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OFFICIAL-SENSITIVE-COMMERCIAL

Defra

Decision-making for the Forestry Commission's Commercial Investments

Final internal audit report

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Contents

Executive summary

Opinion

Unsatisfactory
There are fundamental weaknesses in the framework of governance, risk management and control, such that it is inadequate and ineffective or is likely to fail.

Recent Ministerial correspondence and press reports indicated that there was a need for assurance over decision-making processes resulting in key events in the history of Forest Holidays, which since 2006 has been a joint venture between the Forestry Commission (FC), a series of private sector investors and the company's managers. We reviewed six key transactions:

1. Formation of the joint venture in 2006
2. Extension of cabin lease terms up to 125 years in 2009
3. Restructuring and refinancing of the joint venture, and renegotiation of its governing framework agreement, in 2012
4. FC's loan investments in Forest Holidays in 2012 – 2013
5. Refinancing in 2017
6. Renegotiation of the framework agreement in 2018.

We have not seen the full suite of transaction documents. But, on the basis of our review of available documents and discussion with FC managers, we consider that the following prescribed procedures were not completed by FC:

Prescribed or expected procedure	***Summary***
Obtaining Treasury approval when this may have been required by law (in at least two cases)	FC did not seek Treasury approval in 2012 and 2017, because they did not consider it was required. In the first case, this was due to their interpretation of the legislation. In the second, they relied on the NAO's view (stated in their 2016 management letter) and, while not seeking approval, they did inform the Treasury.
Obtaining Treasury approval when this was required by *Managing Public Money* (in four cases)	FC obtained Treasury approval to create the joint venture in 2006. But they did not (and still do not) consider the later transactions to be contentious. We disagree with this view and ultimately, this judgement is the Treasury's to make: both we and they expect managers to err on the side of caution.

Obtaining ministerial approval when required (in two cases)	We consider that ministerial approval was necessary for the renegotiated framework agreements in 2012 and 2018, as they included changes to lease agreements and the Secretary of State holds title to the public forest estate. FC have told us they consider that it is their responsibility to take decisions on managing the land placed at their disposal under the Forestry Act (the public forest estate) as part of its integrated management, so long as their actions are in line with the FC's Corporate Plan and permitted by the applicable legislation and the management is in accordance with guidance.
Obtaining Ministerial approval when appropriate (in all five cases)	FC sought ministerial approval for the 2006 transaction. They did not seek approval or inform ministers of the 2012 refinancing deal. While they did not seek approval in 2017 and 2018, they did inform ministers about the transactions.
Ensuring an appropriate level of Ministerial oversight (in four cases)	An appropriate level of oversight was exercised, in our view, only in 2018. It appears that FC has considered information to be sufficient to enable oversight. But we consider that consultation is also a necessary condition. There appears to be a fundamental mismatch between the level of ministerial and departmental oversight which we consider appropriate for FC (at least since the change in their funding arrangements in 2008/09) and the level which they consider appropriate. Defra managers told us it was their impression that previous ministers were happy to allow FC to operate at arm's length and not to intervene in commercial decisions, and that position was well understood by both FC and policy officials at the time. We also consider that Defra has not (so far) clearly defined its own expectations.

The table on page 6 provides a summary by transaction of the above-listed control failures. We recommend that Defra obtain full legal advice to clarify the position. Lessons should be learned and disseminated to reduce the risk of repetition and we recommend remedial action to improve the control environment. Defra is working with UK Government Investments to scope a review of governance in Forest Holidays, Forest Enterprise England and the Forestry Commission.

	High	Medium	Low
Number of recommendations	8	3	-

We gratefully acknowledge the contributions of Government Legal Department colleagues, to whom we submitted numerous questions for legal advice during our review and whose advice we have taken account of in our report, [REDACTED] , Defra Spending and Policy Advisor at HM Treasury's Enterprise and Growth Unit, and Alexandra Cran-McGreehin and [REDACTED] of Defra's Accountability and Governance Team.

Summary of findings

As listed above, key approval and oversight controls failed (or, in two cases, may have failed) to operate as prescribed. People who should have been consulted were not consulted: people who should have been informed were not always informed. As a result, actions did not receive approvals when, in our opinion, they were required, and this may have had implications for the regularity of the transactions under review. We consider it highly likely that the Countryside Act 1968 required that FC obtain Treasury approval to the terms of the 2012 and 2017 refinancing deals. FC did not seek Treasury approval for these transactions. We consider that the approval of Defra Ministers was required for the 2012 and 2018 renegotiations. FC did not seek Ministerial approval for these transactions. These failures may have had implications for the regularity of those transactions.

Summary of audit test results

Transaction* / Control objective:	2006 joint venture formation	2012 refinancing & renegotiation	2013 loans to Forest Holidays	2017 refinancing	2018 renegotiation
Treasury approval sought and obtained when required by statute	✓	✗	✗	?	?
Treasury approval sought and obtained when required by Managing Public Money	✓	✗	✗	✗	✗
Approval of Defra Ministers sought and obtained when required	✓	✗	n/a	n/a	✗
Approval of Defra Ministers sought and obtained when appropriate	✓	✗	✗	✗	✗
Appropriate level of Ministerial oversight exercised	✓	✗	✗	✗	✓
Decisions informed by independent expert advice	✓	✓	✓	✓	✓
Decisions not manifestly inconsistent with obligation to secure value for money	✓	✓	✓	✓	✓
No other substantive deficiencies	✗	✗	✓	✗	✓
Decisions documented clearly, sufficiently and availably to enable independent review	✓	✓	✓	✓	✓
Overall opinion for this transaction	Limited	Unsatisfactory	Unsatisfactory	Limited	Limited

*Note – the 2009 lease extensions are not included in this table, because no relevant evidence was submitted for audit and we were therefore unable to test the controls under review.

Detailed findings 1: Joint venture formation in 2006

Defra and the Forestry Commission cannot demonstrate that key decisions were adequately informed and appropriately overseen and approved by Ministers in accordance with their statutory responsibilities, resulting in loss of confidence and reputational damage.

Opinion for this section: Limited

Risk categories: reputational, financial

Summary of findings: Joint venture formation in 2006

✓ Treasury approval was required, sought and obtained for the 2006 transaction.

✓Approval was almost certainly obtained from Defra Ministers, but it was not sought early enough.

? The decision to enter into the 2006 joint venture may not have been subject to an appropriate level of Ministerial oversight.

✓ FC and their joint venture partners were informed by sufficient, independent, expert advice.

✓ The 2006 transaction could reasonably have been expected to ensure value for money.

✗ The 2006 framework agreement may have sought to bind the Secretary of State's power of discretion.

✗ FC's Board of Commissioners should have documented their management of potential conflicts of interest more carefully.

✓ Although two important documents relevant to this transaction were missing, decisions were documented clearly, sufficiently and availably to enable independent review of the decision-making process.

