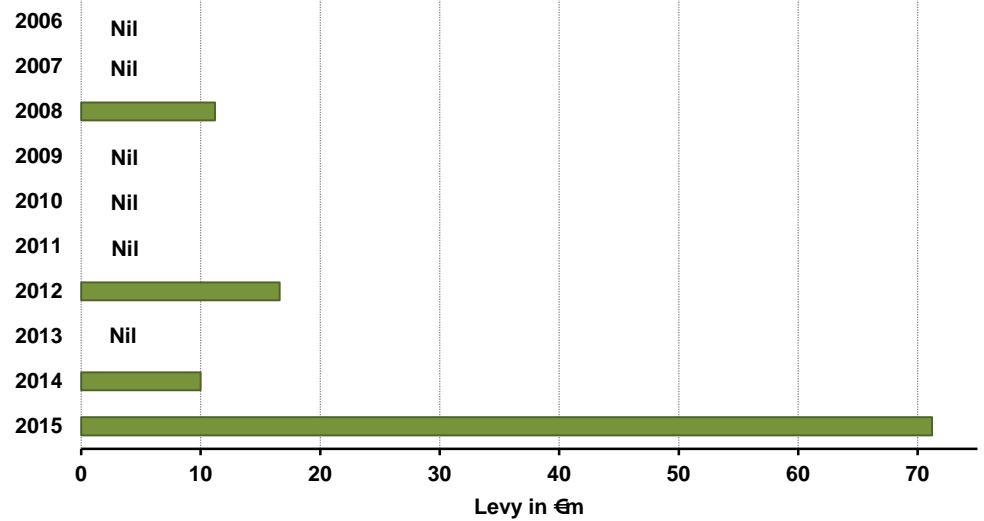
<sup>1</sup> The milk quota year ends on 31 March each year. In this report section, reference to a year refers to the year ending 31 March.

<sup>2</sup> Where a producer supplies more than one processor, their quota is allocated between the processors.

<sup>3</sup> In the period 1985 to 2008, the quota fluctuated between 5.150 and 5.599 million tonnes.

### *Levy payable*

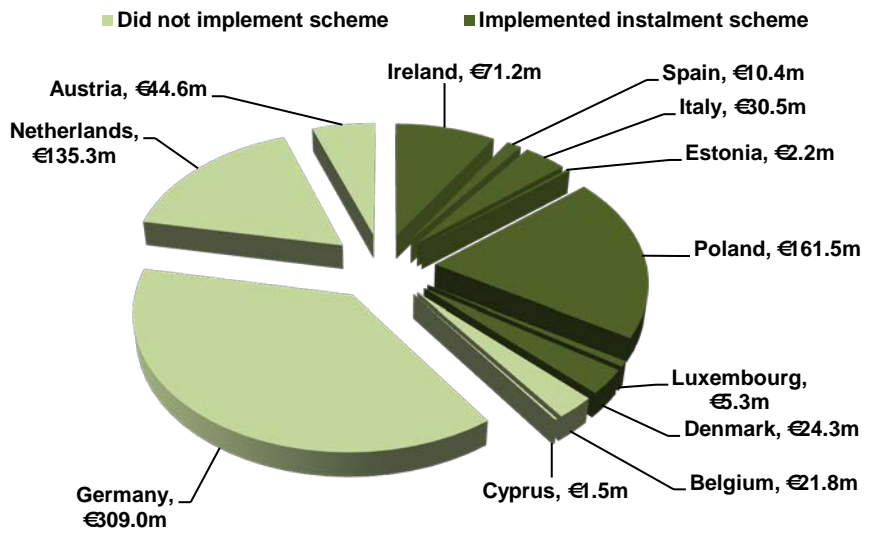
**7.32** The levy incurred by Ireland in recent years is shown in Figure 7.5.

**Figure 7.5 Irish milk levy, 2006 to 2015**

Source: Department of Agriculture, Food and the Marine

- 7.33** The total EU milk quota levy in 2014 was €408 million for eight countries, of which the levy for Ireland was €10 million.
- 7.34** Many EU milk producers increased their output in 2015 in preparation for the ending of the quota regime, with milk production 2.7% higher in 2015 than in 2014. Twelve countries exceeded their quota in 2015, incurring a levy of €18 million, despite the EU producing 2.1% less milk than the total of individual country quotas. Ireland exceeded its milk quota by 4.4%, resulting in a levy of €71 million.
- 7.35** In early 2015, milk prices fell and some milk producers experienced consequent cash-flow difficulties. On 26 March 2015, days before the end of the milk quota regime, the EU approved a scheme whereby a milk quota levy incurred by producers in 2015 could be paid over three years without interest. Each member state was obliged to settle the liability in full in 2015 and had discretion over whether to implement the scheme.
- 7.36** Ireland was one of seven countries that implemented the instalment payment scheme. Where the instalment scheme was not implemented, all producers were required to pay the levy by 1 October 2015. Figure 7.6 shows the levy incurred by each country and whether they implemented the instalment scheme.

