

Public Accounts Committee

Natural Resources Wales: Scrutiny of Annual Report and Accounts 2015-16

June 2017



National Assembly for Wales
Public Accounts Committee

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The Committee was established on 22 June 2016 to carry out the functions set out in Standing Orders 18.2 and 18.3 and consider any other matter that relates to the economy, efficiency and effectiveness with which resources are employed in the discharge of public functions in Wales.

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Welsh Conservative
Monmouth



Mohammad Asghar AM
Welsh Conservative
South Wales East



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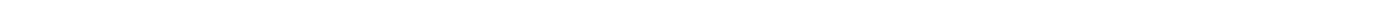
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Chair's foreword

There are numerous publicly funded organisations in Wales whose expenditure amounts to millions of pounds. The National Assembly for Wales' Public Accounts Committee has a crucial role in ensuring the efficient expenditure of this money.

We routinely scrutinise the annual reports and accounts of publicly funded organisations as well as considering issues of value for money alongside organisations governance and audit arrangements.

In March 2017, the Auditor General for Wales, had to qualify his regularity opinion on Natural Resources Wales financial statements in respect of its award of timber sales contracts to a sawmill operator in May 2014. This is an unusual and rare occurrence.

We found the Auditor General's findings to be most concerning in that he found the transactions relating to the timber sales contract irregular, and in his view "contentious and repercussive". The Auditor General also raised concerns that there was uncertainty around whether Natural Resources Wales complied with principles of public law and state aid rules.

During our evidence sessions, we were not convinced by the evidence provided to us by Natural Resources Wales in refuting the Auditor General's findings. We were also concerned their decision making and contracting processes were unsatisfactory. We found there to be numerous flaws and weaknesses in these arrangements leading us to conclude that a serious error of misjudgement was applied in awarding a substantial contract to an individual sawmill operator without a full and open retendering exercise or robust market testing.

We also found Natural Resource Wales to be complacent on a number of areas and our evidence fully supports the Auditor Generals findings that their actions were nothing less than "novel, repercussive and contentious". We find it completely unacceptable that Natural Resources Wales did not refer the decision to award the contracts in question to the Welsh Government, did not test the market and did not record decisions - actions we deem to be 'novel'.

We believe it to be contentious that Natural Resources Wales were influenced by the pressure from the sawmill operator, either by political embarrassment or withdrawal from Wales. Finally, we concur with the Auditor General's findings that Natural Resources Wales may have breached state aid rules, may be legally challenged on the contracts, and the fact their accounts were qualified by the Auditor General for Wales – a matter that without doubt can be defined as repercussive.

Recommendations

Recommendation 1. We recommend that Natural Resources Wales undertake a full evaluation of its governance arrangements relating to contracting processes, clearly setting out lessons learned with specific reference to the timber sales contracts referred to in this report..... Page 22

Recommendation 2. We recommend Natural Resources Wales review its delegation arrangements alongside its awareness raising of State Aid law, public law and the processes for awarding contracts. We recommend the findings of this evaluation are shared with the Public Accounts Committee to enable this Committee to monitor implementation and progress against identified changes. Page 23

Recommendation 3. We recommend that Natural Resources Wales review its internal governance arrangements to ensure that its accounting officer, Executive Team and Board should have a much greater role in scrutinising contracting processes and the awarding of contracts. It is imperative that these processes are robust with a clear and demonstrable audit trail that decisions have been taken on a fair and sound basis. Page 23

01. Introduction

- 1.** The Public Accounts Committee routinely scrutinises the accounts of various publicly funded bodies and had been due to consider Natural Resources Wales's (NRW) Annual Report and Accounts 2015-16 in autumn 2016. However, our consideration of the accounts was delayed until the Auditor General was in a position to qualify the regularity opinion of the accounts which occurred on 9 March 2017.
- 2.** We were prompt in our consideration of the actions of NRW, which had resulted in this qualification and took evidence from NRW on 28 March 2017. We took evidence from a representative of the United Kingdom Forest Products Association and additional evidence from NRW on 22 May 2017.
- 3.** During our inquiry we also considered a number of wider issues relating to the governance and management at NRW but for the purposes of this report we have focussed specifically on the issues arising from the timber sales contracts.
- 4.** At the time of this Report's publication, we are awaiting additional information from NRW in relation to their performance indicators and intend to write to the Climate Change, Environmental and Rural Affairs Committee which will encompass the wider governance issues arising from our inquiry.

