

Natural Resources Wales

Scrutiny of Annual Report and Accounts 2017-18

November 2018



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Natural Resources Wales

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About the Committee

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.

Committee Chair:



Nick Ramsay AM
Welsh Conservative
Monmouth

Current Committee membership:



Mohammad Asghar AM
Welsh Conservative
South Wales East



Neil Hamilton AM
UKIP Wales
Mid and West Wales



Rhianon Passmore AM
Welsh Labour
Islwyn



Adam Price AM
Plaid Cymru
Carmarthen East and Dinefwr



Jenny Rathbone AM
Welsh Labour
Cardiff Central



Jack Sargeant AM
Welsh Labour
Alyn and Deeside

The following Members were also members of the Committee during this inquiry:



Vikki Howells AM
Welsh Labour
Cynon Valley



Lee Waters AM
Welsh Labour
Llanelli

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Recommendations

Recommendation 1. We recommend that Natural Resources Wales share with this Committee the findings of the independent review following its completion, scheduled for late 2018. The review’s findings must be made publicly available.
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Recommendation 2. The Committee recommends that Natural Resources Wales produces an action plan with clear timescales and delivery objectives. These plans must set out the changes required to its operation arising from the independent review. Natural Resources Wales must share these plans with the Committee when finalised. Page 24

Recommendation 3. We recommend that should the independent review findings on the failures of governance be insufficient, that the Welsh Government ensures that there is an immediate comprehensive review of governance within Natural Resources Wales, examining how these failures were able to occur.
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Chair's Foreword

The qualification of accounts by an Auditor General for a prominent public body is a rare occurrence, indeed since the establishment of the National Assembly for Wales this has happened only once before with the accounts for ELWa (Education and Learning Wales) in 2004. Therefore, for Natural Resources Wales to have its accounts qualified for the third consecutive year is unprecedented and unacceptable. As Chair of this Committee, I am extremely disappointed that the Committee has had to publish a further report on the same issue within 18 months.

There were a number of concerning issues around the awarding of these timber contracts which remain unexplained. Not least that the decision when awarding the transitional contracts to follow a process outside of the procurement rules was taken against a backdrop of a damning Auditor General report into the exact same matter. This suggest to the Committee, that there has been a cultural failure within the organisation in relation to governance and that a serious overhaul is needed.

Procurement rules exist to ensure a fair and open process and to protect those who award contracts on behalf of organisations. They are not optional, they are not guidelines and they are not to be ignored. As a Committee, we are adamant that this should never occur again, and we have set out in this report how we intend to monitor Natural Resources Wales over the coming 12 months.

Nick Ramsay
Chair, Public Accounts Committee

Introduction

On 2 March 2017, the Auditor General for Wales (Auditor General) laid before the National Assembly a report on the accounts of Natural Resources Wales (NRW), setting out his reasons for qualifying the 2015-16 regularity opinion on NRW's financial statements. The report related to NRW's decision to award eight high value timber sales long-term contracts to a Sawmill Operator in May 2014.

1. The Auditor General found that:

- these contracts were not referred to Welsh Government as required by its framework of authority;
- the decision-making process leading to the award of the contracts was neither robust nor transparent;
- insufficient documentation was available to demonstrate the considerations taken into account when the decision to enter into the contracts was made; and
- it was unclear whether NRW had complied with State Aid rules when it entered into the contracts.

2. The Committee subsequently carried out its own inquiry into these matters and published a report in June 2017.¹ The report concluded “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”. The report recommended that NRW “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”.

¹ Public Accounts Committee, Natural Resources Wales: Scrutiny of Annual Report and Accounts 2015-16, June 2017

3. The Auditor General subsequently qualified the regularity opinion on NRW's 2016-17 financial statements, as the long-term contracts NRW entered into in May 2014 were still operating and the 2016-17 financial statements included income relating to these contracts.

4. On 31 March 2017, NRW terminated the eight long-term contracts because the Sawmill Operator failed to construct a new saw-line required by contractual requirements. In 2017-18, NRW entered into 59 transitional contracts to sell timber which had been part of the eight long-term contracts. These contracts were awarded without competition to the Sawmill Operator, a timber harvesting company it owned, and a further company that had acted as the harvesting agent on the long-term contracts.

