Correspondence 3.6
Meeting – 14/07/2011 PAC-R-35



**Secretary General's Statement to the PAC**

**14 July 2011**

Thank you Chairman and members of the Committee for this opportunity to address you today.

I propose, with your agreement Chairman, to outline some of the main events of 2009 from a general as well as a Departmental point of view as a reminder to the Committee of the year in question, to comment on the Appropriation Account itself, to respond to some of the issues covered in the C&AG's Annual Report and, finally, to refer briefly to some current developments.

**Review of 2009**

In 2009 the global economic and financial crisis continued to impact on all areas of the economy including the agri-food and fishing sector where the effects were felt most severely in commodity markets and food and drink exports. Agri-food exports in 2009 were €7.12 billion and, in volume terms, reached 97 % of 2008 levels despite the depressed export environment. In value terms, however, there was a drop of 12% over 2008 which was primarily caused by challenging currency fluctuations, particularly the 13% fall in the value of sterling. Towards the end of the year, there were tentative signs of currency and economic recovery which heralded the increased level of agri-food exports in 2010.

2009 was also a difficult year for the Department. There was a substantial cut in the Department's Vote in 2009 by comparison with 2008 which required policy and scheme changes to be implemented. In July 2009, REPS 4 was closed to new applicants due to budgetary pressures. The Department was also heavily involved in negotiations with the Commission on changes to the Rural Development Programme under which a number of the major schemes implemented by the Department are co-funded. The negotiations led to a substantial revision of the Programme in 2009 involving the development of a new Agri-Environment Options Scheme (AEOS) which prioritised biodiversity, water management, climate change and broadband. In addition, a series of new farm investment schemes known as the Targeted Agricultural Modernisation Schemes (TAMS) were developed and agreed. These schemes were introduced in 2009 and 2010 and included measures for dairy and sheep enterprises, pig welfare, poultry welfare, water conservation and bio-energy.

At a structural or organisational level, the restructuring plan for the Department's local office network was announced by the Minister. The rationalisation plan involves the establishment of 16 enhanced regional offices and the closure of 42 offices to provide an improved service to customers using a more cost effective service delivery model. The restructuring process which is now well advanced will result in an overall reduction of around 400 staff and when completed should result in an annual savings of the order of €30 million.

There were also major successes on the disease eradication front and Ireland achieved Official Brucellosis Free status that year. This is a major achievement and, of course, the ongoing objective is to maintain this status. There are considerable benefits to be had from this particularly in relation to the significant reduction in the cost of testing to farmers estimated at some €7m and savings in testing costs to the Department of some €2.4m. The incidence of bovine TB reduced by 20% in 2009 and while the number of reactors fluctuates annually the overall trend continues to be downwards.

In terms of trade, the economic recession and exchange rate movements were the primary factors influencing the market performance of agricultural commodities generally in 2009 and this was evident in the beef sector where a combination of reduced volumes and lower prices also had an impact on export returns. However, live cattle exports surged to an estimated 286,000 head in 2009 – almost double the level recorded in 2008. The value of this trade grew by around 70% to an estimated at €157million.

Dairy markets remained weak following the decline in 2008, reaching a low point in spring. This weak market situation led to the Commission reintroducing the range of market supports at its disposal. Export refunds were reactivated in January 2009 and were increased during the year before being reduced to zero again by December in response to rising prices. Intervention for butter and SMP continued after reaching the mandatory limits, and was extended beyond the August closing date. Tentative signs of recovery showed in the second half of the year.

For the pigmeat sector, the fallout from the dioxin incident dominated the early part of the year. Considerable work was done to restore international confidence in the safety of Irish pork resulting in the reopening of the majority of markets closed in the immediate aftermath of the incident. Profitability margins for pig producers remained low with feed prices remaining high for most of the year. It was also a difficult year for the cereals sector, with dramatic reductions in both prices and harvest.

The other significant issues dominating were the discussions on the broad outline and principles of the future CAP and the reform of the Common Fisheries Policy. In both cases, an extensive consultation process was initiated nationally to seek stakeholders' views on the most appropriate policies to be pursued by Ireland in future negotiations. This process provided valuable input and continues to influence consideration of the policy options being adopted and exercised.

**Expenditure in 2009**

On the 2009 Appropriation Account itself, the Department had a gross Exchequer expenditure of €1.937 billion to cover actual liabilities across a wide variety of schemes and services.

When appropriations amounting to €408 million, which were mostly EU co-funding transfers, are taken into account, net expenditure was €1.529 billion. In addition, a further €1.347 billion in EU funding was dispensed by the Department in 2009, of which approximately €1.3 billion related to the Single Payment Scheme.