**Figure 7.6 EU Milk quota levy by country and levy incurred, 2015**

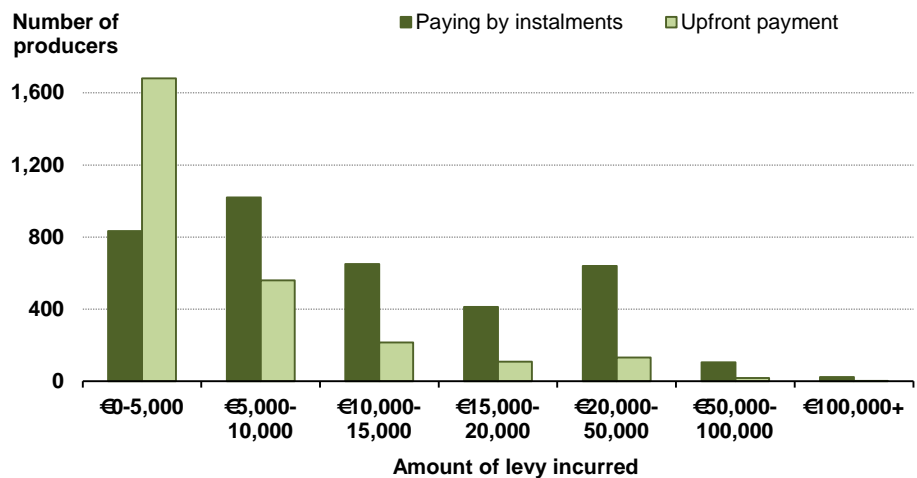


Source: Department of Agriculture, Food and the Marine

- 7.37** The Department paid the milk levy to the EU in November 2015, of which<sup>1</sup>
- €35.6 million had been collected from producers
  - the remainder was sourced from funds the Department had on deposit.<sup>2</sup>

- 7.38** Just over 2,700 producers opted to pay the levy (€16.7 million) to the Department upfront by 1 October 2015. The remaining 3,700 producers paid €18.9 million to the Department by 1 October 2015 and are repaying the balance of €35.6 million in 2016 and 2017. As Figure 7.7 shows, those incurring smaller levies were more likely to opt for upfront payment.

**Figure 7.7 Profile of producers by amount of levy incurred**



<sup>1</sup> The Department paid €70.4 million as Milk Quota Regulations allow member states to retain 1% of the levy owed for cases of default and error.

<sup>2</sup> The Department estimates that it will incur interest costs of around €22,000 in 2016 as a result of the levy payment, as it will be required to borrow more funds to make EU Direct Payments due to farmers. Borrowing will be reported in the EAGF, EAFRD and European Fisheries Fund - Irish Operations account.

Source: Department of Agriculture, Food and the Marine

- 7.39** The Department and processors will continue to operate existing arrangements for the recovery of the milk quota levy.<sup>1</sup>
- 7.40** The Department required producers to sign a legal agreement to avail of the scheme. Key terms of the legal agreement are
- producers must pay at least 10% of the deferred amount in each of the five months from May to September, in 2016 and 2017
  - in the absence of a new payment agreement with the Department, the liability must be repaid early if the terms of the scheme are broken or there is a material change in farming arrangements
  - the full amount of the levy and interest must be immediately paid by the producer where repayments are not made on time
  - where payments have not been made on schedule, the agreement allows the Department to deduct any outstanding amounts from subsequent payments due from the Department.
- 7.41** There was an established practice of milk processors withholding the milk quota levy from payments to producers during the peak production months. This practice avoided the imposition of a large one-off levy on producers and the potential for consequent cash-flow difficulties. Therefore, some producers may have already paid the entire levy to their processor.
- 7.42** Where a processor withheld payment from a producer during the year ended 31 March 2015, the introduction of the instalment scheme may have entitled the producer to a rebate of the payments withheld. The Department stated that levy withholding arrangements are solely a matter between producers and processors. The Department does not have details of the number or value of those arrangements or details of the release of payments withheld by processors after the introduction of the instalment scheme.
- 7.43** The first instalment payment was due in May 2016. In total, over 99% of the €14.2 million payment expected by end-August was received. Thirteen producers have fallen behind in their repayments, totalling €60,000. The Department anticipates that the outstanding monies will be recouped from payments due to eleven producers in late October 2016. The Department has established contact with the other two producers to arrange their repayments.

## Conclusions

- 7.44** The ending of the milk quota regime resulted in a significant levy being incurred by Irish producers resulting in a payment of €71 million by the Department to the EU in 2015. While the Department did publicise the potential magnitude of the levy, it could not control the level of production. The liability for the payment rests with milk producers.
- 7.45** Half the liability was recovered from producers in 2015, and arrangements are in place for the balance to be recouped in 2016 and 2017. Indications are that the systems implemented to collect levy payments from producers are effective.

<sup>1</sup> The Department estimate staff costs to manage the recovery of the levy from producers will be €2,500 per annum in 2016 and 2017.

