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Delegations will find attached document SWD(2014) 175 final.

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**COMMISSION STAFF WORKING DOCUMENT**

**on the assessment of root causes of errors in the implementation of direct payments and  
corrective/preventive actions**

## 1. INTRODUCTION

The Common Agricultural Policy (CAP) of the EU is implemented by way of shared management between the Commission and the Member States. This applies to both pillars of the CAP, i.e. market and direct support and rural development. Implementation in relation to the final beneficiaries of the measures is delegated to Member States, while the Commission is responsible for the overall legal framework, the budget implementation and the supervision of the Member States.

Member States' management and control systems as well as the specific expenditure, including in the area of direct payments, are subject to controls to ensure their compliance with the applicable provisions and avoid irregular payments. An important tool in this respect is the clearance of accounts procedures which may result in the *ex post* exclusion (and recovery) of irregular expenditure from Union financing. While such financial corrections safeguard the EU's financial interests and have an inciting effect to follow the rules, payment errors and insufficiencies of the management and control systems do occur.

The probable error rate affecting CAP expenditure is quantified through extrapolation resulting in a "most likely error" as established by the European Court of Auditors or a "residual error rate" established by the Commission in the framework of the corresponding annual declarations of assurance (DAS). An error rate above 2% is considered material.

The present document, in section 2, identifies the main causes for errors occurring in the current system of direct payments which is covered by the Integrated Administration and Control System (IACS). Section 3 identifies the main causes of errors that could arise in the future system of direct payments once the reform will have been implemented. Corrective and preventive actions already implemented and proposed to address the current and potential root causes are listed in section 4.

By way of preliminary observation, it is notable that the choices in the recent reforms of the CAP aim at an improved targeting of support measures and ultimately a more effective and efficient CAP. Better targeting often implies additional eligibility conditions and thus greater complexity of support schemes where Member States are given more flexibility in their choice and design of eligible measures.

Moreover, compromise solutions incorporated in the basic acts in the inter-institutional decision-making process give sometimes rise to diverging interpretations when implemented by Member States.

Aside from the policy-related considerations which a discussion of the error rate cannot disregard, there is also a trade-off between the pursuit of certain policy objectives and the minimisation of the likelihood of payment errors. As pointed out in the 2008 Commission Communication towards a Common Understanding of the Concept of Tolerable Risk of Error, the policy objective pursued, the budgetary ramifications of increased controls and the expected corresponding gains in terms of the regularity of expenditure must all be taken into

account. The exclusive pursuit of a reduction in irregularities of payments can be in tension with a reduced administrative burden on Member States and beneficiaries, a policy goal in its own right.

## **2. ANALYSIS OF THE MAIN CAUSES FOR ERRORS - CURRENT SYSTEM OF DIRECT SUPPORT (DAS 2012)**

The "most likely error" for expenditure under the European Agricultural Guarantee Fund (EAGF) as estimated by the European Court of Auditors (ECA) has increased from 2.9% in 2011 to 3.8% in 2012 ("market and direct support"). It is above the materiality threshold of 2% and has led the ECA to issue adverse opinions on the legality and regularity of payments underlying the accounts of the "market and direct support" policy group in its statements of assurance ("DAS").

As part of the DAS 2012 exercise, 140 transactions spread over 16 Member States were audited for direct payments. Out of those, 48 transactions were found with quantifiable errors, resulting in the calculation of an error rate of 3.19% up from 2.5% in DAS 2011 (based on 159 transactions in 19 Member States). A total of 14 transactions with high error rate (>5%) account for 88% of this error rate. Overall, the error rate for direct payments, even if above the 2% materiality threshold, is relatively low and tends to confirm the effectiveness of IACS in reducing the risk of non-legal payments.

For 2012, using an integrated approach for the direct decoupled aid the Directorate General for Agriculture and Rural Development's (DG AGRI) adjusted calculation of the residual error rate based on Member States' control statistics has indicated an error rate above materiality at 2.4 % (in comparison with around 0.5 % reported by the Member States).

The root causes for the 2012 error rate are analysed and detailed below. While those described in section 2.1. account for a significant part of the DAS error rate, they are more isolated by nature than those described in sections 2.2 to 2.4. This latter are the main causes for over and under declaration of area, and account for 54.5% of the overall error rate in 2012 (49.3% in 2011). They are also the most frequent as they were spread over 30 transactions in 13 Member States in 2012 and 41 transactions in 12 Member States in 2011.

