



Solidity and use of the requests for additional funding allocated to the Ministry of Agriculture for state support to agriculture to decrease the adverse effect of the COVID-19 outbreak

Interim report

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Inspections carried out and an interim report drafted within the framework of the financial audit “On the annual financial statement of the Ministry of Agriculture for 2020” (Audit schedule No 2.4.1-14/2020 of the Fourth Audit Department of the State Audit Office of 18 May 2020) and following Sub-paragraph c), Paragraph 3, Section 3 of the State Audit Office Law.

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Why have we drafted this interim report?

Since International Standard on Auditing (ISA) 701, Communicating key audit matters in the independent auditor's report¹, has taken effect, the State Audit Office is required to assess the need to include key audit matters in the audit opinion on the financial statements.

For the purposes of those standards, key audit matters are matters that, in the auditor's professional judgment, are significant in the context of the audit of the financial statements of the reported period that one reports to the management of an audited entity and that have been the focus of the auditor's attention. There is no separate opinion on the key audit matters issued.

The information provided on key audit matters serves as additional information for potential users of the financial statements. It helps apprehend both matters that the auditor has identified as significant in the professional judgment and the audited entity and the areas where the management of the audited entity has made significant judgments while drafting the audited financial statements. This information may also serve as a basis for potential users to communicate further with the management of the audited entity about specific aspects of governance, audited financial statements, or audits performed.

The solidity and actual spending of the requests for additional funds allocated to address the consequences of COVID-19 are the key audit matter, which is crucial in all financial audits on the accuracy of drafting the annual consolidated financial statements for 2020 of ministries and central governmental agencies.

In 2020, the COVID-19 pandemic affected Latvia like the rest of the world. The Cabinet of Ministers adopted a decision to declare the emergency on 12 March 2020, which continued until 9 June 2020² and was declared once again on 9 November 2020³. The extraordinary circumstances caused by COVID-19 affected the daily lives of the government, the public, and everyone both during and after the emergency. The new conditions required the ability to react and adapt quickly and caused deviating from the usual order. Under the new conditions, the institutions should have been able to coordinate their activities more intensely and cooperate with each other by avoiding legal formalism and departmentalism to ensure the functioning of the state and the protection of each individual in emergency conditions⁴.

Overcoming the COVID-19 pandemic and dealing with its consequences have required significant funds from the state budget. Since the declaration of the state of emergency, the Cabinet of Ministers has made decisions in connection with overcoming the crisis caused by COVID-19 and eliminating its consequences on the allocation and reallocation of state budget funds for the implementation of basic functions for 1,242,293,398 euros in total by 31 December 2020 and has examined proposals for reallocation of funds for the performance of projects and measures co-financed by European Union policy instruments and other foreign financial assistance for 499,029,112 euros⁵. The State Audit Office pays special attention to assessing the spending of state budget funds allocated for overcoming the COVID-19 pandemic, preventing, and mitigating its consequences.

The Cabinet of Ministers has allocated additional funding of 45,709,594 euros to the Ministry of Agriculture for overcoming, mitigating, and preventing the consequences of COVID-19 between

12 March 2020 and 31 December 2020, including support to producers and other enterprises in the agricultural and food sector of 35,500,000 euros, risk management of agricultural holdings and ensuring a smooth transition to 2021-2027 programming period, maintaining the liquidity and cash flow of holdings of 10,000,000 euros, and mitigation of the negative effects of COVID-19 on the education sector of 709,594 euros. To provide information on the key audit matter raised in the financial audit “On the annual financial statement of the Ministry of Agriculture for 2020” – solidity and actual spending of the requests for additional funds allocated to curb the COVID-19 consequences, the State Audit Office audited and drafted this interim report **on the funding of 35,500,000 euros granted to the Ministry of Agriculture from contingency funds⁶ to support producers and other enterprises in the agri-food sector in connection with the economic impact of the spread of COVID-19.**

An assessment of the 10,709,594 euros allocated to overcome the COVID-19 crisis will be included in the report on the annual financial statement of the Ministry of Agriculture for 2020.

Summary

The Ministry of Agriculture established a crisis management group a few days after the order of the Cabinet of Ministers of 12 March 2020⁷ declaring an emergency situation to monitor the development of the situation regularly related to the impact of COVID-19 on the agricultural and food production sectors. In cooperation with the social partners, the Ministry of Agriculture agreed on the implementation of certain measures to strengthen the viability of agricultural producers and processing companies.