A substantial proportion of expenditure under the Department's Vote covers schemes which are subject to external factors such as demand from beneficiaries, market and economic factors, animal disease incidence, and the pace at which capital investment and research projects are completed. Savings can and do arise due to lower than anticipated drawdown on demand led schemes and for a wide range of other reasons. Conversely, the need for additional spending under particular headings to discharge liabilities can also arise. Every effort is made to ensure that forecasts are as accurate as possible in order to minimise the demands on the Exchequer and, of course, to ensure the maximum return for all monies spent.

Based on on-going review and analysis of expenditure and demands for funding, a decision was taken towards the end of 2009 to seek a Supplementary Estimate, the purpose of which was to make good use of, firstly, €107 million in savings that had been identified in the Vote and, secondly, increased receipts. The Supplementary Estimate did not involve any addition to the Department's net Vote. In addition to the transfer of savings, Dail approval was sought for an increase of €18.437 million on the gross side of the Vote that was matched by additional EU receipts for the same amount. The additional EU co-funding receipts which had not been anticipated when the Estimate was prepared arose from the EU contribution to the cost of the disposal and destruction of livestock and pigmeat product withdrawn from the market in December 2008.

The effect of the Supplementary Estimate, which was approved by the Dail, was that the Department was enabled to make increased budget provisions totalling €125 million to cover the payment of expected maturing liabilities under four demand led budget lines

- REPs, an additional €39 million,
- Farm Improvement Scheme, an extra €15 million,
- Farm Waste Management Scheme, an extra €70 million, and
- the Food Industry Research Measure, an extra €1.288 million.

The final outturn for the year resulted in a saving of just over €65 million on the Supplementary Estimate. These savings arose in a number of areas of the Vote, the largest being under REPs, subhead F. The intention, in seeking the Supplementary Estimate had been to increase expenditure by €39m over the original Vote allocation. However, despite intensive efforts to process as many payments as possible by year end, the increase in expenditure was of the order of €11 million. This was due to the volume of claims, the level of administrative checks required before payments could issue and adverse weather conditions towards the end of the year that disrupted the inspections programme.

I will briefly outline the situation in relation to the other subheads under which significant variations occurred.

Savings of €7.6 million arose within the Department's Administrative budget, including €1.9 million under pay and €2 million on IT services. In fact, by comparison with the original salary budget, savings on salaries for the year were over €9 million due to a combination of factors including, increased age related retirements, retirements under the incentivised early retirement as well as incentivised career breaks and shorter working year schemes.

Under subhead B, which deals primarily with investment in Research and Development, the Department increased its spend to over €15 million on mature liabilities under FIRM, the Food Industry Research Measure. This was an increase of €1.288 million on the original Vote allocation.

Under subhead C, there were savings of just over €16 million spread over a number of budget lines. Approximately €12 million of this related to savings within the animal health area on TB & Brucellosis, BSE and other animal disease measures. This was due to a decrease in disease incidence as well as lower compensation costs as a result of a fall in market prices.

We had approximately €2 million savings under subhead D due to a lower spend on borrowing to fund FEOAG operations.

An additional €3.8 million, funded from savings, was spent on meeting Disadvantaged Area payments. Expenditure on the Early Retirement and Installation Aid Schemes under subhead G was lower than expected resulting in combined savings of €3.1 million.

Subhead H provides funding for the main on farm investment grant schemes, including the Farm Waste Management Scheme. The total expenditure under the subhead in 2009 was in line with the original budget allocation. However, the Supplementary Estimate provided the authority to use the end of year savings to increase expenditure to €293 million on the Farm Waste Management Scheme under subhead H which represented an increase of € million on the original Vote allocation. The use of savings in this way enabled the Department to bring forward some of the second tranche of Farm Waste Management payments which had, for budgetary reasons, been deferred to 2010 under the Financial Emergency Provisions Act, 2009.

Savings under fisheries, subhead J, amounted to €4.4 million and related to a lower spend on foreshore, a lower budget requirement for EAGGF market supports for fish prices and lower than expected draw down of aquaculture and fish processing grants.

Under subhead R which covers a range of budget lines, savings amounted to €2.3 million which arose under the legal cost and quality assurance scheme budget lines.

As I have said, the Department endeavours to forecast expenditure as accurately as possible and to provide in the annual Estimates for anticipated demand for the various schemes we operate. Ultimately, however, expenditure depends on variables I have mentioned already which are to a large extent outside of the control of the Department.