### **2.1. Errors/non-compliances by national administrations**

These arise when the national administration does not adapt its system as to ensure compliance with the rules or does not follow its own instructions. A total of 23 errors in 3 Member States account for 39.5% of the 2012 DAS error rate similarly to what was observed in the 2011 DAS exercise where 43% of the error rate stemmed from such errors.

Non-compliance with the regulations and/or with own instructions automatically lead to undue payments. In some cases, such errors had already been detected by DG AGRI's own conformity clearance audits or by the certification bodies.

It should be stressed here that some of the errors encountered are isolated by nature and cannot be "generalised". In DAS 2012, those errors are found in a few Member States

(France, Luxembourg, Denmark and Spain)<sup>1</sup> and hence do not indicate a cross-cutting problem for CAP direct payments as a whole.

## **2.2. Insufficient quality and update of the Land Parcel Identification System (LPIS)**

Every Member State has the obligation to run and maintain a system where all eligible parcels are identifiable and described. The LPIS systems must be updated in order to ensure the reliability and efficiency of the systems and to incorporate changes such as agricultural land used for other activities, construction of buildings, roads, development of forests, land abandonment. Aid claims are based on the information contained in the LPIS.

Therefore, poor quality of the system and no/or inefficient updates cause errors in claims and finally payments.

## **2.3. Quality of on-the-spot-checks**

As on-the-spot checks do not cover 100% of claims, they cannot detect all errors; however, if they take place, they should indeed detect the possible errors. Furthermore, they have an important deterrent effect. Therefore, non-conforming or inefficient on-the-spot checks over the years may lead to widespread continuation of mistakes or bad practices which are leading to errors.

## **2.4. Mistakes in the aid application**

When the applicant receives the most recent information from the LPIS to fill-in his claim, he still has the responsibility to modify and inform about possible changes. An updated LPIS reduces the risk that such changes need to be performed but does not set it at zero. When changes with respect to what is included in the pre-filled forms handed by the national administrations are not indicated, this usually leads to over-declaration of areas claimed. These are not picked up in the administrative controls as the controls are based on the LPIS.

In DAS 2012, main errors of over declaration were found in France, Portugal, Italy and Ireland.

## **3. ANALYSIS OF THE POTENTIAL CAUSES FOR ERRORS - FUTURE SYSTEM OF DIRECT SUPPORT**

The reform could mitigate the risk that some of the current root causes for errors will indeed persist. This is to a certain extent true because the rules regarding the eligibility of land have been harmonised between Member States: no more link with the Good Agricultural and Environmental Condition (GAEC), removal of the Good Agricultural Condition 2003 (GAC 2003) for the Single Area Payment Scheme (SAPS), extension of the definition of permanent grassland to clearly include the grazable species other than grass and herbaceous forage. Also, some rules regarding e.g. the way financial ceilings ought to be respected have been streamlined and clarified.

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<sup>1</sup> The citing of Member States derives from the European Court of Auditors' audits which do not cover all Member States every year.

However, some persisting risks and a few additional risks are linked to the new direct payments regulation and are listed below.

### **3.1. Ecological Focus Area (EFA)**

The new obligation for farmers to have ecological focus area on at least 5% of their arable land will become a reality as from 2015. In general, this is considered to entail a relatively high risk of errors from both the farmers and the administrations.

It will require that the Commission services pay particular attention to the way Member States implement and control the measure (both from the policy and the IACS perspective) and take due account of the information gathered when planning the audits. On top of this general concern, a series of more specific elements are detailed below.

#### *3.1.1. Transitional period for the creation of the EFA layer in the LPIS*

The Horizontal Regulation<sup>2</sup> foresees an extended transitional period (until 2018) for the creation of an EFA-reference layer in the LPIS. As long as the reference layer is not ready, no administrative cross checks between the EFA declared in the applications and the LPIS will be possible with the consequent higher risk of errors.

