



Report to the Public Accounts  
Committee on the audit of  
EU funds in Denmark in 2013

September  
2014

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Rigsrevisionen submits this report to the Public Accounts Committee under section 17(2) of the Auditor General's Act, see Consolidation Act No. 101 of 19 January 2012.

The report relates to the following sections of the Danish Appropriation Act section 7. The Ministry of Finance), section 8. The Ministry of Business and Growth, section 9. The Ministry of Taxation and section 24. The Ministry of Food, Agriculture and Fisheries.

In the period during which the examination was carried out, the ministries were headed by the following ministers

*Ministry of Finance*

Bjarne Corydon, October 2011 -

*Ministry of Business and Growth*

Annette Vilhelmsen, October 2011 - August 2013

Henrik Sass Larsen, August 2014 - September 2014

*Ministry of Taxation*

Holger K. Nielsen, October 2012 -

Jonas Dahl, December 2013 - January 2014

Morten Østergaard, January 2014 - September 2014

*Ministry of Food, Agriculture and Fisheries*

Mette Gjerskov, October 2011 - August 2013

Karen Hækkerup, August 2013 - December 2013

Dan Jørgensen, December 2013 -

A draft report was submitted to the Ministry of Finance, the Ministry of Business and Growth, the Ministry of Taxation and the Ministry of Food, Agriculture and Fisheries and their comments are reflected in the final report.

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# 1. Audit opinion

## 1.1. Rigsrevisionen's audit opinion on EU funds in Denmark in 2013

1. This report concerns the audit of EU funds in Denmark in 2013, i.e. the audit of revenue received from the EU and contributions made to the EU.

The first section of the report provides an audit opinion on Denmark's total EU revenue and expenditure and follows up on previous reports on the audit of EU funds.

The second section concerns Rigsrevisionen's examination of the effort made by the Ministry of Food, Agriculture and Fisheries (the Ministry of Food) to improve area control in order to reduce the risk of future financial corrections being imposed on Denmark by the European Commission (the Commission).

2. Rigsrevisionen issues an audit opinion on the Danish EU funds every year. Our audit opinion for 2013 is based on our own audit of the EU funds and on audits performed by the internal auditors at the Danish AgriFish Agency and Ministry of Taxation, respectively, with whom we have entered audit agreements. We supervise the two internal audit functions and conclude that we can rely on their work and their audit opinions on EU funds relating to the policy areas of the Ministry of Food and Ministry of Taxation. The audit opinions issued by the internal auditors are attached to this report as annex 1 and 2.

Our opinion on the EU funds is also based on the outcome of the audit conducted by the certifying body of the two agricultural funds, carried out by the certifying body, and on the European Court of Auditors' (ECA) audit visits in Denmark and the Commission's visits of inspection in Denmark.

*In Denmark, the Guarantee Fund and the Rural Development Fund are audited by a private audit firm on behalf of the Commission. This private audit firm is referred to as **the certifying body**. This task is currently carried out by Deloitte.*

### OPINION ON EU FUNDS IN DENMARK IN 2013

In the opinion of Rigsrevisionen, the 2013 financial statements of EU revenue and EU expenditure have been prepared in accordance with the Danish government accounting rules. The financial statements gives a true and fair view of revenue and expenditure in the financial year audited and of the financial position at the end of the financial year.

Based on the audit findings, Rigsrevisionen concludes that, taken as a whole, the transactions underlying the 2013 financial statements of EU revenue and expenditure are legal, regular and in compliance with the provisions laid down by the Commission and the Council of the European Union.

## OTHER SIGNIFICANT AUDIT FINDINGS

### *Area control*

Our examination of area control shows that there is still a risk that financial corrections will be imposed on Denmark by the Commission. Our assessment is based on a strong probability that Danish farmers will receive payments for grassland areas and grazing of natural habitats that are not eligible for support. It is difficult for the AgriFish Agency to determine whether the farmers comply with the regulations for management and protection of grassland areas and natural habitats.

The AgriFish Agency has taken several steps to enhance area control, including also the control of grassland areas and natural habitats. It is Rigsrevisionen's estimation that the Ministry of Food has taken appropriate action to tackle the risk of financial corrections, although the effect of the effort remains to be seen and the risk of future corrections cannot be eliminated.

### *Errors in the accounts of the Rural Development Fund*

The certifying body (Deloitte) has qualified its opinion on the correctness of the Rural Development Fund's accounts concerning project-based payments. Deloitte detected errors in 18 of 230 audited projects. The errors concerned inadequate documentation, insufficient focus on case processing, failure to adjust payments, inclusion of ineligible expenditure and missing and incomplete documentation of payments. The estimated value of these errors is EUR 0.9 million out of EUR 43.8 million, i.e. an error rate of 2.1 per cent, which is 0.1 per cent above the level accepted by the Commission.

In its annual activity report, the Commission's Directorate General for Agriculture and Rural Development estimates the error rate for the entire Danish rural development programme in 2013 at 6.6 per cent. The director-general has therefore qualified its declaration of assurance in this area.

The project-based schemes under the Rural Development Fund account only for a small part of the total funding available in the policy area administered by the Ministry of Food. Therefore, the error rates estimated by the certifying body and the Commission's Directorate General for Agriculture and Rural Development do not give Rigsrevisionen cause to qualify its overall opinion on EU funds in Denmark.

### *Cross-compliance control*

The Ministry of Food has informed Rigsrevisionen that it has been decided to introduce a new control framework for cross-compliance control as part of the Growth Plan from April 2014; cross-compliance control will be centralised and the full responsibility for environmental and animal welfare control in Denmark will be placed on the AgriFish Agency from 2015. With this change, the agency will become responsible for controlling compliance with all cross-compliance requirements, as recommended by Rigsrevisionen in its report on the audit of EU funds in Denmark in 2011.

3. The Danish government accounts for 2013 included a statement of revenue received from the EU and contributions made by Denmark to the EU budget, produced by the Ministry of Finance. This statement is reproduced in table 1.

**Table 1. EU revenue and EU expenditure in 2013  
(EUR million)**

<b>EU revenue:</b>		
<b>Agricultural and structural funds</b>		<b>1,087.3</b>
The European Agricultural Guarantee Fund	923.0	
The European Agricultural Fund for Rural Development	108.3	
The European Social Fund	22.6	
The European Regional Development Fund	17.0	
The European Fisheries Fund	16.5	
<b>EU programmes outside the agricultural and structural funds</b>		<b>25.3</b>
Research and innovation	6.8	
Education and training	0.6	
Transport infrastructure	17.9	
<b>Other EU revenue</b>		<b>30.0</b>
<b>Total EU revenue</b>		<b>1,142.6</b>
<b>EU expenditure:</b>		
<b>Earmarked funds</b>		<b>0.3</b>
Contributions to the Helsinki Commission	0.3	
Contributions to the European Environmental Agency	0.02	
<b>Taxes and levies</b>		<b>2,904.6</b>
Contributions calculated on the basis of the gross national income	2,168.1	
Contributions calculated in accordance with the joint basis of calculation for value added tax	440.4	
Share of custom duties and agricultural fees and levies less collection costs	291.0	
Contributions calculated on the basis of the gross national income	5.1	
<b>Total EU expenditure</b>		<b>2,904.9</b>

Note: Rate of exchange EUR 1 = DKK 7.45. Totals do not add up due to rounding.

Source: The Danish Government Accounts 2013.

It appears from table 1, that the Danish government received approximately EUR 1.2 billion from the EU and contributed approximately EUR 2.9 billion to the EU budget in 2013.

The majority of the revenue that Denmark receives from the EU is generally provided through the agricultural and structural funds and in 2013 revenue from these sources amounted to EUR 1.1 billion. The government serves as the connecting link in financial transfers between the EU agricultural and structural funds, and the final beneficiaries. The AgriFish Agency under the Ministry of Food is responsible for the administration of payments from the European Agricultural Guarantee Fund (the Guarantee Fund), the European Rural Development Fund (the Rural Development Fund) and the European Fisheries Fund (the Fisheries Fund). The Danish Business Authority handles payments from the European Social Fund and the European Regional Fund. EU programmes outside the framework of agricultural and structural funds received EUR 25.3 million as direct payments from the Commission to the national beneficiaries. Other EU revenue of in total EUR 30.0 million was transferred from the Commission to the Danish government.

EU expenditure can be divided into two categories, *earmarked expenditure* of EUR 0.3 million and *taxes and levies* of EUR 2.9 billion. Earmarked expenditure is Denmark's direct contributions to programmes and projects outside the general EU budget. Taxes and levies are Denmark's contributions to expenditure included in the EU budget.

4. The Commission's direct payments to private and independent institutions and organisations are not included in table 1. Rigsrevisionen's review of these payments showed that in 2012 the Commission transferred approximately EUR 268 million to institutions of this kind in Denmark, which appears also from the Commission's statement of EU expenditure and revenue for Denmark. The statement for 2013 had not been published when this report was submitted to the Danish Public Accounts Committee.

5. Rigsrevisionen has in this report focused on the Ministry of Food's effort to minimise the risk of financial corrections being imposed on Denmark in relation to area-based schemes under the Guarantee Fund and the Rural Development Fund. Most of the EU revenue received by Denmark is channelled through the area-based schemes and we are of the opinion that there is still a risk that major financial corrections will be imposed on Denmark in this area.

Rigsrevisionen has also submitted a report to the Public Accounts Committee on Denmark's absorption of EU funds (report no 23/2013), which was covered by our audit of EU funds in Denmark in 2013.

It should be noted that the opinions issued by the internal auditors at the AgriFish Agency and the Ministry of Taxation in combination with Rigsrevisionen's audit, provide the basis for the general assessment of the area that is reflected in the audit opinion.

## 1.2. Follow-up on previous reports on the audit of EU funds

### Errors in the accounts of the Rural Development Fund

6. In its audit report for the EU accounting year 2012 the certifying body expressed reservations about the correctness of the accounts concerning project-based support provided through the Rural Development Fund. The errors detected had a value of EUR 3.6 million out of the total expenditure of EUR 43.1 million, which corresponds to an error rate of 8.3 per cent. Most of the errors were related to the fact that the beneficiaries had failed to erect and maintain notice boards that informed the public that projects were EU co-financed. The certifying body decided that this offence should trigger a penalty of 100 per cent of total payments executed.

7. The certifying body detected errors in 18 out of 230 audited projects and therefore expressed reservations concerning this part of the Rural Development Fund's accounts for the EU accounting year 2013. The value of the errors in the accounts is estimated at EUR 0.9 million out of a total of EUR 43.8 million. This corresponds to an error rate of 2.1 per cent, i.e. 0.1 per cent above the Commission's threshold of 2 per cent.

The audit carried out by the certifying body identified significant errors relating to inadequate documentation, insufficient focus on case processing, inadequate correction of payments, inclusion of not eligible expenditure and missing and incomplete documentation of payments.

8. The drop in the error rate from 8.3 per cent in 2012 to 2.1 per cent in 2013 mainly reflects that the AgriFish Agency has changed its practice concerning the size of penalties that can be imposed on beneficiaries who fail to erect and maintain notice boards informing of EU co-financing. The AgriFish Agency has developed new guidelines according to which serious breaches of the notice board rules may trigger a penalty of 5 per cent of the amount received, but maximum EUR 50,000. The AgriFish Agency has informed Rigsrevisionen that the positive development in the error rate follows improvements in case processing and in the control following the implementation of the agency's action plan for 2012-2013. The Ministry of Food expects to see further improvements in the wake of the reorganisation of the administrative control and the introduction of a new requirement, according to which the applicants are obliged to forward all vouchers to the AgriFish Agency.

9. The Commission's Directorate General for Agriculture and Rural Development states in its annual activity report, that the error rate for the entire Danish rural development programme is 6.6 per cent in 2013 and that the action plans do not address all the deficiencies identified and should therefore be strengthened. The director-general has therefore issued a qualified declaration of assurance in this area. The error rate estimated by the Directorate General is not comparable with the error rate estimated by the certifying body. The error rate of 6.6 per cent is composed of data derived from the AgriFish Agency's statistical control data, which shows an error rate of 3.3 per cent for the Rural Development Fund, and the outcome of the audits carried out in Denmark by the Commission and European Court of Auditors in the last couple of years.