Timeline of events and documents: Joint venture formation in 2006

14/06/01 Memo 39/01 to FC's Board of Commissioners referred to Treasury's conditions for funding in 2001/02

06/09/02 Internal HM Treasury correspondence referred to a letter to FC from the Chief Secretary to the Treasury (date unknown), announcing the award from the Capital Modernisation Fund "on condition that a Public-Private Partnership is formed to further expand the Forest Holidays business"

10/06/04 Memo 16/04 to FC's Board of Commissioners referred to Treasury's conditions for funding in 2001/02.

25/04/05 Option appraisal and strengths and weaknesses of competing bids were submitted to FC's Board of Commissioners

27/04/05 FC's Board of Commissioners considered the paper of 25/04/05 and resolved that there were two bids worth exploring further

09/08/05 Final results of competition to select the point venture partner were presented to FC's Board of Commissioners

17/08/05 FC's Board of Commissioners considered the final results of the bid evaluation and approved the recommendation that the Camping and Caravanning Club be taken forward to a period of exclusivity.

28/09/05 Ministerial submission for information – FC to Minister Knight – to advise Mr Knight on the progress that is being made with a Public Private Partnership to develop the Forestry Commission's Forest Holidays business

01/12/05 The Forest Holidays Project Board recommends to FC's Board of Commissioners that the Camping and Caravanning Club be appointed as preferred bidder

08/12/05 FC's Board of Commissioners approved the appointment of the Camping and Caravanning Club as preferred bidder.

21/12/05 Ministerial submission – FC to Minister Knight copied to Secretary of State – proposal to lay the Regulatory Reform (Forestry) Order 2006

06/02/06 Ministerial submission – FC to Minister Knight – to note appointment of the Camping and Caravanning Club as preferred bidder

04/05/06 and 05/05/06 Ministerial submissions – FC to Minister Knight and Secretary of State – To authorise the Forestry Commission officers to act on behalf of the Secretary of State

05/05/06 Ministerial reshuffle sees Minister Knight and the Secretary of State replaced

05/05/06 HM Treasury gave approval to FC to enter into the 2006 Joint Venture

08/05/06 The 2006 Framework Agreement governing the joint venture was signed by the parties

30/05/06 FC's Board of Commissioners received a report that the project had been concluded.

Objective 1: Treasury approval was obtained as required before committing to transactions.

In our opinion, Treasury approval was highly likely to have been required under section 24A of the Countryside Act 1968, as inserted by the Regulatory Reform (Forestry) Order 2006. FC sought Treasury approval for this transaction. After regular contact over the preceding two years, approval was obtained on the last working day before the legal documents creating the joint venture were signed on 08/05/06 (we understand that this is normal practice).

Objective 2: The approval of Defra Ministers was sought and obtained when appropriate.

The forest estate managed by FC vests in the Secretary of State. As such, the Secretary of State would have had to approve the lease documents forming part of the transaction or, if the statutory scheme permitted such a delegation, delegate that power to FC. The Framework Agreement entered into at that stage included the Secretary of State as a party, and so would have required his approval.

In addition, given that Treasury approval was obtained for this transaction, we consider that the approval of Defra Ministers should appropriately and prudently have been sought also. We say this from a common-sense and good governance standpoint, because we do not know of any written compliance framework which sets out when the approval of Defra Ministers is required for these decisions. In our view, as this decision was taken to HM Treasury for approval, it would have been inappropriate for Defra Ministers not to have been asked for their approval.

FC made three "for information submissions" to Ministers – one on 28/09/05 to advise progress on the Public-Private Partnership, one on 21/12/05 to propose the laying of the Regulatory Reform (Forestry) Order 2006, and one on 06/02/06 to note the appointment of the preferred bidder. There were further submissions on 04/05/06 and 05/05/06, requesting that the Secretary of State issue a certificate of authorisation to sign the legal papers creating the joint venture on 08/05/06. It could be argued that these last two submissions constituted a constructive seeking of Ministerial approval, and we consider that this was the case. The last submission was made on the same day as a Ministerial reshuffle, in which both the Secretary of State and the other Minister concerned were replaced. We conclude that, while Ministerial approval was almost certainly obtained, Ministers may not have had sufficient opportunity to consider and challenge before the Secretary of State (presumably, as the authorisation certificate cannot be found) granted authorisation to execute the leases.

Objective 3: Decisions were subject to an appropriate level of Ministerial oversight.

In view of our findings at Objective 2, it is our opinion that this transaction may not have subject to an appropriate level of Ministerial oversight. For this purpose, we understand the term 'oversight' to mean "making sure something is being done correctly". In our opinion, oversight cannot be said to have been appropriately exercised by Ministers when they were not explicitly consulted on a timely basis. As discussed above, the 2005 submissions did not seek a decision and the 2006 submissions may not have been made early enough to allow consideration and timely challenge.

Objective 4: Decisions were informed by independent, expert advice as appropriate.

This transaction was appropriately informed by sufficient, independent, expert financial, commercial and legal advice.

Objective 5: Decisions were not manifestly inconsistent with Defra's and the Forestry Commission's obligation to secure value for money.

The formation of the joint venture in 2006 could reasonably have been expected to ensure value for money: it was supported by robust financial and risk analysis and the winning bid was fairly selected from a competitive field of bids.

Objective 6: There were no other substantive deficiencies or departures from good practice in decision-making processes.

Delegation of the Secretary of State's authority

On 05/05/06, FC made a Ministerial submission, "To authorise the Forestry Commission officers to act on behalf of the Secretary of State in respect of the Forest Holidays Public Private Partnership … Attached is an Authorisation Certificate ... Our lawyers are content that [the Minister] signs the authorisation." We have not seen that legal advice, and it cannot be traced. We cannot be certain, therefore, that the statutory scheme of the Forestry Act 1967 permits such a delegation and suggest obtaining full legal advice.

On 04/05/06, FC made a similar submission, copied to the Secretary of State. We have seen an email from the Secretary of State's office, also dated 04/05/06, which confirms receipt of this submission and is highly suggestive that the Secretary of State signed the authorisation certificate (which we have not seen and appears not to be among the existing records held by FC and Defra). We have an additional concern about this delegation of authority: it is not clear to us whether it was reasonable for FC to rely in 2012 on an authorisation granted by a previous administration in 2006 (see Section 3, page 19).

Limitation of Secretary of State's power of discretion

The 2006 framework agreement was signed by the Secretary to the Commissioners, acting under a certificate of authority (which we have not seen), on behalf of both the Forestry Commissioners and the Secretary of State. Clause 20.1 of the 2006 framework agreement bound the Secretary of State as follows:

“If and to the extent that FC is bound to an LLP to execute and deliver a new site lease then the Relevant Minister agrees to execute and deliver the same.”

“Relevant Minister” means, in relation to sites situated in England, the Secretary of State for Environment, Food and Rural Affairs.

This condition of the 2006 framework agreement appears intended as a limitation of Ministerial discretion. In general terms, the Secretary of State cannot by contract fetter his right or duty to exercise a discretion vested in him by law, although this principle will not normally include commercial contracts. This principle may have implications for the regularity of the transaction. But in any event, we do not consider it was appropriate to seek to bind the Secretary of State to act in this way without seeking the Secretary of State’s explicit approval, and we have seen no evidence that this was done.