02. Background

- 5.** The Welsh Government created Natural Resources Wales (NRW) on 1 April 2013 replacing three legacy bodies - the Countryside Council for Wales, Environment Agency Wales and Forestry Commission Wales - as well as incorporating certain Welsh Government functions.
- 6.** Under paragraph 23 of Schedule 1 to the Natural Resources Body for Wales (Establishment) Order 2012 (the 'Establishment Order'), the Auditor General for Wales (Auditor General) has a legislative duty to examine, certify and report on the statement of accounts of Natural Resources Wales.
- 7.** The order requires the Auditor General to certify that NRW's financial statements:

 - give a true and fair view of the state of Natural Resources Wales' affairs and of its net operating costs for the year then ended (the 'true and fair opinion'); and
 - have been properly prepared in accordance with Welsh Ministers' directions issued under Paragraph 23 of the Schedule to the Establishment Order (the 'regularity opinion').
- 8.** The Auditor General provided an unqualified 'true and fair opinion' providing assurance that NRW's financial statements give a true and fair view of NRW's financial affairs for the period 2015-16 as at 31 March 2016, and that the financial statements have been prepared as required by Ministerial directions.
- 9.** With regard to the Auditor General's 'regularity opinion' on the financial statements the Auditor General is required to consider whether:

 - the financial transactions within the accounts conform with the framework of authority which governs NRW, (this framework includes legislation, public principles and ministerial direction) and;
 - the expenditure and income in the financial statements have been applied to the purposes intended by the National Assembly for Wales.
- 10.** The Auditor General undertakes his regularity audit work in accordance with the requirements of Auditing Practice Note 10: Audit of Financial Statements of Public Sector Bodies in the United Kingdom, which is issued by the Financial Reporting Council and is in force across the UK.
- 11.** With the exception of transactions relating to timber sales contracts awarded to a sawmill operator in May 2014, the Auditor General was satisfied that the income and expenditure within the financial statements was regular.
- 12.** However, the Auditor General concluded that transactions relating to the timber sales contract were irregular on the basis that the decision to award the contracts were 'contentious and repercussive', and under the provisions of NRW's Framework document and the provisions of the Welsh Government publication, 'Managing Welsh Public Money', which constitutes Ministerial directions, NRW was required to refer contentious and repercussive proposals to the Welsh Government. NRW did not refer these contracts to the Welsh Government and therefore acted outside the framework of authority to which it is subject.

13. The Auditor General also considered that there was significant uncertainty as to whether NRW complied with principles of public law within the decision-making process for the contract awards and whether the award of the contracts complied with State Aid rules. In view of this uncertainty, the Auditor General was unable to positively affirm that the transactions with the sawmill operator conformed to the framework of authority which governs NRW.

03. Governance Arrangements in respect of Timber Sales Contracts

Background

14. The Auditor General set out his concerns regarding the actions of NRW in his substantive audit report on NRW's financial statements for 2015-16 and provided further detail on the background to this matter in a Supplementary Memorandum prepared for the Committee.¹

15. In responding to the qualification of the NRW's accounts 2015-16,² its Chief Executive and Accounting Officer, Dr Emyr Roberts, expressed the view that qualification of the Auditor General's regularity opinion was disproportionate to the issues identified. The Auditor General fundamentally disagrees with this view for two reasons:

- The Auditor General's regularity opinion takes the form of positive assurance. He is required to certify that the financial transactions within the accounts conform to the framework of authority which governs NRW. If he considers that the award of the timber sales contracts did not conform to that framework, (and that was his position) and he cannot positively affirm that the contracts were entered into lawfully, he must qualify his regularity opinion.
- The Auditor General considers that the reasons that have led to the qualification of his regularity opinion, and which are set out in his report on the accounts and his supplementary memorandum to this Committee, are very serious in nature, and it is regrettable that NRW does not appear to have recognised that the way in which it dealt with the timber sales contracts highlighted significant governance weaknesses that NRW now needs to ensure are not systemic.

16. The Auditor General's work highlighted a number of issues regarding NRW's handling of the awarding of the timber sales contracts including:

- Failure to maintain adequate documentation of decision-making;
- Lack of Board and Executive Team scrutiny of major decisions;
- Inappropriate delegation thresholds;
- Failure to document considerations taken into account when making decisions;
- Failure to consider whether a proposal was novel, repercussive or contentious; and
- Failure to subject a major contract to competition or alternatively demonstrate through market-testing that there was only a single possible supplier.

17. In responding to these issues, NRW considered that the Auditor General had not given sufficient consideration to the fact that, in contracting a sawmill operator, NRW was successful in controlling the tree disease, *Phytophthora Ramorum* (P. Ramorum).³ The Auditor General believes

¹ [Supplementary Memorandum of the Auditor General for Wales to the Public Accounts Committee – Timber Sales Contracts](#), March 2017

² [Natural Resources Wales Annual Report and Accounts 2015-16](#) (March 2017)

³ [Phytophthora Ramorum](#) is a fungus like pathogen which causes extensive damage and mortality to a wide range of trees and other plants

³ *Phytophthora Ramorum* is a fungus like pathogen which causes extensive damage and mortality to a wide range of trees and other plants

that this is not a relevant consideration to his regularity opinion, which must be based on applicable auditing standards.

18. The Auditor General considers that NRW could and should have ensured that there was good governance in place in their contracting process, and in failing to establish effective governance arrangements, it was unable to demonstrate that it acted lawfully and that the contracts awarded represent value for money.

