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Supplementary Memorandum of the Auditor General for Wales to the Public Accounts Committee

Timber Sales Contracts awarded by Natural Resources Wales

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I have prepared this memorandum for the Public Accounts Committee of the National Assembly for Wales to support its consideration of my report under the Natural Resources Body for Wales (Establishment) Order 2012 on the financial statements of Natural Resources Wales for the year ended 31 March 2019.

Contents

Supplementary Memorandum – Timber Sales Contracts awarded by Natural Resources Wales	
Summary.....	4
Reasons for qualification of my regularity opinion	8
Failure to demonstrate good reason for departing from NRW policy	9
Failure to comply with the requirements of the Public Contract Regulations 2015	12
Failure to demonstrate that all relevant considerations were taken into account when awarding SS+ contracts.....	12
Failure to comply with NRW's Scheme of Delegation	16
Failure to refer novel, contentious and/or repercussive activities and proposals to the Welsh Government	17
Failure to comply with Article 8 of NRW's Establishment Order.....	18
Appendix 1 – The development, implementation and operation of Standing Sales Plus (SS+) contracts by NRW from 2015 to date	22
Appendix 2 – Summary of SS+ contracts awarded by NRW from 2015 to date by financial year	31

Supplementary Memorandum – Timber Sales Contracts awarded by NRW

Summary

- 1 My predecessor as Auditor General qualified his regularity opinion on NRW's 2015-16 and 2016-17 accounts on the basis that the agreement of eight inter-related long-term timber sales contracts with a sawmill operator did not comply with the framework of authority under which NRW was operating. Furthermore, based on the information provided to him by NRW in relation to its decision-making procedure, he was unable to satisfy himself that the decision to agree those contracts was lawful and did not involve the provision of State Aid.
- 2 In July 2018, my predecessor also qualified his regularity opinion on NRW's 2017-18 accounts on the basis that the award by NRW of 59 new timber sales contracts to three companies did not comply with the framework of authority under which NRW was operating. Furthermore, based on the information provided to him by NRW in relation to its decision-making procedure, he was unable to satisfy himself that the decision to agree those contracts was lawful and did not involve the provision of State Aid.
- 3 This year I have qualified my regularity opinion on NRW's 2018-19 accounts. This relates to 79 contracts known as Standing Sales Plus (SS+) contracts that combined timber sales with the undertaking of civil engineering work and the restocking of felled sites. As at 31 March 2019, NRW had received £6.3m income in respect of these contracts with further income of £4.9m expected in 2019-20. The reasons for my qualification of my regularity opinion on NRW's 2018-19 financial statements are set out in paragraph 12.
- 4 In early 2016, NRW published an 'Interim Timber Marketing Statement' (the Marketing Statement) setting out NRW's approach to marketing timber from the publicly owned forest and woodland estate during the period 1 April 2016 to 31 March 2017. The Marketing Statement set out that NRW would sell approximately 150,000m³ overbarking standing (obs) of the 325,000m³ obs of standing timber volume to be offered on the open market using a new sales approach¹.
- 5 Under the new approach, in addition to harvesting the purchased timber, customers would be required to undertake civil engineering infrastructure at the sale site and could also be required to restock the site in question. Traditionally NRW had either undertaken the civil engineering and restocking work itself or awarded separate contracts to external contractors to undertake the work.

¹ One tonne in weight of softwood timber is equivalent in volume to approximately 1.24 cubic metres obs

- 6 During the 2016-17 financial year NRW began awarding contracts which combined timber sales with civil engineering works and in some cases restocking services. NRW later began to refer to this new sales approach as SS+. SS+ contract opportunities were advertised through an E-Timber sales system and bidders were asked to submit an average price they would be willing to pay per tonne of timber taking account of the requirement to harvest the timber, undertake the required civil engineering works and where applicable restock the site.
- 7 In January 2017, NRW published a Timber Marketing Plan (TMP) setting out its approach to selling timber in the period 1 April 2017 to 31 March 2022. The TMP said that NRW would sell "an annual baseline flexible programme sale offer of 150,000m³ obs which will be offered either as a traditional or conditional method of sale approach, to be known as standing sales plus".
- 8 The TMP also stated that where NRW was "piloting new ways of working, such as the offer of sales of standing sales plus volume, we will carefully assess performance to make sure that they are capable of meeting the outcomes we seek, provide good value for money and customer benefit. There will be no compromise on performance, silvicultural, environment and health and safety standards".
- 9 In the period 1 April 2016 to 31 December 2018, NRW awarded 83 SS+ contracts of which 79 came into effect. All the contracts which proceeded included a requirement for the successful bidder to undertake civil engineering and 44 of the contracts included restocking requirements.
- 10 Following the decision of my predecessor to qualify his regularity opinion on NRW's 2017-18 financial statements, NRW's Chief Executive, supported by NRW's Board, decided to commission Grant Thornton to undertake an independent review into NRW's governance of timber sales.
- 11 Grant Thornton carried out an extensive review which identified significant concerns over the development, implementation and management of SS+ contracts. When NRW became aware of the emerging findings of the review, it took immediate action to suspend the award of any further SS+ contracts.
- 12 As set out in paragraphs 17 to 23, as part of my report on NRW's accounts, I consider the regularity of transactions included within NRW's accounts. I therefore considered the regularity of the transactions included within NRW's 2018-19 financial statements relating to the SS+ contracts. I was unable to satisfy myself of the regularity of these transactions and I therefore qualified my regularity opinion accordingly. Within this supplementary memorandum I have set out the reasons for my qualification. These are:
- a) NRW departed from its own policy as set out in its published Timber Marketing Plan 2017-22 in that it failed to meet the commitment set out in that Plan to assess the performance of SS+ as a new way of working. Furthermore, NRW did not comply with its own procurement rules when procuring civil engineering works and restocking services as part of SS+ contracts (see paragraphs 24 to 36).

- b) NRW is required to comply with EU procurement rules as enshrined in UK legislation by the Public Contract Regulations 2015 (PCR 2015). I consider that NRW did not follow proper procedures to satisfy itself that its actions complied with the PCR 2015. I found that NRW did not seek to estimate the procurement values of SS+ contracts before advertising these contract opportunities as required by the PCR 2015, and in consequence NRW cannot now demonstrate that it followed the procedures that public bodies must follow before awarding contracts to buy supplies, services or works above defined financial thresholds (see paragraphs 37 to 40).
- c) Public law requires public bodies to take into account all relevant considerations and disregard irrelevant considerations when taking decisions. One way in which public bodies can demonstrate that they have complied with this principle is by fully documenting the considerations they have taken into account. NRW failed to properly document the decision-making process that led to its decision to introduce SS+ contracts. I therefore have significant doubt as to whether NRW took into account all relevant considerations and disregarded irrelevant considerations when taking decisions in respect of SS+ (see paragraphs 40 to 58).
- d) NRW's Board made a Scheme of Delegation under the provisions of the Natural Resources Body for Wales Establishment Order 2012 (the Order). This Scheme of Delegation grants delegated powers to specified NRW office holders to agree timber sales contracts on behalf of NRW. My auditors examined 13 SS+ contracts to ensure that they had been authorised in accordance with the Financial Scheme of Delegation and found that 6 of these contracts were authorised by NRW officers without the necessary delegation to authorise contracts awards of the value they signed off. The total contract value of the sample of contracts tested that were not properly authorised was £2,405,375. My auditors also examined a sample of 10 extensions to SS+ contracts granted by NRW and found that 4 of these had were authorised by NRW officers without the necessary delegation to authorise these extensions (see paragraphs 59 to 67).
- e) NRW is required to comply with its Framework Document and Managing Welsh Public Money, which together require NRW to refer novel, contentious and or repercussive proposals to the Welsh Government. I consider that the proposal to introduce SS+ contracts was novel, contentious and/or repercussive. Whilst NRW informed the Welsh Government of its intention to introduce a new 'flexible approach' to timber sales, it did not make a formal referral to the Welsh Government as it was required to do (see paragraphs 68 to 73).
- f) Article 8 of NRW's Establishment Order states that in considering whether or not to exercise any power conferred upon it by or under any enactment, NRW must take into account the likely costs and benefits of the exercise or non-exercise of that power'. I also consider that NRW did not give proper consideration to the cost and benefits of using an average pricing mechanism

within the SS+ contracts, and the way in which the pricing mechanism operates means that NRW is not able to demonstrate that it has sold timber at market rates. I have therefore significant doubt as to whether NRW complied with the requirements of its Establishment Order. (see paragraphs 74 to 87).