Conflicts of interest

The minutes of the Board of Commissioners meeting on 17/08/05, at which the recommendation that the Camping and Caravanning Club’s bid be taken forward to a period of exclusivity, record that “none of the Commissioners present report any conflict of interest relating to the PPP.” But the minutes do not record whether those attending were explicitly asked, at the meeting or at any time, to consider and declare whether they had any conflict of interest. The minutes of the Board of Commissioners meeting on 08/12/05, which approved the Camping and Caravanning Club’s preferred bidder status, do not record whether conflicts of interest were considered or declared for this agenda item.

We are not suggesting that there was any conflict of interest. But, by not documenting declarations of conflicts with sufficient care in meetings at which commercial decisions were considered or taken, FC’s Board of Commissioners may have left themselves exposed to a risk of accusations of impropriety.

Objective 7: Decisions were documented clearly, sufficiently and availably to enable independent review of the decision-making process.

FC sent us most of the evidence we asked for (about 100 documents, spanning 17 years) without delay. That they were able to do this at short notice demonstrates effective records management.

We did not find any evidence relating to the 2009 decision to allow extension of leases to 125 years. Therefore, we are not able to provide any assurance on this matter.

We wanted to see two further documents, relating to the formation of the first joint venture in 2006. These have not been found and FC have abandoned the search:

- a letter from HM Treasury, probably sent in 2001, setting out their conditions for funding to the FH business around that time
- the certificate of authorisation which was probably issued by the Secretary of State to the Secretary to the Commissioners between 04/05/06 and 07/05/06.

Assuming that the missing documents existed (and in the first case, we have seen evidence from HM Treasury which conclusively demonstrates that such a letter was sent), they represent gaps in the record. However, these gaps do not amount to a fundamental limitation of scope and we conclude that decisions were documented clearly, sufficiently and availably by FC to enable independent review of the decision-making process. The Defra client for this review made it clear to us at the outset that they could find no relevant documentation on the forestry team's team-site (where information was stored from 2009-2017) or on a shared drive where some older information was stored. On further examination, they subsequently found one document relevant to Forest Holidays. Ministers' private offices, as a matter of standard operating procedure, do not keep records – they make it clear that it is the originator's responsibility to do so, and this has been done.

Implications and recommendations: Joint venture formation in 2006

Clause 20.1 of the 2006 framework agreement (replicated in clause 16.1 of the 2012 framework agreement) purported to bind the Secretary of State to act in accordance with FC's contractual obligations to issue leases, thus intending to limit the Secretary of State's power of discretion. This may conflict with the general principle outlined above and, therefore, may have had implications for the regularity of the transaction. In any event, we do not consider it was appropriate to seek to bind the Secretary of State in this way without seeking the Secretary of State's explicit approval, and we have seen no evidence that this was done. We **recommend (2)** that Defra seek legal advice on the implications of our findings, particularly as they relate to the regularity of the transactions we have reviewed.

By not documenting declarations of conflicts with sufficient care in meetings at which commercial decisions were considered or taken, FC's Board of Commissioners may have left themselves exposed to a risk of accusations of impropriety. At all meetings where commercial decisions are considered or taken, members of Boards and other governance bodies should be explicitly asked to consider and declare any conflicts of interest they may have and this should be minuted. We **recommend (8)** that Defra group issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff.

Detailed findings 2: Extension of cabin lease terms up to 125 years in 2009

Defra and the Forestry Commission cannot demonstrate that key decisions were adequately informed and appropriately overseen and approved by Ministers in accordance with their statutory responsibilities, resulting in loss of confidence and reputational damage.	**Opinion for this section:** **None, due to limitation of scope** **Risk categories:** reputational, financial

Summary of findings: Extension of cabin lease terms up to 125 years in 2009

No evidence relevant to this transaction was presented. Therefore, we have been unable to perform audit testing and can provide no assurance in respect of this transaction.

Timeline of events and documents: Extension of cabin lease terms up to 125 years in 2009

As no evidence was submitted for audit, we were unable to reconstruct the timeline of this transaction.

Implications and recommendations: Extension of cabin lease terms up to 125 years in 2009

Due to limitation of scope, we have been unable to form opinions or draw conclusions in respect of this transaction.

Detailed findings 3: Restructuring, refinancing and renegotiation of the framework agreement in 2012

Defra and the Forestry Commission cannot demonstrate that key decisions were adequately informed and appropriately overseen and approved by Ministers in accordance with their statutory responsibilities, resulting in loss of confidence and reputational damage.

Opinion for this section: Unsatisfactory

Risk categories: reputational, financial

Summary of findings: Restructuring, refinancing and renegotiation of the framework agreement in 2012

- ✗ FC did not seek Treasury approval for the 2012 refinancing when, in our opinion, this was a legal requirement.
- ✗ FC did not seek Treasury approval for the 2012 renegotiation of the framework agreement when, in our opinion, this was a requirement of Managing Public Money.
- ✗ FC did not seek Defra Ministers' approval for the 2012 refinancing and renegotiation when, in our opinion, this was required.
- ✗ FC did not inform Defra Ministers about the 2012 refinancing and renegotiation, either before or after the event, when, in our opinion, this should have been done.
- ✗ The 2012 refinancing and renegotiation was not subject to an appropriate level of Ministerial oversight.
- ✗ FC's level of engagement with Defra on the 2012 refinancing was insufficient, given the nature and importance of the transaction.

✗ It is not clear to us whether it was reasonable for FC to rely in 2012 on an authorisation to sign legally binding documents on behalf of the Secretary of State which was granted by a previous administration in 2006. There is no record of a new certificate of authorisation having been sought in 2012.

✗ The 2012 framework agreement may have sought to bind the Secretary of State's power of discretion.

✓ FC and their joint venture partners were informed by sufficient, independent, expert advice.

✓ The 2012 refinancing deal was not manifestly inconsistent with Defra's and FC's obligation to secure value for money.

Timeline of events and documents: Restructuring, refinancing and renegotiation of the framework agreement in 2012

10/09/09 FC's Board of Commissioners discussed the options for financing the next cabin developments, and the possibility of new joint venture being created between FH and a third investor

02/03/11 Ministerial submission for information - FC to Minister Paice copied to Secretary of State

12/01/12 The financial consultants who brokered the 2012 restructuring (SRP) told FC that the Bowmark deal had fallen through

10/05/12 FC's Board of Commissioners was informed of the offer from Lloyds Development Capital (LDC)

11/05/12 Forest Holidays' Board advised of revised offer; LDC enter a period of exclusivity

30/05/12 Following the collapse of the Bowmark negotiation, FC's Executive Board expressed its support for the LDC offer

14/06/12 FC's Board of Commissioners was informed of the LDC offer

29/06/12 Deal broker (SRP) updated FC managers on ongoing negotiations with LDC

29/06/12 SRP updated spreadsheet fairness calculations to reflect revised offer

30/06/12 SRP updated Forest Holidays' Board on LDC negotiations, advising that LDC had requested ground rent be phased in over six years rather than three

02/07/12 Internal correspondence between FC managers indicates they were unhappy with LDC's request to slow the phasing of ground rent

09/07/12 SRP circulated revised fairness calculation to FH and FC, reflecting phasing in of ground rent over five years

13/09/12 Approval of the 2012 restructuring deal was sought from FC's Executive Board

18/09/12 SRP sent FC a summary of the key terms of the final deal

19/09/12 FC's Executive Board approved the terms of the 2012 refinancing deal and authorised all acts necessary or expedient to its completion.