Taking into account the observations and calculations of the Ministry of Agriculture on the impact of the COVID-19 crisis on farmers, the Cabinet of Ministers adopted Regulations No. 219, “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Spread” on 14 April 2020. By a subsequent Cabinet Order⁸ of 17 April 2020, funding was granted for the implementation of the three support programs provided for in the Regulation. Funding of up to **35,500,000 euros was intended to support producers and other enterprises in the agri-food sector connected with the economic impact of the spread of COVID-19⁹.**

Orders from the Ministry of Finance allocated funds to the Ministry of Agriculture (Rural Support Service), wherefrom one spent 29,443,600 euros or 84% of the initial maximum amount to support producers and other businesses in the agri-food sector in connection with the effects of the COVID-19 outbreak.

When analysing the calculation and estimation of the funds’ demand by the Ministry of Agriculture, one concluded that the estimates of the Ministry of Agriculture when assessing the potential negative impact of COVID-19 on the sector and the total required public funding, as well as individual support rates were based on a worse scenario than later it turned out. The actual decline in income of producers in the sector was not as large as the Ministry’s initial forecast because after falling in April and May, it recovered in the following months. One should note that annual and seasonal fluctuations are also characteristic of the industry under normal circumstances.

As the Ministry of Agriculture did not revise the fixed support rates for farmers in certain livestock sectors in the course of support disbursement, which was lower than planned in most cases, state aid payments both offset the decrease in the sectoral revenue and even increased revenue compared

to previous years. Therefore, with the actual decrease in revenue, For example, the auditors estimated that state aid to the dairy sector exceeded revenue by at least 7.3 million euros.

From the point of view of the agricultural sector, the actions taken by the Ministry of Agriculture are undoubtedly positive by requesting a relatively significant amount of state budget funds and ensuring that if funds would not be used in some support program, they could be transferred to another program thus keeping them in the sector rather than transferring back to the state budget. The implementation model applied by the Ministry of Agriculture to primary producers¹⁰ in the livestock sector was favourable and convenient for the sector, as the aid was granted 'automatically' by using data on livestock and products delivered for processing, without assessing the individual financial indicators of a beneficiary. The Ministry of Agriculture chose a model because of the large number of farms involved in the sector (support was requested and planned for 17,000 farms and paid to 9,040 individual beneficiaries), and it would not be possible to assess the beneficiaries' financial performance within a reasonable time.

On the other hand, from the public's point of view, one assesses the activities of the Cabinet of Ministers critically when the Cabinet did not assess whether the support provided to farmers was balanced with support to other sectors.

Initially, the Cabinet Regulation stipulated that support for income stabilisation for primary producers should be granted if the total income of producers in the dairy sector decreased by at least 20% between April and June 2020 compared to the average of the last three years in the dairy and beef sector and compared to the equivalent period of 2019 in pig farming.

With the argument provided by the Ministry of Agriculture¹¹ that one should create equal and fair conditions of competition for Latvian farmers with farmers in the Baltic States, especially Lithuanian dairy and beef cattle breeding, to overcome the difficulties caused by COVID-19, the criterion for receiving support in the Cabinet Regulation was reduced from 20% to 5% already in June¹². This also ensured the availability of aid, as a reduction in revenue of at least 20% did not materialise in practice in the sector as a whole. At the same time, one should note that the criterion set for the sector, that is, reduction in revenue in certain months compared to previous years, gives the impression of an impartial indicator regularly compiled in the registers, but it was the result of a calculation made by the Ministry of Agriculture especially for this support. Although they also used objectively verifiable information in the calculation, some of the information used in the calculation was not verifiable by the auditors.

To ensure the disbursement of support and the use of the allocated funding, Cabinet Regulation No 219¹³ was amended four times¹⁴ by 31 December 2020 by changing both the eligibility criteria and the amount of support available in the programs.

When reviewing the sectoral criteria for receiving support, the Ministry of Agriculture did not change the support rates related to the previously established support criteria and calculated based thereof on support per livestock for income stabilisation of farmers in certain livestock sectors. Thus, by declaring a 5% reduction in turnover, aid was also paid in the livestock sectors, where the reduction was less than 20%, calculated based on a 20% reduction in turnover. As a result, support in several livestock sectors exceeded the planned level of support of 70% of the lost profit¹⁵ and exceeded the estimated amount of lost revenue.

One should note that the fall in the price of pork, which was one of the arguments for increasing the amount of aid available to the sector between July and October, was significantly affected not only by COVID-19 but also by the spread of African bovine fever in Germany and the associated reduction in the export market for pork and the consequent overproduction and fall in prices on the European market.

In the light of the European Commission's guidelines¹⁶ stipulating that rescue and restructuring aid is one of the most economically and competition-distorting forms of state aid, the State Audit Office invites the Cabinet of Ministers to assess the conditions of state aid provided to the sectors more thoroughly further on to prevent potential adverse effects and facilitate the effectiveness and solidarity of public spending.