#### *3.1.2. EFA that are difficult/costly to control*

The list of EFAs in the Direct Payments Regulation<sup>3</sup> is set as a menu for Member States who can pick and choose the elements they will allow farmers to declare for the purpose of complying with the EFA obligation. This list contains elements that are difficult or costly to control (e.g. areas with catch crops or green cover, areas with short-rotation coppice with no use of mineral fertiliser and/or plant protection products) and that enlarge the list of EFAs to be digitalised in the LPIS. This could require additional controls, in some cases outside the usual period for controls.

### **3.2. Greening equivalence**

#### *3.2.1. Import of the high error rate from second pillar*

Currently, Agri-Environmental and Climate Measures (AECM) present a higher error rate than direct payments. Equivalence could trigger an import of this error rate into the direct payments/greening error rate. This is however mitigated by the fact that, in view of the high error rate observed in Rural Development, an action plan has been put in place<sup>4</sup>. This should

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<sup>2</sup> Regulation (EU) No 1306/2013 of the European Parliament and of the Council of 17 December 2013 on the financing, management and monitoring of the common agricultural policy and repealing Council Regulations (EEC) No 352/78, (EC) No 165/94, (EC) No 2799/98, (EC) No 814/2000, (EC) No 1290/2005 and (EC) No 485/2008 (Horizontal Regulation).

<sup>3</sup> Regulation (EU) No 1307/2013 of the European Parliament and of the Council of 17 December 2013 establishing rules for direct payments to farmers under support schemes within the framework of the common agricultural policy and repealing Council Regulation (EC) No 637/2008 and Council Regulation (EC) No 73/2009 (Direct Payments Regulation)

<sup>4</sup> See *Commission Staff Working Document on the assessment of root causes of errors in the implementation of rural development policy and corrective action* of 27 June 2013, SWD(2013) 244 final, pages 5 and 18

improve the controllability of the Rural Development measures and thus also of the AECM that will be used by Member States in the framework of equivalence.

Also, it is worth mentioning that the Direct Payments Regulation contains a pre-established list of equivalent AECM for each of the three greening measures. On this basis, the assessment procedure of what Member States will notify as equivalent measures should be facilitated and could limit the link with the error rate found for AECM to only certain well identified measures.

### *3.2.2. Certification schemes*

The certification schemes Member States will notify as equivalent and their functioning are so far unknown and may lead to potential high risk of errors. However, an assessment procedure similar to the one that will take place for equivalent AECM; i.e. on the basis of the list set in Annex to the Direct Payments Regulation, will also be performed for the equivalent certification schemes thus mitigating to a certain extent the potential risks. However, setting up by Member States of strict control rules for equivalent certification schemes is fundamental for addressing the risks.

### **3.3. Greening exemptions**

The Direct Payments Regulation provides for a range of exemptions for EFA and for crop diversification which increases complexity of the rules and could create legal uncertainty and administrative burden to the farmer and the paying agencies during the checks. The farmer could have difficulties in judging with certainty in which case his holding is exempted or is not (risk of errors). If during a control it turns out that the farmer does not meet the threshold to be exempted, the farmer might be unexpectedly sanctioned (i.e. full non-compliance).

### **3.4. Greening penalties**

The Horizontal Regulation foresees that no penalty for greening shall apply in 2015 and 2016 and that it shall be limited to a maximum of 20% of the "declared" in 2017 and 25% as from 2018. This is very low compared to the maximum penalty applied in the current well-functioning IACS penalties (100% of the "declared"). Those penalties may not be deterrent enough against incorrect declarations and the burden of the Paying Agencies could be increased.

### **3.5. Basic Payment Scheme (BPS)**

#### *3.5.1. First allocation of payment entitlements*

The number of derogations (flexibility) added in the course of the negotiations as regards the first allocation of payment entitlements could lead to an increase of the direct payments error rate. The flexibility left to Member States as regards the steps to be defined for internal convergence may also have an impact on the error rate. The main risk is a wrong allocation of entitlements which, if detected too late, could have multi-annual implications.