*The Directorate General for Agriculture and Rural Development is – with a staff of around 1,000 and headed by a Director General – responsible for the implementation of the CAP and the development of the rural areas in the EU. The Directorate General issues an annual activity report, which also includes an assessment of how effectively the Member States manage EU funds.*

Programmes under the Rural Development Fund account for a small amount of the total EU funds managed by the Ministry of Food. Therefore, the error rates estimated by the certifying body and the Commission's Directorate General for Agriculture and Rural Development do not give Rigsrevisionen cause to qualify its overall audit opinion on the Ministry of Food.

#### **Emphasis of matter section on cross-compliance control in 2011**

10. In the report on the audit of EU funds in Denmark in 2011, Rigsrevisionen concluded that the number of cross-compliance controls in certain municipalities was out of proportion to the number of cross-compliance breaches. The AgriFish Agency came to the same conclusion and identified a number of municipalities that had consistently for several years reported very few or no farmers to the agency for breaking the cross-compliance requirements.

The Danish authorities had decided that the local authorities should carry out most of the environmental cross-compliance controls. According to the Ministry of Food, this set-up prevented the ministry from supervising the control performed by the local authorities. In the report, Rigsrevisionen recommended that cross-compliance control should be re-organised and the overall responsibility for the control placed on a central authority in order to achieve the required level of consistency in the control performed.

11. In April 2014, the Danish government agreed with the Liberal Party, the Danish People's Party, the Liberal Alliance and the Conservative Party on a growth plan for the food industry. A decision to centralize cross-compliance control in 2015 was adopted as part of the growth plan.

12. With effect from 2015, the AgriFish Agency will therefore take over cross-compliance control from the local authorities and thus become sole responsible for controlling compliance with all cross-compliance requirements. The agency is currently implementing the decision.

13. Rigsrevisionen finds these initiatives satisfactory and will follow up on the progress of the new cross-compliance control framework.

**Consolidated EU accounts**

14. In the report on the audit of EU funds in Denmark in 2011, we referred to our previous discussions with the Ministry of Finance on the possibility of publishing consolidated financial statements of EU funds in Denmark. The intention was for the Ministry of Finance to present consolidated accounts for all EU funds included in the government accounts. The consolidated financial statements would include a profit and loss account, balance sheet, cash flow statement and explanatory notes, and would thus serve to shed light on the various financial aspects of the transactions between the Danish state and the EU.

15. The first step in the development of consolidated financial statements is the development of financial statements for agricultural EU payments managed by the AgriFish Agency, which constitute the largest source of EU revenue for Denmark. This should have been ready in the spring 2014, covering the fiscal year 2013. According to the plan, the next step should be the development of financial statements in the spring 2015, covering all EU payments received by Denmark including the structural funds that are managed by the Danish Business Authority.

16. In June 2014, the Ministry of Finance informed Rigsrevisionen that it was behind schedule and would not be able to develop consolidated EU accounts for 2013 for the agricultural policy area. However, the ministry expects to present consolidated financial EU statements for 2014, covering all EU funds included in the Danish government accounts, in the spring 2015.

## 2. Introduction and conclusion

### 2.1. Purpose and conclusion

17. In this report, Rigsrevisionen has focused on examining and assessing the effort made by the Ministry of Food and the AgriFish Agency to enhance the control of area-based payments in order to minimise the risk of future financial corrections being imposed on Denmark by the Commission. The AgriFish Agency is responsible for executing payments to the Danish farmers from the Guarantee Fund and the Rural Development Fund.

18. In recent years, the Commission has imposed financial corrections on Denmark due to weaknesses in the control of area-based payments detected during the Commission's inspections in Denmark. The largest correction of EUR 101 million was imposed in 2009 based on the Commission's visit in 2004. This correction is generally referred to as the hectare aid correction. Denmark has received large corrections relating to the area-based schemes also after 2009.

The Commission has charged financial corrections to Denmark regularly and area-based payments are therefore considered a financially risky area by Rigsrevisionen. In addition to that, a consultancy report commissioned by the AgriFish Agency concluded in 2013 that there is a risk that the amount of financial corrections charged to Denmark will increase in the future, if the control of payments under the Single Payment Scheme is not improved.

19. The purpose of the examination is to map and assess the effort made by the Ministry of Food to minimise the risk of corrections. The report addresses the following issues:

- What is the background for and the process followed by the Commission when financial corrections are charged to Denmark in relation to the Single Payment Scheme?
- Are the Danish controls underpinning payments under the Single Payment Scheme and are they contributing to ensuring that payments are made on a correct basis?
- Has the Ministry of Food taken appropriate steps to minimise the risk of financial corrections?

*The Commission recovers ineligible expenditure by imposing **financial corrections**. Financial corrections are imposed when the results of the Commission's audit findings in, for instance, Denmark on the use of EU funds, indicate that the control of payments carried out by the Danish authorities has fallen short of the EU rules and standards.*

## CONCLUSION

Weaknesses in the control of area-based payments detected during the Commission's inspections in Denmark in the period 2002-2013 led to financial corrections of in total EUR 134.2 million of which EUR 101 was related to the hectare aid scheme.

Rigsrevisionen has established that the Commission detected weaknesses in the reference parcel system, remote sensing and in on-the-spot checks. The Commission also found that the AgriFish Agency had failed to implement controls to check that the beneficiaries comply with all eligibility requirements.

The examination shows that the Danish authorities have in some cases succeeded in reducing the amount of the corrections through dialogue with the Commission and by providing solid supplementary calculations of the financial risk to the EU funds.

Rigsrevisionen has established that the control of area-based schemes has improved. As per February 2014, the AgriFish Agency has ensured that all reference parcels have been updated within the preceding three years. Access to better aerial photos and more diligent scrutiny of the photos have also enhanced the quality of remote-sensing control. The internal quality assurance of remote-sensing control showed that errors still occur, but that they are of minor financial significance.

However, the Commission may charge financial corrections to Denmark because on-the-spot checks still reveal significant over declaration of eligible land and high error rates in relation to schemes concerning grassland areas and natural habitats. This means that Danish farmers may receive payments for ineligible grassland areas and natural habitats – in particular in relation to the schemes under the Rural Development Fund and the specific Article 68 schemes. It is Rigsrevisionen's estimation that it is difficult for the AgriFish Agency to determine whether the farmers are complying with the regulations for the management and protection of grassland areas and natural habitats.

The Danish eligibility requirements in relation to claiming payment for grassland areas and natural habitats include several requirements concerning the protection of nature and the environment, and are quite complex. It follows that also the requirements that the farmers are expected to meet when they apply for payments under the individual schemes are quite complex. The farmers find it difficult to ensure that they comply with the current rules, and the inspectors are not to the extent necessary able to determine and check whether the farmers comply with the regulations – including the regulations for management and protection of grassland areas and natural habitats. The Commission also checks whether the Danish rules are being fulfilled when these are incorporated in the eligibility requirements. The complexity of the Danish regulations increases the risk that corrections are imposed on Denmark.

Rigsrevisionen finds it satisfactory that the Ministry of Food has launched several initiatives to improve the control of area-based schemes. Rigsrevisionen has established that steps have been taken to improve the LPIS (land parcel identification system), remote-sensing control and on-the-spot checks. The Ministry of Food is planning to apply a variety of control measures in order to strengthen, among other things, the control of grassland areas and natural habitats. It is Rigsrevisionen's estimation that these initiatives will address the weaknesses detected by the Commission during its visits in Denmark and the challenges concerning area control detected by Rigsrevisionen.

## RECOMMENDATIONS

In order to support the Ministry of Food's effort to reduce the risk and amount of financial corrections, Rigsrevisionen recommends that

- the Ministry of Food should continue the current proactive dialogue with the Commission concerning financial corrections and continue to provide supplementary information and calculations, as this approach may have a positive effect on the amount of the corrections that the Commission charges to Denmark.
- the Ministry of Food should consider whether the Danish regulations could be simplified without abandoning the environmental considerations. If the Danish regulations regarding payment for grassland areas and natural habitats can be rephrased to make it easier for the farmers and inspectors to determine compliance with the eligibility requirements, the risk of ineligible payments will be reduced and thus also the risk of future financial corrections being imposed by the Commission.

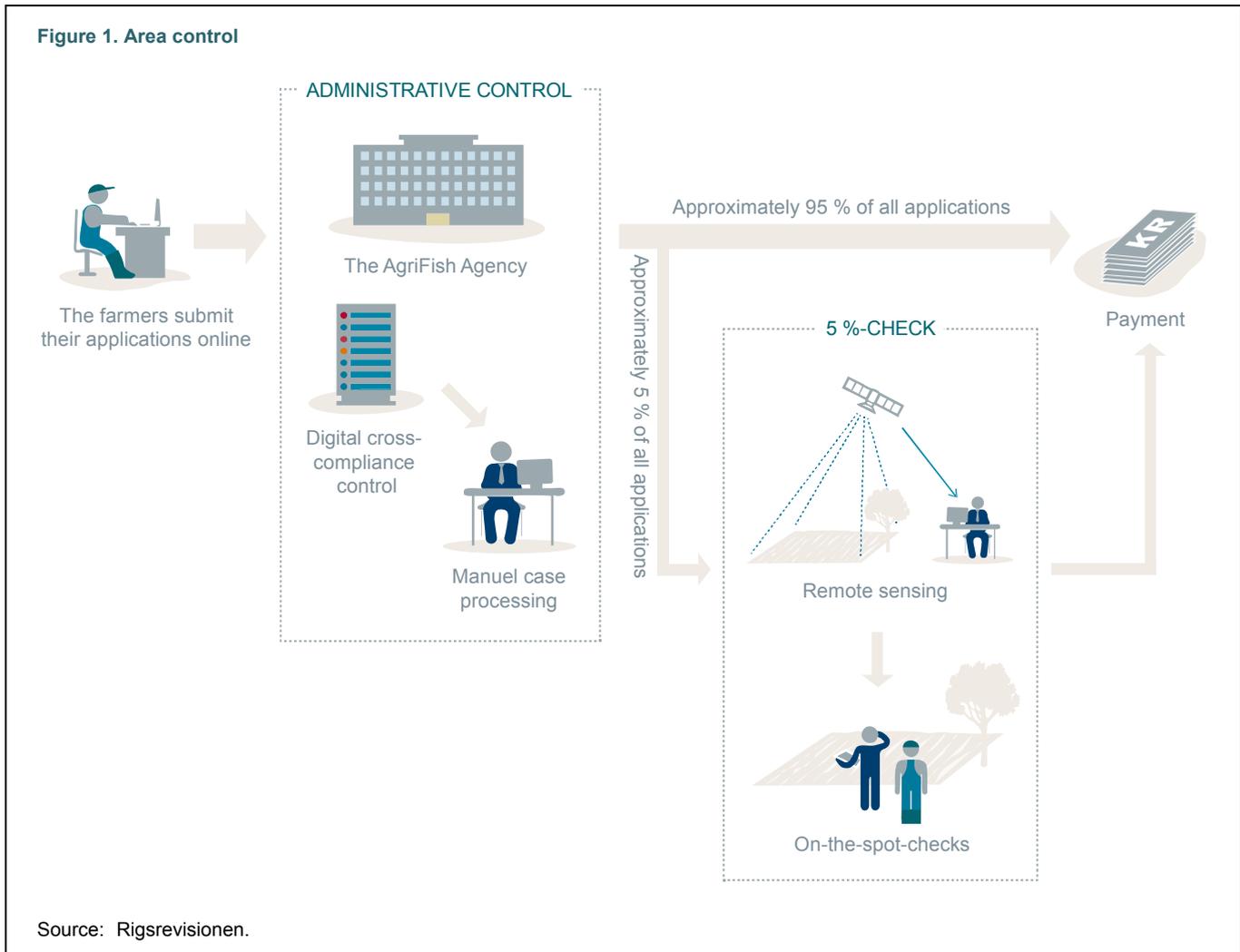
## 2.2. Background

### **Area control is composed of three controls**

20. In connection with the corrections imposed on Denmark, the Commission has criticised the control carried out by the AgriFish Agency. The Commission is of the opinion that weaknesses in some of the controls increase the risk that farmers will receive payment for ineligible land. The area control is composed of several controls, which combined are designed to contribute to ensuring that the payments executed to the farmers are correct. The area control procedures have been drawn up on the basis of Council regulations and the Commission's supplementary regulations and guidelines.

The EU regulations on area control are also implemented through Danish laws and regulations, which define the control procedures to be followed in Denmark. The Danish authorities are therefore responsible for organising the control effectively and efficiently and in a manner, that ensures that the farmers comply with the eligibility requirements of the individual area-based schemes.

