

## Belgian Court of Audit



### **Two types of aid in the agricultural sector: investment aid and aid for setting up young farmers**

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at the Joint Training Event of the Contact Committee and the EUROSAI  
Experience with the development and carrying out CAP audits

Prague, 25-27 October 2010

## 1. Introduction

The EU Council Regulation N° 1257/1999 of 17<sup>th</sup> May 1999 established a single framework on support for rural development from the European Agricultural Guidance and Guarantee Fund (EAGGF) as well as the measures eligible for support, their objectives and criteria for eligibility.

The Walloon Rural Development Program approved by the European Commission in 2000, falls within the scope of the CAP's second pillar, as shown in diagram 1.

The Walloon Rural Development Program comprises ten measures, among which investment aid to agricultural holdings and setting-up aid for young farmers.

In view of their importance, the Court of Audit carried out a performance audit on the co-financing of investments and the aid for setting up young farmers, whose results were published in June 2005.

The four audit themes adopted are:

- The quality of the examination of aid project applications and the internal control,
- The length of the procedure for granting aid from the decision-making to the payment to beneficiaries
- The risk related to aid in the form of interest subsidies
- The granting and the management of the regional guarantee

As part of its operational plan 2010, the Court intended to follow up this audit in order to assess the implementation of its own recommendations and of the commitments taken by the minister in charge of agriculture. This follow-up is still going on, which means that the results cannot be commented upon during this presentation. I will nevertheless give a broad outline of the structure of aid as applied since 1st January 2007, when the Walloon Rural Development program 2007-2013 came into effect.

As this presentation is limited to 20 minutes, it will be focussed on the audit report's following elements: methodology, budgetary management, internal control of the administration, complexity of regulations, risks related to aid in the form of interest subsidies and the minister's response.

## 2. Methodology

The methodology that was used for this audit of two types of aid in the agricultural sector mainly consists in exploiting management databases. The objective was to bring out findings on all applications for aid projects and, in some cases, on a proportional stratified sample<sup>1</sup> of

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<sup>1</sup> The strata, made up of mutually exclusive and exhaustive subsets, correspond in this analysis to applications submitted in the frame of the 17 intervention systems within these two types of aid but also applications for which no decision had been recorded in the data base as of 1 October 2003 and files for which the latest decision to date was unfavorable. In order to determine the sample size, the materiality level (5%) was set in

196 administrative files of applications submitted between January 2000 and end of June 2003. Files were selected on a random basis, while ensuring coverage of all local administration units charged with the examination of the applications and excluding the files that were not handled exclusively by the Directorate General for Agriculture<sup>2</sup>.

In order to get comprehensive data on aspects related to the subsidized credit interest rate, six banks were consulted. 15 European supreme audit institutions were also contacted in order to collect information on the regulations and audits which could be relevant to the subject. Except for the European Court of Audit, none of the 10 SAIs<sup>3</sup> that answered our query had performed an audit related with these two measures.

Finally, the audit team conducted interviews with civil servants of the local administration units and the central administration unit.

These precautions made possible a concrete approach to the issue and enabled the Court to form a nuanced opinion on the management of both measures in the Walloon Region.

### 3. Budgetary management

Investment aids and setting-up aid for young farmers can be awarded:

- in the form of interest subsidies, when the farmer finances his investment through a bank loan,
- or in the form of capital subsidies, in case of self-financing.

Additional premiums may be granted when the agricultural holding is located in a less-favoured area or when the farmer is considered as a young farmer.

The interest subsidies accounted for 80% of all applications for aid projects. The budgetary burden was spread over a period varying from five to fifteen years. The budgetary and financial impact of the awarded aid justified a thorough examination of this matter, especially as the Walloon Region's regulations did not set any effective limit on the interest rate provided to the farmer. This limit is a crucial element in determining the subsidy amount.

#### Walloon Rural Development – budgetary envelope for the period 2000-2006 (euro)

Aid measures	Public expenditure (Walloon region and EAGGF)	EAGGF
Investment	36,522,600.00	9,023,400.00

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accordance with standards that are generally used in audits and applied by the European Court of Audit. The required accuracy level was limited to 7% in order to optimize the audit's cost-benefit ratio.