### 3.5.2. *Eligible area to BPS*

In the current system, an important source of error is caused by misinterpretations of the rules on eligibility of land on behalf of both the administrations and the farmers. This is in particular true for areas of permanent grassland. Although this risk could persist in the future system, it could potentially be lowered thanks to the changes introduced (i.e. no more link between eligibility and GAEC, clear-cut rule that non-herbaceous features that can be grazed are included in the eligible area of permanent grassland). On the other hand, issues of interpretation and controllability of what are the species that can indeed be grazed, as well as a quite significant impact on the need to update the LPIS accordingly are to be expected. Moreover, the reduction coefficient which foresees to reduce the eligible area for permanent grassland with predominant non herbaceous species could pose a specific risk in terms of determination of the eligible area of permanent grassland.

## **4. CORRECTIVE/PREVENTIVE MEASURES ALREADY IMPLEMENTED AND POSSIBLE FURTHER ACTION**

DG AGRI is already addressing the main risks created to the Funds by the root causes listed under section 2 by means of audit enquiries and already initiated action plans. A series of actions covering improvements in monitoring, communication and remedial action are envisaged to mitigate the situation further and prevent issues from arising in the future.

### **4.1. Quality of the LPIS**

In 2010, the Commission introduced a legal requirement for Member States to annually assess the quality of the LPIS (LPIS QA) in order to identify pro-actively possible weaknesses in the system and to take remedial action when required<sup>5</sup>.

The quality/effectiveness of the assessment performed by the Member States will be actively followed-up by a new unit in DG AGRI ("Implementation support, monitoring, IACS and LPIS") with increased emphasis on the correct assessment of the quality of the system to ensure that Member States do take the remedial actions required to meet the quality standards DG AGRI considers appropriate; namely:

- Follow-up of the compliance with regulatory deadline to submit LPIS QA and of its content (i.e. all documents are presented in the right format, an assessment is done and, if necessary, remedial actions are foreseen),
- Screening of LPIS QA using the methodology developed by the Joint Research Centre (JRC) (i.e. use of the right methodology, quality of the imagery used)

Moreover, the clearance of account will include in its process the assessment of the correct application of the LPIS QA method including the correct interpretation of the imagery.

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<sup>5</sup> See Article 6(2) of Commission Regulation (EC) No 1122/2009



## **4.2. Communication, information and advice**

Targeted communication and information actions towards Member State authorities covering the analysis of root causes of errors and the development of corrective actions allow raising awareness on most frequent errors, misinterpretations and ways to prevent them.

To this end, DG AGRI, possibly with the support of the Court of Auditors, will reinforce its actions to inform in meetings (e.g. meeting with paying agencies; or ad hoc expert groups) the actors in charge (paying agencies, managing authorities) and, where relevant, will develop guidance documents addressing problematic issues (e.g. via Wikicap, Working docs, etc.). The new unit in DG AGRI referred to in point 4.1 is foreseen to support Member States in the implementation of the direct payment schemes, in particular as regards the integrated administration and control system (IACS), by providing guidance and ensuring exchange and dissemination of best practices.

The Farm Advisory System (FAS) set up in the framework of the CAP will also include as from 2015 the greening obligations as well as the criteria for the maintenance of land in the context of eligibility to direct payments. This is expected to contribute raising farmers' awareness to these requirements, which could avoid errors.

## **4.3. Specific actions targeted to certain Member States**

Specific actions towards deficiencies in certain Member States have been taken following clearance of account enquiries that detected major deficiencies and they have proven effective in triggering changes. The current procedure is to ask the concerned Member States to draw up an action plan for each of the deficiencies identified (Spain and Greece on the issue of permanent pasture, France on the general issue of the LPIS as well as regarding controls in the field of cross compliance and non-area coupled payments). This requires follow-up via audit missions but also bilateral meetings and frequent contacts with DG AGRI's officials. By combining close discussions on measures to take, follow-up and evaluation of implementation of those corrective measures, the specific actions transcend the usual clearance of account exercise.

Based on a combined analysis of the previous DAS exercises (2010, 2011 and 2012), of Member States' statistics and of DG AGRI audit results, new specific actions would need to be started towards specific Member States as described in the Annual Activity Report of DG AGRI for 2013: in Hungary an action plan is to be set up on the issue of claim lodging and quality of on-the-spot checks; in Portugal the consolidation of entitlements following the action plan on permanent pasture will be closely monitored by DG AGRI; in the United Kingdom an action plan to formalise the up-dating of the LPIS is presently underway.