**Annual Report of the C&AG**

The Annual Report of the Comptroller covers a number of issues, the first being the Agricultural Inspections. The C&AG's report highlights two main issues

1. The risk v random outcomes of eligibility inspections where random outperformed risk in 2009, and
2. The overall cost of inspections and average number of inspections conducted weekly.

Before I address the conclusions in the report I believe that it would be helpful to put the inspections regime and the findings in context. Agriculture still accounts for about 45% of the EU Budget and, within that, the main element of EU spending on agriculture and rural development is on direct incomes and market supports. Expenditure under the Single Payment Scheme, which applies throughout all Member States and is 100% funded by the EU, is the single biggest component of expenditure. Ireland's share of the 2009 EU budget amounted to over €1.7bn, €1.3bn of which came through the Single Payment Scheme. In addition, payments under the Rural Development Programme under REPS, Disadvantaged Areas, Early Retirement and Farm Improvement Schemes, all of which are co-funded amounted to €324million.

The direct payments under the Single Payments Scheme are crucial to the farming sector in Ireland. The direct benefit to the farmers concerned and their families is obvious and the reality is that direct payments comprise a high proportion of the income on many farms. The injection of substantial funds also benefits the wider rural economy, enabling a wide variety of businesses, both large and small, to operate successfully.

The key to unlocking the €1.7 billion in EU payments that is channelled to farmers from the EU through the various schemes operated by the Department in 2009 and every year is the inspection system which underpins the payments and provides assurance to the EU commission that the expenditure is in compliance with EU Regulations. Without a robust inspection regime Ireland could not stand over the legality and regularity of payments and severe financial corrections would be imposed by the EU Commission. This is the regime which is the subject of the C+AG's examination and which is described in some detail set out in the report.

**Risk V Random Inspections**

The basis for the inspection regime is, as I have said, strict EU requirements under which the number and type of inspections are prescribed. Under the Single Payment Scheme, the Department is obliged to carry out two types of inspection - land eligibility and cross-compliance. Inspections are selected mainly on the basis of risk assessment but 20/25% of cases must be selected on a random basis.

***Land eligibility***

Five percent or around 7,000 farmers who submit applications for Single Payment Scheme and other direct payments, including the Disadvantaged Areas Scheme, must be checked for eligibility annually. Individual farmers are selected for inspection on a risk assessment or random basis and the checks are generally carried out as one inspection in one of two ways, either by:

- Remote sensing using satellite technology, or
- Ground or field inspections.

In the case of remote sensing, the checks are carried out without the need for an on-farm visit. The reality is that level of problems, due for instance to ineligible features, uncovered during remote sensing checks will generally be lower than that uncovered by the classical ground inspections. The more detailed close scrutiny of a farm by an inspector on the ground is always likely to pinpoint more problems that an image generated by satellite technology. As there is a higher proportion of fields visits involved in the random selection process, the results of inspections tend to be distorted in favour of randomly selected inspections. This explains the apparent anomaly which is commented upon by the C+AG in his report.

I think that an indication of the breakdown in inspections may help to clarify the outcome. Of the inspections carried out under random selection in 2009, 12% were carried out by remote sensing and 88% by field inspection. Under the risk based selection, 68% of inspections were carried out by remote sensing and only 32% by field inspection. The breakdown in each case is dictated by the procedures set down by the Commission. On the basis of the general principle that field inspections will produce a higher rate of problem cases, it is inevitable that the 88% of field inspections under random sample will produce a higher penalty rate than the 32% of field inspections carried out under the risk based selection.

Finally, on this point, the latest situation is that this issue was recently discussed with EU auditors who accepted that the use of remote sensing will distort the results of eligibility inspections in favour of randomly selected cases. Given developments in the meantime, including the improved accuracy of the Land Parcel Identification System and the increased involvement of consultants and advisors at application stage, I can advise the Committee that the error rate in the risk sample for eligibility inspections is now approaching that in the random sample.

### *Cross-Compliance*

While random selected cases produced more penalty cases that risk based selections in eligibility inspections, this is not the case with cross-compliance inspections. The 2009 outcome was not available during the C+AG's audit, however, this is now to hand and in 2009 over 19% of farms selected on the basis of risk received penalties while just over 10% of those selected on a random basis received penalties. This is the more logical outcome and gave rise understandably to the C+AG's comments on the inspections outcomes.

I will provide further clarification on this point later if required.