21. Figure 1 shows how the various control measures are interlinked.



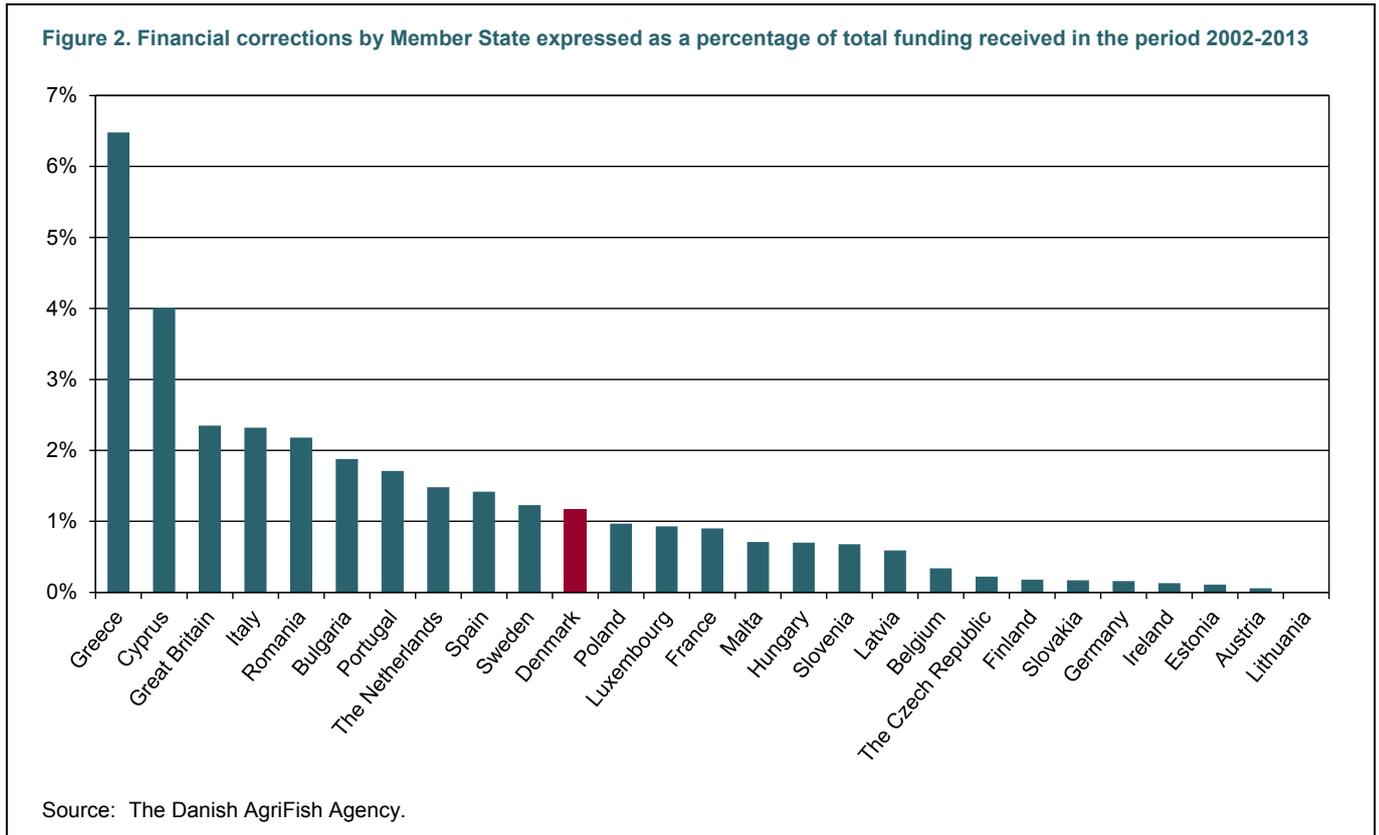
The farmers' applications provide the basis for the control that is carried out before payments are executed. The control includes the following elements:

- The farmers submit their applications online to the Danish AgriFish Agency through the Ministry of Food's web-based field map system (the Danish Land Parcel Identification System (LPIS)), which includes field maps, reference parcels and aerial imagery.
- The AgriFish Agency carries out administrative control by way of digital cross controls and manual case processing. All applications are subjected to digital cross control, whereas manual control is applied only when there are deviations between the data stated in the application and the data in the LPIS.
- Approximately 95 per cent of all payments are executed on the basis of the administrative control.
- The remaining approximately five per cent of the farmers' applications are selected for the so-called 5 per cent check, which includes:
  - Remote-sensing control of all fields referred to in the applications. The results of this exercise helps target the subsequent checks at the farms.
  - On-the-spot inspections at the farms.

22. The purpose of the overall area control is to ensure that payments to the farmers are executed in compliance with EU regulations as well as Danish rules. Corrections are imposed by the Commission based on an assessment of the effectiveness and efficiency of the individual controls in the overall Danish area-control framework in ensuring that payments are in compliance with the relevant EU regulations and the Danish rules.

### Financial corrections in the period 2002-2013

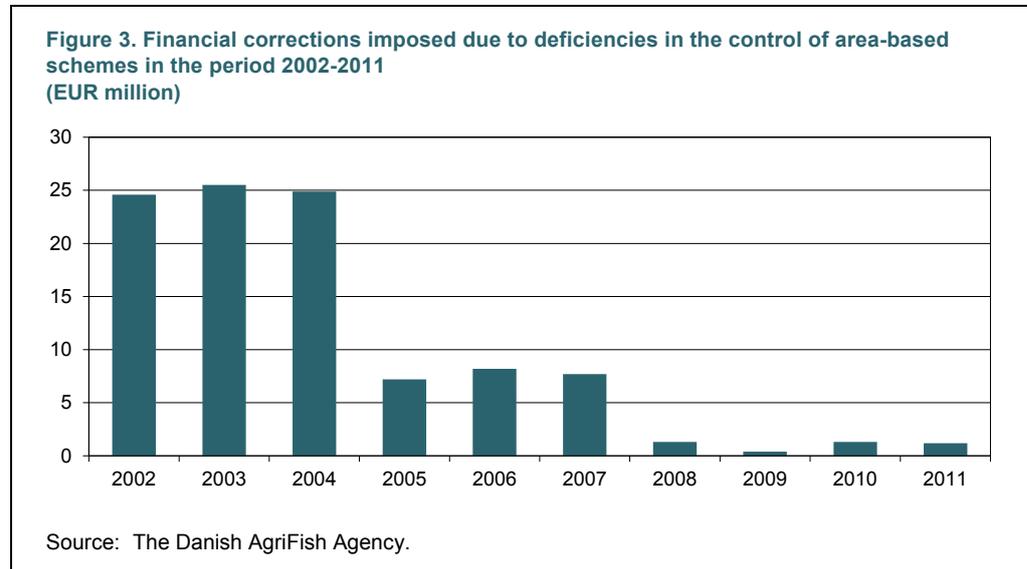
23. The AgriFish Agency has prepared an overview of all corrections imposed on Denmark and the other Member States in the period 2002-2013. Figure 2 shows corrections by Member State expressed as a percentage of total funding received.



The figure shows wide variation between the Member States. Relatively large corrections have been imposed on, for instance, Greece, whereas very small corrections – compared to funding received – have been imposed on other Member States. The financial corrections imposed on Denmark in the period represented 1.2 per cent of total funding received, which is 0.2 per cent lower than the average of 1.4 per cent for all Member States.

24. In the period 2002-2013, corrections imposed on Denmark amounted to approximately EUR 153.3 million. Corrections relating to the area-based schemes accounted for EUR 134 million – or 87 per cent – of this amount.

25. The AgriFish Agency has also elaborated an overview (figure 3) of the amounts of the financial corrections imposed on Denmark due to deficiencies in the control of area-based schemes in the period 2002-2011. Payments executed under the area-based schemes for the years 2012 and 2013 have not yet been checked by the Commission and are therefore not included in the summary.



It appears from figure 3 that the amounts of the financial corrections have dropped significantly during the period and remained stable since 2008 on a considerably lower level than in the past. The figures clearly reflect the hectare aid correction concerning the years 2002, 2003 and 2004 that resulted in exclusion of expenditure of EUR 101 million in 2009.

Despite the considerable decrease in financial corrections from 2002 to 2011, the AgriFish Agency is of the opinion that area control should be further enhanced to reduce the risk that large financial corrections are imposed on Denmark by the Commission in the future.

### 2.3. Delimitation, audit criteria and method

#### Delimitation

26. All area-based schemes under the Guarantee Fund and Rural Development Fund that are managed by the AgriFish Agency are subject to area control. For this examination, we have selected the schemes where potential financial corrections would have great financial implications for Denmark.

27. With respect to the Guarantee Fund, our focus has been on the largest scheme, the Single Payment Scheme (SPS), which funded payments of EUR 899.3 million in 2013. We have also focused on the specific area-based payments provided under Article 68 to extensive farming and maintenance of permanent pastures. In 2013, payments executed to farmers under the Article 68 schemes amounted to EUR 18.2 million.

The Danish farmers also received area-based payments from the Rural Development Fund in 2013. In the report, we focus on the three schemes that concern environmentally friendly agricultural production, conversion to organic agricultural production and agri-environmental farming. These are – in financial terms – the most significant area-based schemes under the Rural Development Programme. In the report, they are referred to collectively as RDP schemes. In 2013, Danish farmers received total payments of EUR 32.2 million from the RDP schemes.

28. This examination is focused only on the controls that have been criticised by the Commission and led to financial corrections. Our focus will therefore be on the LPIS, reference parcels, remote sensing and on-the-spot checks, and not on the administrative control.

#### **Audit criteria and method**

29. The purpose of the examination is to map and assess the effort made by the Ministry of Food to minimise the amounts of the financial corrections that are imposed on Denmark. The audit criteria applied are therefore reflecting the rules and principles that guide the Commission in its assessment of the Member States' administration of the EU regulations.

The Commission applies financial corrections when national authorities fail to establish essential controls in accordance with the EU rules like, for instance, a system for registration of reference parcels. The rules on controls are included in the Council's regulation on "*establishing common rules for direct support schemes for farmers under the common agricultural policy and establishing certain support schemes for farmers*".

The point of departure for the examination is an assessment of whether the Ministry of Food and the AgriFish Agency are complying with the EU regulations and Danish rules governing the area.

We have also examined whether Denmark has established the controls required by the EU regulations and we have considered whether the steps taken by the AgriFish Agency to improve the control procedures address the criticism that has been raised by the Commission and led to the financial corrections.

The audit has been performed in compliance with good public-sector auditing practice, cf. box 1.

#### **BOX 1. GOOD PUBLIC-SECTOR AUDITING PRACTICE**

Good public-sector auditing practice is based on the fundamental auditing principles (ISSAIs 100-999) of the International Standards of Supreme Audit Institutions

30. In section 3 of the report, we look into the Commission's reasons for imposing financial corrections on Denmark in relation to area control. In section 4, we present our assessment of whether the Danish area-control procedures worked appropriately in 2013 and served to ensure that payments were executed to the farmers on a correct basis. Section 5 presents our assessment of whether the Ministry of Food has taken appropriate steps to improve the control and reduce the risk of future financial corrections.

31. We have interviewed staff at the AgriFish Agency who have been involved in either the Commission's or ECA's audit visits, are working to strengthen the agency's area control or processing applications. We have also reviewed four cases of financial corrections and looked at the initiatives launched to improve area control, which are based on the consultancy report that was commissioned by the AgriFish Agency in 2013.

Applications for area-based payments are subjected to various controls and these have been reviewed in collaboration with relevant staff at the agency. We have also looked at 24 cases, 12 of which concerned payments from the Guarantee Fund and the Rural Development Fund.

### 3. Financial corrections imposed for irregularities in the control of area-based payments

Financial corrections imposed for irregularities in the control of area-based payments are imposed when the Commission finds that, for instance, farmers have received payment for claims on land that is not eligible for support for the following main reasons:

- the LPIS and reference parcels were not updated and therefore included land that was not eligible for support;
- remote sensing was inaccurate and resulted in overstatement of the size of eligible land;
- the inspectors did not have the skills required to assess the eligibility of the land;
- the Danish rules did not comply with the EU rules.

The examination shows that the Danish authorities have managed to reduce the amounts of the financial corrections through dialogue with the Commission and submission of solid supplementary calculations of the potential maximum financial risk to the EU budget.