Governance Arrangements

19. Given the concerns raised by the Auditor General and the counter arguments put forward by NRW, we focussed our attention on analysing the adequacy of NRW's governance arrangements in respect of the timber sales contracts awarded by NRW to a sawmill operator in May 2016. We noted that the contracts awarded to the sawmill operator were very large in terms of both timber volumes and value, with the purchase price the sawmill operator agreed with NRW amounting to approximately £72 million over a ten year period.

20. Although, the sawmill operator is entitled to deduct from the purchase price agreed costs for felling, extraction, haulage and management fees, we note that NRW estimated that the contract value to NRW would be approximately £39 million over the ten year contractual period.

21. Given the scale of this expenditure of public money, we were keen to establish whether the NRW's Board and Executive Team had been sufficiently involved in scrutinising such a substantial deal with the sawmill operator. In explaining the decision making processes surrounding the proposed deal, NRW's Accounting Officer stated:

"I think, at the time, we were dealing with a mounting crisis regarding larch disease. It was expanding very, very quickly. So, we had to move very quickly, we felt, to deal with the issue. The team that was dealing with the contracts, and with the issue, was a very experienced team—obviously, previously the Forestry Commission for Wales—and they knew the market very well. I, as chief executive, was briefed on the situation, and we briefed the NRW board on the position as well. Some of the members were more closely involved than others. So, there was awareness of the issue. I was certainly told about the issue."⁴

22. Despite the claim that an experienced team was tasked with dealing with these contracts, we remain surprised by the Auditor General's findings, that the decision to enter these contracts was delegated to just one officer. We pressed NRW's Accounting Officer on whether he thought this delegation was appropriate particularly given the volume and value of the contracts. He informed us:

"I'm very comfortable with the delegation that was given to the officer. It was, in fact, the former director of Forestry Commission Wales; so, he was very well-versed in forestry issues and timber matters. So, I have every confidence in that decision taken. I should also say that he didn't take that decision in isolation. There was a full business case behind the options and the strategies that we

⁴ National Assembly for Wales, Record of Proceedings (RoP), 28 March 2017, paragraph 8

could have and it was felt that that was the right thing to do, so there is the business case and that was being shared with the auditor general.”⁵

23. In commenting on the contents of this business case, Mr David Sulman, Executive Director of the UK Forest Products Association told us:

“I think my immediate response was that certainly I for one, and, I suspect, very few of my colleagues in the industry, if they’d seen that document, would recognise it as a business case. We might recognise it as an options paper or a discussions paper, but what seems to be glaringly absent is a reasoned financial case. It almost reads as though someone had made up their mind what they were going to do and worked backwards from that point, rather than the opposite way, which you would expect a normal, commercial business case to do. So, it’s a somewhat unusual document that is deficient in many aspects.”⁶

24. During our second evidence session, we asked NRW’s Accounting Officer if he accepted the criticism that, for a business case, there did not appear to be much rationale for the decisions that were taken with regard to the awarding of the contracts. We noted specifically that the business case failed to provide any financial analysis and sufficient evidence of market analysis and testing. Upon further questioning on the lack of financial rationale within the ‘business case’ to support the decisions that were taken, NRW’s Accounting Officer clarified that it would be “more correct to describe it (the business case) as an options appraisal” adding:

“The reality is that the number of options that were available to us were very limited, and what the paper tried to do was to actually set out what those options were—the pros and cons of each. So, I do accept that it was more of an options paper than a business case.”⁷

25. NRW’s Accounting Officer has also accepted that with hindsight, both himself, as accounting officer, the Executive Team and the Board should have had a much greater role in scrutinising the contracts as they developed. He added that moving forward, NRW would be looking at the delegation arrangements on contracts to see whether they are set at the right level, both in terms of executives, but also the board itself, but again reiterated that:

“I’m comfortable that the decision was taken by the right person at the time.”⁸

26. With regard to the awarding of contracts, we reflected on NRW’s Accounting Officer’s evidence that he was comfortable with the delegation that was given to the one officer. We specifically note his comments that the officer was the former director of Forestry Commission Wales who was well-versed in forestry issues and timber matters. However, we are concerned that issues regarding the Forestry Commissions approach to the awarding of contracts by Forestry Commission Wales were raised by our predecessor Committee in the third assembly. In the Committee’s report on *Forestry Commission Wales: Public funding of Ffynone and Cilgwyn Woodlands* published in February 2011, it recommended that:

⁵ RoP, 28 March 2017, paragraph 12

⁶ RoP, 22 May 2017, paragraph 95

⁷ RoP, 22 May 2017, paragraph 129

⁸ RoP, 28 March 2017, paragraph 12

“We recommend that FCW review its grant award processes and contracts in the light of, and to ensure compliance with, Annex 5.1 (grants to third parties) and Annex 5.2 (protecting public investments) of Managing Welsh Public Money.”⁹

27. We are concerned that despite this recommendation made several years ago, the awarding of contracts by NRW relied on experience from Forestry Commission Wales, which had in the past been subject to question and one could assume remains open to question given the issues raised by the awarding of the contracts by NRW which are the subject of this report.