- 13 In consequence of the matters set out in paragraph 12, I have significant uncertainty as to whether NRW acted in accordance with its statutory duties, public law principles and public procurement regulations.
- 14 This report highlights serious concerns regarding NRW's decision-making in respect of the introduction and management of SS+ contracts. This is the fourth consecutive year in which the Auditor General has found it necessary to qualify his regularity opinion on NRW's financial statements due to concerns over timber sales contracts. This report is a further example that highlights serious deficiencies in the way in the historic management by NRW of its timber sales function. It also highlights that there has been a lack of effective corporate oversight of this function.
- 15 Whilst transactions relating to SS+ contracts are included in NRW's 2018-19 financial statements, (and will also be within the 2019-20 financial statements), the issues referred to in this report are largely the consequence of historic decisions. The initial decision to introduce SS+ was taken in 2016. Since that time, many new appointments have been made at both Board level and senior management. This includes the appointment of a new Chair and Chief Executive. I have been very encouraged by the efforts NRW has made in the last year in starting to address some of the historic issues that have undermined NRW's reputation and impacted on its effectiveness. It is pertinent that concerns regarding SS+ contracts were brought to light by a review NRW itself commissioned into its governance of timber sales. I recognise that NRW took immediate action to address these concerns when it became aware of them.
- 16 Appendix 1 sets out a detailed chronology of events relating to the award of the contracts. Appendix 2 details of all SS+ contracts awarded by NRW in 2016-17, 2017-18 and 2018-19.

Reasons for qualification of my regularity opinion

- 17 Under Article 23(5) of NRW's Establishment Order 2012 (the Order), I am required to:
- examine, certify and report on NRW's statement of accounts;
 - provide a copy of the certified statement of accounts together with my report on it to NRW; and
 - no later than four months after the statement of accounts is submitted, lay before the National Assembly for Wales a copy of the certified statement of accounts and my report.
- 18 In addition to certifying that the financial statements give a true and fair view of the state of Natural Resources Wales' affairs as at 31 March 2019, I provide a regularity opinion certifying that 'in all material respects, the expenditure and income in the financial statements have been applied to the purposes intended by the National Assembly for Wales and the financial transactions recorded in the financial statements conform to the authorities which govern them'.
- 19 In providing my regularity opinion, I form a view on whether in the exercise of its functions, NRW has:
- acted within its statutory remit;
 - complied with relevant legislation;
 - acted in accordance with principles of public law; and
 - complied with the framework of authority which governs it, eg the provisions of NRW's Framework Document and ministerial directions given under Article 11 of the Order.
- 20 My regularity opinion takes the form of positive assurance, which means that I state whether transactions are in accordance with the authorities that govern them. Where there is significant uncertainty that transactions within NRW's accounts are irregular and/or unlawful, I am unable to provide a clear regularity opinion on the accounts. This is because positive assurance cannot reasonably be given where there is significant uncertainty.
- 21 I have doubt as to whether NRW acted in accordance with its statutory duties and public law principles in awarding SS+ contracts in 2016-17, 2017-18 and 2018-19. In consequence, I am unable to positively affirm that the transactions in NRW's 2018-19 financial statements conform to the framework of authority governing them. I have therefore qualified my regularity opinion accordingly.
- 22 However, a decision is not unlawful unless and until declared to be so by a court. Therefore, in the absence of a legal challenge the contracts remain valid and enforceable.
- 23 I have set out in the following sections the considerations I have taken into account in reaching my decision to qualify my regularity opinion on NRW's 2018-19 financial statements.

Failure to demonstrate good reason for departing from NRW policy

Failure to comply with the Timber Marketing Plan 2017-2022

- 24 For a decision of a public body to be lawful it must be made in accordance with applicable legislation and with public law principles. Public bodies must (a) take into account and (b) follow relevant policies, unless they have a good reason to depart from them. At the very least they must have stated clear reasons for the departures. A failure to do so can render a decision, and in turn an item of account, contrary to law. Public law also requires that any reasons given are substantiated.
- 25 In January 2016, NRW's Board approved an Interim Timber Marketing Statement (the Statement) setting out its approach to harvesting and marketing of timber from the Welsh Government's Woodland Estate (WGWE) during this period 1 April 2016 to 31 March 2017. The document was published on NRW's website. Prior to this, NRW had offered timber to the market either as felled timber at roadside or through sale of standing timber where the purchaser would be responsible for harvesting the timber. The Statement introduced an additional method of timber sales. It set out that a timber volume of approximately 150,000m³ obs would "be sold on an open market Standing Sales basis without harvesting facilities and infrastructure in place. These sales parcels will require the purchaser to undertake all necessary requirements to good forestry practice as set out in the [UK Forestry Standard], a minimum civil engineering standard and compliant with [the Construction Design and Management Regulations 2015] which will be specified in the individual sale lot details. For these sale parcels in addition we will also consider bids to restock the felled area to specified replanting plan standards". NRW subsequently named this new approach which combined the sale of standing timber with a requirement on the purchaser to undertake civil engineering work and in some instances, to restock felled sites as Standing Sales Plus (SS+).
- 26 During the 2016-17 financial year 10 SS+ contracts were awarded and of these only 8 came into effect, resulting in the sale of 28,219 m³ obs of timber. NRW officers told my auditors that that SS+ contracts were introduced during 2016-17 on a trial basis to test the market, and NRW's intention was to undertake an evaluation of this form of sale during the trial period.
- 27 In January 2017, NRW published a Timber Marketing Plan 2017-2022 (the TMP). The plan is essentially a policy which sets out how NRW will market timber. The TMP set out that NRW was piloting a new way of working called Standing Sales Plus (SS+). This new way of working would involve selling timber "on an open market Standing Sales basis without harvesting facilities and infrastructure in place. For these sale parcels in addition we will also consider bids to restock the felled area to specified replanting plan standards". Whilst SS+ was considered a "new way of working" as set out in paragraphs 25 and 26, this sales approach had already been used during the 2016-17 financial year.

- 28 In November 2016, NRW also wrote to the Welsh Government's Cabinet Secretary for Energy, Planning and Rural Affairs stating that it would be establishing a formal assessment and review process of the SS+ pilot to provide assurance that SS+ was meeting NRW's desired outcomes, providing value for money and meeting its environmental, health and safety obligations, (See Appendix 1, paragraphs 1.21 to 1.22).
- 29 NRW's commitment to evaluate the pilot as set out in the TMP was of vital importance because without such an assessment NRW was unable to demonstrate that it was meeting its legal obligation under Article 8 of its Establishment Order to consider the likely costs and benefits of the continued use of SS+ contracts (see paragraphs 74 to 77). The evaluation was also necessary to determine what impact SS+ was having on competition within the market (see paragraphs 43 to 46)) and whether SS+ was helping to delivering NRW's strategic objectives.
- 30 NRW has been unable to provide my auditors with any evidence that it carried out a formal evaluation of the SS+ methodology as it had committed to do in the TMP and as shown in Appendix 2, Table 5, it extended its use of SS+ during the 2018-19 financial year without undertaking such an evaluation.
- 31 I consider that NRW has been unable to demonstrate that it had good reason to depart from the commitment in the TMP to evaluate the SS+ pilot exercise. I am therefore not satisfied that NRW complied with principles of public law when it continued and extended the use of SS+ without evaluating the pilot.

Failure to comply with NRW's procurement policy

- 32 NRW has established rules governing the way in which it will procure works, goods and services. These procedures are set out in its, 'Procurement Instruction - A Summary of the Regulatory and Policy requirements for Procurements with a value of £25,000 and over in NRW' (the Procurement Instruction). The Procurement Instruction sets out how purchases with a value of £25,000 and over must be handled and states "all staff must follow NRW's procurement rules. Any deviations from the Procurement Rules must be fully justified and must be authorised at Head of Procurement or Procurement Manager level. Any course of action that could be regarded as non-compliant must be reported to a Procurement Manager or Head of Procurement".
- 33 The Procurement Instruction specifies that procurements with a value of £25,000 and over must be carried out by NRW's Procurement Team. During 2018-19, NRW officers estimated that at least 16 of the 43 SS+ contracts awarded by NRW had procurement values above £25,000. As set out in paragraph 25, SS+ contracts are mixed contracts combining the sale of timber with the procurement of civil engineering works and in some cases the procurement of restocking services. The Procurement Instruction applied to mixed contracts. NRW's Procurement Team has competitively awarded framework contracts to be used to procure civil engineering works and restocking services. However, the civil engineering works and restocking services included within the SS+ contracts were not procured through these

framework contracts. The advertisement and award processes for SS+ contracts were handled by NRW's Timber Sales Division with no involvement from NRW's Procurement Team. In consequence, NRW did not comply with its own procurement policy.