#### 3.1. The Commission's application of financial corrections

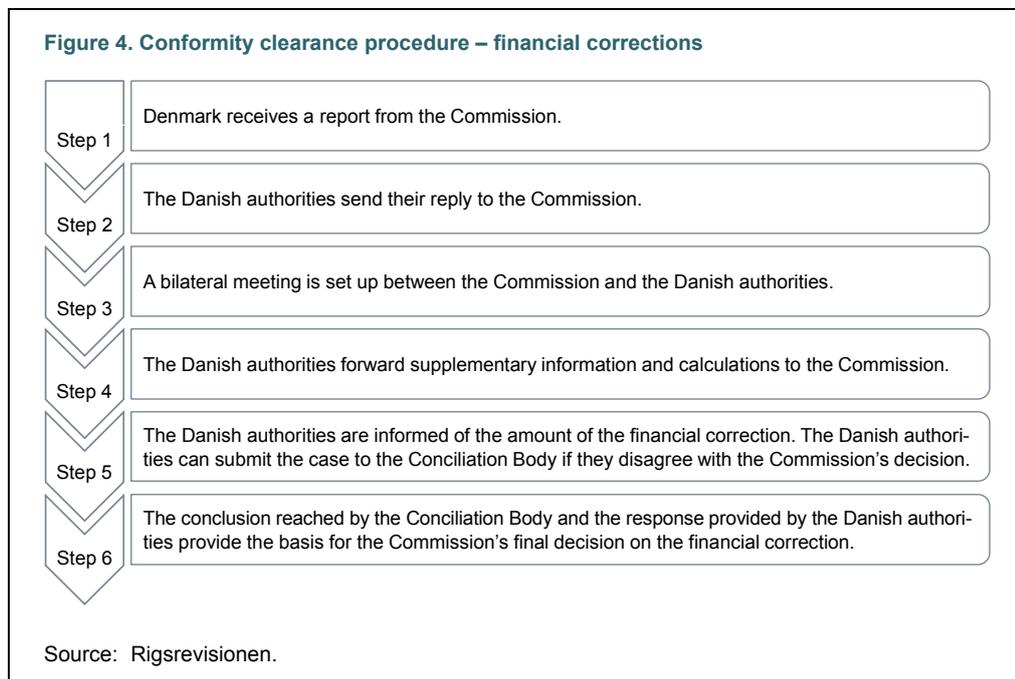
32. This section describes the Commission's conformity clearance procedure for the application of financial corrections, explains why the Commission applies flat-rate corrections, and presents the background for the financial corrections that have been imposed on Denmark.

##### **Financial corrections are applied on the basis of the audits performed by the Commission in the Member States**

33. Every year, the Commission audits payments executed to the beneficiaries in the Member States in past years. The audit visits are planned on the basis of a risk analysis of all agricultural expenditure broken down on funds, schemes and Member States. The results of this risk analysis provide the basis for the Commission's planning of its audit visits the subsequent year. The control carried out by the Commission is referred to as compliance checks and its purpose is to exclude expenditure that is not complying with the Community rules, from financing. The Commission's audits are focused on the administrative management and control carried out by national authorities.

The scope, nature and gravity of the irregularities and their financial implications for the Community determine the amount of expenditure that the Commission decides to exclude from financing.

34. Figure 4 illustrates the six steps of the procedure for imposing a financial correction on a Member State.



*The Conciliation Body resolves disputes between the Commission and Member States concerning the basis for and size of financial corrections. The Conciliation Body draws up a report with recommendations, which the Commission is not under any obligation to follow.*

Under step 1, the Commission informs the Member State (Denmark) of the risk that payments have been executed for land that does not meet the EU and Danish regulations on eligibility. The Commission also indicates the corrective measures, which the Member State should take to ensure compliance with the regulations in the future. Under step 2, the Member State provides its response to the Commission's report. Under step 3, the Commission arranges a bilateral meeting with the Member State where both parties shall endeavour to reach an agreement on the gravity of the infringement and the financial damage caused to the EU budget, and the amount of the financial correction. Under step 4, the Member State is requested to send any supplementary information to the Commission and under step 5, the Commission informs the Member State of its conclusions concerning the amount of the financial correction it intends to impose on the Member State. If the Member State does not agree with the Commission's conclusions, the case can be submitted to the Conciliation Body, which will draw up a report with its recommendations. Under step 6, the Commission will consider the information provided by the Member State and any recommendations made by the Conciliation Body and decide on the final amount of the financial correction.

#### **The majority of financial corrections imposed by the Commission are flat-rate corrections**

35. Generally, the Commission determines the amount of financial corrections after an assessment of the financial risk to the Community. If it is not possible to determine the financial risk, a flat rate will be applied. Flat-rate corrections are also applied in instances when no specific loss for the Community has been demonstrated, but the Commission merely estimates that there is a risk of a loss.

36. Systems-based auditing is the methodology most frequently used by the Commission for assessment of whether the management and controls established by the national authorities ensure compliance with the EU regulations. This approach makes it difficult to estimate the exact amounts that should be excluded from financing and therefore the Commission often applies a flat-rate penalty, i.e. a penalty of a fixed percentage of the total funding provided under the respective scheme.

The scope of error and deficiencies detected during the audit of the various controls determines the flat-rate correction. Controls are divided into two categories, i.e. key controls and ancillary controls. Key controls are the checks required to establish, for instance, whether a land parcel identification system (LPIS) has been established for registration of the farmers' land, whereas ancillary controls are the administrative functions required to ensure correct processing of claims like, for instance, procedures to verify that applications have been correctly filled out and are including the required information.

37. According to ECA's latest estimate, flat-rate corrections account for 92 per cent of all financial corrections imposed on Member States.

#### BOX 2. FLAT-RATE CORRECTIONS

*A flat-rate correction of 25%* is imposed if a Member State has no control system, or the control system is gravely deficient and there is evidence of widespread irregularity and negligence in tackling irregular or fraudulent practices.

*A flat rate of 10%* is imposed when one or more key controls are not applied or applied so poorly or infrequently that they are ineffective in determining the eligibility of a claim.

*A flat rate of 5%* is imposed when all key controls are applied, but not in the number, frequency or depth required.

*A flat rate of 2%* is imposed when a Member State has applied the key controls appropriately, but has failed to apply one or several ancillary controls.

Source: The Commission.

### 3.2. Financial corrections imposed on Denmark for deficiencies in area control

38. In this section, we focus on lessons learnt from four financial corrections imposed by the Commission. We also provide an assessment of whether Denmark's strategy for tackling these financial corrections has been appropriate.

#### The four financial corrections

39. We have reviewed the following four cases concerning financial corrections in order to establish what triggers the Commission's decision to apply financial corrections for deficiencies or irregularities in area control:

- financial correction of EUR 101 million from 2009 concerning hectare aid received in the period 2002-2004;
- financial correction of EUR 20.3 million concerning the SPS for 2005 and 2006;
- financial correction of EUR 11.5 million imposed in 2013 following the Commission's audit of the SPS and RDP schemes for the period 2007-2009;
- financial correction of EUR 3.4 million from 2014 following the Commission's audit of the SPS and RDP schemes for 2010 and 2011.

#### Hectare aid received in the period 2002-2004

##### *Amount of financial correction*

40. The largest financial correction ever imposed on Denmark was the hectare aid correction of EUR 101 million from 2009. EUR 99.5 million of the EUR 101 million was excluded from EU financing due to weaknesses detected in the control of compliance with the regulations concerning land set aside.

*Reasons for the financial correction*

41. Upon inspection of land set aside, the Commission found that this land had been returned to nature after having been set aside for many years without any requirements to mow sprouting plants, etc. Therefore, the Commission questioned the status of the land as agricultural farmland, which could be brought into agricultural production again directly. The Commission found that some of the land set aside was used in a manner that violated the regulations governing set-aside land. For instance, the Commission detected fields scattered with debris. The Commission therefore concluded that the Danish rules on maintenance of set-aside land did not reflect the regulations of the EU correctly.

The Commission also criticised that the control of land had largely been based on poor quality satellite remote-sensing imagery.

42. The Danish authorities decided to bring the case before the General Court, which is the court of first instance in the EU court system. However, the General Court upheld the Commission's decision concerning repayment of the hectare aid in 2012 and Denmark therefore appealed to the European Court of Justice. A final ruling is expected in the autumn 2014.

**Audit of the SPS for 2005 and 2006***Financial corrections*

The Commission audited the SPS on its visit in Denmark in 2006, which led to a financial correction of EUR 20.3 million imposed on Denmark in 2010.

*Reasons for the financial correction*

43. The Commission criticised that the Danish LPIS included large ineligible areas that might have led to irregular payments to beneficiaries. The Commission also found that land set aside, waste land and permanent pastures that were not eligible for support had been approved by the AgriFish Agency in connection with the remote-sensing control and subsequent physical inspections.

44. The Danish authorities conceded that there were weaknesses in the Danish LPIS, remote sensing and physical inspections, but considered the risk to the EU fund limited and too low to justify a flat-rate correction of the amount proposed.

*Negotiations with the Commission*

45. In 2010, the Commission notified Denmark of a pending total flat-rate correction of approximately EUR 39.8 million for the period 2005-2006. The correction consisted of a flat rate of 5 per cent for area-based payments for permanent pastures, land set aside and waste land, which was considered risky, and a flat-rate correction of 2 per cent for the remaining areas that were considered less risky.

46. For the first time, the Danish authorities decided to enter into negotiations with the Commission in order to reduce the amount of the correction. Following extensive analysis of the maximum risk to the fund, the Danish authorities succeeded in convincing the Commission to reduce the amount of the correction from EUR 39.7 million to EUR 20.3 million. This result was achieved, among other things, because the Danish authorities had made very precise calculations in relation to the areas that were seen to represent a risk of losses to the EU fund, i.e. permanent pastures, land set aside and waste land. The Commission also decided to convert the original 2 per cent flat-rate correction concerning the remaining areas to a minor financial correction, when the Danish authorities had demonstrated that these areas represented only a limited risk of loss to the fund.

**Audit of the SPS and the RDP schemes in the period 2007-2009***Amount of financial correction*

47. The Commission audited the SPS and the RDP schemes in the period 2007-2009, which led to a financial correction of EUR 11.4 million in 2013.

*Background for correction*

48. The Commission found that many of the parcels recorded in the reference parcel system still included ineligible areas, which increased the risk of irregular payments being made to beneficiaries.

The Commission also noted that the inspectors were not always aware how they should determine the eligibility of certain areas like, for instance, permanent pastures where the Danish rules prescribe that areas with less than 50 per cent grass and grazing plants are not eligible.

Finally, the Commission noted that some of the grassland areas that had been approved solely on the basis of remote sensing in 2007 were ineligible. The Commission found that the Danish authorities had failed to detect these irregularities, because the scope of follow-up inspections had been inadequate. The Commission's assumption was based on the fact that the Danish authorities detected many errors in this area after the introduction of systematic follow-up inspections in 2008, which increased the frequency of checks to the level required by the Commission.

49. The Commission decided to impose a flat-rate correction of 10 per cent to the SPS in 2007, corresponding to approximately EUR 0.8 million, on account of inadequate systematic follow-up on permanent pastures. For 2008, the correction was reduced to 2 per cent, because the Danish authorities had tightened the control and introduced systematic inspection of grassland areas, increased the frequency of checks and included grassland areas as a source of risk in the selection of areas for physical inspection.

**Audit of the SPS and RDP schemes in the years 2010 and 2011***Amount of financial correction*

50. In 2012, the Commission audited the area-based schemes under the SPS and RDP for 2010 and 2011. The AgriFish Agency initiated a dialogue with the Commission, which subsequently – in 2014 – decided on a correction of EUR 3.4 million.

*Background for correction*

51. The Commission emphasized the weaknesses in the LPIS and physical inspections (remote sensing and on-the-spot checks) as the main reasons for the correction.

The Commission also noted that in 2010 and 2011 not all on-the-spot checks were performed in compliance with the regulations. Although the Danish inspectors had deducted areas that did not meet the eligibility requirements, the Commission detected areas that were not eligible and therefore should have been deducted.

The Commission also found that not all inspectors – in connection with on-the-spot checks – had checked grazing land whose eligibility had been questioned during the remote-sensing control.

