



Audit Conclusion

18/08

Funds Spent to Support Animal Production

The audit aimed to review the management and support system in the animal production sector, including the setting of strategic objectives, and verify whether the funds provided contributed to the anticipated benefits and effects.

The audit was performed at the audited entities between March 2018 and October 2018.

The audited period was 2014-2017; both the previous and subsequent periods were also considered for contextual reasons.

Audited entities:

Ministry of Agriculture (hereinafter “MoA”);

Státní zemědělský intervenční fond, Praha (hereinafter “SZIF”);

SELMA a.s., Jihlava;

PROVEM a.s. Havlíčkův Brod, Kojetín;

LIPRA PORK a.s., Rovensko pod Troskami.

I. Summary and Evaluation

The SAO reviewed the system for the management and allocation of funds of the state budget and the European Union (hereinafter the "EU") to support the animal production sector, including the setting of strategic objectives, and verified whether the funds provided contributed to the anticipated benefits and effects. To this end, it assessed the provision of subsidies from the state budget (hereinafter the "national subsidies"), *the Rural Development Programme 2007-2013* (hereinafter "RDP 07-13"), *the Rural Development Programme 2014-2020* (hereinafter "RDP 14-20"), direct payments and extraordinary support to the animal production sector. It focused on the setting of this support, management and control activities of MoA and SZIF, and the reliability of monitoring and assessment of impacts of the support provided. The SAO verified applications for subsidies of a total of CZK 1.2 billion and audited three subsidy beneficiaries.

Overall Evaluation

The Czech Republic is one of the EU countries which intensively subsidizes animal production. A large number of various support and subsidies with a significant financial volume are allocated to this sector. This support is provided from both national and European sources.

The audit revealed major shortcomings in national subsidies. The MoA has set the subsidy conditions and control system in a way which shows a number of major shortcomings negatively affecting the effectiveness and economy of the public funds incurred. The SAO identified cases where the MoA reimbursed subsidy beneficiaries for expenses that were not substantiated by invoices or were in conflict with the subsidy conditions.

Apart from some partial deficiencies, the management system and conditions set by the MoA for the provision of support from European sources were found to be functional and effective. Deficiencies with a financial impact were identified in the case SZIF's unauthorised provision of a subsidy to a subsidy beneficiary.

The SAO states that the MoA is failing to meet the strategic objectives set in the animal production sector. At the end of 2017, the number of livestock (dairy cows and pigs) and the self-sufficiency rate of the Czech Republic to cover the consumption of beef and pork decreased compared to 2015, even though the subsidies to animal production have been increasing since 2012. The largest percentage increase in subsidies is reported by the pig and poultry sector.

The overall evaluation is based on the following deficiencies:

- The strategic objectives in animal production, e.g. to increase the number of dairy cows and pigs, have not been fulfilled. Five of the eight evaluated indicators showed a decrease at the end of 2017 compared to 2015, even though an increase had been envisaged.

- The aim of the subsidies from the national subsidy programme 19.A *Aid for the participation of producers and processors of milk in the Q CZ quality scheme*¹ is to support improvement in the quality of milk. The SAO has found out that:
 - The subsidies were allocated to cover ordinary operating costs of dairies with long-term profits. The MoA's assessment of the cost calculations demonstrating the operating costs was only formal and the MoA did not verify whether the costs were actually associated with the purpose of the support.
 - One of the main indicators of the Q CZ milk quality set by the MoA was the "*number of somatic cells per millilitre of milk*" with a value which significantly exceeds the average value of raw cow milk in the Czech Republic.
 - The applicant could also belong to the category of large enterprises. However, it had to prove that the support is essential to it and it has an incentive effect. The applicants submitted inadequate evidence based on which the MoA could not verify compliance with this condition. Yet, it provided support to these applicants.
- Subsidies from the national subsidy programme 8.F *Epidemic Fund* are intended for pig and poultry farmers to support selected activities aimed at stopping the spread of dangerous livestock diseases. The MoA granted these subsidies based on invoices with a generally formulated subjects of performance, without further specification, more detailed description and genuine link to the subsidy purpose. The scope of activities and the volume of work performed could not be verified from the documentation. The MoA thus did not assess the effectiveness and economy of the expenses.
 - An example of inefficiency is the case of a subsidy beneficiary who received, inter alia, a subsidy to cover professional supervision of cleaning of stables in the total amount of CZK 3.1 million between 2015 and 2017, where one hour of supervision cost CZK 2,600. Moreover, the same beneficiary paid a several time higher amount for the rental of cleaning disinfection machines than it would pay for new machines.
- The MoA annually administers more than two thousand applications for national subsidies. The MoA has not set a system to ensure that the applications are administered and checked properly. There have been cases where applicants were reimbursed for expenses which were not substantiated by invoices or which were not eligible.
- When checking the condition of the number of stabling places for the RDP 14-20 projects, SZIF does not create an adequate audit trail and it is not clear whether SZIF performs these checks. The subsidy amount to be granted to a recipient is subject to the fulfilment of this condition.
- In the case of RDP 07-13 projects, the MoA and SZIF approved procedures where beneficiaries divided investment agricultural projects into several subsidy applications. By dividing projects into multiple applications, the beneficiaries achieved a higher subsidy.
- The audit sample showed the following:
 - Due to insufficient control of subsidy applications by the MoA and SZIF, CZK 23.7 million was paid out from the 19.A subsidy programme which should not have been paid.
 - In the case of two RDP 07-13 projects, SZIF granted unjustified funds in a total amount of CZK 16.4 million and thus violated the budgetary discipline.