5. NRW's 2017-18 financial statements record that NRW received timber income of £2.76 million in respect of the 59 transitional contracts. NRW anticipates that it will receive a further £0.18 million in 2018-19. These figures represent the net sales price of the timber after contractor deductions for harvesting and haulage.

6. The Auditor General was unable to satisfy himself of the regularity of the transitional contracts, and he therefore qualified his regularity opinion accordingly. The reasons for his qualification are as follows:

- NRW departed from its own policy as set out in its published Timber Marketing Plan 2017-22 when it entered into the 59 contracts without openly marketing the timber, and NRW has been unable to demonstrate that it had good reason to depart from its stated policy.
- NRW's rationale for determining the volume of timber to be contracted under the transitional arrangements is not supported by the available contemporaneous documentation.
- NRW is required to refer novel, contentious and/or repercussive proposals to the Welsh Government in order to comply with its Framework Document and Managing Welsh Public Money. The Auditor General considers the proposal to enter into the transitional contracts to be novel, contentious and/or repercussive, however, although NRW informed the Welsh Government of its intention to put in place transitional arrangements it did not formally refer them to the Welsh Government as it was required to.
- NRW's Scheme of Delegation grants delegated powers to specified NRW office holders to agree timber sales contracts on behalf of NRW. Thirteen of the transitional contracts were not authorised in accordance

with the Scheme of Delegation, and therefore the Auditor General considers that they were not entered into lawfully.

- The Auditor General found no evidence that NRW took into account the market price of the timber being sold within the transitional contracts, when determining the contract prices.
- The Auditor General considers that NRW did not follow proper procedures to satisfy itself that its actions complied with State Aid rules when entering into the transitional contracts. It did not seek to ensure that the prices in the contracts were at market rates, and by NRW's own admission it did not consider its own legal advice which had highlighted the risk that the transitional arrangements could have State Aid implications.

7. The Auditor General also set out wider lessons that he felt NRW needs to learn. Although they had to act quickly given the situation, in its haste NRW did not follow due process and disregarded principles of good governance. The audit found that:

- documentation of the decision-making process was wholly inadequate;
- it was unclear who had made decisions and the rationale for those decisions;
- contractual operations commenced in advance of written contracts being signed;
- communications regarding the transitional arrangements, both internally and with the Welsh Government, were incomplete and on some occasions inaccurate;
- the proposal to enter into transitional arrangements was both significant and potentially contentious, but was not subjected to proper scrutiny; and
- No written reports were made to NRW's Board or Audit and Risk Assurance Committee (ARAC) in respect of this matter prior to entering into the arrangements.

8. In February 2018, a new Chief Executive took up position at NRW, following the retirement of the previous Chief Executive in October 2017.

9. Following the signing of the qualified regularity opinion by the Auditor General in July 2018, the Chair of the Natural Resources Wales Board resigned.

10. Given the seriousness of NRW having their accounts qualified for a third consecutive year, the Committee agreed it was imperative to examine the issues with NRW. An oral evidence session was held on 24 September 2018 and the Committee also heard from Mr David Sulman from the UK Forest Products Association on 1 October 2018.

11. During our inquiry we considered a number of wider issues relating to the annual report and accounts of NRW but for the purposes of this report we have focussed on the issues arising from the timber sales contracts. We have written to the Climate Change, Environmental and Rural Affairs Committee drawing their attention to the wider issues we have identified for them to consider as part of their regular scrutiny of NRW.

12. The findings arising from the evidence the Committee heard are set out below.

1. Qualification of 2017-18 Accounts

What went wrong?

13. Just eighteen months ago, the Committee received evidence regarding the qualification of NRW's 2015-16 accounts, due to irregularity issues. Having their accounts qualified for the third year running is unprecedented and difficult to comprehend. We found it difficult to find any logical explanation why NRW allowed this situation to arise and have serious concerns about whether NRW's internal controls are fit for purpose.

14. The Committee found itself "in a certain sense of groundhog day"² having looked at the same irregularity issues during its scrutiny of NRW's 2015-16 accounts. We wanted clarification of what went wrong, whether any lessons had been learned and assurances that the same issues would not arise again in the future.