Outbreak of P Ramorum

28. NRW’s Accounting Officer has told us that the Auditor General has not given NRW credit for its successful approach to addressing the P Ramorum outbreak. We asked Mr Sulman how well he felt NRW had handled the outbreak and were told:

“...the measures that were taken in Scotland and in England, which were considerably less draconian, have been proven to have been appropriate, and seem to have enabled the plant health authorities to operate effectively, to provide reasoned, sensible scientific and technical advice to the industry. It’s interesting to reflect that the sources of that scientific information—there would be a few here in the UK, but the principle one would be Forest Research, which is the Forestry Commission agency that deals with all aspects of forest and timber research, including plant health, tree pests and diseases. It’s interesting that, based on the evidence presented in each of the three countries, the solution that was taken in Wales appeared to be so markedly different from that taken elsewhere.”

29. Mr Sulman went on to comment:

“...it does seem that a somewhat over-zealous response was perhaps adopted in Wales, which, if anything, potentially made the situation in terms of marketing the wood and getting best value for the public purse perhaps not well served.”¹⁰

30. NRW’s Accounting Officer refuted the claim that NRW had taken a different approach confirming that the response NRW had taken in Wales was the same as that taken in Scotland and England.¹¹

Contracting Processes

31. The Auditor General has expressed his concern that NRW entered into very large ten year contracts with the sawmill operator without competition or relevant market-testing. This raised searching questions for us as we found it to be truly shocking that such a large contract would be awarded to one operator without a competitive tendering process. We challenged NRW on how they could be certain that no other operators throughout the UK would have been interested in the opportunity. We pressed for evidence based assurances from NRW that could validate such a decision

⁹ Public Accounts Committee - [Public funding of Ffynone and Cilgwyn Woodlands](#) (February 2011)

¹⁰ RoP, 22 May 2017, paragraph 89

¹¹ RoP, 22 May 2017, paragraph 136

being taken and that better value for money could not have been achieved from taking an alternative approach.

32. NRW's Accounting Officer stated:

“The view at the time, amongst a very professional team, was that, in reality, there were only two operators who could have taken on the volumes that we were looking for. And the view of the team was, had we gone out to retender, there would not have been a different outcome of that, and we would have lost weeks, if not months, during that process.”¹²

33. During oral evidence, we also questioned NRW on the conclusions of the Auditor General's report which states that NRW do not think the award of the contracts were contentious at the time particularly given that the contracts:

- had a sales value of £72m;
- the operator had been unsuccessful in the tender process;
- the operator was threatening NRW that it would withdraw from its Welsh operation and;
- NRW had recognised that it risked challenge by deviating from the tender process.

34. We note from the Auditor General's supplementary memorandum that the sawmill operator in question tendered for c522,000 tonnes of larch in April 2013, which although was unsuccessful in the tender process, was later awarded contracts of c1.9m tonnes of larch and spruce in May 2014 without any further competition. We asked NRW whether they thought this was a contentious decision.

35. NRW's Accounting Officer informed us that any decision taken on this issue would have been contentious “in the sense that it would have benefitted some operators and not others”.¹³ He also raised concerns around the definition of ‘contentious’ stating:

“...I think there needs to be greater clarity around what precisely ‘contentious’ actually means. So, in this case, had we provided 100 per cent of the timber to an operator, that is almost definitely contentious, yes; 50 per cent - contentious. Five per cent - would 5 per cent have been contentious? What about 20 per cent? So, I think there is an issue here that needs to be resolved so that all accounting officers, not just me, are aware of the issue.”¹⁴

36. In oral evidence NRW's position remained unchanged in their view that the contracts were awarded to address a rapidly spreading tree disease, P Ramorum and that these were:

“...exceptional circumstances. We needed to move quickly, which is what we did, and decisively. So, that's why I'm saying that it is not clear in my mind whether this was novel, contentious and repercussive. We had to deal with it. We had to deal with it at the time.”¹⁵

¹² RoP, 28 March 2017, paragraph 97

¹³ RoP, 28 March 2017, paragraph 58

¹⁴ RoP, 28 March 2017, paragraph 58

¹⁵ RoP, 28 March 2017, paragraph 86

37. NRW's Accounting Officer has repeatedly told us that he does not consider the contracts to be contentious or repercussive, adding:

“...specifically on this contract, it was not challenged at the time. We published a press notice and nobody came back to us.”¹⁶

38. We asked Mr Sulman whether he or any of the organisations he represents raised concerns with NRW regarding the contracts and were told:

“...we have persistently raised our concerns with NRW. Looking back in my records, we have done this on a regular basis since the summer of 2014, when the award of the larch—and, indeed, the spruce—contracts first came to light. We had raised, as I say, with senior NRW staff, very significant concerns that were expressed by sawmillers in Wales, and, indeed, further afield, about the way in which not only the larch had been marketed but, of course, this totally unexpected award of spruce contracts as well.”¹⁷

39. We asked NRW's Accounting Officer to confirm his statement that no other sawmill operator had contacted NRW and he confirmed that this was indeed the case.¹⁸ Contrary to this claim, Mr Sulman stated in written evidence that he is aware that at least one operator did directly approach NRW in 2014 expressing interest in a larch contract. We are aware this is consistent with contemporaneous documentation that was sent to the Auditor General by the operator in question.