¹ It is a quality scheme which goes well beyond the standards defined for raw milk.

- The *Farm Accountancy Data Network's* (FADN) data analysis shows that the Czech Republic pays above-average subsidies to the animal production sector in comparison to other EU Member States. In 2016, the subsidies granted to all monitored production sectors increased compared to 2010, except for cattle breeding.

Note: The laws and regulations cited in this Audit Conclusion apply as amended for the period under review.

Development and allocation of subsidy funds to animal production

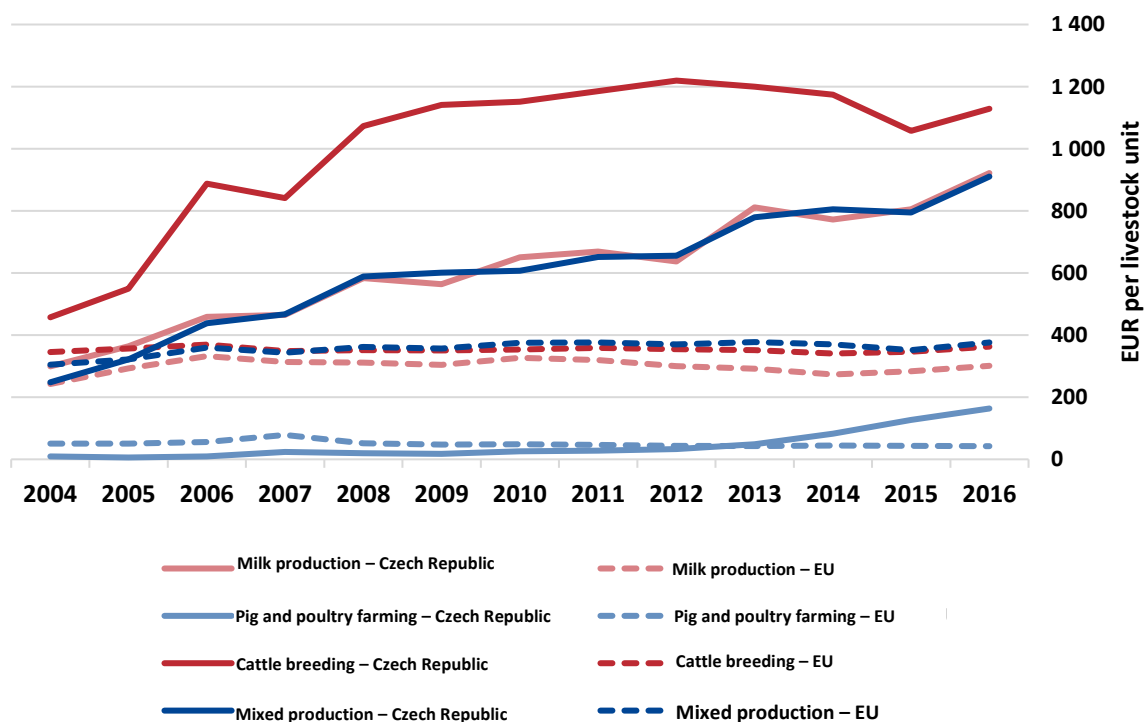
Using data from the FADN international network, the SAO verified to which animal production sectors the subsidies are allocated and compared their levels to other EU Member States.

The data in the FADN network come from a sample survey of the economic results of enterprises in agriculture. In this survey, the agricultural holdings are grouped according to their production orientation. Animal production is associated with the following production orientations:

- mixed production,
- milk production,
- breeding of cattle, sheep, goats and other animals grazing coarse fodder,
- pig and poultry farming.