15. In a Memorandum to the Committee, the then Auditor General for Wales, highlighted his concern that NRW had not appeared to fully accept his criticisms of their actions in respect of the award of the long-term contracts and sought to downplay their significance:

"The fact that the issues raised in my report on NRW's 2017-18 financial statements are so similar to those included in my report on NRW's 2015-16 financial statements has confirmed that NRW did not treat the findings of 2015-16 report sufficiently seriously."³

16. NRW told us that they are now taking the issues "incredibly seriously", so that they are never repeated. The Committee is unclear why it took a further qualification of its accounts for NRW to adopt this position.

17. Given it was eighteen months ago when the Committee first received evidence regarding the qualification of NRW's 2015-16 accounts, we questioned whether NRW had learnt anything from the criticism of its actions surrounding the award of eight high value timber supply contracts to one company in 2014.

18. NRW confirmed that many lessons had been learned, but the issue with the awarding of the transitional contracts in 2017-18, was that the letting of the

² RoP, 24 September 2018, paragraph 11

³ AGW Supplementary Memorandum July 2018, paragraph 15

transitional contracts happened at the same time as the Auditor General's report was being published and the Committee were undertaking their evidence gathering. We were told after that time NRW accepted the findings of the Auditor General and the recommendation of the Public Accounts Committee, and put in place an action plan.⁴

19. This response causes us concern as it suggests that NRW were unaware of the issues and deficiencies identified by the Auditor General when it awarded the transitional contracts in April 2017. We find this to be somewhat disingenuous in that the Auditor General qualified NRW's regularity opinion in March 2017 and had for several months before then been discussing with NRW his findings in respect of the award of the long term contracts. It is clear that NRW was aware of these issues and awarded the transitional contracts in the full knowledge of the Auditor General's findings, which they clearly disregarded.

Urgency and Policy Departure

20. In January 2017, NRW published a Timber Marketing Plan 2017-2022 (the Plan). The Plan is essentially a policy which sets out how NRW will market timber, which will generally be on the open market. The Plan includes a caveat that:

"in exceptional circumstances only we may decide to negotiate the sale of timber to customers who are able to respond quickly to unexpected events."

21. In a Memorandum to the Committee, the previous AGW, set out that this implies an urgency requirement insofar as the decision would be to negotiate with customers who are able to respond quickly. It might be expected that the early termination of the long-term contracts, resulting from the decision of the Sawmill Operator not to construct a new saw line was an unexpected event. However, this event should have been expected if NRW had managed the long-term contracts differently.

22. The Memorandum also stated that it was disappointing that the urgency of the situation arose because NRW failed to properly monitor the long-term contracts and plan for the eventuality that the contracts would terminate. A new saw line typically has a construction period of 12 to 18 months and therefore NRW should have been aware many months before March 2017 that the saw line was very unlikely to be constructed. The termination of the contracts was eminently foreseeable and NRW should have developed detailed plans which would have

⁴ RoP, 24 September 2018, paragraph 12

given the Sawmill Operator and Timber Harvesting Company time to source alternative timber supplies and NRW time to arrange to market the timber within the long-term contracts from 1 April 2017 thereby minimising market disruption.

23. The former AGW acknowledged that public bodies may depart from their own policies where they first considered their policy and second, are able to demonstrate a good reason to do so, and he accepted that NRW could have constructed a reasoned case and rationale for departing from the Plan. For example:

- On 16 February 2017, NRW's then Chief Executive emailed the Welsh Government stating that NRW needed to be mindful of investment made by the Sawmill Operator and the role timber processing plays in the rural economy;
- In May 2017, NRW's acting Head of Commercial Operations wrote to NRW's then Chief Executive giving the following reasons for the contract awards:
 - to avoid damaging the timber supply chain. In the event that the long-term contracts ended with no transitional provision, contractors could be put out of work through no fault of their own; and
 - to avoid adversely affecting NRW's timber income as the lead in time for marketing timber would have resulted in a major dip in NRW's income.