<sup>2</sup> To avoid situations where responsibilities should be shared by various administration bodies.

<sup>3</sup> ECA, Austria, Denmark, Finland, France, Germany, Greece, Luxemburg, Portugal, and Sweden.

Setting-up of young farmers	44,048,800.00	9,690,200.00
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#### 4. Complex regulations

The audit highlighted the regulations' complexity (seventeen aid schemes and additional premiums) and the consequent risks of different interpretations. These risks were amplified by the fact that the examination of applications for aid was conducted either by the central administration or by the seven local units. The different interpretation caused unequal treatment among beneficiaries.

The Court recommended measures for giving clear and precise instructions, providing specialized training to civil servants, establishing a forum for frequently asked questions and answers made thereto and periodically rotating the files among civil servants.

#### 5. Internal control of the administration

The examination of the aid project applications started in the local administration units and was later carried on by the central administration unit. Except for occasional non-formal prior contacts between the farmer and the local unit, the application's examination took place when the loan had already been granted by the bank, or when the investment had come to an end (or was being completed by the self-financing farmer). This system prevented the administration from advising and guiding the project with a view to improving the farmer's position.

The Court recommended setting up an authorization procedure prior to the start of the investment programme whereby the local unit would be able not only to play a stronger role in this matter, but also to help to avoid the risk of over-equipment or excessive indebtedness.

#### Processing time

The Court also tried to assess to what extent the complaints that were regularly made regarding the delays of aid payment to farmers were justified.

#### *Decision-making processing time*

Between 1994 and 2003, the number of agricultural holdings decreased by about 30 %, while the number of aid applications rose by more than 47 %. The rise in the number of applications caused saturation in all concerned units and had an impact on the decision-making processing time.

On average, more than 14 months elapse between the moment when the farmer takes out his loan and the day he is notified of the granting decision.

For setting-up aid, the European regulations limit the decision-making process to 12 months starting from the setting-up. The average processing time is 271 days from the setting-up date and 235 days from the date when the application was received.

### *Payment processing time*

It takes on average more or less 16 months between the submission of the application and the payment of the setting-up premiums to the beneficiary. The average processing time of additional premiums in less-favoured areas and premiums to young farmers exceeds 30 months.

Up to February 2003, 85 % of all capital subsidies were paid to the farmer less than 6 months after the theoretical granting date. The situation worsened in 2004 because of insufficient budget resources: several hundreds of claims were on hold for several months.

As far as interest subsidies are concerned, when the decision is notified before the first scheduled loan payment (i.e. in 34,5 % of the cases), the first subsidy is paid to the financial institution a little more than 6 months after the first payment date. When the decision is notified after the first scheduled payment, the bank receives the first subsidy more than 9 months after the decision. As for the subsidy for the second loan payment, the payment period is approximately 4 months.

The Court also found that delays in transmission of payment lists among administration units and the irregular rhythm of payments during the year (the first payments of some subsidies are put off to the second or even the third quarter) also contribute to lengthening processing times.

The Court recommended that local units should amplify contacts with farmers to speed up the examination of applications. Generalized access to databases as SIGEC (integrated management and control system) and Sanitel (animal identification database) would also contribute to administrative simplification.

## **6. Risks related to aid in the form of interest subsidies**

Investments aid and setting-up aid for young farmers can be awarded in the form of interest subsidies, when the farmer finances his investment through a bank loan.

The interest subsidy amount resulted from a theoretical calculation based on the principle of straight-line depreciation of the subsidized loan. Under the aid scheme, the farmer has to bear a 1% or 3% minimum interest rate, whereas the Walloon Region's share corresponds to a maximum interest rate of 5%. The administration doesn't take into account the current terms agreed on between the bank and its client.

### Interest rate exposure

Since mid-1995, the five-year investment interest rate has been under 8%, a level from which the farmer whose minimum interest share is 3% is not encouraged to negotiate the interest rate, as every rate decrease is only beneficial to the Region. On the other hand, it will be in the farmer's interest to negotiate the interest rate up to 6% if he enjoys an aid scheme where his minimum interest share is 1%.