- 34 My auditors have found little evidence that officers within NRW's Timber Sales Division, recognised that SS+ contracts involved the procurement of works and in some cases service and that these contracts were subject to both NRW's procurement policies and public procurement regulations. However, contemporaneous notes kept by Executive Director of the UK Forest Products Association of a meeting he held with NRW's then Head of Commercial Operations and NRW's Head of Harvesting on 10 May 2017, record that he was told by the NRW officers present that procurement issues had been encountered with SS+ (Appendix 1, paragraph 1.31).
- 35 The Procurement Instruction sets out NRW's requirements for procuring supplies, services and works with a value of £25,000 and over include:
- the procurement value of contract opportunities must be estimated in advance of advertising procurement opportunities. For mixed contracts, the procurement procedure to be used is to be based on the element with the highest estimated cost, ie in the case of SS+ the value of civil engineering works and restocking services are required to be separately estimated and the highest value of these will determine the procurement procedure to be followed. My auditors found no evidence that NRW sought to estimate the separate values of the works and services to be procured within SS+ contracts, (with the purpose of determining the procurement procedure to be followed) in advance of advertising SS+ contract opportunities. I therefore consider that this requirement of the Procurement Instruction was not followed.
 - The Procurement Instruction specifies that procurements of £25,000 and over must be openly advertised on Sell2Wales (a Welsh Government established procurement portal), and subject to a sealed bid tender process. SS+ contracts opportunities were not advertised on Sell2Wales. They were advertised however on the Timber E-Sales portal used by NRW to advertise its timber sales opportunities. I acknowledge that NRW might have had a good reason for advertising these opportunities on the Timber E-Sales portal, ie SS+ contracts included the sale of timber and timber purchasers would look for opportunities to purchase on the Timber E-Sales portal. However, I have seen no documentary evidence that NRW gave consideration to how SS+ contracts should be advertised given that they were mixed sales and procurement contracts. I consider therefore that NRW departed from the advertisement requirement of the Procurement Instruction without seeking the necessary written approval of NRW's Head of Procurement or Procurement Manager to do so, (see paragraph 32). NRW has been unable to demonstrate that it had good reason to depart from the requirements of its own procurement policy when procuring works and services included within SS+ contracts. I therefore have significant doubt whether NRW complied with principles of public law in the procurement of these contracts.

Failure to comply with the requirements of the Public Contract Regulations 2015

- 36 NRW is required to comply with EU procurement rules. The rules governing the award of contracts for goods, works and services have been enshrined in UK law through the Public Contract Regulations 2015 (PCR 2015). SS+ contracts include both timber sales and procurement and therefore fall within the scope of the PCR 2015. The PCR 2015 sets out procedures that public bodies must follow before awarding contracts to buy supplies, services or works above defined financial thresholds. The PCR 2015 requires public bodies to calculate the estimated value of a contract at the moment at which a call for competition is sent. I have seen no evidence that NRW sought to estimate the value of the civil engineering and restocking elements of the SS+ contracts to determine whether the estimate procurement values of these contracts were above the PCR financial. I therefore consider that NRW did not comply with the requirements of the PCR 2015 and therefore the award of SS+ contracts and associated transactions included within NRW's 2018-19 financial statements were irregular.
- 37 NRW has retrospectively estimated that the procurement value of the works and services elements of the SS+ contracts it awarded were below the thresholds specified in the PCR 2015. However, as set out above, bidders for SS+ contracts were required to submit bids on an average price basis covering timber sales, civil engineering works and restocking services. As these individual elements were not separately priced in the bidding process, I have not been satisfied by the information provided by NRW that the procurement value of all the SS+ contracts was below the relevant PCR 2015 threshold.
- 38 I therefore consider that the award of SS+ contracts and transactions included within NRW's 2018-19 financial statements in respect of these contracts were irregular.

Failure to demonstrate that all relevant considerations were taken into account when awarding SS+ contracts

- 39 Public law requires public bodies to take into account all relevant considerations and disregard irrelevant considerations when taking decisions. One way in which public bodies can demonstrate that they have complied with this principle is by fully documenting the considerations they have taken into account.
- 40 NRW failed to properly document the decision-making process that led to its decision to introduce SS+ contracts. In particular, NRW has been unable to provide me with contemporaneous documentation setting out its rationale for introducing SS+ contracts or how it considered the potential risks and benefits of this new approach to timber sales.

41 Whilst an internal NRW email dated 9 November 2016 stated that SS+ had been developed "in liaison with customers", NRW has not been able to provide me with evidence of this (Appendix 1, Paragraph 1.20).

Consideration of the impact of SS+ on competition within the timber market

- 42 I am of the view that the introduction of SS+ was always likely to favour larger customers who had the capacity and capability to undertake a combination of harvesting, civil engineering and restocking work as a condition of buying timber from NRW. Of the 79 SS+ contracts that operated in 2016-17, 2017-18 and 2018-19, 49 were awarded to two customers and it is estimated that these two customers will receive approximately 69% of the timber sold by NRW under SS+ contracts.
- 43 I have seen no documentary evidence to show that NRW considered the impact that SS+ would have on the operation of the market when it introduced this new method of timber sales in its Interim Timber Marketing Statement covering the period 1 April 2016 to 31 March 2017.
- 44 On 7 December 2016, NRW's then Head of Enterprise reported to a meeting of NRW's Board that there was "a concern that the [SS+] approach favours larger companies, as risks are considered too high for smaller businesses" (Appendix 1, paragraph 1.26). NRW has not provided any evidence to show that this concern was considered, or that NRW satisfied itself that the use of a methodology that favoured large companies was in accordance with its policy objectives and its aim of ensuring market sustainability. Notwithstanding the concern reported to the Board in December 2016, NRW significantly increased its use of SS+ contracts during the 2017-18 and 2018-19 financial years (Appendix 2, Table 5).
- 45 The impact that SS+ would have on the operation of the market was a relevant consideration that NRW should have taken into account in deciding to introduce SS+ and to increase its use of the SS+ approach. NRW has been unable to demonstrate that it took this consideration into account in its decisions.

Legal and procurement considerations

- 46 NRW's decision to introduce of SS+ contracts in 2016-17 was a novel and possibly innovative approach to timber sales. It involved combining the sale of timber with the procurement of civil engineering works and restocking services. The new approach introduced certain complexities including the need to ensure,
- procurement regulations were complied with when awarding mixed contracts
 - that contractual terms were appropriate and protected NRW's interests
- 47 To address these matters, my expectation is that NRW's Timber Sales Division would have sought internal or external legal, procurement and financial advice in advance of introducing SS+ contracts.

- 48 NRW has been unable to provide my auditors with any evidence to indicate that advice was sought on the procurement aspects of SS+ contracts. I note that external legal advice was sought on contract wording for SS+ contracts as part of an overall review of NRW's timber sales contracts. On 14 August 2016, NRW's external legal advisors sent NRW's Timber Division proposed wording changes for contracts to be used for SS+. NRW did not implement these changes and instead used its existing standing sales contract documents to award SS+ contracts. NRW has been unable to provide me with an explanation of why it did not action the legal advice it received (Appendix 1, paragraph 1.15). On 10 April 2018, a meeting of staff within NRW's Forestry Division recognised that the contract documents being used for SS+ contracts were not effective for contracts with a restocking element (Appendix 1, paragraph 1.33)
- 49 In early 2019, NRW sought legal advice on whether procurement regulations applied to SS+ contracts. NRW received advice that SS+ contracts were mixed contracts containing a sales element and procurement of works and services, and as such fell within the scope of the Public Contracts Regulations 2015 (PCR 2015). As set out, in paragraph 36-38, NRW's failure to consider the procurement implications of SS+ contracts before their introduction or subsequently has resulted in a failure to comply with the requirements of the PCR 2015. Furthermore, I consider the failure of NRW to consider the legal and procurement implications of SS+ contracts prior to their introductions means that NRW failed to take into account all relevant considerations when taking that decision.

Accounting considerations

- 50 NRW introduced SS+ contracts during the 2016-17 financial years. Bidders for SS+ contracts were required to submit bids on an average price basis, ie they bid a single price per tonne of timber to be purchased which took into account the requirement to undertake civil engineering works and in some instances site restocking. The income NRW has received from SS+ contracts was therefore offset by the costs of civil engineering works and restocking services. In consequence NRW is unable to disaggregate the income and expenditure associated with each element of the contract. NRW is required to separately account for income from sales and expenditure related to procurement of works and services.
- 51 Since the introduction of SS+, NRW has accounted for SS+ transactions on a net income basis, ie it has not separated income and expenditure as it is required to under International Accounting Standards. I am satisfied that this has not led to a material misstatement of NRW's financial statements. Nevertheless, how SS+ transactions arising from contracts with an average pricing mechanism should be accounted for was a relevant consideration that NRW should have taken into account when it introduced SS+ contracts.