24. The previous AGW concluded that while the above seem like good reasons, there is little documentary evidence to show that these reasons were considered at the time the contracts were entered into.

25. It appears that NRW were not aware, until early 2017, that the sawmill operator was not fulfilling its contractual obligation to construct a new saw line. If NRW been properly monitoring this contractual requirement it would not have been necessary to put in place transitional arrangements. We note that NRW has fully accepted that monitoring of the contract should have been better and there are lessons to be learnt from this episode.⁵

26. NRW officials indicated to us that their failure to foresee that the Sawmill Operator would not construct the contractually required saw line was due to a

⁵ RoP, 24 September 2018, paragraph 39

failure of contract management. This appears to us to be an untenable position to take. The new saw line was a fundamental component of the long term contracts and the requirement to construct the line had already been extended by a year. Construction of a new saw line is a major capital project and it is inconceivable that NRW staff were unaware until early 2017 that nothing was happening. Not only is it likely that NRW Forestry staff would have visited the site between April 2016 and January 2017, the environmental consents for the saw line would have needed to be progressed through NRW.

27. Evidence from Mr David Sulman, Executive Director – UK Forest Products Association, supports this view in which he stated that it was not unreasonable to have expected NRW, in their regular meetings with the sawmill company, to have enquired about the progress of the contract, and perhaps even ask for evidence. Mr Sulman went further stating:

“I would say it’s almost impossible to believe that NRW were apparently unaware of the status of the project, especially as we as an organisation had repeatedly asked NRW senior staff during the currency of that original long-term contract about what was happening, because it seemed to many people in the industry who are knowledgeable about these affairs that, as time went on, it seemed increasingly unlikely that the timescale for the installation and construction of the saw line would be met within that contract period.”⁶

28. In our view, it is likely that NRW knew the saw line was not being constructed but chose to take no action. It is also our view, that if the Auditor General had not reviewed the long term contracts, NRW would not have enforced the requirement to construct the saw line and would not have terminated the long term contracts.

29. We were told by NRW Officials that NRW’s failure to effectively monitor the contracts with the Sawmill Operator meant that by the time NRW realised that the long term contracts would end on 31 March 2017, to avoid disruption to the supply chain it had no option but to enter into transitional contracts with the Sawmill Operator without openly marketing the timber.⁷ We asked Mr Sulman whether he agreed that this was the only option available to NRW and we were told that while he did not believe this was the only option it may have been the easiest. Mr Sulman also set out:

⁶ RoP, 1 October 2018, paragraph 29

⁷ RoP, 24 September 2018, paragraphs 29 and 86

“I certainly wouldn’t call these actions mistakes or oversights, as has been claimed. And it seems to us that these actions were premeditated, deliberate, and made in the full knowledge of the facts and the existence of long-standing and well-understood official procedures around timber marketing. Talking to people in industry, some might even go so far as to say that, in view of the very serious concerns that the Auditor General and his staff—and, indeed, this committee had expressed about NRW’s behaviour, their action might amount to almost being contemptuous.”⁸

30. In discussing the events surrounding NRW’s decision to enter the transitional arrangements we found ourselves bewildered. We find it difficult to comprehend why NRW would reward an organisation that had failed to comply with a contractual commitment. Mr Sulman agreed with this highlighting that the official procedures for the marketing and sale of timber from the public forest estate are very well established, and the only reason a state organisation might decide to depart from these procedures is expediency.

31. Mr Sulman clearly set out that there were other options available to NRW and other companies who could have dealt with the volumes of timber necessary. We heard:

“The harvesting and marketing resource in the private sector, in terms of harvesting contractors, specialist timber hauliers and what have you, is very well established, and is ready and waiting to go. So, that resource, which had previously been occupied in the long-term contract volumes, could simply be redeployed to work for others. So, it seems to me that NRW probably overplayed the significance of their actions, and I think it was suggested that they did this in order to prevent chaos and people stopping work and businesses going under. That, frankly, doesn’t stack up.”⁹

32. We consider that if the sole rationale for NRW’s actions was to avoid disruption to the market, it would have made NRW’s actions understandable. However, there are a number of issues arising in the evidence we heard that cause us to question this rationale.