40. We note that during the tendering process that occurred in April 2013, the saw mill operator in question had made an unsuccessful offer. However, in 2014, NRW found themselves in a situation that without going back to the market, they amended the offer to include 25 per cent of the available larch - available for sale by NRW over a 10 year period - and they did not feel the need to put the offer back out to tender. When asked for an explanation NRW stated:

“The view at the time, amongst a very professional team, was that, in reality, there were only two operators who could have taken on the volumes that we were looking for. And the view of the team was, had we gone out to retender, there would not have been a different outcome of that, we would have lost weeks, if not months, during that process. That was a risk that was recognised in the business case.”¹⁹

41. We challenged this sense of urgency given the tendering process took a year and questioned what NRW had to lose by being able to satisfy the market, ensure good governance was met and value for money was achieved. NRW's Accounting Officer repeated his argument that his organisation were reacting to a “real crisis” and had to “move very, very quickly” stating:

“There was a danger of the timber market collapsing at the time. So, it's easy to say, with hindsight, that we should have spent that extra time going back to

¹⁶ RoP, 28 March 2017, paragraph 280

¹⁷ RoP, 28 March 2017, paragraph 51

¹⁸ RoP, 28 March 2017, paragraph 160

¹⁹ RoP, 28 March 2017, paragraph 97

the market. Our view at the time was that we would have come out with the same outcome on that.”²⁰

42. NRW’s Accounting Officer confirmed that the extra capacity required to process Larch was provided within the industry without a new saw mill line being built and alternative means were found to increase capacity. During our second evidence session with NRW, he told us:

“they expanded the capacity within the sawmill—they went from two shifts to three shifts. They did make other investments on the site and they did develop new markets. So, yes, they grew the market. They dealt with the capacity that way.”²¹

43. On this basis, we posed the question of whether NRW had misjudged that fact that extra capacity could have been brought in without a new saw line, which as NRW have claimed, was a pivotal factor in awarding the operator the contract without going to tender.

44. NRW’s Accounting Officer told us:

“I think, with hindsight, perhaps we should have tested the market more thoroughly, but, as I say, we based our decision on the initial market testing and there were very few players in the market.”²²

45. We repeatedly pressed NRW’s Accounting Officer on whether the contractual obligation to build an additional saw line had been met. He informed us that NRW were in on-going discussions with the operator regarding this matter but due to commercial sensitivities he was unable to confirm whether the line had been built or not.

46. We pointed out, during our evidence session with NRW on 27 March 2017, that the deadline for meeting this obligation was a few days away on 31 March 2017. We concluded from NRW’s Accounting Officer’s lack of clarity that the saw mill would not been built within the timescales set out in the contract and asked whether:

“...With hindsight, do you think they pulled the wool over your eyes in making you feel that the only way in which they were going to deal with this crisis, which you were understandably concerned about, was by investing in new, expensive capital equipment...”²³

47. He defended his position stating:

“No, I don’t think they’ve pulled the wool over our eyes at all. At the time, there was no market for larch, and I can say this from personal experience because, at the time, I visited timber merchants—they would not touch larch, let alone diseased larch. So, there was no market,”²⁴

²⁰ RoP, 28 March 2017, paragraph 99

²¹ RoP, 22 May 2017, paragraph 188

²² RoP, 28 March 2017, paragraph 194

²³ RoP, 28 March 2017, paragraph 110

²⁴ RoP, 28 March 2017, paragraph 111

48. The claim that there was no market for larch was strongly refuted by Mr Sulman who told us:

“There has always been a market for larch. In fact, to put it into perspective, larch is the third most commonly planted conifer species in the UK. So, it has been around for a long time. Its end uses are well known, although it would be true to say that, for some end uses—it’s particularly well-suited for some and not others, like most species of timber. So, it would be untrue to say that there wasn’t a market and there wouldn’t be interest in it.”²⁵

49. We asked Mr Sulman how he could validate his assertion that there had always been a market for larch given the evidence provided previously by NRW that there was no market for larch at the time the contracts were awarded. He explained:

“One could look at utilisation data. Surveys are regularly done in terms of not only how much wood is used in the UK, but what sort of species are grown, sold and, indeed, used in the marketplace. In general terms, there are three principal markets for the softwood species that we grow here in the UK. The principal ones are, in descending order: Sitka spruce, which is the most commonly planted new species; various pines; and then larch and Douglas fir.”²⁶

50. Mr Sulman added that although P Ramorum presented a problem in terms of dealing with diseased larch there were a number of sawmills in Wales that were able to process this and that a fundamental problem arose from the way in which NRW offered larch to the market. He stated:

“I think there can be little doubt that the apparent difficulties that they experienced were largely of their own doing, if I may say so, inasmuch as they chose to offer the larch in such large volumes that the vast majority of their customers simply wouldn’t have had the capacity or the capability to deal with it in one fell swoop.”²⁷