Performance of restocking considerations

- 52 Since SS+ was introduced NRW has entered into 43 SS+ contracts that contained a restocking requirement. Restocking a site may take place several years after a site has been felled. The average pricing mechanism for SS+ contracts meant that contractual transactions occurred at the time of felling not when the site was restocked. NRW was therefore paying for customers to restock the site several years in advance of the service being delivered. In April 2016, an NRW 'Restocking Working Group identified that paying in advance for restocking services created a risk that restocking might not be undertaken or might not be undertaken to the required standard (Appendix 1, paragraphs 1.11 to 1.12). The Group proposed to address this risk by requiring customers to provide a financial bond to ensure effective delivery of the service. This proposal was not implemented, and NRW has not been able to provide my auditors with an explanation why this did not happen.
- 53 The Grant Thornton's review of NRW's governance of its timber sales reported in January 2019 that NRW had not effectively monitored the level of restocking required by the SS+ contracts, and it was not clear to what extent NRW was exposed by paying for a service prior to its performance by agreement to accept reduced sales revenues. NRW is currently seeking to negotiate the removal of any contractual civil engineering and restocking requirements with its SS+ customers (Appendix 1, paragraph 1.43).
- 54 I consider that the question of how NRW would ensure that future restocking services, paid for in advance would be provided to required standards was a relevant consideration that NRW should have taken into account when introducing SS+ contracts. Whilst there is evidence that NRW did consider the risk that the service would not be delivered effectively, it did not put in place measures to address the risk.

Value for money considerations

- 55 The Grant Thornton's review of NRW's governance of its timber sales found that NRW had been unable to provide it with documentation to evidence that SS+ contracts represented best value for money.
- 56 I concur with this view. Whilst my auditors have seen documentation from 2016 that shows that NRW made commitments to assess a pilot of SS+ to determine whether this timber sales approach delivered value for money (Appendix 1, paragraphs 1.20 to 1.22), NRW has been unable to provide evidence that any such assessment was undertaken or that it developed any methodology to assess whether SS+ contracts represented value for money. The question of whether SS+ represented value for money should have been a relevant consideration in NRW's decisions to a) continue using this approach and b) increase its use of the approach. I have seen no documentary evidence that NRW took account of this consideration.
- 57 I have further concerns regarding NRW's consideration of the cost and benefits of SS+ contracts which I have set out in paragraphs 73 to 86.

Failure to comply with NRW's Scheme of Delegation

- 58 The functions of NRW are set out in the Natural Resources Body for Wales Establishment Order 2012 (the Order). These functions include undertaking any devolved function of the Forestry Commissioners. NRW is therefore empowered to manage the publicly-owned forest estate and to make decisions necessary to effectively carry out that function. The 2012 Order sets out that NRW may delegate the exercise of its functions to a committee, sub-committee, member or employee of NRW. This includes entering into contracts with external suppliers and purchasers.
- 59 NRW's Board has approved a Financial Scheme of Delegation called 'Managing Our Money' under which all financial activities of NRW have been delegated to an agreed level of authority or specific post holder. It allows the Board to delegate decision-making responsibility for certain financial matters.
- 60 The Financial Scheme of Delegation is the method by which NRW's Board delegates its function of entering into contracts to individual members of staff and is a mechanism for risk management and financial probity. If contract authorisations are non-compliant with the Scheme of Delegation transactions in respect of those contracts will be items of account contrary to law.
- 61 The Financial Scheme of Delegation sets out the office holders authorised to enter into timber sales contracts, and the contract values to which their delegations extend, (Appendix 2, paragraphs 2.9 to 2.10).
- 62 As set out in Appendix 2, paragraph 2.11, my auditors tested a sample of 13 of the SS+ contracts and found that six of these were authorised by NRW officers without the necessary delegation to authorise contracts awards of the value they signed off.
- 63 The estimated value of the contracts not properly authorised was £2,405,375.
- 64 My auditors also tested a sample of eight extensions to SS+ contracts to ensure that contract extensions had been authorised in accordance with the Financial Scheme of Delegation. My auditors found that whilst all the contracts extensions had been authorised by NRW officers, four contract extensions were authorised by NRW officers without the necessary delegation to authorise contracts awards of the value they signed off.
- 65 The testing undertaken by my auditors found that the failure to comply with the Financial Scheme of Delegation when awarding timber sales contracts was not isolated to SS+ contracts. Towards the end of 2018, NRW put in place improved arrangements to ensure that future contracts awards comply with the Financial Scheme of Delegation.
- 66 I consider that in those instances where NRW failed to comply with its Financial Scheme of Delegation in awarding contracts or contract extensions, the transactions

included within NRW's 2018-19 financial statements are contrary to law. In consequence, I have qualified my regularity opinion on NRW's financial statements.

Failure to refer novel, contentious and/or repercussive activities and proposals to the Welsh Government

- 67 The principal document that provides authority for NRW transactions is the Framework Document. The Framework Document sets out that payment of grant-in-aid to NRW is conditional upon the satisfactory performance by NRW of all its obligations, which includes compliance with the Welsh Government publication, Managing Welsh Public Money. The requirement to comply with Managing Welsh Public Money relates to section 70 (2) of the Government of Wales Act 2006 (2) which states that 'the Welsh Ministers may attach conditions to the giving of financial assistance by them; and the conditions which may be attached include, in particular, conditions requiring the repayment of the whole or any part of a grant, or the making of any other payments, in any circumstances.'
- 68 Under the title 'Expenditure', paragraph 3.9.1 of the NRW Framework Document says that: 'NRW shall comply with the delegations set out in Annex 5'. Annex 5 sets out that approval of the relevant Welsh Government sponsor team is required for any novel, contentious or repercussive proposals.
- 69 I have considered the version of the Welsh Government's Managing Welsh Public Money published in January 2016. This document says in 'paragraph 3.8.2: The framework document (or equivalent) agreed between a public body and its sponsor Branch always provides for the sponsor Branch to exercise meaningful oversight of the public body's strategy and performance, pay arrangements and/or major financial transactions, eg by monthly returns, standard delegations, exception reporting. Public bodies should refer to their sponsor Branch any issues which appear novel, contentious or repercussive'.
- 70 The NRW Framework Document sets out in relation to expenditure that NRW must obtain written approval in advance of proceeding with any proposal which could be considered novel, contentious or repercussive. For income (including disposal proceeds from the Welsh Government Woodland Estate) it states 'NRW must seek as far as possible to maximise its income... where this is consistent with its functions and is in line with the agreed Corporate Plan'. SS+ contracts are mixed contracts involving income from the sale of timber and expenditure on civil engineering works and restocking services.
- 71 NRW was required therefore to refer to the Welsh Government any novel, contentious or repercussive proposals and obtain written approval involving expenditure. I consider that the transitional contracts were novel, contentious and/or repercussive because the proposal to enter into SS+ contracts:

- was a new and untested approach to timber sales and involved combining timber sales with the procurement of works and services. I therefore consider the proposal was novel (see paragraph 46).
- SS+ contracts had the potential to impact on the operation of the market and to favour larger customers. In December 2016, a report to NRW's Board set out that feedback from the first SS+ contracts awarded indicated SS+ favoured larger customers. (see paragraph 44). Nevertheless, NRW decided to increase its use of SS+. I consider therefore that both the initial proposal to introduce SS+ contracts and the decisions to continue and increase their usage were contentious and/or repercussive.

72 Whilst NRW did make the Welsh Government aware that it was introducing SS+ contracts, it did not inform the Welsh Government that SS+ was potentially novel, contentious and or repercussive, and it did not make a referral to the Welsh Government as required by its Framework Document and Managing Welsh Public Money, nor did it obtain the necessary written approval to award SS+ contracts. In consequence, I consider that NRW did not meet this requirement. I consider that the transactions related to these contracts which are included within NRW's financial statements for 2018-19 were outside the framework of authority governing them and are therefore irregular. In consequence, I have qualified my regularity opinion on NRW's 2018-19 financial statements.

Failure to comply with Article 8 of NRW's Establishment Order

Assessment of costs and benefits

- 73 Article 8 of the NRW Establishment Order 2012 (the Order) states that 'in considering whether or not to exercise any power conferred upon it by or under any enactment, the Body must take into account the likely costs and benefits of the exercise or non-exercise of that power'.
- 74 In its 2016-17 Timber Marketing Statement NRW set out that it would sell approximately 150,000m³ of standing timber on an open market basis without harvesting facilities and infrastructure in place. This timber sales approach was subsequently re-named SS+. NRW told my auditors that SS+ contracts were introduced during 2016-17 on a trial basis to test the market during this period. NRW's intention was to undertake an evaluation of this form of sale during the trial period.
- 75 I acknowledge that to assess the likely costs and benefits of a new approach, it is sometimes necessary to undertake a trial of that approach and evaluate the outcome before reaching a decision on whether to continue with it. NRW stated in its Timber Marketing Plan for the period 1 April 2017 to 31 March 2022 that it was piloting the

use of SS+ contract, and that it would “carefully assess performance [of SS+ contracts awarded within the pilot exercise] to make sure that they are capable of meeting the outcomes we seek, provide good value for money and customer benefit (Appendix 1 paragraph 1.28). NRW also informed the Welsh Government’s Cabinet Secretary for Energy, Planning and Rural Affairs in November 2016 that a formal assessment and review process [of SS+ was to be established “to provide an assurance role that we are meeting the outcomes we seek, providing value for money and meeting our environmental, health and safety obligations” (Appendix 1, paragraph 1.22).