⁸ RoP, 1 October 2018, paragraph 41

⁹ RoP, 1 October 2018, paragraph 58

- 33.** Firstly, contemporaneous documentation indicates that this was not the sole rationale. For example, the matching of the timber volume offered under the transitional contracts to the investment BSW claimed to have made in its sawmill.
- 34.** We are also concerned that NRW were dealing with a company that was one of the largest in its sector, but was in fundamental breach of the contract. The obligation to construct a new saw line was a prerequisite to the Sawmill Operator receiving contractual benefits, but it failed to fulfil the condition. We were surprised that the Sawmill Operator threatened NRW with legal action when NRW might have been able to seek legal remedy against the Sawmill Operator. The Sawmill Operator lost nothing when the long-term contracts were terminated because NRW awarded it the subsequent transitional contracts.
- 35.** We can understand the policy objective of protecting the supply chain to ensure that small operators were not adversely affected, but we do not understand why was it not possible for a number of operators to substitute for the Sawmill Operator in this situation.
- 36.** NRW kept no documentation to indicate what volume of timber needed to be sold without competition to ensure a smooth market transition, and the transitional timescale necessary before timber could be openly remarketed.
- 37.** There was no explanation provided to us as to why it was necessary to offer the 3 transitional contractors the equivalent of a year's supply of timber under the long term contracts. There appears to us to be no reasonable explanation why NRW could not have commenced remarketing timber within 3 months of the close of the long term contracts.
- 38.** If NRW was focussed on ensuring a smooth transition, it is unclear why they do not appear to have held any discussions with other suppliers to determine the market need and options available for transitional arrangements.
- 39.** NRW confirmed to the Committee that the timber within the transitional contracts was sold below market rates. Even if the objective of the transitional arrangements was to achieve a smooth transition, this does not provide any explanation for the decision to sell under-value. The Sawmill Operator needed timber supply to avoid disruption to its own operations. The Committee has not received any rational explanation as to why NRW priced the contracts below market rates.
- 40.** The Committee also noted that the proposal to enter into transitional arrangements was both significant and potentially contentious, but was not subjected to proper scrutiny. No written reports were made to NRW's Board or

Audit and Risk Assurance Committee (ARAC) in respect of this matter prior to entering into the arrangements.¹⁰

41. Looking at the evidence about what went wrong at NRW leading to the qualification of its accounts for a third consecutive time we considered whether it was a matter of incompetence, recklessness or corruption.

42. We heard from Mr Sulman that having carefully considered the matter and having taken views and opinions from a variety of individuals, he had concluded that the shortcomings and failures admitted by NRW in this case were the result of deliberate actions by NRW staff.

43. Mr Sulman pointed out that all of those members of staff involved in this exercise were experienced people, who were well versed in the official procedures and routines of timber marketing and sales within NRW.

44. On that basis, Mr Sulman informed us that he cannot believe that the actions of NRW and the consequences can simply be explained by incompetence adding:

“I think the word we would use is perhaps ‘expediency’ but certainly not ‘incompetence’. And I would also make the point that, sadly, several members of NRW staff who were intimately involved in this matter in recent years are no longer in the employ of NRW, either having left or retired. As a consequence, we may never get to the bottom of this sorry and shameful state of affairs.”¹¹

45. The Committee believes that incompetence alone cannot explain NRW having its accounts qualified for three consecutive years on the same issue of timber sales. It is evident to the Committee that there have been a number of significant failures of governance which have not been sufficiently explained to date. To address this, we are recommending in this Report, that a full investigation into these failures is undertaken immediately.

Decision Making and Authorisation

46. NRW has been unable to provide evidence that five contracts were authorised, and in eight cases contracts were authorised by NRW officers without the necessary delegation to authorise contract awards of the value they signed off. NRW’s Financial Scheme of Delegation “requires some delegated actions to be

¹⁰ AGW Supplementary Memorandum July 2018, paragraph 13

¹¹ RoP, 1 October 2018, paragraph 73

reported at Board level, when they involve either significant sums of money or where they are potentially contentious, novel or sensitive”.¹²

47. We found that the decision to award the transitional contracts was not reported to NRW’s Board, and the former Auditor General considered this a further breach of NRW’s Scheme of Delegation.