*Discussions with the Commission*

52. For the bilateral discussions with the Commission, the Danish authorities elaborated a draft calculation of the financial risk to the Guarantee Fund and the Rural Development Fund and proposed a correction. The Danish authorities based their calculations on the weaknesses found in the LPIS and on-the-spot checks and proposed a flat-rate correction of 2 per cent – corresponding to EUR 3.3 million – of the payments made in 2010 and 2011 concerning permanent pastures.

53. The Commission acknowledged the measures taken by Denmark to follow up on-the-spot inspections of grassland areas and accepted the proposed flat-rate correction.

**Denmark is increasingly entering into dialogue with the Commission to reduce corrections**

54. In its special report no 7 from 2010, ECA stated that it found the principles applied by the Commission for imposing flat-rate corrections problematic. ECA based its opinion on the fact that the Commission is not required to document irregular payments, but is required only to identify weaknesses in the national control systems. This means that the Commission can impose large flat-rate corrections on Member States on account of a few errors found. ECA finds that the Commission should consider using statistical sampling more extensively when it detects weaknesses in the control systems to allow extrapolation of error rates to the entire relevant population.

The Commission has stated that producing calculations of the financial losses to the EU budget that are more accurate will require active involvement of the Member States since only they have access to the data necessary to make such calculations. Moreover, the European Court of Justice has confirmed that it is not for the Commission to put exact numbers on the losses, but rather up to the Member States to demonstrate that, the Commission's estimation of the losses is incorrect.

55. We have noted that the AgriFish Agency is increasingly entering into dialogue with the Commission on the financial corrections. Experience shows that it is possible to have a constructive dialogue with the Commission and have the amounts of corrections imposed reduced. To succeed, however, the agency must be able to provide well-documented calculations of the maximum risk of losses to the funds.

Rigsrevisionen therefore recommends that the AgriFish Agency should pursue its current strategy of communication with the Commission also in the future.

**Summary of findings**

56. The review of the four cases concerning area control in the period 2002-2011 shows that corrections were imposed because the control systems – for various reasons – had not detected all ineligible areas. The Danish LPIS system was not fully updated and included ineligible land. Remote sensing was not accurate enough to support correct statement of eligible land, which, if remote sensing is not followed by on-the-spot checks, increases the risk of financial corrections. The inspectors had difficulties determining the eligibility of certain areas, in particular grassland areas that are subject to special rules under the SPS, and failed to check – to the extent required – that the EU regulations and Danish regulations had been observed.

Rigsrevisionen notes that the Danish AgriFish Agency's strategy of communication with the Commission on the amount of the financial corrections imposed on Denmark has been successful and has resulted in a reduction of the amount of the correction initially proposed by the Commission.

## 4. Area control

The examination of Danish area controls shows that progress has been made, but also that there is room for further improvement.

Reference parcels were not updated in accordance with the Commission's best practice requirements in 2012 and 2013, but as from the application year 2014, the AgriFish Agency has ensured that all reference parcels meet the three-year updating requirement.

Rigsrevisionen notes that the quality of remote sensing has improved, because the quality of aerial imagery has improved and is checked more thoroughly. Almost all remote-sensing results are followed up by on-the-spot checks. The internal quality control of remote sensing reveals that errors still occur, but also that they are mainly of limited financial importance. Rigsrevisionen recommends, however, that efforts to enhance the quality of remote sensing further should be continued.

On-the-spots checks carried out at a number of randomly selected farms revealed significant over declaration of land and high error rates. Statistically this means that also the farms that have not been checked will be affected by many errors. In particular, the area-based schemes that include requirements concerning cover of vegetation and management of grassland areas and natural habitats will be affected. In the opinion of Rigsrevisionen, this entails increased risk of financial corrections being imposed on Denmark.

The rechecks performed by the internal auditors at the AgriFish Agency show that the inspectors still make mistakes when performing on-the-spot checks. To reduce the risk of financial corrections, the consistency of the assessments made by the inspectors must be improved and their general competencies upgraded. Rigsrevisionen finds it satisfactory that the internal auditors at the AgriFish Agency are working to step up rechecks to address the current level of over declaration and irregularities detected in certain area-based schemes.

The Danish eligibility requirements in relation to claiming payment for grassland areas and natural habitats include several requirements concerning the protection of nature and the environment, and are quite complex. It follows that also the requirements that the farmers are expected to meet when they apply for payments under the individual schemes are quite complex. The farmers find it difficult to ensure that they comply with the current rules, and the inspectors are not to the extent necessary able to determine and check whether the farmers comply with the regulations – including the regulations for management and protection of grassland areas and natural habitats. The Commission also checks whether the Danish rules are being fulfilled when these are incorporated in the eligibility requirements. The complexity of the Danish regulations increases the risk that corrections are imposed on Denmark.

Rigsrevisionen recommends that the Ministry of Food should consider whether the Danish regulations could be simplified without abandoning the environmental considerations. If the Danish regulations regarding payment for grassland areas and natural habitats can be rephrased to make it easier for the farmers and inspectors to determine compliance with the eligibility requirements, the risk of ineligible payments will be reduced and thus also the risk of financial corrections.

57. In this section of the report, we shall examine and assess whether the controls implemented by the AgriFish Agency meet the EU regulations. The main focus will be on the controls that have been criticised by the Commission and led to financial corrections.

The review concerns

- the LPIS;
- remote sensing;
- on-the-spot checks.

#### 4.1. LPIS

58. In this section, we assess whether the AgriFish Agency has provided a LPIS that includes all Danish agricultural land and meets the criteria of quality determined by the Commission. The LPIS database provides a system for registration of applications for area-based support and subsequent control of payments executed to the farmers.

##### **Some reference parcels include ineligible areas**

59. The AgriFish Agency is the administrator of the LPIS, which is a geographical database that includes information on reference parcels, a layer of entitlements, aerial imagery and other geographical layers. The LPIS includes all data on reference parcels and other areas eligible for funding under the Guarantee Fund and Rural Development Fund. At the beginning of February 2014, the LPIS included 324,000 reference parcels.

60. The Commission detected ineligible areas in reference parcels that were labelled as eligible in the LPIS. Some of the errors could be traced back to the irregular updating of the reference parcels.

61. According to the Commission's best practice for updating of reference parcels, these should be included in the LPIS only if they have been updated within the last three years. The Commission and the AgriFish Agency have also defined a set of quality criteria for reference parcels. These criteria are included in the annual test of reference parcels developed by the Commission and in the AgriFish Agency's internal quality assurance policy from 2012.

*A **reference parcel** is a geographically delimited area (field boundaries, roads, etc.). A reference parcel includes several fields that may be owned by more farmers. A reference parcel has a total area and an eligible area.*

*The **entitlement layer** provides data on the areas in a reference parcel that are eligible for funding under the RDPs. Entitlements generally cover a five-year period.*

The LPIS offers functionalities for registration of the farmers' applications for area-based payments and for the agency's administrative checks of applications. It follows that it is essential that the LPIS and reference parcels are updated to ensure that the farmers have the best possible basis for applying for area-based payments and to ensure that fully updated data provide the basis for the administrative checks, remote sensing and on-the-spot checks that are carried out by the AgriFish Agency.

62. The examination shows that approximately 10 and 20 per cent of the reference parcels in 2012 and 2013, respectively, had not been updated during the three years preceding the new application period. This increases the risk of financial corrections being imposed on Denmark and is not considered satisfactory by Rigsrevisionen.

The examination also shows that the AgriFish Agency in 2013 launched a process to ensure that all reference parcels would be updated with a frequency of three years in compliance with the Commission's requirements. Based on an assessment of risk, the agency has outsourced the reference parcels that are considered to represent less of a risk to a private company for updating. All risky reference parcels will be updated in-house, but the agency will also verify the updating of the outsourced reference parcels. In compliance with the Commission's best practice requirements, all reference parcels had been updated within the three years preceding the opening of the 2014 application round. Rigsrevisionen welcomes that reference parcels, in the future, will be updated with a frequency of three years and thus provide a better basis for the farmers' applications for area-based payments and the subsequent controls.

#### **Efforts made by the AgriFish Agency to ensure the quality and updating of reference parcels**

63. The AgriFish Agency has developed an internal quality assurance policy that provides guidelines for the quality of data on reference parcels to ensure that they meet EU regulations and national rules.

64. It is Rigsrevisionen's assessment that the quality assurance policy underpins the agency's efforts to reduce the risk that the LPIS and reference parcels lead to financial corrections. The quality assurance policy clearly defines the distribution of responsibility among the units in the agency. It also defines how the agency should monitor compliance with the appropriate rules and standards concerning reference parcels.

65. The quality of reference parcels is assessed by the Commission through an annual test based on a random sample of 800 reference parcels. The AgriFish Agency carries out the test and determines whether the reference parcels meet the seven quality criteria defined by the Commission. The quality of the Danish reference parcels was tested in 2012 and 2013.

The results of the tests performed in the individual Member States are forwarded to the Commission along with action plans outlining the measures that the national authorities will implement to improve quality.

66. Rigsrevisionen's examination shows that Denmark failed to pass the test in 2012 as well as in 2013. The AgriFish Agency has informed Rigsrevisionen that discrepancies between land declared and actual holdings are the primary reason why the reference parcels did not pass the test. To this should be added that some of the reference parcels included ineligible areas and some were not correctly delimited.

67. The AgriFish Agency has informed Rigsrevisionen that the test is a new quality assurance tool, which is still by the Commission seen as an instrument that can help the Member States improve their performance step-by-step. The test can be used for systematic follow-up and collection of knowledge concerning issues related to reference parcels.

### Summary of audit findings

68. The examination shows that not all reference parcels have been updated within the three years preceding the opening of the application rounds in 2012 and 2013, which entails a risk of financial corrections. However, Rigsrevisionen notes with satisfaction that the reference parcels meet the three-year updating requirement in 2014.

The reference parcels failed the Commission's annual quality assurance test in both 2012 and 2013. The quality assurance test is a new tool and it is Rigsrevisionen's estimation that reference parcels will do better on the test following the implementation of the three-year updating frequency.

### 4.2. Remote sensing

69. This section addresses the quality of remote sensing and the activities implemented by the AgriFish Agency up until early 2014, in response to criticism raised by the Commission.

#### **The AgriFish Agency has endeavoured to reduce the number of remote-sensing errors**

70. The AgriFish Agency is responsible for remote sensing in Denmark. Every year, approximately five per cent of all applications for payments under the SPS and RDP schemes are selected for remote sensing, which means that approximately 2,500 farmers and 20,000 reference parcels are checked. Remote sensing used for measuring reference parcels must meet a number of requirements prescribed in the EU regulations. All satellite and aerial photos must be subjected to visual inspection and interpretation in order to measure the size of the areas and determine the vegetation. If the photo material does not suffice to determine the correctness of the information provided in the applications, the agency will follow up with on-the-spot checks of the respective fields.

71. The Commission has criticised the quality of remote-sensing images. The Commission found it impossible to determine whether the species of grass and other crops growing on grassland areas and set-aside land were eligible for support. The hectare aid correction from 2009 was also triggered by the Commission's assessment that control of set-aside land had been performed on the basis of images of poor quality.

72. Rigsrevisionen notes that the AgriFish Agency has purchased satellite imagery of a better quality in 2013 and that the assessment of land areas is now based on several sets of photos taken at different times of the year. This allows the inspectors to follow how the vegetation develops in grassland areas and natural habitats, and in areas with other crops.

The agency has also introduced work routines that are designed to ensure that the inspectors review the imagery more thoroughly and, for instance, check whether the boundaries of fields are correctly mapped. The inspectors also assess the eligibility of areas and select applications for physical inspection if the eligibility is questioned. One inspector checks the correctness of field boundaries, areas deducted, and selects the fields that should be subjected to on-the-spot checks and another inspector verifies this work.

73. As a result of the criticism raised by the Commission in 2007 concerning Denmark's inadequate systematic control of grassland areas, remote sensing is now predominantly supplemented with other controls. In 2013, only 2.9 per cent of all applications for direct payments under the SPS were approved based on the outcome of remote sensing only. Fifty five per cent of the fields belonging to farmers that were selected for on-the-spot checks were inspected visually. The remaining 45 per cent of the fields were approved on the basis of remote sensing. Rigsrevisionen notes that almost all the farmers that were checked and approximately half of all fields are followed up with on-the-spot checks, because the AgriFish Agency is of the opinion that the risk of financial corrections increases, if the farmers are controlled through remote sensing only.