- 76 NRW has been unable to provide my auditors with evidence that the pilot of SS+ contracts was assessed or evaluated, or that any subsequent assessment was undertaken of the costs and benefits of SS+ contracts. Nevertheless, NRW exercised the power conferred upon it to continue awarding SS+ contracts, without being able to demonstrate that it had considered the likely costs and benefits. I have therefore significant doubt as to whether NRW complied with the requirements of its Establishment Order.

Contract Pricing

- 77 As set out in paragraph 50 bidders for SS+ contracts were required to submit bids on an average price per tonne of timber purchased. In determining the price per tonne to be bid, potential customers had to take into account a range of factors including:
- the amount of timber (volume and tonnage) to be harvested at the site
 - the mix of timber (species and quality) to be purchased
 - harvesting costs,
 - the cost of undertaking civil engineering works and restocking required by NRW.
 - their required return
- 78 In consequence, calculating an average price per tonne involved a level of complexity not associated with standard timber sales contracts. Potential customers were reliant on the accuracy of NRW’s estimation of the amount and mix of timber available at the site covered by the SS+ contract. The accuracy of this information was critical to enable potential bidders to calculate the average price per tonne of timber they were willing to pay. This was because bidders needed to ensure that the average price bid would enable them to fully recover the mainly fixed costs of undertaking the civil engineering and restocking works required by NRW. The following worked example illustrates simplistically how a potential customer might construct an average price bid.

Worked Example

Contracted weight of timber - 10,000 tonnes (tonnage provided by NRW to potential bidders)

Gross price of timber the purchaser is willing to pay after harvesting costs - £40 per tonne

Civil Engineering Costs - £30,000 (estimated by bidder based on NRW specification)

Harvesting Costs - £60,000 (estimated by bidder based on NRW specification)

Calculation of average price

Step 1: Calculate gross timber purchase price

10,000 tonnes to be purchased x £40 per tonne = £400,000

Step 2: Deduct costs of civil engineering and restocking from the timber purchase price

£400,000 - £30,000 - £60,000 = net timber price of £310,000

Step 3: Calculate average price per contracted tonne

£310,000 divided by 10,000 tonnes = bid price of £31 per tonne

79 Once the customer has harvested the contracted volume of 10,000 tonnes at a net price of £31 per tonne, it would in effect have purchased the timber it required at its target gross price of £40 per tonne.

80 However, if only 5,000 of the 10,000 contracted tonnage specified by NRW was available for harvesting, the customer would potentially be disadvantaged. As shown below, whilst the customer would still pay NRW a net price of £31 per tonne, the gross price the customer would be paying would increase to £49 per tonne, resulting in the customer paying £9 per tonne more than the £40 gross price its bid was based on, as shown below.

Step 1: Price paid to NRW

£31 per tonne for 5,000 tonnes = £155,000

Step 2: Add civil engineering and restocking costs incurred by the purchaser

£155,000 + £30,000 + £60,000 = £245,000

Step 3: Calculate gross price per tonne paid by customer

£245,000 divided by 5,000 tonnes = £49 per tonne

81 Alternatively, if the customer was able to harvest 15,000 tonnes of timber, as opposed to the 10,000 tonnes specified by NRW, the customer would potentially benefit from the oversupply, and NRW would potentially be selling timber at less than market rates. The customer would still pay NRW a net price of £31 per tonne but it would effectively only be paying a gross price of £37 per tonne of timber bought, compared to the £40 per tonne its bid was based on, as shown below.

Step 1: Price paid to NRW

£31 per tonne for 15,000 tonnes = £465,000

Step 2: Add civil engineering and restocking costs incurred by the purchaser

£465,000 + £30,000 + £60,000 = £555,000

Step 3: Calculate gross price per tonne paid by customer

£555,000 divided by 15,000 tonnes = £37 per tonne

- 82 As set out in Appendix 1, paragraph 1.35, in a meeting with NRW officers on 15 May 2018, SS+ customers informed NRW that where the volume of timber to be harvested within an SS+ contract was significantly less than estimated it posed unacceptable risks for bidders. They also raised concern that the quality, transparency and consistency of mensuration data held by NRW for the areas within SS+ contracts, and the way in which this data was presented by NRW constituted a significant risk for potential buyers.
- 83 My auditors compared the amount of timber NRW had contracted to sell to SS+ customers to the amount sold for each of the 44 SS+ contract that had been completed before 31 March 2019. They found that 7 of the 44 contracts completed had an outturn volume within +/-10% of the contracted volume. The majority, 59%, had out-turn volumes in excess of 110% of that contracted, with 18% of contracts having out-turn volumes in excess of 150% of that contracted. The outturn volume on 11 contracts varied by over +/-50% from what had been contracted (Appendix 2, paragraph 2.8).
- 84 In view of this, I have significant concerns regarding the accuracy of the mensuration data used by NRW to determine the contracted tonnages on which bidders were asked to bid. I accept that there must be some degree of tolerance when estimating timber volume and tonnage. However, it is disturbing that only 7 of the 44 SS+ contracts completed had an outturn tonnage within 10% of that contracted.
- 85 I have seen no evidence, that NRW considered the impact that the introduction of an average price mechanism could have on both fairness to customers and delivering value for money for NRW where contracted timber tonnages were not available or exceeded. In the event, a large majority of SS+ contracts exceeded contracted volumes and in consequence, NRW has been unable to demonstrate to me that the timber sold on these contracts was at market rates.
- 86 I am therefore not satisfied that in entering into SS+ contracts which included an average pricing mechanism, NRW considered the likely costs and benefits which would result from the operation of that pricing mechanism. I have therefore significant doubt as to whether NRW complied with the requirements of its Establishment Order.

Appendix 1

The development, implementation and operation of Standing Sales Plus (SS+) contracts by NRW from 2015 to date

The development of SS+

- 1.1. On 1 April 2013, NRW commenced operations as the newly created environmental body for Wales. One of its duties is to manage the Welsh Government's Woodland Estate (WGWE) as a national asset. This includes harvesting and marketing timber from the WGWE. NRW is the largest supplier of certified timber in Wales.
- 1.2. NRW communicates its approach to the harvesting and marketing of timber through a Timber Marketing Plan (TMP). The TMP sets out the volume of timber NRW will release to the market each year and its marketing approaches and methods of sale. From 1 April 2013 to 31 March 2016, NRW continued to work within the former Forestry Commission Wales' 5-year 'Timber Marketing Strategy 2011-16'.
- 1.3. In early 2015, NRW commenced work on producing a new 5-year TMP to apply in the period 1 April 2016 to 31 March 2021. Between July 2015 and October 2015 NRW consulted on a draft 5-year TMP. The draft TMP set out that NRW was proposing to utilise traditional sales methodologies and contracts, but that it was 'open to suggestions of how different approaches or a more effective combination of approaches to timber contract types and methods of sale could be used to generate more benefit from the WGWE timber resource, in particular to stimulate the supply chain and broader forest sector performance'.
- 1.4. NRW produced a summary of responses to the TMP consultation, but the summary does not record that consultees suggested combining sales contracts with contracts for civil works or re-planting (what became known as SS+ contracts).
- 1.5. Due to a number of uncertainties including questions over NRW's long term funding, in December 2015 NRW's Executive Team decided to delay introducing a 5-year TMP and to instead publish an Interim Marketing Statement for the period 1 April 2016 to 31 March 2017.
- 1.6. A paper was presented for consideration to a meeting of NRW's Board held on 28 January 2016. The Paper set out reasons why NRW's Executive Team had decided to postpone publication of a 5-year TMP and was instead intending to issue a one-year Interim Marketing Statement. Appended to the paper was the draft Interim Marketing Statement. The Board was 'asked to approve the proposed approach to developing a Timber Marketing Plan for 2017-22 and the Interim Marketing Statement for 2016-17'.
- 1.7. The Interim Marketing Statement provided to the Board set out NRW's intention to offer 850,000m³ obs of timber to the market in 2016-17. It states that 'of the

850,000 m³ obs maximum offered for sale, approximately 150,000m³ obs will be sold on an open market Standing Sales basis without harvesting facilities and infrastructure in place. These sales parcels will require the purchaser to undertake all necessary requirements to good forestry practice as set out in the [UK Forestry Standard], a minimum civil engineering standard and compliant with [the Construction Design and Management Regulations 2015] which will be specified in the individual sale lot details. For these sale parcels in addition we will also consider bids to restock the felled area to specified replanting plan standards'. Whilst the Interim Marketing Statement does not use the term SS+, it sets out for the first time NRW's intention to offer timber sales contracts to the market which would require the purchaser to undertake civil infrastructure works with the possibility of restocking felled areas. This approach to the sale of timber was new to NRW. NRW has been unable to provide my auditors with any contemporaneous documentation setting out what considerations it took into account when deciding to introduce this new method of sale, or evidence that advice was sought from its Legal, Procurement and Finance Departments on the proposed approach.