To ensure the comparability of the data, the outputs are converted to one livestock unit (LU). More information on the methods of the FADN survey is provided in Annex 1 to this Audit Conclusion.

Chart 1: Development of operating subsidies to agricultural holdings according to the production orientation per livestock unit



Source: FADN PUBLIC DATABASE (http://ec.europa.eu/agriculture/rica/database/database_en.cfm).

Chart 1 shows the development of operating subsidies to agricultural holdings according to their production orientation in the Czech Republic and the average level of operating subsidies within the EU. It follows from the data presented in the chart that the largest volume of subsidy funds is allocated to agricultural holdings whose production is oriented to

cattle breeding. The level of funds received by agricultural holdings specialising in milk production and mixed production is approximately the same and has a similar growth trend. The smallest portion of subsidies is allocated to enterprises focusing on pig and poultry farming.

As for the development of subsidy level over time, subsidies have been increasing in all animal production sectors since 2012, with the exception of cattle breeding. The most significant increase has occurred in pig and poultry farming, where only minimum subsidies were allocated by 2012.

The volume of subsidies granted to animal production in the Czech Republic is far above the EU average in all production sectors on a long-term basis, except for the sector of pig and poultry farming. Subsidies allocated to this sector have increased since 2013.

Table 1: Development of total production, total costs and ratio of total costs to total production in the Czech Republic

Year	Milk production			Cattle breeding			Pig and poultry farming			Mixed production		
	Production	Costs	Ratio	Production	Costs	Ratio	Production	Costs	Ratio	Production	Costs	Ratio
2004	EUR 1,620	EUR 1,742	107 %	EUR 868	EUR 1,120	129 %	EUR 798	EUR 804	101 %	EUR 1,979	EUR 2,072	105 %
2005	EUR 1,630	EUR 1,815	111 %	EUR 966	EUR 1,133	138 %	EUR 820	EUR 794	97 %	EUR 1,967	EUR 2,217	113 %
2006	EUR 1,684	EUR 1,948	116 %	EUR 860	EUR 1,475	172 %	EUR 886	EUR 895	101 %	EUR 2,013	EUR 2,370	118 %
2007	EUR 1,889	EUR 2,120	112 %	EUR 955	EUR 1,557	163 %	EUR 1,007	EUR 1,065	106 %	EUR 2,321	EUR 2,585	111 %
2008	EUR 2,129	EUR 2,532	119 %	EUR 1,082	EUR 1,723	159 %	EUR 928	EUR 995	107 %	EUR 2,675	EUR 3,134	117 %
2009	EUR 1,654	EUR 2,180	132 %	EUR 906	EUR 1,613	178 %	EUR 1,080	EUR 1,154	107 %	EUR 2,175	EUR 2,836	130 %
2010	EUR 1,919	EUR 2,371	124 %	EUR 962	EUR 1,768	184 %	EUR 1,247	EUR 1,281	103 %	EUR 2,477	EUR 3,020	122 %
2011	EUR 2,407	EUR 2,777	115 %	EUR 1,109	EUR 1,885	170 %	EUR 1,286	EUR 1,398	109 %	EUR 3,137	EUR 3,475	111 %
2012	EUR 2,562	EUR 2,947	115 %	EUR 975	EUR 1,752	180 %	EUR 1,421	EUR 1,391	98 %	EUR 3,228	EUR 3,605	112 %
2013	EUR 2,470	EUR 2,996	121 %	EUR 1,028	EUR 1,779	173 %	EUR 1,384	EUR 1,390	100 %	EUR 3,154	EUR 3,574	113 %
2014	EUR 2,793	EUR 3,159	113 %	EUR 1,022	EUR 1,720	168 %	EUR 1,364	EUR 1,327	97 %	EUR 3,364	EUR 3,701	110 %
2015	EUR 2,560	EUR 3,168	124 %	EUR 1,069	EUR 1,738	163 %	EUR 1,419	EUR 1,462	103 %	EUR 3,157	EUR 3,745	119 %
2016	EUR 2,551	EUR 3,201	125 %	EUR 1,073	EUR 1,773	165 %	EUR 1,388	EUR 1,440	104 %	EUR 3,155	EUR 3,854	122 %

Note: The production and cost indicators are converted to one livestock unit.

Table 1 shows the development of production, costs and their ratio since 2004. The analysis of these data shows that enterprises specialising in cattle breeding are the least profitable ones as the ratio of the total production to total costs is the highest (165%). By contrast, the lowest ratio is associated with the sector of pig and poultry farming (approximately 104%). The analysis also showed that the total costs of milk production and mixed production sectors had increased significantly since 2010.