48. NRW’s then Chief Executive stated at the time the transitional contracts were being negotiated that he needed to ratify any final agreement on the transitional arrangements, but for some reason, he did not formally authorise or ratify the arrangements. However, the Auditor General acknowledged that the Scheme of Delegation as drafted did not require multiple concurrent contracts awarded to a single supplier to be considered collectively for delegation purposes, nor did it give NRW’s Chief Executive the power to authorise the contracts or amend the lines of delegation.

49. We questioned the type of environment NRW was operating within. The structure in place appears to have enabled executives to take the law into their own hands against no oversight from the board, no formal intervention from the chief executive, and the Welsh Government unaware.

50. NRW did communicate with the Welsh Government regarding its intention to enter into transitional arrangements. Emails from NRW on 15 March 2017 and then on 3 April 2017 to the Welsh Government set out in broad terms NRW’s intention to contract with the Sawmill Operator, and provided a schedule of the timber volumes. However:

- neither the Welsh Government nor NRW regard these communications as being framed as a referral of novel, contentious or repercussive proposals in accordance with Managing Welsh Public Money, and the Welsh Government did not treat it as such; and
- the communications did not provide full details of the proposals [...] they did not make mention of the proposal to contract with the Timber Harvesting Company and they did not accurately record the volume to be contracted under the transitional arrangements.

¹² AGW Supplementary Memorandum July 2018, paragraphs 55-58

51. NRW now accepts that the proposals should have been referred to the Welsh Government as novel, contentious and/or repercussive and take the view that approval should have been sought to enter into the transitional contracts.¹³

52. The Committee sought explanations from NRW as to why the transitional contracts were not authorised in accordance with its Scheme of Delegation.

53. NRW Officials explained that they fully accepted that they were not able to provide signed hard copies of all the contracts, and accept the Auditor General's findings on that point. They told the Committee that this was an oversight. They explained that despite the absence of signed contracts, day-to-day controls for the implementation of the contracts, including site management arrangements would have been in place.¹⁴

54. We raised concerns that the then Chief Executive of NRW had stated that he wanted to authorise or ratify the arrangements, but the Auditor General didn't find any evidence he actually did. We heard from NRW's Head of Commercial Operations that he had been given a mandate to put in place an orderly closure of the long-term contracts, and was in correspondence with NRW's Chief Executive on a regular basis about this to keep him informed, but did not seek his formal approval for the exact arrangements that were put into place. They were within his overall level of authorisation, but he recognised that he should have sought his formal ratification for the contractual arrangements, and that was an oversight on his part.¹⁵

55. The Committee does not agree that the transitional contracts could have been legitimately approved by NRW's Head of Commercial Operations within his level of authorisation. The contracts were novel, contentious and repercussive and therefore required Welsh Government approval.

56. We are concerned that NRW awarded a series of contracts without competition, some of which were not signed. Other contracts were authorised by members of NRW staff who did not have the requisite authority to do so. Furthermore, NRW's Chief Executive was not asked to ratify the contractual arrangements, even though he had set out that he would need to do so. The proposal to award the contracts was not reported to NRW's Board or ARAC and NRW did not refer the contracts to the Welsh Government as novel, contentious and repercussive, even though it was required to do so.

¹³ AGW Supplementary Memorandum July 2018, paragraph 47-48

¹⁴ RoP, 24 September 2018, paragraph 96

¹⁵ RoP, 24 September 2018, paragraph 113

57. As a Committee, we struggled to get to grips with what occurred at NRW with regard to the handling of its timber contracts over the past few years. We have constantly heard from NRW that they were operating in exceptional, difficult and busy times but as far as we can see, having already had their accounts qualified, as an organisation they should have been alert to the problems that had previously occurred and put water-tight measures in place to prevent reoccurrence. Instead what we see is an organisation which was so complacent it was content to rest on delegated authority to award controversial contracts without putting in place any oversight and scrutiny arrangements. The NRW official responsible for the award of the contracts was the Head of Commercial Operations yet we note from an organisational chart provided to us by NRW, that there were two Directors of Operations in place at the time. A copy of the chart can be found at Annex A.