- 1.8. The Board paper to which the Interim Marketing Statement was appended did not draw the Board's attention to the new approach to timber sales being proposed or any potential risks and benefits of this alternative sales methodology.
- 1.9. The minutes of the Board meeting of 28 January 2016 record that the Board discussed the Interim Marketing Statement, noted 'the proposals to test the market in innovative ways' and approved the document.
- 1.10. On 17 March 2016, NRW officials presented the Interim Marketing Statement to a Timber Customer Liaison meeting. Contemporaneous notes of this meeting taken by the Executive Director of the United Kingdom Forest Products Association (UKFPA), a representative organisation for timber processing companies, record that NRW's customers were informed that NRW was introducing a new method of sale of standing timber. The new sales method would require buyers to undertake site-related civil engineering work as well as restocking the site after harvesting. The notes also record that considerable reservations over this new approach were voiced by NRW customers. These included that the introduction of the new methodology was being rushed without sufficient thought or consultation with customers.
- 1.11. In April 2016, an internal NRW restocking working group considered the restocking aspects of SS+ contracts. A note issued by the group states 'Combining felling and restocking (and civil engineering) into single contracts is an approach we wish to test, in the 16/17 timber marketing plan this may result in more of the less economic elements of [Forest Resource Plans] being delivered through potential efficiencies that fell and restock contracts may bring'.
- 1.12. The note indicates that the working group considered how the delivery of future restocking could be managed and how it would ensure that the restocking would be completed to appropriate standards and timescale. It was acknowledged that this would involve contractual specification of the service to be provided, and

contractors would be required to provide a bond that NRW would be able to liquidate, in the event that the service was not delivered or was not delivered to the required specification.

- 1.13. NRW officials have told my auditors that by the end of 2016 it had produced a document entitled 'Generic Requirements for the Restocking and Establishment of Trees on NRW Conditional Standing Sale Contracts'. This document was appended to SS+ contracts containing a restocking requirement. The document states that 'the restocked area will meet the prescribed spacing and density, as described in the [contract specific restocking prescription] and within the time period described in the [prescription]'. However, whilst SS+ contracts awarded subsequently contain specific restocking prescriptions that set out restocking spacing and density, not all of these specify time periods for restocking.
- 1.14. The working group's proposal requiring SS+ customers with a restocking requirement to provide a bond to ensure the service was effectively delivered was never implemented. NRW has not been able to provide my auditors with an explanation why this did not happen.
- 1.15. In or around July 2016, NRW's Timber Sales Division sought external legal advice on the wording of its standard contracts for the sale of standing trees and for the sale of standing trees where the customer was required to undertake civil work as a condition of purchase, ie SS+. On 14 August 2016, NRW's external legal advisors sent NRW copies of the contracts they had amended. NRW did not implement these changes. NRW has been unable to provide me with an explanation of why it did not action the advice it received.

The introduction of SS+

- 1.16. The start date for the first SS+ contracts awarded by NRW was 20 August 2016.
- 1.17. NRW entered into 10 SS+ contracts with start dates in the 2016-17 financial year. Two of the contracts awarded did not proceed. A summary of these contracts is set out in [Appendix 2](#), Table 1.
- 1.18. NRW told my auditors that SS+ contracts were introduced during 2016-17 on a trial basis to test the market during this period. NRW's intention was to undertake an evaluation of this form of sale during the trial period, however, NRW has been unable to locate any documentation indicating that a formal evaluation was undertaken.
- 1.19. During 2016, NRW commenced work on the production of a new 5-year TMP to cover the period 1 April 2017 to 31 March 2018. An initial draft of the plan was circulated within NRW for comment in October 2017. The draft plan set out that NRW would seek to provide an annual volume of 150,000m³ obs of timber under conditional contracts (SS+).
- 1.20. On 9 November 2016, NRW's the former Head of Commercial Operations commenting by email on the draft TMP stated 'it might be better to say a little less about [Long Term Contracts] and insert a paragraph about the development in

liaison with customers of the new 'Conditional' methods of sale. It would be useful to have a better term of these as all sales have conditions and something like Standing Sales plus might convey the nature of the contracts that we are experimenting with. We need to explain that we will explore this new way of working to see if they provide better value for money and customer benefit without compromising environmental and safety standards. And without detracting from the condition of our infrastructure and the delivery of sound silvicultural standards'. This email is the first reference to the 'rebranding' of conditional timber sales contracts as SS+ contracts.

- 1.21. On 10 November 2016, NRW received a request from the Welsh Government to provide a briefing note to the Welsh Government's Cabinet Secretary for Energy, Planning and Rural Affairs in advance of a meeting she had scheduled with industry representatives. NRW provided a briefing note that set out that a draft TMP for the period 2017 to 2022 had been prepared but was yet to be approved by NRW's Executive Team or Board. The briefing note set out that the TMP included an 'annual baseline flexible programme sale offer of 150,000m³ obs on the basis of either a traditional or a 'conditional' method of sale approach. The pilot of the 'conditional' (to be known as 'standing sales plus) contracts are on the basis that the buyer carries out their own civils work and restocks the site to our specification'.
- 1.22. The briefing note also set out that, in view of the change in approach to timber sales, a recommendation had been made to a meeting of NRW's Executive Team on 15 November 2016 that 'a formal assessment and review process be established to provide an assurance role that we are meeting the outcomes we seek, providing value for money and meeting our environmental, health and safety obligations'. The review would include 'use of the standing sales plus approach to deliver the flexible component of the programme'.
- 1.23. The content of the briefing note demonstrates that in November 2016,
 - NRW still regarded SS+ as operating on a pilot basis, and that NRW would conduct a review which would evaluate whether SS+ was delivering NRW's required outcomes whilst delivering value for money and meeting environmental and health and safety obligations. However, NRW has been unable to provide any evidence to show that the planned review was undertaken.
 - NRW's intention was that only part of the 150,000m³ obs 'annual flexible programme sales offer would be through SS+ contracts, with part of that volume being offered through a 'traditional' sales approach'.
- 1.24. NRW's Executive Team met on 15 November 2016. To support its consideration of the draft TMP, the Executive Team received an officer briefing note on the TMP which set out key changes from the previous TMP. There was no direct reference to SS+ contracts within the briefing note. Whilst Executive Team meetings were not minuted, NRW kept an action log of decisions made by the Executive Team. The action log for the 15 November 2016 meeting records that the Executive Team was

'happy to approve [the TMP] to go to board'. The action log does not record that the Executive Team's considered or was asked to consider the recommendation referred to in paragraph 1.22.

- 1.25. On 7 December 2016, NRW's Board met to consider the draft TMP. To support the Board in its consideration, NRW's then Head of Enterprise provided the Board with a paper summarising the content of the plan. The paper referred to an 'annual baseline flexible programme sale offer of 150,000m³ obs' and confirmed that part of this volume would be sold through SS+ contracts and part through traditional sales methods. The paper did not provide any indication that SS+ contracts were novel or introduced risks not found with more traditional sales methods (other than the risk that SS+ might favour large companies as set out in paragraph 1.26). The paper did not set out legal, procurement and financial implications of SS+ or how value for money would be assessed.
- 1.26. The paper provided to 7 December 2016 Board meeting recognised that feedback received on the operation of the first SS+ contracts awarded in 2016-17 had highlighted concerns that SS+ might favour larger companies. The paper set out that 'whilst preliminary feedback from the pilot of 'standing sales plus' contracts offered in 2016/17 has been encouraging in terms of maximising our revenue, it represents a new way of working for us and we need to assess and report back on the impact and opportunities of this approach to ensure it is fit for purpose for the duration of the five year Plan. There is a concern that the approach favours larger companies, as risks are considered too high for smaller businesses'. Although this market risk was identified and the need for evaluation of SS+ contracts acknowledged, NRW has been unable to provide evidence that any formal assessment of SS+ took place.
- 1.27. At the Board meeting of 7 December 2016, NRW's former Head of Commercial Operations gave a presentation on the draft TMP. The only reference to SS+ on the presentation slides was a mention of SS+ as an example of one of NRW's new ways of working.
- 1.28. The draft TMP presented to the Board stated 'the annual baseline flexible offer as a 'conditional' method of sales approach, to be known as 'Standing Sales plus' will be sold on an open market Standing Sales basis without harvesting facilities and infrastructure in place. These sales parcels will require the purchaser to undertake all necessary requirements to best practice safety standards ... For these sale parcels in addition we will consider bids to restock the felled area to specified replanting plan standards ... where we are piloting new ways of working, such as the offer of sales of 'standing sales plus' volume, we will carefully assess performance to make sure that they are capable of meeting the outcomes we seek, provide good value for money and customer benefit. There will be no compromise on performance, silvicultural, environment and health and safety standards'.
- 1.29. NRW has retained a copy of the draft TMP which contains comments made by the then Chair of NRW's Board. In response to the commitment in the plan to 'carefully assess performance' when piloting new ways of working including SS+, the former

Chair questioned 'will we be asking customers what they see as the benefits and if so how and when'.