51. Mr Sulman added that had NRW divided the timber into smaller parcels, this would have suited other operators’ capabilities who would have expressed interest, which he believed had happened.²⁸

52. We questioned NRW on why it had not been possible to package the timber in smaller parcels which would have been more attractive to small or medium sized operators. NRW’s Accounting Officer explained:

“I think, at the time, because we were faced with this crisis, we had very limited options in the way we actually went about marketing the timber. As the auditor general’s report pointed out, we did try an earlier exercise of smaller volumes of larch, and had a very limited response to that. So, we weren’t confident at the time, bearing in mind the exponential growth in the amount of larch disease that was happening—we weren’t confident at the time that there was a

²⁵ RoP, 28 March 2017, paragraph 11

²⁶ RoP, 22 May 2017, paragraph 31

²⁷ RoP, 22 May 2017, paragraph 38

²⁸ RoP, 22 May 2017, paragraph 38

sufficient market for that larch. So, that's the way that we marketed in the way that we did."²⁹

53. In additional written evidence, Mr Sulman reflected on NRW's claim that it would have been futile to test the market following its market testing in 2012 and that they had no option but to award new long term contracts to a single company. However, Mr Sulman also highlighted:

"...it must be noted that not only was the sawmill operator in question awarded new LTCs for Spruce as well; it must be noted that spruce had not been offered to any other NRW customers. This is a very significant point; as there can be no doubt that if NRW had offered combinations of Larch with Spruce, there would have been considerable interest from many of their customers."³⁰

54. Mr Sulman told us that the suggestion that the market testing of Larch carried out by NRW in 2012 would reliably inform the development of their later marketing strategy is simply not credible stating:

"Conditions in 2014 were so significantly different to those that prevailed in 2012, that NRW's subsequent marketing decisions was ill-advised, flawed and inappropriate."³¹

55. In concluding on this matter, NRW told us in additional written evidence that its decisions about the marketing of larch timber had been informed by both the rapid spread of the disease and by the market response. NRW explained that between May 2012 and May 2013, they offered the market the following parcels of infected larch as standing timber:

"18 Standing Sale Parcels with a total quantity of 64, 670 tonnes. The parcels ranged in size from 725 tonnes to 7,593 tonnes:

9 of these parcels did not sell (26, 216 tonnes)

9 parcels sold (38,454 tonnes), of which:

5 achieved positive prices of between £1.00 and £12.20 per tonne.

4 achieved negative prices of between -£1.52 and -£32.62

The total value of the 9 sales to NRW was -£133,482.27; an average price for the 9 sold coupes of -£2.06"³²

56. NRW have suggested that this demonstrates that the market had been tested with a range of parcels, of different sizes, in open market sales. NRW have stated that if they had continued to adopt this policy, they would have only been able to clear around 500 hectares a year.

57. NRW informed us that it undertook an additional Customer liaison meeting in 2012, during which they identified a need to increase the amount of larch in the harvesting programme, and

²⁹ RoP, 22 May 2017, paragraph 133

³⁰ Written evidence, PAC(5)-16-17 PTN2, 5 June 2017

³¹ Written evidence, PAC(5)-16-17 PTN2, 5 June 2017

³² Written evidence, PAC(5)-16-17 PTN3, 5 June 2017

proceeded to offer several Long-Term Contract opportunities in order to secure the investment required in the supply chain to harvest and process the increasing volumes of infected larch.

58. We were told that only 3 companies submitted bids and following a scoring exercise contracts were allocated to 2 of the companies and that NRW were working through the process of awarding the contracts and negotiating the start-up phase when the surveys in the spring of 2013 showed a further major increase in the infection (2,300ha, in excess of 5000, 000m³ of timber). In light of this NRW concluded that re-tendering would add delay and was unlikely to result in a stronger market response.

59. The decision was therefore made to offer the 3rd bidder a long-term contract of 65,000m³. The company agreed but only on the conditions that their existing spruce LTCs were extended by 10 years. They also negotiated with one of the successful companies to assign one of their larch LTCs over to them. The other of the original bidders failed to secure the finance to progress with their project and so their LTC was never taken forward. The end result was that most of the Standing Sales LTCs for larch were with the 3rd company who were contractually committed to undertaking some £10m of investments, including the installation of a new saw line for the shorter, small diameter logs that arise from the larch crops. NRW have claimed that this history demonstrates that it did not choose to directly award a single large LTC to one company without market testing.

60. NRW have also highlighted that Mr Sulman's prime objection to the Long-Term Contracts, namely the decision by NRW to extend the spruce LTCs of the 3rd company, overlooks the extremely difficult position that NRW was in with respect to P Ramorum and the efforts made to secure markets for infected larch through a combination of methods.³³

Development of an Additional Saw Mill Line

61. The evidence is clear that one of the key reasons NRW entered into the contract was to create additional capacity in the timber industry with a new saw line. In light of NRW's evidence to us sufficient capacity has since been achieved without the construction of a new saw line, this raises further questions for us about the decision to award the contract to the saw mill operator in the first place. Following our initial evidence session, it was confirmed in the media that the saw mill company had indeed breached its contractual obligation and had not built the additional saw line.³⁴ We are extremely disappointed that a firm, that was awarded £39 million contract, for which no other company was able to bid for, had failed to fulfil this significant element of the deal.