Data Annex to the Conclusion No. 18/08 – Animal Production

(See also <https://www.nku.cz/scripts/detail.php?id=10222>.)

The SAO analysed the data on animal production from the *Farm Accountancy Data Network*. This network serves as the main information source of the European Commission regarding the actual economic situation of agricultural holdings. FADN data come from a sample survey of agricultural entities and annually includes about 1,400 enterprises in the Czech Republic. The enterprises are grouped according to their production orientation and size. The plan for the selection of enterprises is based on the legislation and methodology of the European Commission. For the purposes of sample surveys, a special classification system is introduced under which it is possible to classify each enterprise according to its economic size (four classes) and determine its production orientation based on its specialisation. In the Czech Republic, small enterprises account for about 15% of the sample, medium enterprises account for 30%, large enterprises represent 25% and the largest enterprises form 30%.

In the analysis, the SAO used the following indicators of individual agricultural holdings:

SE 020 Total labour input – the number of hours worked by paid workers.

SE 080 Total livestock units – the average annual number of livestock converted to a livestock unit according to the EU methodology.

SE 131 Total agricultural production – the sum of animal, plant and other production.

SE 270 Total costs – the indicator consisting of the sum of direct costs, overhead costs, depreciation and external factors.

SE 405 Balance of investment subsidies and taxes – consists of the sum of investment subsidies reduced by the VAT deductions on investments.

SE 410 Gross value added – defined as the difference between the total agricultural production (animal, plant and other production) and production consumption (direct and overhead costs). The value includes the balance of operating subsidies and taxes.

SE 415 Net value added – this indicator is based on the value of total production and all operating aids reduced by all costs, except for costs of external factors, i.e. except for labour costs, ground rent, rent for buildings and interest on loans. The net value added thus represents the company's resources to cover costs of production factors.

SE 420 Income from agricultural activities – profit or loss expressed as a net value added after deducting costs of external factors (labour costs, ground rent, rent for building and cost interest) and adding investment subsidies.

SE 600 Balance of operating subsidies and taxes – the sum of operating subsidies and the VAT balance reduced by taxes.

Operating subsidies – the sum of operating subsidies.

Difference between total production and total costs – a positive indicator means that the production was higher than the costs.

ODVOZENÍ UKAZATELŮ EKONOMICKÝCH VÝSLEDKŮ PODLE METODIKY FADN EU

DEFINITION OF INDICATORS OF ECONOMIC RESULTS ACCORDING TO THE FADN

CELKOVÁ ZEMĚĚLSKÁ PRODUKCE TOTAL OUTPUT SE 131			SALDO PROVOZŇNÍCH DOTACÍ A DANÍ BALANCE CURRENT SUBSIDIES & TAXES SE 600	
PRODUKCE RV OUTPUT CROP & CROP PRODUCTS	PRODUKCE ŽV OUTPUT LIVESTOCK & LIVESTOCK PRODUCTS	OSTATNÍ PRODUKCE OTHER OUTPUT		
VÝROBNÍ SPOTŘEBA INTERMEDIATE CONSUMPTION		HRUBÁ PŘIDANÁ HODNOTA GROSS FARM INCOME SE 410		
PŘÍMÉ NÁKLADY SPECIFIC COSTS	OSTATNÍ VĚCNÉ NÁKLADY FARMING OVERHEADS			
		ODPISY DEPRECIATION	ČISTÁ PŘIDANÁ HODNOTA FARM NET VALUE ADDED SE 415	SALDO INVESTIČNÍCH DOTACÍ A DANÍ BALANCE SUBSIDIES & TAXES ON INVESTMENT SE 405
		EXTERNÍ FAKTORY EXTERNAL FACTORS		DŮCHOD ZE ZEMĚĚLSKÉ ČINNOSTI FAMILY FARM INCOME SE 420
		MZDOVÉ NÁKLADY WAGES	PACHTOVNÉ RENT	

Source: FADN Czech Republic.

The data processed concern the period from 2004 to 2016. The analysis contains data from the European part of FADN, which serve as the basis for comparison between individual EU Member States or between a Member State and the EU average. The data are collected and processed using a uniform methodology across the European Union².

The data annex provides a graphical representation of these indicators: “balance of operating subsidies and taxes”, “balance of investment taxes and subsidies”, “total agricultural production”, “total costs” and “net value added”, for individual years and the EU Member States.

The data annex also includes a breakdown of indicators “total costs”, “total agricultural production” and “operating subsidies” for individual Member States. The values of indicators of the Czech Republic can be compared with the EU average.

² Subsidy systems in individual Member States may show differences that may affect the reported data and indicators from the FADN database.