A comparative analysis of the difference between an investment reference interest rate and the subsidized interest rate revealed "the pernicious effect of the mechanism": the subsidized interest rate increases as part of aid schemes for which the minimum interest share to be supported by the farmer adds up to 3%.

Examination of files underscored the two following phenomena:

For loans contracted up to 2001: in some cases the rate rise was partially retroceded to the farmer in the form of commercial discounts. The impact of this measure was evaluated to 2.68 million euro, only for granting decisions of interest subsidies notified during 2000.

From mid 2001: loan agreements do not mention explicitly these commercial discounts anymore. The deviation between the interest rate and the reference rate was not reduced significantly for loans granted after this date. The question that must be asked is whether these discounts were actually suppressed.

With the relatively low interest rates, the guarantee measures provided for in the regulations had lost their efficiency. As a result, there was an absolute loss for the European and regional finances because of undue payment.

It was the Court's opinion that if the Walloon Region wished to maintain this aid system, it should amend it in order to avoid deviations and to ensure maximum transparency. The Region could draw its inspiration in this respect from the experience of other Member states such as France and Luxemburg, which have systems of low-interest loans.

#### How can undue payment risks be limited?

The current undue payment risks could be reduced by requiring IT-supported transmission of statements of claims, by introducing a reliable mechanism for an automated detection of interest subsidies' payments in excess of the committed aid amount (which should be adapted according to the real credit rate), by increasing the security of payment data files and by using a unique identification based on the integrated management and control system.

### **7. The minister's response**

Responding to the Court's arguments, the minister put forward the following elements.

The important supplementary budgetary resources granted to the administration had made it possible to considerably reduce the payment delays in the first semester of 2004 and the supplementary budgetary resources granted should enable it to maintain its catching-up efforts. Besides progressively modernizing the computer systems, several measures had been taken to improve the administrative follow-up, the monitoring of commitments and the budgetary follow-up.

The minister also intended to favour aid in the form of capital subsidies rather than interest subsidies in the 2007-2013 rural development program.

### **8. Audit follow-up and Court of Audit's recommendations**

As I told you in the introduction, the audit follow-up has not been completed so far, and therefore, its results cannot be presented yet. Here is however, in a nutshell, the structure of aid as applied from 1st January 2007.

In the Walloon Rural Development program 2007-2013, the Walloon Region contemplates suppressing altogether aid in the form of interest subsidies by 2013 and introducing capitalization of the still unpaid annual instalments by 31 December 2015.

The regulations applicable in the Walloon Region have modified the calculation method of interest subsidies from 1st January 2007. As a result, for the applications submitted from 1st January 2007, the subsidy is not calculated according to the credit rate but according to a reference rate which is published by the administration on a quarterly basis.

The interest subsidy rate equals the difference between the reference rate and the minimum rate which is supported by the farmer (1, 2 or 3% according to the scheme). The reference rate is calculated by adding 1 % to the average value of the ten-year linear bonds rate during the three months preceding publication date.

Whereas between 2000 and 2005, almost 80% of all aid to investment and setting-up was granted in the form of interest subsidies, since the Walloon Rural Development program 2007-2013 came into force, we can notice a reversal of this tendency. In fact, from 1st January 2007, 77% of all aid was awarded in the form of capital subsidies and only 23 % in the form of interest subsidies.

*A copy of the original report in French is available on our website:*

[http://www.ccrek.be/docs/Reports/2005/2005\\_21\\_Secteur\\_Agricole.pdf](http://www.ccrek.be/docs/Reports/2005/2005_21_Secteur_Agricole.pdf)

*A copy of the abstract in English is available on our website:*

[http://www.ccrek.be/DOCS/REPORTS/2005/2005\\_21\\_SECTEUR\\_AGRICOLE\\_ABSTRACT.PDF](http://www.ccrek.be/DOCS/REPORTS/2005/2005_21_SECTEUR_AGRICOLE_ABSTRACT.PDF)

Thank you very much for your attention.