30/09/12 FC's Executive Board instructed that the 2012 restructuring deal should proceed as proposed

21/09/12 The 2012 Framework Agreement governing the new joint venture was signed by the parties

04/10/12 FC's Board of Commissioners was informed that the 2012 restructuring deal had been completed

10/12/15 FC replied to NAO's request for information, explaining why Defra had not been consulted on the 2012 refinancing deal and Treasury approval had not been sought to issue loans

Objective 1: Treasury approval was obtained as required before committing to transactions.

In our opinion, it is highly likely that the 2012 restructuring, refinancing and renegotiation required statutory Treasury approval under section 24A of the Countryside Act 1968, as inserted by the Regulatory Reform (Forestry) Order 2006. We have two reasons for this opinion:

1. The restructuring and refinancing involved FC investing in bodies corporate (in this context, it should be noted that limited liability partnerships are bodies corporate under section 1 of the Limited Liability Partnerships Act 2000). FC stated during our review that they disagreed with our interpretation of the Countryside Act's requirements. FC told us that, in making the decision that Treasury approval was not required for the 2012 refinancing, they viewed the transaction as a rollover or reconstitution of an existing shareholding, not an investment in a new body corporate. We consider, and the evidence we have seen is clear, that the transaction comprised an exchange of shares in the previous joint venture for shares in the new joint venture, and that this amounted to a sale and purchase of shares – an investment in bodies corporate which, by our understanding of section 24A of the Countryside Act, required Treasury approval. In any event, given the statutory provisions, we would have expected FC to err on the side of caution and seek Treasury consideration and approval.

2. The refinancing deal committed FC to make loans for the development of new sites – making loans also requires Treasury approval, by our understanding of section 24A of the Countryside Act.

FC did not seek Treasury approval for this transaction when, in our opinion, it was highly likely that this was required. This may have had implications for the regularity of the transaction.

Treasury approval for the 2012 renegotiation of the framework agreement was (in our opinion) also a requirement of Managing Public Money, because the overall nature of the transaction, the process adopted to enter into it and specific terms (such as concessions in the framework agreement on phasing in the ground rent payable to FC for new cabins over a longer period) were novel and contentious (see also Objective 5). This may have had implications for the regularity of the transaction.

Objective 2: The approval of Defra Ministers was sought and obtained when appropriate.

The forest estate managed by FC vests in the Secretary of State. As such, the Secretary of State would have had to approve the lease documents forming part of the transaction or, if the statutory scheme permitted such a delegation, delegate that power to FC. The Framework Agreement entered into at that stage included the Secretary of State as a party, and so would have required his approval.

Moreover, given our opinion that Treasury approval was required, we consider that Ministerial approval would appropriately and prudently have been sought. We say this from a common-sense and good governance standpoint, because we do not know of any written compliance framework which sets out when the approval of Defra Ministers is required for these decisions. In our view, if this decision had been taken to Treasury Ministers for approval (as we believe was required), it would have been inappropriate for Defra Ministers not to have been asked for their approval also. But Ministerial approval was not sought for this decision. And Ministers were not informed about the conclusion of the 2012 refinancing. They were informed, in March 2011, of discussions with a potential investor (Bowmark), with whom negotiations fell through in January 2012. Negotiations with Lloyds Development Capital (LDC) then commenced and the 2012 refinancing deal was concluded with them in September 2012. We have not seen any evidence that Ministers were informed of these developments, either before or after the event. After the March 2011 submission, there were no further submissions on Forest Holidays until September 2017.

We discussed this finding with FC managers, who told us that Ministers did not question the 'Bowmark' submission of March 2011, and that may have been why no submission was made to inform Ministers of LDC's offer. They accepted that, in hindsight, FC should have informed Ministers of the 2012 deal. After the 2012 refinancing, FC managers told us that, in a context of controversial non-forestry developments, such as windfarms, they viewed Forest Holidays as uncontroversial "business as usual". Defra managers told us, "It is our impression that previous ministers were happy to allow FC to operate at arm's length

and not to intervene in commercial decisions and that that position was well understood by both FC and policy officials at the time. This kind of mood music is of course hard to evidence with documents, but very real nonetheless."

FC appeared to have considered that FC's minority shareholding and (after 2012) the "drag and tag" rights enjoyed by the majority shareholder meant that the decisions under review were the exclusive prerogative of Forest Holidays. But we do not consider that these factors deprived: (i) the Secretary of State the power to approve the leases forming part of the transaction; (ii) the Secretary of State of the power to exercise an appropriate level of oversight over FC's own decisions in the context of these transactions; or (iii) FC of the ability and duty to exercise influence over Forest Holidays and to consult and inform Ministers appropriately, ensuring an appropriate level of Ministerial oversight.

We recognise that: (i) Forest Holidays is a private sector business with a minority public sector shareholding; (ii) FC and Defra do not exert substantial control over decisions taken by the business; and (iii) the Forestry Commission is a non-ministerial department and so has a freedom to operate (see detailed discussion of this point on pages 21-22). But this does not change the fact that the Secretary of State is the landlord of the forest estate and that FC is expected to comply with the statutory approvals framework and with the requirements of Managing Public Money in respect of its own investments in Forest Holidays.

Objective 3: Decisions were subject to an appropriate level of Ministerial oversight.

In view of our findings at Objective 2, it is our opinion that the 2012 refinancing was not subject to an appropriate level of Ministerial oversight. For this purpose, we understand the term 'oversight' to mean "making sure something is being done correctly". In our opinion, oversight cannot be said to have been appropriately exercised by Ministers when they were not consulted (by which, we mean that they were not given an opportunity to review the proposal and say 'yes' or 'no' to it). We consider that FC's level of engagement with Defra on the 2012 refinancing was insufficient, given the nature and importance of the transaction and, in this, we concur with the NAO's opinion, expressed in their management letter of 16/05/16.

Objective 4: Decisions were informed by independent, expert advice as appropriate.

FC and Forest Holidays were appropriately informed by sufficient, independent, expert financial, commercial and legal advice.

Objective 5: Decisions were not manifestly inconsistent with Defra's and the Forestry Commission's obligation to secure value for money.