74. Every year, the AgriFish Agency makes an internal quality check of a random sample of 4 to 5 per cent of all remote-sensing controls performed during the year. During the quality control, the correctness of all the elements in remote sensing are checked once more, including field boundaries, areas deducted and decisions made to perform on-the-spot inspections. Rigsrevisionen's examination shows that errors still occur in remote sensing. In 2012 and 2013, the internal quality control revealed error rates of 13 and 11 per cent, respectively, caused by errors in digitization and other deficiencies. In most cases, however, the errors did not affect payments.

75. The AgriFish Agency has informed Rigsrevisionen that the recently implemented three-year updating frequency for reference parcels has improved the basis for its administration and delineation of reference parcels, which is expected to reduce the number of errors in remote sensing. The implementation of a new screening system for control of grassland areas is also expected to result in detection and deduction of more ineligible features.

#### **Summary of audit findings**

76. The examination shows that steps have been taken to improve the quality of remote sensing, including enhanced quality of photo material and increased attention to detail in the control. Despite these initiatives, the internal quality checks reveal that remote sensing is still affected by many errors, although only very few of these have affected payments. It is Rigsrevisionen's estimation that the agency should continue its current efforts to raise the quality of remote sensing.

#### **4.3. On-the-spot checks**

77. In this section, we assess the results of on-the-spot checks and whether the AgriFish Agency selects the most risky farmers for control. We also review the quality of the work currently performed by the inspectors based on the rechecks made by the internal auditors at the AgriFish Agency.

#### **Random sample revealed high error rates**

78. On-the-spot checks are generally organised to follow up on the results of remote sensing that are considered inconclusive. One of the main purposes of the checks at the farms is to assess the condition of the land and the eligibility of crops and other vegetation. Ensuring compliance with the rules governing vegetation on land declared for payments is another important aspect of on-the-spot checks. With regard to the RDP schemes and Article 68 schemes, the inspectors also assess whether the land is managed in accordance with the maintenance requirements concerning use of pesticides and fertilisers, for instance.

79. The results of these checks are reported to the Commission in an annual statistical report, which provides information on total area declared by the farmers and irregularities detected by the inspectors through the checks. The results of the checks are stated in hectares as well as euros and broken down by random and risk-based controls.

80. The results of the control are assessed in relation to *over declaration* and *error rates*. Over declaration is when farmers declare land that is subsequently checked and found to be ineligible. The over-declaration rate reflects the percentage of total payment claims that were deemed ineligible. The error rate indicates the percentage of errors found at the farms.

81. Box 3 shows an example of calculation of over declaration and error rates.

**BOX 3. OVER DECLARATION AND ERROR RATES AFFECTING THE SPS FOR 2012 – CALCULATED ON THE BASIS OF THE RANDOM SAMPLE**

In 2012, the farmers that were included in the random sample had claimed payment for 29,621 hectares, corresponding to EUR 11,447,110. The subsequent check made by the AgriFish Agency showed over declaration of 156 hectares, corresponding to EUR 55,870. The over-declaration rate was thus 0.48 per cent (EUR 55,870/EUR 11,447,110 x 100).

Of the 531 farmers that were included in the random sample, 184 did not meet all the requirements of the SPS. The error rate was subsequently calculated at 34.65 per cent (185/531 x 100).

82. The Commission accepts an over-declaration rate of 2 per cent of the total payments claimed in the random sample. If over declaration in the sample exceeds 2 per cent, the Commission will conclude that the rest of the population is severely affected by over declaration. High over-declaration rates in the random sample are taken very seriously by the Commission, as it indicates that payments have been made for large ineligible areas.

83. In the following sections, Rigsrevisionen reviews the results of on-the-spot inspections carried out under the largest area-based schemes in the period 2009-2013.

84. Table 2 shows how over declaration and error rates have developed in the random samples drawn from the SPS, RDP schemes and Article 68 schemes in the period 2009-2013.

**Table 2. Over declaration and error rates in the random samples drawn from the SPS, RDP schemes and Article 68 schemes in the period 2009-2013**

	2009	2010	2011	2012	2013
SPS – over declaration	0.9	0.8	0.8	0.5	1.0
SPS – error rate	39.9	33.	39.7	34.7	29.2
RDP – over declaration	3.0	3.8	9.7	5.3	5.1 <sup>1)</sup>
RDP – error rate	53.8	59.2	45.7	39.3	36.6
Article 68 – over declaration	-	5.5	3.0	4.5	4.9
Article 68 – error rate	-	41.5	45.0	48.3	46.6

<sup>1)</sup> Two randomly selected cases were still being processed at the time of the audit and are therefore not included in the table.

Source: The AgriFish Agency.

It appears from table 2 that SPS over declaration of land has been declining since 2009 and below 2 per cent for the entire period. The SPS over declaration was 0.5 per cent and 1 per cent in 2012 and 2013, respectively, whereas the error rates were 34.7 in 2012 and 29.2 per cent in 2013.

The random samples drawn from all RDP schemes revealed that over declaration has increased and remained above the 2 per cent threshold since 2009. In 2012 and 2013, over-declaration was 5.3 and 5.1 per cent, respectively, and 39.3 and 36.6 per cent of all checked applications were affected by errors.

85. The error rates under the RDP schemes that provide direct payments for managing pastures were very high in 2011, 2012 and 2013. In 2012, violations of the regulations were so severe that approximately 13 per cent of the farmers that were checked did not receive any payments. For the overall RDP, over-declaration was 17 per cent in 2011, 9 per cent in 2012 and 11 per cent in 2013.

In addition, the random samples drawn from the Article 68 schemes revealed high over declaration and error rates. The rate of over declaration was 4.5 per cent in 2012 and 4.9 per cent in 2013, and the corresponding error rates 48.3 per cent and 46.6 per cent, respectively.

86. The AgriFish Agency has explained that the RDP schemes and Article 68 schemes are affected by many errors, because the farmers find it difficult to ensure that they comply with the regulations concerning management of land, cf. box 4.

**BOX 4. REASONS FOR THE HIGH OVER DECLARATION AND ERROR RATES CONCERNING GRASSLAND SCHEMES UNDER THE RDP AND ARTICLE 68 SCHEMES**

To receive payments under the grassland schemes, the farmers must comply with a number of requirements: the vegetation must be cut and, for instance, turned into hay, and removed, or the area must be included in a rotational cycle with grazing in the period 1 June to 31 August. With regard to the Article 68 schemes, a minimum of 50 per cent of the area must be grown with specific grass types. Most of the errors detected are caused by the fact that the farmers apportion too few livestock units to graze the respective areas. In large areas with mixed vegetation, the animals will favour certain types of grass over others and thus other species like rush, for instance, will spread. This will trigger a correction due to inadequate grazing of part of the eligible area.

87. The statistical report shows that the random samples drawn from Article 68 schemes and RDP schemes are affected by very high error rates, which seems to indicate that farmers that have not been checked are affected by high error rates and receiving payments to which they are not entitled. This is considered unsatisfactory by Rigsrevisionen.

**The Danish rules are complex and difficult to apply**

88. The examination shows that not only failure to comply with the EU regulations triggers corrections; the Commission also looks at compliance with Danish rules when these are incorporated in the eligibility requirements. In respect to the SPS, the Danish rules expand on and interpret the EU regulations. The special Danish requirements concerning management of areas under the RDP schemes and Article 68 schemes have been elaborated to support achievement of national political goals set for the environment and nature in connection with the implementation of various EU directives. The Danish rules governing payments for grassland and natural habitats therefore include several requirements concerning the protection of the environment and nature.

89. The current EU regulations governing single payments define grassland (permanent pastures as well as grass in rotation) as areas used to grow crops of grass and other herbaceous forage. In the EU, grass and other herbaceous forage is defined as herbaceous plants suitable for grazing, hay or ensilage. The AgriFish Agency's guidance on single payments includes a list of plants that are not included in this category and therefore not allowed to be dominant in grassland areas.

90. According to the EU regulations, grassland area must be cultivated for agricultural purposes. The AgriFish Agency has translated this into a requirement for mowing the land at least once annually. Mowing can replace livestock grazing. The Danish rules prescribe that the land should be kept in good agricultural condition if it is used for grazing. Grassland is accepted as being kept in good condition if the height of vegetation does not exceed 40 centimetres.

The Article 68 schemes and RDP schemes are supplemented with Danish requirements concerning management of land. Farmers applying for payments under the Article 68 schemes must meet the requirements of the SPS plus a number of requirements concerning, for instance, grazing, mowing or use of pesticides. The RDP schemes on management of grassland and natural habitats can be combined with the SPS, and the RDP schemes are therefore frequently based on the requirements of the SPS. The RDP schemes also include requirements for managing the areas, i.e. livestock grazing, mowing, use of fertilisers and management of natural habitats.

In order to simplify the rules and control, and at the same time consider the needs of areas with a high level of biodiversity, farmers with entitlements applying for support under the RDP schemes may choose to have the areas grazed with a density of 1.5 livestock units per hectare rather than letting the areas grow over with thick, low vegetation.

The complexity of the Danish rules is – in the opinion of Rigsrevisionen – the main reason why the schemes concerning pastures and natural habitats are affected by such high error rates. The complexity makes it difficult for both the farmers and inspectors to apply the Danish rules effectively. Rigsrevisionen therefore finds that a simplification of the Danish rules on managing land will make it easier for the farmers and inspectors to apply and meet the rules. However, a simplification of the rules should take into consideration the special Danish objectives set for the protection of the environment and nature.

#### **Ineffective risk criteria defined for several of the schemes**

91. The Commission prescribes that a risk analysis should provide the basis for the selection of farmers for control to ensure that the most risky areas are also more frequently selected for control. In order to assess the effectiveness of the risk analysis, 20 to 25 per cent of the sample must be randomly selected, whereas selection of the rest should be based on specific risk factors.

92. The Commission has previously criticised Denmark for omitting to define effective risk criteria, as more errors were detected in the randomly selected sample than in the risk-based sample. The fact that risk criteria had not been defined for permanent pastures was also criticised by the Commission.

93. Rigsrevisionen's audit shows that the risk criteria defined for the SPS were effective in 2008, 2010 and 2012, but ineffective in 2009 and 2011. In 2009 and 2011, the randomly selected sample was affected by higher over-declaration rates and error rates than the risk-based sample.

94. The risk-based criteria were not effective for the Article 68 schemes either. In 2012, over declaration of areas under both schemes was higher in the randomly selected sample than in the risk-based sample.

Overall, the risk criteria are therefore considered ineffective by Rigsrevisionen and the AgriFish Agency is encouraged to define criteria that are more effective.

#### **The internal auditors at the AgriFish Agency detect errors that should have been found during the ordinary control**

95. The audits referred to in chapter three of this report demonstrated that financial corrections were primarily imposed because the inspectors found it difficult to determine the eligibility of grassland and land set-aside.

96. In connection with the annual rechecks, the internal auditors at the AgriFish Agency look at the inspectors' assessment of compliance with the eligibility requirements. The internal auditors check whether reference parcels have been correctly measured and whether the areas meet the eligibility requirements.

97. In 2012, the internal auditors made 20 rechecks against 25 in 2013. The results of the checks appear from table 3.

**Table 3. Results of rechecks made in 2012 and 2013**

	2012		2013	
	Area	Amount	Area	Amount
SPS	0.34 %	0.85 %	0.08 %	0.05 %
RDP	2.25 %	9.52 %	0.52 %	0.15 %
Article 68	0.40 %	1.65 %	0.48 %	1.28 %

Source: The internal auditors at the AgriFish Agency.

Table 3 shows over-declaration of land area and corresponding amounts expressed as a percentage of all land/payments claimed. It appears from the table that the amount of ineligible hectares that should have been deducted during the ordinary control is limited. The only exception is the RDP schemes, where the internal auditors at the AgriFish Agency found many errors that had not been detected during the ordinary control in 2012.

98. Like the Commission, the internal auditors at the AgriFish Agency established that the requirement that 50 per cent of the vegetation on grassland areas must be eligible species of grass was causing problems for farmers as well as inspectors. Only very few applications are rechecked and a few errors may therefore have a great impact on the results. As an example, the high error rate recorded for the RDP schemes in 2012 was due to just one farmer.

99. In the opinion of Rigsrevisionen, the AgriFish Agency should increase the number of rechecks to address the high levels of over declaration and errors affecting some of the area-based schemes. More control would contribute to generating experience on the areas where the inspectors find it difficult to determine if the farmers are complying with the eligibility requirements. Rigsrevisionen therefore finds it unfortunate that only 25 of the 45 rechecks planned for 2013 were carried out. With effect from 2015, the Commission has furthermore set a target that calls for approximately 30 rechecks of applications for payment under the SPS, including the Article 68 schemes, and approximately 20 rechecks of RDP applications.