58. NRW officials have told us that they have since tightened up on the authorisation limits and placed a renewed emphasis on compliance with its processes for handling contracts.¹⁶

Pricing and State Aid

59. In a Memorandum to the Committee, the former AGW stated that NRW may determine the price at which it sells timber, however, the market price is a relevant factor which NRW should take account in determining the contractual prices. Furthermore, the market price is relevant in terms of whether NRW is conferring a potentially unlawful advantage contrary to the State Aid rules. Comparisons conducted by auditors against Forestry Commission Timber Price Indices and NRW's average sales prices indicate that there is a serious doubt as to whether the transitional contracts were priced at market rates (although the AGW noted that the Sawmill Operator contends that the transitional contracts it was awarded were priced at market rates).¹⁷

60. The AGW had seen no evidence that NRW took into account the market price (and therefore, potential State Aid) when determining the price under the contracts. NRW has advised that whilst its own legal advisors advised that entering into transitional arrangements could have State Aid implications [...] NRW did not consider or address this risk.

61. We asked the Head of Commercial Operations at NRW whether it was the case that legal advisers at the time advised NRW that those transitional

¹⁶ RoP, 24 September 2018, paragraph 98

¹⁷ AGW Supplementary Memorandum July 2018, paragraph 69

arrangements could have state-aid implications, but that NRW did not address this risk.

62. We were told that was correct and that advice should have been followed up and it was not. The Head of Commercial Operations added, “Having has some state-aid training now, I better understand what the significance of that reference was”.¹⁸

63. We find this response to be extremely complacent coming from a senior NRW official. The issue is not whether the Head of Commercial Operations had a good knowledge of State Aid but that he chose to disregard the legal advice he had received and did not seek clarification from NRW’s legal advisor on how the risk identified could be addressed.

64. NRW’s admission that the transitional timber was sold without competition at below market rates has exposed NRW to the risk of legal action on State Aid grounds, which could result in financial penalties and reputational damage.

Lessons Learnt

65. During our scrutiny of NRW’s accounts in 2017, we asked the then Chief Executive of NRW whether he was confident that the issues arising from the timber contracts would not arise again. He confirmed that at that moment he was confident.¹⁹

66. In a Supplementary Memorandum to the Committee in July 2018, the then Auditor General set out that when NRW were informed of his initial findings, NRW’s response was constructive and there was an acceptance of the seriousness of the matters raised, and a commitment to ensure rigorous action is taken to ensure that policies and procedures are improved and that cultural and behavioural issues are addressed. NRW also informed the then Auditor General that it planned to commission a full independent review of the issues raised in his report on NRW’s 2017-18 financial statements. The scope of the review being undertaken by Grant Thornton, includes examining the breadth of the governance and contract management of timber sales and marketing. The findings of the review will be used to inform changes within NRW’s timber sales and marketing arrangements to ensure the matters highlighted in the former

¹⁸ RoP, 24 September 2018, paragraph 193

¹⁹ RoP, 28 March 2017, paragraphs 174-175

Auditor General's report are not repeated in the future. NRW is aiming to ensure that the independent review is completed in the autumn of 2018.²⁰

67. We questioned the new Chief Executive of NRW on whether she was confident that the same sort of regularity issues involved in the qualification of the 2015-16, 2016-17 and 2017-18 accounts would not arise again in the near future. We asked for clarity on what she was doing to prevent a recurrence of these very serious, repeated failings.

68. The Chief Executive explained that as accounting officer she is accountable for everything that happens within NRW and fully accepts the responsibility for the failings that have occurred, adding:

“It is vital that we learn the lessons from what went wrong. I think that a lot has been done to improve the processes and procedures and cultures within the organisation since your first report on this some 18 months ago. We absolutely aren't complacent, which is why, in agreement with the WAO, after they had completed their audit, I commissioned Grant Thornton to undertake a review of this whole area to really look into every last bit of it, because for me it's just incredibly important that the staff working in this area can have the confidence in the systems and processes in place and that we create that culture that means that we really do minimise the risk of this ever happening again.”²¹

69. Although we recognised the Chief Executive's commitment to ensuring the mistakes of the past are not repeated we sought cast iron assurances as we have been told last year, by the previous Chief Executive, that mistakes would not be repeated, but they of course were.