In previous drafts of our report, we reported that the search for refinancing in 2012 may not have ensured sufficient competition. Potential investors were engaged with consecutively, not concurrently. During negotiations with Lloyds Development Capital, the

latter part of which took place in exclusivity, there were no alternative options to consider, which may have weakened Forest Holidays' negotiating position and may have resulted in the concession to phase in ground rent over five years rather than three. We are not able to judge whether this was the best deal that could have been struck in these circumstances. We still consider that phasing in ground rent for new cabins over five years might reasonably have been considered contentious. However, having considered:

(i) FC managers' representations that their rental income from Forest Holidays is a risk-free and reliable return to FC for their limited investment; and

(ii) representations by Forest Holidays' Chief Executive Officer, that:

(a) Forest Holidays was loss-making and generating little cash, rendering it a difficult investment proposition;

(b) an information memorandum (which we have seen) was produced

(c) about 40 potential investors were approached;

(d) this was one of the first deals in this sector done since the 2007 financial crash; and

(e) FC invested £1.7m in 2012, which crystallised a value of £13.9m in 2017, representing an 8x multiple for the taxpayer, compared to a 2.5x multiple for the private equity investor

(f) CBRE (real estate services and investment specialists) report that "the current market for ground rent deals is around 10% of earnings before interest, tax, depreciation and amortisation. £3,000 per cabin would have equated to 9.7%"

we have concluded that the 2012 refinancing deal was <u>not</u> manifestly inconsistent with Defra's and Forestry Commission's obligation to secure value for money.

Objective 6: There were no other substantive deficiencies or departures from good practice in decision-making processes.

Delegation of the Secretary of State's authority

As reported at Section 1, we have one remaining concern about the Secretary of State's probable delegation of authority in May 2006 to the Secretary to the Board of Commissioners to sign legally binding documents on behalf of the Secretary of State. There is no record of a new certificate having been sought in 2012. If the authorisation granted was on the same terms as that attached to the submission of 5 May 2006, it would not, on its face, have extended to authorising the lease documents entered into as part of the 2012 transaction or the 2012 framework agreement.

Limitation of Secretary of State's power of discretion

The 2012 framework agreement was signed by the Secretary to the Commissioners, presumably acting under the certificate of authority which was probably issued in May 2006 (which we have not seen), on behalf of both the Forestry Commissioners and the Secretary of State. Clause 16.1 of the 2012 framework agreement bound the Secretary of State as follows:

"If and to the extent that FC is bound to an LLP to execute and deliver a new site lease then the Relevant Minister agrees to execute and deliver the same."

"Relevant Minister" means, in relation to sites situated in England, the Secretary of State for Environment, Food and Rural Affairs.

As noted above, this condition of the 2012 framework agreement appears intended as a limitation of Ministerial discretion. This may conflict with the general principle outlined above and, therefore, may have implications for the regularity of the transaction. In any event, we do not consider it was appropriate to bind the Secretary of State to act in this way, thus seeking to limit the Secretary of State's power of discretion, without seeking the Secretary of State's approval, and we have seen no evidence that this was done.

Implications and recommendations: Restructuring, refinancing and renegotiation of the framework agreement in 2012

We consider it highly likely that the Countryside Act 1968 required that FC obtain Treasury approval to the terms of the 2012 refinancing and FC's 2013 loan investments, when it did not do so. This may have had implications for the regularity of those transactions. The lesson must be learned to prevent a recurrence: while only the courts can definitively interpret the law and decide whether Treasury approval is required as a matter of law for any particular transaction, investments in bodies corporate, whether share purchases, share exchanges or loans, are highly likely to require approval from HM Treasury. Rollovers and other significant changes to existing investments may also require Treasury approval. Even when there is no statutory requirement for Treasury approval, Managing Public Money requires that Treasury approval be sought and obtained for transactions which may potentially be novel, contentious or repercussive. Box 2.3, on page 18 of the current edition of Managing Public Money, gives examples of such transactions. Joint venture investments are likely to fall within the scope of "unusual financial transactions, for example, imposing lasting commitments or using tax avoidance" (for the avoidance of doubt, we are not suggesting that there has been tax avoidance in any specific case we have reviewed). We would expect, and HM Treasury have told us that they would expect, management to err on the side of caution, seeking HM Treasury's consideration and approval in any case where it may reasonably be considered that there is room for doubt on whether Treasury approval is required, whether by statute or by

Managing Public Money. We **recommend (1)** that Defra group issue clear direction on this point to the Accounting Officers of all of its sponsored bodies. FC told us during our review that they disagreed with our interpretation of the Countryside Act's requirements, but we consider that the legal requirements are clear. As the landlord of the forest estate, the Defra Secretary of State has the power to approve the leases forming part of the transaction. As noted above, the proposed 2006 authorisation certificate did not, on its face, extend to the 2012 refinancing. We **recommend (2)** that Defra seek legal advice on the implications of our findings, particularly as they relate to the regularity of the transactions we have reviewed.

Given these points and the potentially novel and contentious nature of the 2012 refinancing, we consider that Ministerial approval (both from Treasury and the Defra Secretary of State) should have been sought. But it was not.

There is a legal question as to whether the Secretary of State has power to direct FC in the matter of Forest Holidays, which is a joint venture empowered by the Countryside Act 1968 (**recommendation 2** – Defra should seek legal advice). Notwithstanding, we note that Ministers would not have directed, but rather approved, the transaction. In any event, an appropriate level of Ministerial oversight was one of the assurance objectives for this review and we consider it is reasonable to expect that that control should be in place. Approval, by which we mean the opportunity to say 'yes' or 'no' to a proposed course of action, is an indispensable part of oversight.

Defra's management asked us whether this finding took full account of FC's status as a Non-Ministerial Department (NMD). We recognise that the appropriate level of oversight by Ministers and the parent department is normally lower for an NMD than it is for an executive Non-Departmental Public Body. The terms of the relationship between FC and Defra, as set out in *Working Together* (June 2012), say the Principal Accounting Officer (Defra's Permanent Secretary) "must be satisfied that the financial and other management controls being applied by the Commission conform with Parliamentary requirements in the control of expenditure and, more generally, provide for regularity, propriety and value for money". In our opinion, the failure to seek approval from Treasury and from Defra Ministers may have had significant implications for the regularity of these transactions. It follows that FC's management controls may not have successfully provided for regularity. In this, the level of control may have fallen below Defra's expectations, as set out in Working Together, and it now appears that the level of oversight exercised by Defra at that time was insufficient to prevent or detect these failures.

Working Together, and its 2008 predecessor (*The Deal*), refer to a memorandum of agreement (2008) between the Accounting Officers of Defra and FC. This document states that FC's accounting officer will advise Ministers on matters which have a bearing on regularity, propriety or value for money, and that this advice will be cleared with the Permanent Secretary if the same matters have a bearing on funding provided by Defra. As reported above, Ministers were not informed of the 2012 deal with LDC, either before or after the event. Given too our view that failure to seek Treasury approval may have had a significant bearing on the

regularity of the 2012 transaction, we therefore consider that the expected level of departmental oversight set out in *Working Together* was not achieved.

It is also relevant that, while FC is classified as an NMD, unusually it does not have its own Supply Estimate, but is instead contained within Defra's Supply Estimate (as a result of a decision by HM Treasury about ten years ago). The way funding is received is a key characteristic which distinguishes a body as an NMD and reflects its level of independence from the parent department. But no action was taken to change FC's classification as an NMD following this change in its funding arrangements. Consequently:

(i) FC is listed in the Supply Estimates as effectively being a part of Defra and its budget comes from Defra's budget lines;
(ii) its Accounting Officer is named as 'additional' to Defra's Principal Accounting Officer (PAO) and listed within the Defra pages of the Estimates, which is exceptional for an NMD;
(iii) Defra's PAO is the person with direct accountability to Parliament for FC; and therefore
(iv) we conclude that, in the case of FC, a greater level of oversight by the parent department's Ministers and PAO should be considered appropriate than for a body that has more traditional NMD characteristics.