#### **Summary of audit findings**

100. The randomly selected sample drawn from the RDP schemes and Article 68 schemes was affected by very high over-declaration rates and error rates, which indicated that also farmers that were not checked would probably be affected by high error rates and have received payments to which they were not entitled. This is not considered satisfactory by Rigsrevisionen.

Rigsrevisionen has noted that the Danish rules on managing grassland and natural habitats are complex, which may be the main reason for the high error rates that affect these schemes. The complexity makes it difficult for both farmers and inspectors to apply the Danish rules effectively. Rigsrevisionen therefore finds that a simplification of the Danish rules on managing land could make it easier for the farmers and inspectors to apply and meet the rules. However, a simplification of the rules should take into consideration the special Danish objectives set for the protection of the environment and nature.

The examination also shows that the risk criteria defined for the RDP schemes and Article 68 schemes were ineffective; the randomly selected sample was affected by higher over-declaration rates and error rates than the risk-based sample.

Rigsrevisionen notes that errors are detected during the rechecks performed by the internal auditors at the AgriFish Agency. Rigsrevisionen recommends that the agency should increase the number of rechecks performed to collect more knowledge and experience on the nature of the errors that are detected through on-the-spot checks, and use this information to improve the control.

## 5. Tackling financial corrections

It is Rigsrevisionen's estimation that the Ministry of Food is focused on reducing financial corrections to a minimum. However, the risk that corrections are charged to Denmark cannot be eliminated, because the Commission's assessments and requirements to the control system are continuously being tightened.

Rigsrevisionen finds that the ministry has taken steps to remedy the current deficiencies in the controls to ensure that they meet the requirements of the Commission.

It is Rigsrevisionen's estimation that the effort made to minimise financial corrections is satisfactory, although the effect of the effort remains to be seen. The Ministry of Food should have documented the background for its decisions more extensively and should develop a strategy for the future effort to tackle financial corrections. Rigsrevisionen also sees a potential for further improvement of on-the-spot inspections if better documentation of the eligibility of land can be provided.

### 5.1. The Ministry of Food's effort to minimise financial corrections

#### **Initiatives launched by the Ministry of Food to tackle financial corrections**

101. We have focused on whether the Ministry of Food has directed its effort at the weaknesses in the Danish area control that were detected by the Commission.

102. The examination shows that the Ministry of Food is working on implementing cost-effective measures to reduce the risk of financial corrections being charged to the agricultural funds of the EU. The ministry is of the opinion that it is not possible to eliminate the application of financial corrections on area-based schemes. One of the reasons is that the Commission's inspections in the Member States provide the basis for ongoing tightening of the requirements and elaboration of new best practice guidelines.

103. The examination shows that the ministry has launched a number of initiatives to minimise corrections; one of the key initiatives in 2013 was an overall analysis of the risk of corrections being implemented under the Guarantee Fund and Rural Development Fund. The analysis was prepared by a consultancy firm, which together with the AgriFish Agency set up three scenarios that each introduced various measures to tackle financial corrections.

Based on the consultants' report, the agency decided to launch various initiatives in the period 2013-15. The total cost of these activities are estimated at approximately EUR 22.2 million. The initiatives have been or will be launched in continuation of current and completed projects such as, for instance, the *Enhanced control* project. This was launched by the Ministry of Food and the AgriFish Agency in 2010 with the purpose of strengthening the control of area-based payments and was completed in 2013. The department has also tightened its supervision of how requests received from the supervisory authorities are followed up. The ministry also monitors and assesses – on an ongoing basis – whether the rules applying to current and new schemes under the Rural Development Fund increase the risk of corrections being charged to Denmark.

Rigsrevisionen's main focus has been on initiatives launched on the basis of the consultants' report. These initiatives impose considerable costs on the Ministry of Food, and additional funding has therefore been requested and granted by the Ministry of Finance.

104. The Ministry of Food has informed Rigsrevisionen that it has not developed an overall strategy for minimising the risk of financial corrections. Rigsrevisionen finds that the ministry should develop such a strategy and clarify the link between its strategic considerations and the initiatives launched to improve area control.

#### **The three scenarios presented in the consultants' report**

105. In response to the criticism raised by the Commission concerning area control, a consultancy firm was commissioned to prepare a report on the quality of the control of EU funding financed by the Guarantee Fund and Rural Development Fund, and make recommendations to improve the control.

106. Based on their findings, the consultants were asked to set up three scenarios for tackling financial corrections. The three scenarios each present different options to improve controls, involve different investment and operating costs and have different effect on the estimated risk of corrections.

The Ministry of Food has informed Rigsrevisionen that the consultants' report was prepared in collaboration with the ministry; the AgriFish Agency provided the expertise, and the consultants provided the systematic and methodic basis for the analysis. The ministry agreed with the consultants on the problems highlighted in the report and took part in setting up the three scenarios. The scenarios are not only addressing area control, but also cross-compliance control and issues relating to project-based schemes. Table 4 presents an overview of the three scenarios.

Table 4. The three scenarios

		Recommen- dations (Number)	Investment costs (EUR million)	Operating costs (EUR million)	Estimated effect on the amount of financial corrections (EUR million)
<b>Scenario 1:</b> Risk-based administration	Investment in maintaining the current level of quality and at the same time strengthen the control of risky applications.	24	3.7	8.0	14-21
<b>Scenario 2:</b> Focused risk-based administration	Limited-scale version of scenario 1 with focus on initiatives that are considered indispensable.	14	3.4	6.7	12-19
<b>Scenario 3:</b> Best-in-class	Investment in enhancing administration with focus on securing that the Danish quality standards are set at a higher level than the current standards in other Member States, the Commission's criteria and best practice recommendations.	24	3.7	17.4	16-23

Source: The consultancy report 2013.

Table 4 shows that scenario 1, *Risk-based administration*, includes 24 suggestions to improvements and is the second-most cost-heavy recommendation. Scenario 2, *Focused risk-based administration*, includes 14 initiatives and is the most inexpensive. It is also a limited-scale version of scenario 1. Scenario 3, *Best-in-class*, is the most ambitious recommendation, but also the most costly. The 24 recommendations to improvements under scenario 3 build on and further strengthen the initiatives presented under scenario 1. The table also summarises implementation costs and the estimated effect on the amount of financial corrections.

107. The ministry has informed Rigsrevisionen that it has decided to implement scenario 2. The ministry has held the implementation costs up against the potential effect of the initiatives on the risk of corrections being charged to Denmark and has concluded that scenario 2 is aimed at the controls most in need of improvement and representing the greatest risk of new financial corrections.

The Ministry of Food has not documented the considerations that led to this decision.

108. Rigsrevisionen approves of the Ministry of Food's decision to commission an analysis of the weaknesses in area control, but finds that the ministry should have accounted for its assessment of the three scenarios presented in the consultants' report. Improving area control requires a substantial financial investment and the ministry should therefore have documented the background for its decision to go with scenario 2. Based on the account provided subsequently by the department, Rigsrevisionen is, however, convinced that the ministry's choice of scenario 2 was made on an informed basis.

## 5.2. Focused risk-based administration (scenario 2)

109. Six of the 14 initiatives proposed under scenario 2 are aimed at strengthening area control. Four of the initiatives are designed to improve updating of reference parcels, remote sensing and on-the-spot inspections, whereas the last two initiatives concern administrative controls and the implementation of a cross-cutting quality assurance and management information system. The remaining eight initiatives are directed at cross-compliance control and project-based schemes. All the initiatives are to be implemented in the period 2013-15.

### **Quality enhancement of reference parcels, remote sensing and on-the-spot inspections**

110. The consultants' report shows a need for enhancement of the reference parcels to ensure that they are all updated within a three-year period. Reference parcels must meet the quality criteria set by the Commission and it must be ensured that proposed changes to the reference parcels are registered when the farmers and inspectors submit their reports. One of the initiatives under scenario 2 is aiming to ensure that reference parcels are updated within a three-year frequency and their quality enhanced by reducing the number of reference parcels where two or more farmers apply for support, for instance. According to the consultants' analysis, the implementation of this initiative will have a great positive effect on financial corrections.

It is also Rigsrevisionen's assessment that this initiative will improve the quality of the reference parcels.

111. Three of the recommendations are aiming to strengthen remote sensing and on-the-spot inspections through the implementation of differentiated controls, consolidation of quality criteria in relation to remote sensing and generation of knowledge concerning on-the-spot inspections. Focus is on optimising screening of field maps to ensure that particularly permanent pastures can be identified and correctly categorized, but also to ensure that the farmers do not change the land use of permanent pastures between support years.

Differentiated controls are intended to increase the focus on high-risk areas to ensure that adequate time is allocated to challenging remote-sensing cases. Emphasis is also on increasing quality assurance. In connection with on-the-spot checks, the implementation of differentiated controls will entail that two inspectors will be assigned to potentially difficult cases that are expected to require professional judgement. The AgriFish Agency assumes that 40 per cent of the approximately 2,500 cases that are selected for the five per cent control can be characterized as risky.

Remote sensing will also be strengthened through allocation of additionally 2.3 man-years, which will be instrumental in consolidating the quality criteria set for remote sensing. The Commission has criticised the quality of remote sensing, but the consultants' estimation is that Denmark will be able to meet the Commission's quality requirements by allocating more resources to the currently understaffed area.

The third and last of the three recommendations concerns on-the-spot checks, which are to be strengthened by assigning two instead of one inspector to more of the cases and by establishing a quality assurance team. This team will support the inspectors' in their work at the farms and act as professional sounding boards for the inspectors. These steps are intended to increase quality assurance of on-the-spot inspections. The AgriFish Agency has informed Rigsrevisionen that the purpose of assigning two inspectors to difficult cases is two-fold: the cases will be subjected to two separate assessments and one of the two will be an experienced inspector. Double staffing will be restricted to complex cases concerning the eligibility of grassland areas and challenging cases under the RDP.

112. It is Rigsrevisionen's estimation that differentiated controls can contribute to rectifying the weaknesses detected by the Commission and during our examination of area control. The recommended initiatives will target the control at the areas where the implementation of effective controls has proven difficult. It is also recommended to increase the frequency of re-checks to learn more about the nature of errors. Rigsrevisionen finds that these initiatives will improve the quality of both remote sensing and on-the-spot inspections.

It is also Rigsrevisionen's assessment that the greatest risk of financial corrections is still related to the schemes that require the farmers to comply with specific terms like, for instance, the special requirements to management of grassland areas and natural habitats. Rigsrevisionen finds that the recommendation to assign two inspectors instead of one to all difficult cases will enhance the quality of on-the-spot inspections.

Rigsrevisionen's audit of the 24 cases referred to under item 31 on page 13 demonstrated that the inspectors' approval of the eligibility of land is inadequately documented. The Agri-Fish Agency would be better positioned to handle eligibility issues raised by the Commission, if the documentation requirements were tightened. The AgriFish Agency has informed Rigsrevisionen that the requirements to documentation will be increased to improve the quality of evidence supporting the inspectors' approval of grassland and natural habitats, whose eligibility has been questioned by the Commission.

#### **Improvement of administrative controls and implementation of a cross-cutting quality assurance and management information system**

113. Scenario 2 also includes an initiative that aims to improve administrative control and strengthen control of the farmers' disposal of the land on which they claim payment.

114. The last initiative under scenario 2 is designed to create a coherent cross-cutting quality assurance and management information system. According to the consultants' report, the agency has no systematic overview of the quality of control performed in the individual areas, which increases the risk that financial corrections are imposed on Denmark. In connection with the approval of the AgriFish Agency as paying agency, the Commission made it clear that the agency would be expected to have a quality assurance and management information system in place. However, this omission has not led to any financial corrections so far.

115. Rigsrevisionen finds it positive that scenario 2 is focused not only on minimising the current risk of financial corrections being imposed by the Commission, but is also looking ahead. Thus, implementation of scenario 2 will minimise the risk that deficiencies in the administrative control lead to financial corrections, and at the same time, it will secure the required cross-cutting focus on management information and quality assurance of controls.

#### **Translation of the initiatives into action plans**

116. Scenario 2 has been translated into an overall project initiation document and action plans for the six recommendations that concern area control. The overall project initiation document provides an overview of the initiatives and action plans launched to tackle corrections and indicates where they are anchored in the AgriFish Agency.