62. We are concerned at what appears to be a lack of monitoring of progress made with regard to the building of an additional saw line by the saw mill company. We heard in evidence from Mr Sulman that the construction of a saw line is a long process given each saw line is a bespoke engineering product. We were told that as a minimum a saw line would take between 18-24 months to build. We questioned NRW on at which point did it become clear to them that this fundamental element of the contract was going to be breached, why a decision was taken to grant an extension and why it took a further year to finally terminate the contract.

63. NRW's Accounting Officer explained:

“I understand that at the time the company did provide evidence that they were going to purchase a line. As I understand it, they showed the specification to

³³ Written evidence, PAC(5)-16-17 PTN3, 5 June 2017

³⁴ [BBC News article, 4 April 2017](#) [accessed 23 May 2017]

the team. Clearly, they didn't go through with that, but at the time that the contract was extended our belief was that they would be going ahead with the sawmill, so we extended by a year.”³⁵

64. Mr Sulman was explicit in his evidence that the decision to award such a large contract to the saw mill operator to incentivise it to invest in a new saw line does not stand up to scrutiny. He told us:

“Frankly, I don't think it does. I think the interim period between the contracts being awarded back in 2014 and now proved to us—because we've seen that all of the larch that's come to the market in Wales has been satisfactorily processed and sold into the market, without the need for investment in a wholly new saw line.”³⁶

65. We pressed NRW in our final evidence session on what impression he felt the fall-out of the controversial awarding of contracts had impacted on NRW and were told:

“I'm happy to justify the decision we took but with hindsight we would have handled things differently.”³⁷

Regularity Opinion

66. The Auditor General qualified his regularity opinion on the basis that:

- NRW did not refer its intention to award the contracts to the sawmill operator to the Welsh Government as a contentious and repercussive proposals, as it was required to do under its Framework Document. Failure to comply with the requirements of the Framework Document is by definition irregular;
- There is significant doubt as to whether NRW complied with principles of public law, in that it failed to keep proper records of its decision-making process that led to the award of the contracts and it is unclear whether the decision to award the contracts was made based on valid consideration. In these circumstances, I am unable to positively affirm that the contracts were lawful and therefore regular; and
- There is significant doubt as to whether NRW complied with State Aid rules. The contracts were not awarded on the basis of competition or proper market-testing and NRW's failed to follow appropriate processes for ensuring that the outputs for which it contracted with the sawmill operator were obtained on market terms. This failure gives rise to doubt as to the compliance of the contracts with the State aid rules. In these circumstances, I am unable to positively affirm that the contracts were lawful and therefore regular.

67. NRW had informed the Auditor General that it considered that qualification of the regularity opinion is disproportionate to the issues identified.

68. Following concerns raised by the Auditor General, NRW sought legal advice on the contracts. We asked NRW why legal advice had not been sought on State Aid in advance of the contracts being awarded, what considerations had given to questions of State Aid and whether they regarded the contracts as contentious or repercussive before entering into them.

³⁵ RoP, 22 May 2017, paragraph 274

³⁶ RoP, 22 May 2017, paragraph 24

³⁷ RoP, 22 May 2017 paragraph 267

69. NRW's Accounting Officer informed us that NRW did not believe that advice on State Aid was necessary, at the time had no awareness of state aid issues but neither sought advice on it.³⁸ Most concerning for us is that it appears NRW's awareness of these issues has only been initiated as a result of the Auditor General's findings.

70. We are most concerned that given that State Aid is, or at least should be, a clearly understood risk for those responsible for the expenditure of public money, and the fact that NRW felt it was necessary to flag up to the Welsh Government that there might be some political issues arising from the contract being awarded to one contractor over another, NRW did not feel it necessary to seek advice on State Aid. We are astonished by the fact NRW did not feel it was appropriate, prior to any contracts being awarded, to seek legal advice.

71. We are extremely concerned that NRW did not refer its intention to award the contracts to the sawmill operator to the Welsh Government as a contentious and repercussive proposal, as it was required to do under its Framework Document. During evidence, we challenged NRW's Accounting Officer on why the matter was not referred to the Welsh Government and were disturbed by what appeared to be a complacent response in that he challenged the definition of 'novel and contentious' adding:

"At the time, the Welsh Government was aware of the fact that we were proposing to deal with it in this way, but we do accept that we didn't actually formally ask for their approval to do that. But they were certainly aware of that. Again, I think with hindsight we would have probably been more explicit in the way that we actually discussed that with the Welsh Government so that they were quite clear in what we were doing and why we were doing it."³⁹

72. We were left confused regarding NRW's Accounting Officer's position on this matter given the lack of clarity in his evidence. We were also left perplexed given that on one level he accepted misgivings on the part of NRW, and yet we found this to conflict with the lengths to which he has gone to challenge the findings of the Auditor General. These challenges have included seeking costly legal advice.