In view of the scope for uncertainty and disagreement we observed over the level of oversight which the parties may or may not consider appropriate, we **recommend (8)** that a governance review of FC be undertaken, which should consider (i) its relationships with Defra, Forest Enterprise England and Forest Holidays and (ii) whether FC should retain its interest in Forest Holidays. It is proposed that this review be led by Defra group Commercial and conducted by UK Government Investments.

We **recommend (3)** that, from a standpoint of common-sense and good governance, if a commercial investment decision requires (or appears likely to require) Treasury approval, a similar need for approval by Defra Ministers is indicated, and should be presumed. For this purpose, a reinvestment (or rollover) should be regarded as an investment. The Defra group should issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff.

A Ministerial submission "for a decision" should have been made, but was not. This amounts to a deficit in Ministerial oversight, which (in our opinion) may have given rise to high reputational risks and possible implications for the regularity of the transactions. In cases when no decision is sought, Ministerial submissions on matters which are likely to affect the security or value of government investments in undertakings which have, at any stage, been funded or part-funded with public money should explain the reasons why no decision is being sought. And when "for information" submissions are made by arm's length bodies on matters which are likely to affect the security or value of government investments in undertakings which have, at any stage, been funded or part-funded with public money, the relevant policy owners should challenge the originators why no decision is being sought. We **recommend (4)** that Defra group issue clear direction on these points to the Accounting Officers of all of its sponsored bodies and to its senior staff.

We recognise that businesses such as Forest Holidays, which are not substantially controlled by a public body, are not subject to the Public Contracts Regulations 2015. We also recognise that it isn't always feasible to ensure competition in the search for finance, and it may not have been feasible in this case. But there needs to be a clear understanding, that where there is no competition in the context of a commercial decision, that is highly likely to have a material impact on value for money in the outcome. So, whenever competing offers are not evaluated in parallel, the reasons why not should be well justified, exposed to challenge, authorised at a senior level and clearly documented. We **recommend (7)** that Defra group issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff.

We have significant concern that Treasury and the Defra Secretary of State's approval was required for the 2012 joint venture. This leaves Defra, FC and Forest Holidays exposed to a high risk of reputational damage and creates possible implications for the regularity of the transaction. We **recommend (2)** that Defra seek legal advice on the implications of our findings, particularly as they relate to the regularity of the transactions we have reviewed.

As noted above, clause 16.1 of the 2012 framework agreement appears intended as a limitation of Ministerial discretion. This may conflict with the general principle outlined above and, therefore, may have had implications for the regularity of the transaction We do not consider it was appropriate to or seek to bind the Secretary of State in this way without seeking the Secretary of State's explicit approval, and we have seen no evidence that this was done. We **recommend (2)** that Defra seek legal advice on the implications of our findings, particularly as they relate to the regularity of the transactions we have reviewed.

Detailed findings 4: FC's loan investments in Forest Holidays in 2012-13

Defra and the Forestry Commission cannot demonstrate that key decisions were adequately informed and appropriately overseen and approved by Ministers in accordance with their statutory responsibilities, resulting in loss of confidence, reputational damage and exposure to legal challenge.

Opinion for this section: Unsatisfactory

Risk categories: reputational, financial

Summary of findings: FC's loan investments in Forest Holidays in 2012-13

- ✗ FC did not seek Treasury approval to issue loans (agreed in 2012 and phased through 2012 and 2013) when, in our opinion, it is highly likely that this was a legal requirement.
- ✗ FC did not seek Treasury approval to issue loans when, in our opinion, this was a requirement of Managing Public Money.
- ✗ FC did not seek Defra Ministers' approval for the 2012 refinancing and renegotiation (including the issue of loans) when, in our opinion, this was an appropriate and prudent course of action.
- ✗ FC did not inform Defra Ministers about the 2012 refinancing and renegotiation (including the issue of loans), either before or after the event, when, in our opinion, this should have been done.
- ✗ The 2012 refinancing and renegotiation (including the issue of loans) was not subject to an appropriate level of Ministerial oversight.
- ✗ FC's level of engagement with Defra on the 2012 refinancing (including the issue of loans) was insufficient, given the nature and importance of the transaction.

✓ FC and their joint venture partners were informed by sufficient, independent, expert advice.

✓ The 2012 refinancing deal (including the issue of loans) was not manifestly inconsistent with Defra's and FC's obligation to secure value for money.

Timeline of events and documents: FC's loan investments in Forest Holidays in 2012-13

The loans were a condition of the 2012 refinancing deal, so the 2012 refinancing timeline (Section 3, pages 15-16) is also the loans timeline. Beyond this, relating specifically to loans:

August 2013 – A funding report set out the dates and amounts of FC's post-refinancing loan investments, totalling £1.7m

10/12/15 FC replied to NAO's request for information, explaining why Defra had not been consulted on the 2012 refinancing deal and Treasury approval had not been sought to issue loans

25/01/17 Shareholding report summarised FC's new loan investments since the 2012 restructuring

Objective 1: Treasury approval was obtained as required before committing to transactions.

We consider it highly likely that the issuing of loans by FC, as part of or consequent to the 2012 refinancing deal, required Treasury approval under section 24A of the Countryside Act 1968, as inserted by the Regulatory Reform (Forestry) Order 2006. We have two reasons for this opinion:

1. Making loans to a body corporate requires Treasury approval, on our understanding of section 24A of the Countryside Act;
2. The loans made in 2013 were part of the overall 2012 refinancing deal and, as discussed at Section 3 (see pages 16-17), we consider that the whole deal required Treasury approval, according to our understanding of section 24A of the Countryside Act.

FC did not seek Treasury approval to issue these loans (agreed in 2012 and phased through 2012 and 2013) when, in our opinion, this was highly likely to have been a legal requirement. Treasury approval for these loans was also a requirement of Managing Public Money.

FC told the NAO that these loans were not severable from the 2012 refinancing deal, and that was why they hadn't sought approval to lend. In our opinion:

1. The severability or otherwise of the loan investments from the transaction did not negate the need to comply with the approvals framework in respect of loans set out at section 24A of the Countryside Act 1968 and, in this, we concur with the NAO's opinion set out in their management letter of 16/05/16;
2. FC's reason for not seeking Treasury approval to make loans was based on a false premise (that the 2012 refinancing deal did not require Treasury approval).

FC had also made loans before 2012. We have discussed this issue with FC, who told us that the pre-2012 loans were part of the 2006 deal, which was approved by the Treasury, and we have accepted this point. FC have accepted that Treasury approval should have been sought for the loans in 2012-13.

Objective 2: The approval of Defra Ministers was sought and obtained when appropriate.