117. The project initiation document includes a time schedule for deliveries, an overview of resources and economy, a project organisation, a risk analysis and an estimation of the expected results and effects of the project. Separate action plans, including timetables, have been developed for the initiatives that address area-control issues. The entire project is expected to be finished mid-2015 and final reporting on the effect of the individual deliveries will be available early in 2016. The main objective of the project is to reduce the amounts of the financial corrections that may be imposed on Denmark after 2015.

It is Rigsrevisionen's assessment that the AgriFish Agency has organised the implementation of scenario 2 in a satisfactory manner.

**Summary of audit findings**

118. The examination shows that the Ministry of Food has taken steps to improve area control. The initiatives launched in 2013 were based on the outcome of an analysis carried out by a consultancy firm, which presented three options to address financial corrections. The ministry decided to implement the option referred to as scenario 2 in the report, which included 14 initiatives of which six were aimed at improving area control.

The audit of the scenario 2 initiatives shows that they are focused on addressing the issues raised by the Commission and on the weaknesses detected during our examination.

119. Rigsrevisionen notes that the Ministry of Food has prioritised implementation of the initiatives that are assumed to have the largest positive effect on the amounts of future financial corrections.

Rigsrevisionen finds that on-the-spot inspections can be further strengthened if the experienced inspectors that are currently consulted in difficult cases become even more specialized. In addition, the inspectors that are performing on-the-spot checks of grassland areas that are difficult to assess, should provide more adequate documentation of their decisions to confirm the eligibility of the areas. The AgriFish Agency has informed Rigsrevisionen that it is currently implementing a new procedure for documentation of the eligibility of such grassland areas.

120. Overall, the effort made by the Ministry of Food to minimise the risk of financial corrections is considered satisfactory by Rigsrevisionen. However, the final effect of the initiatives under scenario 2 cannot be determined before 2016, when all the initiatives have been implemented.

Rigsrevisionen, 10 September 2014

Lone Strøm

/Morten Henrichsen

## Appendix 1. Audit opinion of the internal auditors at the AgriFish Agency

### To the management of the AgriFish Agency

We have, as internal auditors at the AgriFish Agency, audited the financial statements and management's report for the accounting year 1 January - 31 December 2013 for the AgriFish Agency, 30 Nyropsgade, DK-1780 Copenhagen V, in accordance with the section 9 agreement between the Auditor General and the minister for food, agriculture and fisheries. The audit was conducted partly in the course of the year and partly in the period February-May 2014. Our audit opinion is accompanied by a report on the results of our audit.

The management of the AgriFish Agency is responsible for the preparation of the annual report. It is our responsibility as section 9 auditors to express an opinion on the annual report based on our audit.

### The auditors' responsibility

We conducted our audit in accordance with international auditing standards and good public-sector auditing practice. The standards applied require that we plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement and that the administrative structure of the AgriFish Agency provides reasonable assurance that the schemes are administered in compliance with laws and regulations and the provisions of the European Commission and the Council of the European Union, and that the Integrated Administration and Control System (IACS) is applied correctly and functions as intended.

An audit includes sample-based examination of supporting documentation of the amounts and information provided in the annual report. An audit also includes evaluating the appropriateness of the accounting policies applied by management and the reasonableness of the accounting estimates made as well as evaluating the overall presentation of the financial statements and management report. The audit also includes the AgriFish Agency's administration of EU funds, which has been subjected to financial audit, conducted mainly by the certifying body (Deloitte, state-authorized public accountants). We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our opinion.

### Opinion

#### *The regularity of the accounts*

In our opinion the accounts for the EU area, cf. the government accounts sections 24.21.01, 24.21.02, 24.23.03, 24.23.04, 24.23.05, 24.23.33, 24.23.50, 24.24.05, 24.26.30 and section 24.42 indicating expenditure/contributions of EUR 1,167.1 million and revenue of EUR 1,147.4 million, have been prepared in compliance with the Danish government accounting rules. The accounts give a true and fair view of expenditure/contributions/revenue in the EU area concerning this financial year and the agency's financial position at 31 December 2013.

#### *The legality and regularity of underlying transactions*

Based on the audit conducted by the certifying body and our own audit, it is our assessment that, taken as a whole, the transactions underlying the accounts for 2013 in the EU area are legal and regular and in compliance with the overall provisions laid down by the European Commission and the Council of the European Union, and the Integrated Administration and Control System (IACS) is applied correctly and functions as intended.

*General comments*

It is our opinion that the financial statements give a true and fair view of the AgriFish Agency's assets, liabilities and financial position at 31 December 2013 and that the administrative structure of the AgriFish Agency provides reasonable assurance that the schemes are administered in compliance with laws, regulations and the provisions of the European Commission and the Council of the European Union. The financial statements are not affected by material misstatement and the transactions included in the financial statements are in compliance with appropriations granted, legislation, other rules and regulations, agreements made and common practice.

*Emphasis of matter concerning understanding the accounts*

Without qualifying our opinion, we draw attention to the certifying body's (Deloitte) reservations concerning the accounts for the European Agricultural Fund for Rural Development non-IACS populations. The audit disclosed material errors relating to missing documentation, inadequate case processing, missing correction of payments, inclusion of ineligible expenditure and missing and incomplete documentation of payments. The value of these errors is estimated at EUR 0.9 million.

Copenhagen, 2 June 2014

Vibeke Højmark  
Head of internal audit

## Appendix 2. Special audit opinion on the EU's own resources issued by the internal auditors at the Danish Ministry of Taxation

### **SKAT's statement, settlement and accounts concerning Denmark's contributions to the EU's own resources in 2013 (customs duties)**

The audit showed that section 38 of the operating unit – Accounting management of statement and settlement of contributions to the EU – was not entirely satisfactory despite the fact that the accounts were correct, i.e. free from material error and deficiencies.

The conclusion was based on the following findings:

- Not before August 2013, did SKAT implement a method/solution that would assist Denmark in its efforts to meet the Commission's requirements to the level of specification in the monthly settlements to the EU. SKAT still has not made the final reconciliation nor taken steps to make potential corrections as implied in the report that the internal auditors at SKAT issued in December 2013.
- SKAT had not made the annual reconciliation of accounts for the fiscal years 2012 and 2013.
- SKAT had not identified the reason for a debt balance of EUR 2.7 million in the government accounts under account no. 97.69 *Depositors*. Balances in this account are generally entered as credit balances.

### **Audits of SKAT's statement and settlement of Denmark's VAT and GNI-based contributions to the EU's own resources in the fiscal year 2013**

In accordance with an agreement with Rigsrevisionen, the internal auditors at SKAT issued a special opinion on Denmark's VAT- and GNI-based contributions to the EU's own resources for the fiscal year 2012 and whether these had been calculated and settled correctly by SKAT. SKAT calculates and settles Denmark's contribution to the EU's own resources in compliance with Council Regulation no. 1150/2000 (amending Council Regulations no. 2028/2004 and 105/2009), Council Regulation no. 1553/1989 and Council Decision no. 436/2007.

SKAT is responsible for the calculation and settlement of Denmark's VAT- and GNI-based contributions to the EU's own resources, whereas the expenditure as such is included in the government accounts under section 7.51.11 The Ministry of Finance. The audit conducted by the internal auditors at SKAT comprised only SKAT's calculation and settlement of contributions.

The audit conducted by the internal auditors included assessment of the effectiveness of SKAT's business procedures and internal controls in preventing, detecting and correcting errors. The internal auditors also carried out substantive audit procedures.

The internal auditors at SKAT concluded that Denmark's VAT- and GNI-based contributions to the EU's own resources for the fiscal year 2013 had been calculated and settled in compliance with the government accounting rules and the EU's formal and substantive provisions.

Overall, the internal auditors at SKAT were of the opinion that SKAT's administration of the area was satisfactory.

### Appendix 3. Glossary

Area control	Performed to determine whether land claimed by farmers in their applications corresponds with the data held by the AgriFish Agency in the reference parcel system and the results of remote sensing. It is also checked whether the farmers are complying with the eligibility requirements of the relevant schemes.
Article 68 schemes	The objective of the specific environmental aid provided under Article 68 is to increase the effort to support farming in environmentally sensitive areas. Basically, the eligibility terms are the same as under the SPS, but these are supplemented with specific environmentally-based requirements. Support is provided for extensive farming, management of permanent pastures and energy crops. The Article 68 schemes will be closed in 2015.
Cross compliance	Farmers must comply with a number of national requirements concerning the environment, health, animal welfare and the maintenance of all agricultural land in good agricultural and environmental condition to be eligible to receive payments under the Single Payment Scheme. These requirements also apply to area- and animal-based schemes financed by the Rural Development Fund.  This connection between payments and compliance with the requirements is called cross compliance.
Cross-compliance control	Planned risk-based checks of cross compliance performed on one percent of all applications in accordance with the EU regulations.
Eligible/not eligible areas	Land used for agricultural activities (including grassland) is eligible for payments under the Single Payment Scheme. The following areas are not eligible, fire lanes, property lines, windbreakers, natural habitats like heather, areas overgrown with rush and other wetland plants, and areas planted with Christmas trees.
EU financial correction	The Commission may refuse to reimburse in full the payments executed by the Member State to the farmers, if the Member State fails to comply with relevant EU regulations.
EU funds	Funding provided through the EU funds to Denmark, i.e. the Guarantee Fund, the European Fisheries Fund, the European Social Fund and the European Regional Fund. The EU funds make up the EU general budget and are not funds in the traditional legal sense of the word.
EU revenue and EU expenditure	Revenue received by Denmark from the EU is referred to as EU revenue, whereas contributions made by Denmark to the EU budget are referred to as EU expenditure.
Flat rate	The Commission generally applies a flat-rate penalty when project expenditure has been disqualified from reimbursement, which means that EU funding of the respective programme will be reduced by a fixed percentage.
Grass in rotation	Arable land used for growing grass or other herbaceous forage, sown as well as self-seeded, and included in the farm's rotational cycle. When land has been used to grow grass in rotation for five consecutive years, it must be re-seeded with another crop the sixth year. If the farmer fails to do so, the area will be classified as permanent pasture.
Hectare	A hectare is an area of 100 m x 100 m, i.e. 10,000 square meters or 0,01 km <sup>2</sup> . Hectare is commonly used in the measurement of land.
Layer of entitlements	Farmers can submit claims for payment under the RDP schemes based on the size of their land and the number of entitlements they hold. Entitlements are generally awarded for a period of five years. The layer of entitlements in the internet-based field map database reflect changes in the farmers' applications or the measurements of land following on-the-spot checks.
Ortho imagery	The AgriFish Agency has developed digital field maps based on aerial photos that have been geometrically corrected to ensure that the scale of distances, areas, etc. are as accurate as ordinary maps. These photos are referred to as ortho imagery.

Permanent pasture	Arable land used for growing grass or other herbaceous forage, both sown and self-seeded, that has not been included in the crop rotation of the farm for five years or longer. The classification as permanent pasture also applies if the land has been ploughed and resown with grass or other herbaceous forage in the course of a five-year period.
RDP schemes	General term used to refer to area-based schemes under the Rural Development Fund. The schemes provide aid for environmentally friendly management of land. Entitlements are generally awarded for a period of five years. RDP schemes include payments for conversion to organic agricultural production, environmentally friendly farming and management of grassland.
Reference parcel	Piece of land with natural boundaries, i.e. field boundaries, roads, etc. A reference parcel includes several fields that may be owned by one or more farmers. Reference parcels have a total area and a maximum eligible area.
Reference parcel system	System for registration of reference parcels.
Remote sensing	Measurement of agricultural land by satellite or aerial photos (ortho imagery).
The European Agricultural Fund for Rural Development (Rural Development Fund)	EU fund financing payments provided under the Rural Development Programme, i.e. area-based payments and other payments for mainly agricultural projects.
The European Fisheries Fund	EU fund financing projects under the Fisheries Development Programme.
The European Agricultural Guarantee Fund (the Guarantee Fund)	EU fund financing direct agricultural payments provided through the Single Payment Scheme and Article 68 schemes.
The European Regional Fund	The objective of the fund is to strengthen social and financial cohesion in the EU and reduce disparities between the regions of Europe.
The European Social Fund	The objective of the fund is to promote financial and social cohesion and reduce differences in living standards in the EU.
The Single Payment Scheme (the SPS)	Payments provided directly to farmers from the European Agricultural Guarantee Fund.