## **4.4. Audit activity**

Although the national authorities play the key role in protecting EU-Funds under shared management, the Commission services provide guidance to the Member States and monitor the effectiveness of the control systems on an on-going basis, in particular through

compliance audit missions (including also audits of paying agencies' compliance with the accreditation criteria and audits of the certification bodies) as well as clearance of accounts.

Whenever weaknesses are found, the Commission protects the Union's financial interests by means of financial corrections imposed on the Member States. The error rate for direct payments is also being addressed through DG Agri's audit activity.

The reported error rates have been fully taken into account in deciding which Member States and paying agencies are to be included in the 2014 work programme. In addition, the work programme also include those agencies in which specific plans need to be followed up, such as action plans committed by the paying agencies due to reservations in the DG AGRI's 2012 Annual Activity Report (AAR), and improvements / changes to be implemented in their control systems.

In addition, reviews of the LPIS QA will be included more often in the scope of clearance of account's audits. The LPIS QA is a supplementary tool to assess yearly the LPIS and take appropriate measure to bring it to the standard. The emphasis given in 2012 and 2013 on the reduction of the open audit enquiries enable DG AGRI to increase the number of new audit missions as from 2014. This continued priority in ex-post audits will lead to sounder financial management and maintain awareness and understanding of the issues at stake among national administrations and beneficiaries. This should lead to more efficient practices that comply with sound financial management.

#### **4.5. Suspension of payments**

The previous legislation provided for the possibility to suspend direct payments but only in the case of repeated deficiencies having been the reason for at least two financial correction Decisions by the Commission. The Horizontal Regulation now contains a more flexible procedure (Article 41) and should provide Member States with a stronger incentive to improve their systems where necessary.

#### **4.6. Legal implementation**

In the process of elaborating the secondary legislation, DG AGRI has proposed a series of rules aiming at mitigating the risks mentioned in sections 2 and in particular 3 above. These mainly concern control provisions; e.g.:

- increase in the rate of on-the-spot checks where these reveal significant non-compliances in the context of a given aid scheme or support measure,
- clear rules on the need to control on the spot also the farmers exempted from the greening obligations,
- proposed rules on the equivalent certification schemes and the corresponding control requirements to minimise the risk of errors,
- clarification of the rules in respect of the allocation of payment entitlements.

As it is already common use, the need to amend the secondary legislation in view of specific difficulties encountered in the process of implementation of the reform will be constantly assessed and acted upon.

#### **4.7. Improved inventory and processing of information**

More specifically in the framework of the reform, exhaustive inventory of information regarding the options taken by Member States to implement the new system of direct payments will have to be obtained by the services of DG AGRI in charge of the management of the policy and processed for diffusion to the concerned services in charge of monitoring of the implementation and audit. To this end, a series of notification obligations have been included in the Direct Payments Regulation and in the Commission services' proposals for secondary legislation both in respect of direct payments and IACS (i.e. control statistics).

Based on an enhanced co-operation with Member States, the quality and reliability of the information gathered will need to be improved to allow the monitoring of the implementation of Direct Payment rules and control systems.

The information at hand will be used to feed the risk analysis established for planning the usual audits and in the decisional process on the relevance of launching actions plans.

### **5. CONCLUSION**

Providing flexibility to Member States to cater to the specific needs of their agricultural sectors has been a constant and deliberately pursued policy objective in the recent CAP reforms. Having said this, there is a risk that increased flexibility and improved targeting of support may lead to, all other things being equal, an increased risk of errors<sup>6</sup>.

It is against this backdrop that seven main preventive/corrective actions are outlined in the present document. They address common problems identified in the shared management of direct payments. The actions draw upon the Commission services and Member States in equal measure, cognizant of the fact that containing the error rate will depend on the cooperation between all the stakeholders in the implementation chain, that is to say the Commission, the Member States, the paying agencies, and the final beneficiaries.

DG AGRI is committed to follow up on the actions listed, to discuss the modalities of their implementation with Member States, to monitor their application as well as to consider any further possible measures conducive to containing the error rate affecting direct payments.

As to the timing of the implementation of the legislative actions, this will depend on the adoption of the secondary legislation substantiating the CAP reform outcomes. Most of the actions should be set in motion in the course of 2014.

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<sup>6</sup> See also footnote 1, SWD(2013) 244 final, pages 5 and 18