Given our opinion that Treasury approval was required, we consider that Ministerial approval should appropriately and prudently have been sought. We say this from a common-sense and good governance standpoint, because we do not know of any written compliance framework which sets out when the approval of Defra Ministers is required for these decisions. In our view, if these transactions had been taken to Treasury Ministers for approval (as we believe they should have been), it would have been inappropriate for Defra Ministers not to have been asked for their approval also, considering the aggregate materiality (£1.7m) of the loan investments, the nature of the transactions and the level of departmental oversight which we consider was appropriate in the case of FC (as discussed at pages 21-22). But Ministerial approval was not sought and (as discussed at Section 3, page 17) Ministers were not informed about the conclusion of the 2012 refinancing.

Objective 3: Decisions were subject to an appropriate level of Ministerial oversight.

In view of our findings at Objective 2, it is our opinion that the loan transactions in 2012 and 2013 were not subject to an appropriate level of Ministerial oversight. For this purpose, we understand the term 'oversight' to mean "making sure something is being done correctly". In our opinion, oversight cannot be said to have been appropriately exercised by Ministers when they were not consulted.

Objective 4: Decisions were informed by independent, expert advice as appropriate.

The loan transactions, as part of the 2012 refinancing deal, were appropriately informed by sufficient, independent, expert financial, commercial and legal advice.

Objective 5: Decisions were not manifestly inconsistent with Defra's and the Forestry Commission's obligation to secure value for money.

As discussed at section 3, we have concluded that the 2012 refinancing deal (of which the loan transactions were part) was not manifestly inconsistent with Defra's and Forestry Commission's obligation to secure value for money. See page 19 for details.

Objective 6: There were no other substantive deficiencies or departures from good practice in decision-making processes.

We noted no other substantive deficiencies in relation specifically to loans.

Implications and recommendations: FC's loan investments in Forest Holidays in 2012-13

As Section 3 (see pages 20-23).

Detailed findings 5: Refinancing in 2017 ("Project Canopy")

Defra and the Forestry Commission cannot demonstrate that key decisions were adequately informed and appropriately overseen and approved by Ministers in accordance with their statutory responsibilities, resulting in loss of confidence, reputational damage and exposure to legal challenge.	**Opinion for this section: Limited** **Risk categories:** reputational, financial

Summary of findings: Refinancing in 2017

✗ FC did not seek Treasury approval for the 2017 refinancing, when, in our opinion, this may have been a statutory requirement. However, FC acted in good faith on the basis of views which we consider it was reasonable for them to have considered correct.

✗ Treasury approval for the 2017 refinancing was not sought, when in our opinion, FC should have appreciated that the matter might reasonably be seen as potentially contentious and that Treasury approval was therefore a requirement of Managing Public Money. However, FC took reasonable steps to inform the Treasury of the 2017 refinancing.

✗ FC did not seek Defra Ministers' approval for the 2017 refinancing when, in our opinion, this was the appropriate and prudent course of action. However, FC did inform Defra Ministers about the 2017 refinancing on a timely basis.

✗ The 2017 refinancing was not subject to an appropriate level of Ministerial oversight.

✓ FC and their joint venture partners were informed by sufficient, independent, expert advice.

☆ We cannot form an opinion on the value for money aspect of the 2017 refinancing, because the renegotiation of the 2018 framework agreement was not completed.

Timeline of events and documents: Refinancing in 2017

25/09/17 Ministerial correspondence – FC to Minister Coffey – to inform the Minister of a possible change of ownership

28/09/17 FC's Board of Commissioners recognised that disposal of its share would require Ministerial and Treasury approval, but not that the same was true of reinvestment

28/11/17 Ministerial submission - FC to Minister Coffey - to inform the Minister of the refinancing deal with Phoenix Equity Partners

05/12/17 Minister Coffey's office responded to the submission of 28/11/17

13/12/17 FC's commercial consultant summarised the 2017 refinancing deal

13/12/17 Legal commentary by Eversheds Sutherland on the terms of the 2017 refinancing deal

14/12/17 The Board heard that Phoenix Equity Partners had bought the majority stake in Forest Holidays. The Forestry Commission would roll over its interest in the new structure and receive repayment of the loan notes on completion of the agreement.

Objective 1: Treasury approval was obtained as required before committing to transactions.

FC told us during our review that, in making the decision that statutory Treasury approval was not required for the 2017 refinancing, they were guided by the NAO's view, expressed in their management letter of 2016, that "there was no requirement for the Forestry Commission to seek formal HM Treasury approval for the 2012 joint ventures *per se*". Although we cannot reconcile that view to our understanding of the legislation, we consider that it was not unreasonable for FC to have relied on this view from this source.

FC told us:

> With regard to the 2017 transaction we maintain our view that there was no actual fresh investment in the new company and so HMT approval to 'invest in a body corporate' was not required. Immediately before the 2017 deal, the FC held equity in Forest Holidays Group Limited (FHGL). Following the deal, the FC continued to hold equity in FHGL, that share of equity being reduced to 13.4% as a result of the restructuring. The shareholding was diluted by additional investment – the FC did not dispose of shareholding in exchange for cash or other consideration. From an accounting perspective, it is the substance of the transaction that matters. The creation of a series of special purpose companies to receive and reissue share certificates in relation to FHGL's equity would not appropriately be disclosed

as a disposal and subsequent repurchase of our equity in FHGL: the substance of the transaction was that the Forestry Commission did and still does have an investment in FHGL.

We recognise that this argument has merit. However, the purpose of Treasury approval of investments is to ensure that they are an acceptable use of taxpayers' money. It seems likely to us, therefore, that section 24A of the Countryside Act may apply to significant changes to investments, not just to new investments. We put this question to HM Treasury, who gave us this answer:

> "Only the courts can interpret the law and decide whether FC required Treasury approval as a matter of law in relation to the 2017 refinancing deal. However, we are content to offer a view in this instance, but this is not to say that HM Treasury's view is of a higher status than other interested parties. On section 24A of the Countryside Act 1968 as amended we accept that there are multiple plausible interpretations on this point and we don't think we are in a position to give a definitive judgment. We also see the merit of FC's argument and, as an initial view, we agree that the 2012 and 2017 refinancing was not "an investment", but was rolling over – however, to determine this fully it would be necessary to closely examine the contract's "drag and tag" rights and to understand whether it is true that FC had no option to act otherwise. Moreover, given the statutory provisions, we would have expected FC to err on the side of caution, and to seek HMT's consideration and approval in any case."

We also consider – given that it was, or should have been, evident by this time that aspects of the joint venture were a matter of public speculation and controversy – that the 2017 refinancing might reasonably have been considered potentially contentious, and that Treasury approval was therefore a requirement of Managing Public Money. Treasury approval was not sought, when, in our opinion (which HM Treasury have confirmed they agree with), this was a requirement of Managing Public Money. In our opinion, FC should have appreciated that the matter might reasonably be seen as potentially contentious and that Treasury approval was therefore a requirement of Managing Public Money.

We conclude, therefore, that: (i) statutory Treasury approval for the 2017 refinancing may have been required; (ii) Treasury approval for the 2017 refinancing met the criteria for being considered potentially contentious and was therefore required by Managing Public Money; and (iii) Treasury approval was not sought.