73. In seeking clarification of these matters we were told :

"At the heart of this there are three issues: one is the definition of novel, contentious and repercussive. As I say, the auditor general believed that it was; as accounting officer, I'm not so sure about that, I think the main point is that that needs to be clarified. The auditor general sought legal advice on two other aspects: one was the state aid; and one was the way that we took the decision. We've also taken legal advice, and the legal advice I have received is that there was no state aid involved, and the way we took our decision was appropriate. Now, ultimately, that can only be resolved by the courts. The auditor general has come to a position and I needed to take my legal advice as well, so I'm certainly not—. You know, we're not trying to raise this as an issue or a battle, but I think there's a genuine difference between us on those points."⁴⁰

³⁸ RoP, 28 March 2017, paragraphs 142 - 145

³⁹ RoP, 28 March 2017, paragraph 19

⁴⁰ RoP, 28 March 2017, paragraph 31

74. In commenting more widely on the way in which NRW manages the public woodland estate and regulating the wider industry in Wales Mr Sulman stated:

“...we are very seriously concerned at the way in which the public forest estate here in Wales is being managed by NRW, and their approach to their customers, with a seemingly indifferent view of how to treat customers, is at risk of squandering that legacy, and that, I think, should be of serious concern to all of us. There is a need to get forestry in Wales back where it belongs. It has the potential to deliver huge benefits to society in general, today and for future generations, but it requires a long-term view to be taken.”⁴¹

75. Mr Sulman added that he had very serious concerns about the very significant loss of forestry expertise within NRW which was extremely worrying. He explained that having previously raised concerns with NRW regarding the loss of expertise and knowledge, and questioning what plans NRW had in place to fill that gap, a response was received from Dr Roberts setting out:

“...that he and his team didn’t place particular importance on what he described as ‘sectoral knowledge’ in terms of choosing members of the executive team, but rather their ability to lead and contribute to the team. It will probably come as no surprise to you when I say that, when that response was relayed back to industry, it was met with absolute incredulity.”⁴²

Conclusions

76. We note NRW’s claim that the sawmill operator concerned was the only one that could meet their operational requirements. However, we do not believe there is sufficient evidence to support this or in the absence of a further tendering process there is no absolute certainty that there was only one operator able to meet NRW’s requirements. Given the sums of public money involved we find it to be wholly unacceptable that a full, open and fair retendering process did not take place.

77. While we are aware of the sense of urgency that preceded at the time, we do not believe that this justified over riding usual tendering procedures, which we believe demonstrated a serious misjudgement. We acknowledge the NRW’s success in controlling the tree disease P. Ramorum, however, we do not think this justifies the approach taken nor for deviating from usual tendering procedures.

78. We believe that NRW could and should have ensured that there were good governance arrangements in place in the contracting process, and in failing to establish effective governance arrangements, it is unable to demonstrate how it acted lawfully. We do not believe there is any evidence to demonstrate whether the contracts represent value for money. Furthermore, we are most concerned about Dr Roberts’ insistence that the Auditor General’s qualification of the regularity opinion is disproportionate to the issues identified.

Recommendation 1. We recommend that Natural Resources Wales undertake a full evaluation of its governance arrangements relating to contracting processes, clearly setting out lessons learned with specific reference to the timber sales contracts referred to in this report.

⁴¹ RoP, 22 May 2017, paragraph 100

⁴² RoP, 22 May 2017, paragraph 104

Recommendation 2. We recommend Natural Resources Wales review its delegation arrangements alongside its awareness raising of State Aid law, public law and the processes for awarding contracts. We recommend the findings of this evaluation are shared with the Public Accounts Committee to enable this Committee to monitor implementation and progress against identified changes.

79. Having heard the evidence, we have serious concerns that the decision to enter into the contracts with the sawmill operator, was delegated to one officer at Natural Resources Wales. We are left unconvinced by Dr Robert's assertion that the decision was not taken in isolation and supported by a full business case. As we later heard the aforementioned business case was in fact better described as an 'options paper' lacking in essential data and analysis to ensure informed decision making. We find it truly extraordinary that a contract of such magnitude would be awarded without a detailed business case for doing so. These facts alone demonstrate weak governance arrangements and decision making processes that are far from robust.

Recommendation 3. We recommend that Natural Resources Wales review its internal governance arrangements to ensure that its accounting officer, Executive Team and Board should have a much greater role in scrutinising contracting processes and the awarding of contracts. It is imperative that these processes are robust with a clear and demonstrable audit trail that decisions have been taken on a fair and sound basis.

Annex – Witnesses

The following witnesses provided oral evidence to the Committee on the dates noted below. Transcripts of all oral evidence sessions can be viewed in full at:

<http://senedd.assembly.wales/mgIssueHistoryHome.aspx?IId=15048>

Date	Name and Organisation
28 March 2017	Dr Emyr Roberts, Natural Resources Wales Kevin Ingram, Natural Resources Wales
22 May 2017	David Sulman, UK Forest Products Association Dr Emyr Roberts, Natural Resources Wales Kevin Ingram, Natural Resources Wales