70. The Chief Executive explained that while there is always a risk that something can go wrong, we look at what she as accounting officer, the board, the ARAC, and the Executive Team can do. She assured us all these elements would work as hard as they can to make sure that the right systems and processes are in place and the right culture that means that people are confident in operating those systems and processes and turning to the right people for advice and guidance if they have problems. The Chief Executive added that the Welsh Government were providing additional assistance at a senior level including

²⁰ AGW Supplementary Memorandum July 2018, paragraph 16

²¹ RoP, 24 September 2018, paragraph 199

regular conversations about a whole range of issues and that a member of Welsh Government staff has been seconded to NRW to assist.²²

71. We asked Mr Sulman whether he had confidence that NRW has the capability and capacity it needs to make the necessary improvements. Mr Sulman outlined that the evidence is very plain for the new Chief Executive of NRW and her senior team to see that there have been fundamental and systemic failings at various levels in the organisation, and that has to be a priority for action and improvement. There needs to be change and NRW should go back to basics in terms of its timber operations to ensure that it has the right people in the right places, the right procedures and the right processes.²³

72. Mr Sulman added:

“I hope that the Welsh Government and NRW recognise that the forestry and forest products sector is a vitally important element of the rural economy in Wales, because it certainly is. And it deserves better recognition by both. Indeed, one really feels quite sorry for the many good employees with NRW who must be wondering what they’re going to hear next, and they surely deserve better.”²⁴

73. In conclusion, Mr Sulman explained that there is a lot of work to be done, and addressing tarnished reputations inevitably takes a considerable amount of effort, but it is not impossible and hopefully there will be dramatic improvement in the situation and NRW can move on. We hope this is the case too.

²² RoP, 24 September 2018, paragraph 201

²³ RoP, 1 October 2018, paragraph 172

²⁴ RoP, 1 October 2018, paragraph 173

Conclusions and Recommendations

74. We are extremely disappointed that, despite the findings of previous reports by the Auditor General for Wales and this Committee regarding their approach to timber transactions, NRW have had their accounts qualified for a third consecutive year. It seems the concerns raised previously were disregarded and the subsequent actions of NRW appear to defy logic. The decisions made by experienced staff at NRW are inexplicable and it is difficult to view these actions a result of incompetence. We can only conclude that we will never fully understand or have an explanation for what happened.

75. We welcome NRW's initiation of a full independent review of the issues raised in the Auditor General's report on NRW's 2017-18 financial statements. This review is being undertaken by Grant Thornton and we welcome the assurance that the findings of the review will be used to inform changes within NRW's timber sales and marketing arrangements to ensure the matters highlighted in the report are not repeated in the future.

76. We understand the independent review will consider a broad range of issues relating to the timber contracts and we would expect this to cover the governance failure issues highlighted in this Report. If the independent review does not examine these issues sufficiently, we will expect the Welsh Government to ensure that there is a comprehensive review of governance within NRW to ensure that issues relating to the awarding of contracts cannot happen again.

Recommendation 1. We recommend that Natural Resources Wales share with this Committee the findings of the independent review following its completion, scheduled for late 2018. The review's findings must be made publicly available.

Recommendation 2. The Committee recommends that Natural Resources Wales produces an action plan with clear timescales and delivery objectives. These plans must set out the changes required to its operation arising from the independent review. Natural Resources Wales must share these plans with the Committee when finalised.

Recommendation 3. We recommend that should the independent review findings on the failures of governance be insufficient, that the Welsh Government ensures that there is an immediate comprehensive review of governance within Natural Resources Wales, examining how these failures were able to occur.

77. This Committee will schedule an evidence session with NRW in February 2019 to examine the recommendations and actions arising out the independent review.

78. The Committee will further examine NRW's actions to address the issues raised during its scrutiny of NRW's Annual Report and Accounts 2018-19 in Autumn 2019 in order to satisfy itself that progress has been made and the issues identified in this report have been fully addressed.