- 1.30. The minutes of 7 December 2016 Board meeting record that the Board approved the TMP 2017-22 subject to a small number of amendments. The Plan was finalised and published in January 2017.
- 1.31. On 10 May 2017, NRW's then Head of Commercial Operations and NRW's Head of Harvesting met with the Executive Director of the UKFPA. UKFPA's contemporaneous notes of this meeting record that he was told by the NRW officials present that procurement issues had been encountered with SS+.
- 1.32. NRW entered into 30 SS+ contracts with start dates in the 2017-18 financial year. Two of these contracts did not proceed. Fifteen of the contracts were awarded to three contractors as set out in [Appendix 2](#), Table 2.

Operation and Management of SS+ contracts

- 1.33. On 10 April 2018, NRW officers employed within the NRW's Timber Division met to discuss SS+ contracts. The notes of this meeting show that members of staff were aware of a number of concerns regarding the operation of SS+ contracts. The notes record that:
 - Planners were concerned that coupes to be harvested as part of SS+ contracts were being notified at a late stage resulting in various operational difficulties.
 - The contract documents being used for SS+ were not designed for contracts with a restocking element. The closure date within the contracts was linked to the end of harvesting operations. However, with SS+, because restocking could continue for up to five years after harvesting there was a need for contractual terms to continue beyond the end of harvesting.
 - Bids received for SS+ contracts were not submitted on a consistent basis making assessment of bids problematic. (that some bidders were bidding on a net price basis, whilst others were submitting bids showing the price for timber, civil engineering and restocking separately).
- 1.34. The notes of the NRW meeting of 10 April 2018 set out several planned actions to address the SS+ concerns. One of these actions was to 'explore the contractual issues with legal/finance/procurement and draw up a contract/process that covers all [operations]'. NRW has not provided me with any information indicating that this occurred. The notes also record an action to arrange a meeting with operators to discuss SS+ issues.
- 1.35. A meeting was held on 15 May 2018 with industry representatives to discuss SS+. The notes of this meeting record that a number of concerns were raised with NRW regarding the way in which SS+ contracts were operating. These concerns included:

- Perceived inconsistency of NRW staff in handling information required to award SS+ contracts and commence contractual operations.
 - Whether the contractual documents for SS+ were fit for purpose.
 - That the requirement to bid on an average price basis for SS+ contracts posed unacceptable risks for bidders where the volume of timber to be harvested within an SS+ contract was significantly less than estimated by NRW.
 - That the quality, transparency and consistency of mensuration data held by NRW for the areas within SS+ contracts, and the way in which this data was presented by NRW was a particular cause for concern and constituted a significant risk for potential buyers.
- 1.36. At the meeting held on 15 May 2018, NRW officials agreed to act to address the concerns expressed. However, in the event most of the proposed actions were placed on hold when NRW commissioned Grant Thornton to undertake a review of the governance of its timber sales as set out in paragraph 138.
- 1.37. NRW entered into 43 SS+ contracts with a start date in the 2018-19 financial year. As at 31 March 2019, 33 of these contracts were yet to be completed. Each contract included a requirement for the successful purchaser to undertake civil infrastructure work. Thirty-one of the contracts also included a requirement to undertake future restocking of the site. Thirty-one of the contracts were awarded to three contractors as set out in [Appendix 2](#), Table 3.
- 1.38. In July 2018, the former Auditor General for Wales qualified his regularity opinion on NRW's 2017-18 financial statements due to concerns over 59 timber sales contracts NRW had awarded during that year. This was the third consecutive year the former Auditor General had qualified his regularity opinion due to concerns over timber sales contracts. NRW senior officials accepted that there had been serious issues in relation to NRW's timber sales that were historic, deep rooted and widespread. In view of this, the Chief Executive supported by the NRW Board decided to commission Grant Thornton to undertake an independent review into NRW's governance of timber sales.
- 1.39. Grant Thornton commenced an extensive project and during the course of its work identified significant concerns relating to SS+ contracts. When NRW became aware of the emerging findings of the review, it took immediate action to suspend the award of future SS+ contracts, until such time as the concerns had been addressed.
- 1.40. In February 2019, Grant Thornton issued a report setting out the findings of its review, and NRW made the report publicly available. The report set out included specific concerns regarding NRW's implementation and management of SS+. These included:
- NRW had been unable to provide it with evidence that it had given appropriate consideration to the impact of SS+ on contract terms and

financial reporting. It had also not able to provide documentation to evidence that SS+ contracts represented best value for money.

- NRW did not have a clear sign off process for introducing SS+ contracts.
- There had been inadequate involvement of NRW's procurement function in the development of the SS+ activity; and given SS+ involved offsetting the cost of procuring works and services from timber sales income, it was reasonable to expect the arrangements to have been fully agreed by procurement prior to any SS+ contracts being let.
- NRW had in 2016 commissioned an external legal review of a range of contracts, including SS+ but the advice received was not implemented. NRW's legal department was not involved in oversight of the externally provided legal advice.
- NRW had not updated its timber sales contract guidance to take into account the introduction of SS+ contracts.
- NRW had not effectively monitored the level of future services (replanting of trees) due to NRW within SS+ contracts, and it was not clear to what extent NRW was exposed by paying for a service prior to its performance by agreement to accept reduced sales revenues.
- Concerns had been raised with Grant Thornton regarding the robustness of NRW's SS+ contract terms and whether the contractual schedules for future services to be carried out by the customer were adequate for ensuring quality work was carried out.
- NRW's finance function had not got access to financial information to separately show the value of component elements of SS+ contracts, ie sales income, works to be undertaken and services to be delivered by the customer. The only information available to the Finance function was the income from timber sales after the cost of works and services had been offset.

1.41. As soon as NRW received the preliminary findings of the Grant Thornton report it took immediate action to suspend any further awards of SS+ contracts.

1.42. In January 2019, following receipt of Grant Thornton's report, NRW established a 'Timber Sales Governance' project with the aim of ensuring the effective implementation of all the improvement measures within NRW's Timber Sales function identified by NRW itself, the Auditor General's reports and the Grant Thornton review. Whilst many of these improvements have already been implemented, some matters will take some to be resolved.

1.43. NRW has also agreed a negotiation strategy within which it is seeking to negotiate the removal of any contractual civil engineering and restocking requirements with its SS+ customers.

1.44. In early 2019, NRW sought legal advice on whether procurement regulations applied to SS+ contracts. NRW received advice that SS+ contracts were mixed

contracts containing a sales element and procurement of works and services, and as such fell within the scope of the Public Contracts Regulations 2015.

Appendix 2

SS+ Contracts Awarded by NRW

Summary of SS+ contracts awarded by NRW from 2015 to date by financial year

2.1 NRW entered into 10 SS+ contracts with start dates in the 2016-17 financial year. Two of the contracts awarded did not proceed. Each contract included a requirement for the successful purchaser to undertake civil infrastructure work. Two of the contracts also included a requirement to undertake future restocking of the site (Table 1).

Table 1: SS+ contracts with start dates in the 2016-17 financial year, volume and value by contractor

Successful Contractors	Number of contracts awarded that proceeded ¹	Volume of contracted timber m3 obs	Estimated net income value of contracts to NRW ²	Actual Volume of timber sold m3 obs	% of total volume sold	Net contractual income received by NRW
Contractor 1	3	6,702	£133,555	7,258	24%	£141,645
Contractor 2	3	5,069	£88,338	6,547	18%	£117,223
Contractor 3	1	15,749	£488,226	13,865	55%	£463,506
Other contractor	1	838	£25,688	549	3%	£16,852
Total	8	28,358	£735,807	28,219	100%	£739,226

¹ One further contract awarded to Contractor 1 and one further contract awarded to another contractor did not proceed.

² Net income represents the price paid to NRW by the contractor for the timber offset by the contractor for undertaking civil infrastructure and restocking work.

2.2 NRW entered into 30 SS+ contracts with start dates in the 2017-18 financial year. Two of these contracts did not proceed. Each contract included a requirement for the successful purchaser to undertake civil infrastructure work. Of the contracts which proceeded, 10 of the contracts also included a requirement to undertake

future restocking of the site. Fifteen of the contracts were awarded to three contractors (Table 2)

Table 2: SS+ contracts with start dates in the 2017-18 financial year, volume and value by contractor

Successful Contractors ¹	Number of contracts awarded	Volume of contracted timber m ³ obs	Estimated net income value of contracts to NRW ²	Actual volume of timber sold m ³ obs to 31 March 2019	Estimated volume of timber m ³ obs to be sold in 2019-20 ³	% of total contracted volume to be dispatched (2018-19 and 2019-20)	Total contractual income to be received by NRW (actual & estimated)
Contractor 1	7	38,208	£725,028	39,699	3,472	34%	£796,015
Contractor 2	7	22,402	£455,995	30,206	0	24%	£611,355
Contractor 3	1	1,833	£73,191	1,216	0	1%	£48,574
Other contractors (7)	13	48,748	£1,291,529	44,344	6,432	41%	£1,360,715
Total	28	111,191	£2,545,743	115,465	9,904	100%	£2,816,659

¹ One further contract was awarded to both Contractor 1 and Contractor 2 and a contract was awarded to another contractor but did not proceed.