### **Cost of Farm Inspections**

The C&AG Report also comments on the cost of farm inspections and estimates that the total cost of the farm inspection service in 2009 was €15.8m including direct salary, overheads, imputed pension costs, and travel and subsistence. To put the overall cost in context, it underpins and facilitates the payment of €1.3billion in payments to farmers under the Single Payment Scheme. The cost of inspections identified by the Comptroller covered the cost of all 140 staff in the Integrated Control Division (ICD) and works out at a cost of €1,800 per inspection. The C&AG report is based on the 8,650 cross-compliance and eligibility checks selected as part of the annual selection process that I have already outlined.

I would like, at this stage, to make a number of comments on the C+AG's findings, which let me hasten to add the Department does not dispute. However, we should be clear about what is covered in the C+AG's comments. First of all, besides the direct costs of inspections work, the costings include the full annual cost of the salaries and all associated costs of the staff concerned in the inspections as well as the full cost of local office infrastructure and all its service and back-up costs, from which the inspections staff operate. The calculation also isolates the inspection work of the staff concerned without taking into account the limited timescale within which the inspections are carried out, the other work done by the staff concerned or, indeed, even other inspections that may have been carried out.

The direct cost of inspections to which I referred are the actual salary cost for the number of hours spent by the inspector on the farm, plus the actual cost of travel to and from the farm subsistence, if any, and the time required to complete the inspection report. This calculation would, of course, show a massive reduction in cost by comparison with the C+AG's methodology but I accept that it would not present a full picture of the total cost to the taxpayer.

There are two important points I also want to make in relation to the cost of inspections. Firstly, the Department has the data, procedures and processes in place to identify the actual cost of inspections. This issue is the subject of C+AG comment and I can confirm that capacity is available to analyse the data with a view to securing efficiencies. Secondly, on the latter point, the Department has made substantial progress in reducing the cost of inspections since 2009. Staff numbers are down, travel and subsistence costs have been cut, additional inspections are now being carried out and the overhead, in the form of the local office structure, has been rationalised and the cost reduced.

And of course, we continue to seek further efficiencies. The Department has always accepted the need to avoid duplication of inspections and to maximise efficiencies and has acted accordingly. I would again to emphasise to the Committee that these inspections protect the €1.7bn in payments made to farmers each year. This is an administrative cost of 0.9% to underpin the income platform that determines farmers' livelihoods. All Member States are obliged to carry such administrative costs.

**EU Financial Transactions**

The Annual Report of the C&AG also has a chapter on EU financial transactions for 2009 which, inter alia, details agriculture and rural development funds received in 2009 and the methodology employed by the EU Commission in conjunction with Member States to manage and account for those funds, including EU audits, Court of Auditors audit opinion and irregularities, recoveries and financial corrections which may be imposed.

I am pleased that the Comptroller has noted that Ireland's disallowances in relation to expenditure incurred in the years 1999 – 2008 inclusive amounted to approximately 0.13% of EU funding as compared to a disallowance averaging 1.44% for the EU 15 over the same period. I would also like to take this opportunity to draw the Committee's attention to a recent special report of the Court of Auditors which looks at the issues to be addressed to improve financial management. A précis of the report and a specific letter written to you Chairman by Eoin O'Shea, a member of the Court is complimentary of Ireland stating "Ireland is considered both honest and careful in its performance." In addition he states that there is a strong control environment in the agriculture receipts area involving the Department, the External Auditors and the C&AG.

**State Body Management**

The Annual Report of the C&AG also deals with State Body Management and other than a reference in the Annex relating to Bord Bia, BIM and COFORD in the context of rationalisation there are no specific DAFF related references in the Chapter. Nevertheless, I wish to assure the Committee that the Department is committed to ensuring that the State Bodies that come within its aegis comply with the highest standards required from them, taking particular account of the Guidelines on Corporate Governance issued by the Department of Finance in May 2009.

**Response to the Current Environment**

The operating climate for the agriculture, food fisheries and forestry sector continues to be difficult as a result of the unfavourable economic and financial conditions both at home and in our major trading partners. Exchange rates continue to be unstable and consumer spending continues to be tight. Nevertheless, 2010 was a very positive year for the Irish agri-food sector following a very difficult year in 2009. Exports in the sector have grown faster than many other sectors and are now worth close to €8bn per annum. The cereals and dairy sectors had a particularly good year, while new markets were found for the forestry sector in the UK and for potatoes in Russia.

However we do not underestimate the challenges ahead. A key element of our strategy is implementation of the Food Harvest 2020 report which proposes a strategy of smart green growth that will map the future direction of the agri-food sector for the next decade, a period that will be crucial for the development of a dynamic and forward-looking industry.

I am happy, Chairman, to deal with any questions or comments that the members of the Committee may have.