During a random inspection of the administration of support by the Rural Support Service, the auditors did not detect any non-compliance in the disbursement of the aid and concluded that the support was paid under the administrative requirements of the Cabinet Regulation¹⁷. However, as the Ministry of Agriculture did not revise the fixed support rates for income stabilisation support for farmers in certain livestock sectors, the economic nature of the calculation does not comply with the requirement of Cabinet Regulation No 219¹⁸ that support income stabilisation in certain livestock sectors be granted as a one-off compensatory payment. **State aid payments not only offset the reduction in the sectoral revenue as estimated by the Ministry of Agriculture but also even increased revenue compared to the corresponding periods in previous years.** The auditors estimated that state aid to the dairy cattle breeding exceeded the reduction in revenues by at least 7.3 million euros.

Support for the agricultural sector to mitigate the negative effects of the COVID-19 crisis will continue in 2021. Therefore, it is important to evaluate and take into account existing experience and provide full information on the conditions and justification of the support provided. Because only by using complete and unbiased information when deciding on the rules for the payment of aid, the Cabinet of Ministers will be able to compare it with the aid provided to other sectors and prevent the possible negative impact of state aid on the overall economy.

Recommendations and proposals of the State Audit Office

In case there is a similar situation and the need for additional state budget support, the audit provides **two** recommendations to the Ministry of Agriculture, whose implementation will establish clearer criteria for granting state aid and prevent exceeding the set level of support.

The audit also provided one proposal to the Cabinet of Ministers to ensure effectiveness and solidarity in the provision of public spending.

References

- ¹ The International Organisation of Supreme Audit Institutions (INTOSAI) also uses International Standards on Auditing for the financial audits; hence, the latter are binding on the State Audit Office under Section 1.3 of the State Audit Office Law, which conducts audits in accordance with international standards on public sector auditing.
- ² Cabinet Order No 103 “On Declaring a State of Emergency” of 12 March 2020.
- ³ Cabinet Order No 655 “On Declaring a State of Emergency” of 6 November 2020.
- ⁴ Communication of the President of Latvia No 8 “Basic Principles of Activities of State Constitutional Bodies in an Emergency Situation” of 23 March 2020.
- ⁵ Article 2, Informative Report “On Redistribution of Financing from the European Union Structural Funds and the Cohesion Fund and Solutions for Mitigating the Consequences of COVID-19” of the minutes No 34, § 33 of the Cabinet sitting on 19 May 2020.
- ⁶ Sub-paragraph 1.1 of Cabinet Order No 200 “Allocation of Financial Resources from the State Budget Program “Contingency Funds”” of 17 April 2020.
- ⁷ Cabinet Order No 103 “On Declaring a State of Emergency” of 12 March 2020.
- ⁸ Cabinet Order No 200 “Allocation of Financial Resources from the State Budget Program “Contingency Funds”” of 17 April 2020.
- ⁹ Sub-paragraph 1.1 of Cabinet Order No 200 “Allocation of Financial Resources from the State Budget Program “Contingency Funds”” of 17 April 2020.
- ¹⁰ Primary production means the production or rearing of primary products, including harvesting, milking, and the production of farmed animals before slaughter. It also includes hunting, fishing, and the collection of wild products (Regulation (EC) No 178/2002 of the European Parliament and of the Council of 28 January 2002 laying down the general principles and requirements of food law, establishing the European Food Safety Authority and lays down procedures in matters of food safety).
- ¹¹ Annotation of Cabinet Regulation No 395 of 16 June 2020 amending Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020 at <http://tap.mk.gov.lv/mk/tap/?pid=40490138>, resource viewed on 29 January 2021.
- ¹² For the pig breeding sector in August, Cabinet Regulation No 517 “Amendments to Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020” of 11 August 2020.
- ¹³ Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020.
- ¹⁴ Annotation of Cabinet Regulation No 395 of 16 June 2020 amending Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020; Cabinet Regulation No 517 “Amendments to Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020” of 11 August 2020; Cabinet Regulation No 655 of 27 October 2020 amending Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020; Cabinet Regulation No 745 of 10 December 2020 amending Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020.
- ¹⁵ Article 14 of Commission Regulation (EU) No 702/2014 of 25 June 2014 declaring certain categories of aid in the agriculture and forestry sector and in rural areas compatible with the internal market in application of Articles 107 and 108 of the Treaty on the Functioning of the European Union; Annotation of Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020 at <http://tap.mk.gov.lv/lv/mk/tap/?pid=40486051>, resource was viewed on 29 January 2021.
- ¹⁶ European Commission Guidelines on State Aid for Rescuing and Restructuring Non-financial enterprises in difficulty (2014/C 249/01).
- ¹⁷ Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020.
- ¹⁸ Section 17 of Cabinet Regulation No 219 “Procedures for Granting, Administering, and Monitoring State Aid to Agriculture to Reduce the Negative Impact of COVID-19 Outbreak” of 14 April 2020.