² Net income represents the price paid to NRW by the contractor for the timber offset by the contractor for undertaking civil infrastructure and restocking work.

³ Based on 100% of contracted volume being sold.

2.3 NRW entered into 43 SS+ contracts with a start date in the 2018-19 financial year. As at 31 March 2019, 33 of these contracts were yet to be completed. Each contract included a requirement for the successful purchaser to undertake civil infrastructure work. Thirty-one of the contracts also included a requirement to undertake future restocking of the site. Thirty-one of the contracts were awarded to three contractors, Table 3.

Table 3: SS+ contracts volume and estimated outturn by contractor (contracts commencing in 2018-19)

Successful Contractors	Number of contracts awarded	Volume of contracted timber m ³ obs	Estimated net income value of contracts to NRW ¹	Actual volume of timber sold m ³ obs to 31 March 2019	Estimated volume of timber m ³ obs to be sold in 2019-20 ²	% of total contracted volume to be dispatched (2018-19 and 2019-20)	Total contractual income to be received by NRW (actual & estimated)
Contractor 1	16	78,895	£2,905,420	39,297	42,112	39%	£3,375,376
Contractor 2	13	73,877	£2,302,569	46,265	32,291	38%	£2,707,589
Contractor 3	2	11,076	£519,128	5,861	5,204	5%	£585,551
Other contractors (9)	12	34,910	£884,041	16,157	20,662	18%	£1,050,374
Total	43	198,747	£6,611,158	107,580	100,269	100%	£7,718,890

¹ Net income represents the price paid to NRW by the contractor for the timber offset by the contractor for undertaking civil infrastructure and restocking work.

² Based upon 100% of contracted volume being sold.

2.4 In the financial years 2016-17, 2017-18 and 2018-19, the 79 SS+ contracts that proceeded had an estimated net contract value of £9,892,708. NRW has estimated that the civil engineering and restocking elements of these contracts was approximately £2,063,637. The gross contracted timber sales value of these contracts to NRW was therefore approximately £11,956,345. All SS+ contract opportunities were advertised, and potential customers invited to submit bids via NRW's e-sales portal. Table 4 sets out the volume and value of timber contracted and sold or expected to be sold since the commencement of SS+.

Table 4: SS+ contracts volume and estimated out-turn by contractor 2016-17 to date

Successful Contractors	Number of contracts awarded	Volume of contracted timber m ³ obs	Estimated net income value of contracts to NRW ¹	Actual volume of timber sold m ³ obs to 31 March 2019	Estimated volume of timber m ³ obs to be sold in 2019-20 ²	Estimated total volume m ³ obs of SS+ sales	Total contractual income to be received by NRW (actual & estimated)
Contractor 1	26	123,805	£3,764,003	86,253	45,584	131,837	£4,313,037
Contractor 2	23	101,348	£2,846,902	83,018	32,291	115,309	£3,436,166
Contractor 3	4	28,648	£1,080,545	20,943	5,204	26,147	£1,097,631
Other contractors (12)	26	84,495	£2,201,258	61,050	27,094	88,144	£2,427,941
Total	79	338,296	£9,892,708	251,264	110,173	361,437	£11,274,775

¹ Net income represents the price paid to NRW by the contractor for the timber offset by the contractor for undertaking civil infrastructure and restocking work.

² Based upon 100% of contracted volume being sold.

Trends in SS+ contract numbers, volumes and values over time

2.5 Since the introduction of SS+ contracts in 2016-17, the use made of this contract type has increased, (Table 5).

	Number of contracts which proceeded with start date in financial year	Contracted volume m ³ obs	Net contract value based on contract volume multiplied by average price	Volume of timber sold to 31 March 2019 + estimated to be sold in 2019-20	Average net value of contracts
2016-17	8	28,358	£735,807	28,219	£91,975
2017-18	28	111,191	£2,545,743	125,369	£90,919
2018-19	43	198,747 ¹	£6,611,158	207,849³	£153,748
Total	79	338,296	£9,892,708	361,437	£125,224

¹ Standing Sales+ contracts were suspended in December 2018.

² Net income represents the price paid to NRW by the contractor for the timber, offset by the contractor undertaking civil infrastructure and restocking work.

³ As at 31 March 2019, two contracts with start dates in 2017-18, and 33 contracts with start dates in 2018-19 were still live. The contracted volume on these contracts to be sold in 2019-20 amounted to 110,173m³ of timber.

- 2.6 Each SS+ contract includes a contracted volume of timber to be sold by NRW to the contractor at a specified average price. The contract also provides a schedule of the estimated timber product mix within the contracted volume. The volume specified in the contract is determined by NRW based upon an assessment of the timber available at the harvesting site. Assessment of timber volume is not an exact science, and there will always be a degree of tolerance between the contracted volume and the volume harvested under contracts for the sale of standing trees.
- 2.7 With SS+ contracts it was vital that NRW's assessments of the timber available in the contracted area to be sold using SS+ was as accurate as possible because SS+ contracts operated on an average price per tonne of timber sold. Purchasers needed to fully recover the cost of undertaking the civil engineering and harvesting costs incurred within the contracted volume. As set out in Appendix 1, paragraph 1.35, contractors raised concerns in a meeting held with NRW on 15 May 2018 that where areas to be harvested under SS+ contracts did not contain the timber volume contracted to be sold, they risked losing money. The converse is also true, where the volume of timber sold within SS+ contracts was in excess of the contracted volume it led to a risk that NRW was selling timber below market value.
- 2.8 My auditors compared the out-turn volume on SS+ contracts that had been completed by 31 March 2019 against contracted volume. Only seven of the 44 contracts completed had an out-turn volume within 10% of the contracted volume. The majority (59%) of contracts completed by 31 March 2019 had out-turn volumes in excess of 110% of that contracted, with 18% of contracts having out-turn volumes in excess of 150% of that contracted. The out-turn volume on 11 contracts varied by over 50% from what had been contracted, (Table 6).

Table 6: Out-turn v Contracted volume on SS+ contracts completed by 31 March 2019 by contractor

	Number of SS+ contracts completed	Number of contracts with outturn within 10% of contracted volume	Number of contracts with outturn - 10% to - 50% under contracted volume	Number of contracts with outturn 50%+ under contracted volume	Number of contracts with outturn 10% to 50% over contracted volume	Number of contracts with outturn 50%+ over contracted volume	outturn over/under contract volume – all completed contracts
Contractor 1	11	2	2	0	5	2	14.6%
Contractor 2	15	4	1	1	7	3	24.2%
Contractor 3	2	0	2	0	0	0	-14.6%
Other Contractors	16	1	3	2	6	3	7.7%
Total	44	7	8	3	18	8	10.3%

Authorisation of SS+ Contracts

- 2.9 The functions of NRW are set out in the Natural Resources Body for Wales Establishment Order 2012 (the Order). These functions include undertaking any devolved function of the Forestry Commissioners. NRW is therefore empowered to manage the publicly-owned forest estate and to make decisions necessary to effectively carry out that function. The 2012 Order sets out that NRW may delegate the exercise of its functions to a committee, sub-committee, member or employee of NRW. This includes entering into contracts with external suppliers and purchasers.
- 2.10 NRW's Board approved a Financial Scheme of Delegation called 'Managing Our Money' under which all financial activities of NRW have been delegated to an agreed level of authority or specific post holder. It allows the Board to delegate decision-making responsibility for certain financial matters. The Scheme of Delegation is the method by which NRW's Board delegates its function of entering into contracts to individual members of staff and is a mechanism for risk management and financial probity. The Financial Scheme of Delegation sets out the office holders authorised to enter into timber sales contracts, and the contract values to which their delegations extend.
- 2.11 As part of the audit of NRW's 2018-19 accounts, my auditors examined 13 SS+ contracts to ensure that they had been authorised in accordance with the Financial Scheme of Delegation. My auditors found that whilst each contract was authorised

by NRW officers, six were authorised by NRW officers without the necessary delegation to authorise contracts awards of the value they signed off.

- 2.12 The total contract value of the sample of contracts tested that were not properly authorised was £2,405,375.
- 2.13 My auditors also tested a sample of eight extensions to SS+ contracts to ensure that contract extensions had been authorised in accordance with the Financial Scheme of Delegation. My auditors found that whilst all the contracts extensions had been authorised by NRW officers, four contract extensions were authorised by NRW officers without the necessary delegation to authorise contracts awards of the value they signed off.
- 2.14 The testing undertaken by my auditors found that the failure to comply with the Financial Scheme of Delegation when awarding timber sales contracts was not isolated to SS+ contracts. Towards the end of 2018, NRW put in place improved arrangements to ensure that future contracts awards comply with the Financial Scheme of Delegation.

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