FC managers told us that, although they did not seek Treasury approval for the 2017 refinancing deal, they did seek their understanding, in a letter dated 06/12/17, which concludes:

> "The current majority shareholder enjoys 'drag and tag' rights which require the FC to participate in the refinancing process. We are also explicitly enjoined not to take any steps which might unreasonably obstruct the refinancing carried out by LDC. The FC could therefore face a legal challenge if it was considered to be unreasonably obstructing the transaction. The potential investor has made it a condition of their offer that FC roll-over its investment and continue to participate as a minority shareholder as critical to the deal which may otherwise collapse, thus making

uncertain future opportunities for further site development. This, along with lack of any viable option for selling our minority interest given that the JV is not a public company, severely limits any choice that the FC may have in the deal. Given the decision-making constraints on FC we felt it important that, although the RRO [the Regulatory Reform (Forestry) Order 2006, amending the Countryside Act 1968] does not require us to formally seek HMT approval of the refinancing deal, we advise you prior to signing given the nature of the transaction. We have also discussed the refinancing deal with NAO. Recommendation – that HMT note the FC's approach to the prospective refinancing deal, the approvals and decision making process, the limited choice that the FC has in the matter and the key outcomes of the change in ownership."

FC managers told us that the Treasury did not reply to this letter. In view of this, we also conclude that, in respect of statutory Treasury approval, FC acted in good faith on the basis of views which it was reasonable for them to consider correct, and took reasonable steps to inform the Treasury of the 2017 refinancing. FC's letter to the Treasury was sent one week before the 2017 refinancing sign-off.

Objective 2: The approval of Defra Ministers was sought and obtained when appropriate.

Given (i) our opinion that Treasury approval was required and (ii) that it was, or should have been, evident by this time that aspects of the joint venture were a matter of speculation and controversy, the approval of Defra Ministers should appropriately and prudently have been sought. Approval was not sought, although Ministers were appropriately informed.

FC managers told us that they had learned lessons from the mistakes in 2012 (reported in the NAO's management letter of May 2016), which was why they sent information notes to Minister Coffey in September and November 2017 and wrote to HM Treasury in December 2017 advising them of the proposed refinancing deal.

The submission of 28/11/17 to Minister Coffey said, "This does not require any decisions by Ministers but they do need to be aware of the change of ownership from us rather than any third-party source." On 05/12/17, Minister Coffey's private office responded to FC, stating, "Thank you for the below, which the minister has noted and is content."

We conclude that the approval of Defra Ministers was not sought for the 2017 refinancing when, in our opinion, that would have been the appropriate and prudent course of action.

Objective 3: Decisions were subject to an appropriate level of Ministerial oversight.

In view of our findings at Objective 2, it is our opinion that the 2017 refinancing was not subject to an appropriate level of Ministerial oversight. For this purpose, we understand the term 'oversight' to mean "making sure something is being done

correctly". In our opinion, oversight cannot be said to have been appropriately exercised by Ministers when their approval was not sought, by which we mean that they were not given an opportunity to say 'yes' or 'no' to FC's proposals.

Objective 4: Decisions were informed by independent, expert advice as appropriate.

The 2017 refinancing was appropriately informed by sufficient, independent, expert financial, commercial and legal advice.

Objective 5: Decisions were not manifestly inconsistent with Defra's and the Forestry Commission's obligation to secure value for money.

We are unable to form a view on the 2017 refinancing deal because: (i) in our view, the 2018 renegotiation was part of the consideration for the 2017 refinancing deal; and (ii) the renegotiation was not completed, the necessary approvals having been denied.

Objective 6: There were no other substantive deficiencies or departures from good practice in decision-making processes.

Defra group has an Investment Committee, whose terms of reference require that commercial transactions requiring Treasury approval first be approved by the Investment Committee. This was not done.

Implications and recommendations: Refinancing in 2017

The 2017 refinancing deal was done without the approval of Defra Ministers, which we consider should appropriately and prudently have been sought. There is also a lesson to learn: Failure to follow prescribed Treasury and Ministerial approval processes, is likely to give rise to high-risk issues in the longer run, which may have serious consequences. We **recommend (5)** that Defra group issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff. We wish to make it clear that we are not suggesting that Defra group Finance takes short-cuts for expediency, nor are we suggesting that FC intentionally avoided approval processes for any of the transactions under review. We make the recommendation to ensure that the lessons of Forest Holidays are learned and disseminated.

The 2017 refinancing deal was not submitted to the Defra group's Investment Committee. We **recommend (10)** that Defra group issue guidance to the Accounting Officers of Defra's arm's length bodies, highlighting the role of the Investment Committee and setting out the need for the committee's approval of commercial transactions which require Treasury approval.

We have concluded that: (i) statutory Treasury approval for the 2017 refinancing may have been required; (ii) Treasury approval for the 2017 refinancing met the criteria for being considered potentially contentious and was therefore required by Managing Public Money; and (iii) Treasury approval was not sought. FC managers have told us several times that they do not recognise the reinvestments in Forest Holidays as contentious. We therefore consider that specific guidance on this point would help to reduce the risk of recurrence. We **recommend (11)** that the next version of FC's Framework Document (which is currently in drafting) should provide that proposals for FC or its controlled bodies to enter into commercial investments (including reinvestments) must be submitted to Defra ministers, the Investment Committee and HM Treasury for prior approval whenever there is either (i) a foreseeable prospect that HM Treasury might consider the proposed transaction potentially contentious or (ii) any doubt over whether the proposed transaction might reasonably be considered contentious. For the avoidance of doubt and considering the findings of our review, we also recommend that investments and reinvestments in undertakings operating on the public forest estate should be presumed to meet this criterion.

Detailed findings 6: Renegotiation of the framework agreement in 2018 ("Project Bluebell")

Defra and the Forestry Commission cannot demonstrate that key decisions were adequately informed and appropriately overseen and approved by Ministers in accordance with their statutory responsibilities, resulting in loss of confidence, reputational damage and exposure to legal challenge.	**Opinion for this section:** **Limited** **Risk categories:** reputational, financial

Summary of findings: Renegotiation of the framework agreement in 2018

✗ FC did not seek Treasury approval for the 2017 refinancing, when, in our opinion, this may have been a statutory requirement. However, FC acted in good faith on the basis of views which we consider it was reasonable for them to consider correct.

✗ FC did not seek Treasury approval for the 2018 renegotiation when, in our opinion, FC should have appreciated that the matter might reasonably be seen as potentially contentious and that Treasury approval was therefore a requirement of Managing Public Money. However, FC did inform the Treasury about the 2018 renegotiation.

✗ FC did not seek Defra Ministers' approval for the 2018 renegotiation when, in our opinion, this was required. However, FC did inform Defra Ministers about the 2018 renegotiation.

✓ Notwithstanding that Ministerial approval was not sought, the 2018 renegotiation has been subject to an appropriate level of Ministerial oversight.

✓ FC and their joint venture partners were informed by sufficient, independent, expert advice.

☆ We cannot form an opinion on the value for money aspect of the 2018 renegotiation of the framework agreement, as Ministerial and Treasury approvals to proceed were not given and the transaction cannot, therefore be considered complete.

Timeline of events and documents: Renegotiation of the framework agreement in 2018

10/05/18 FC sent briefing paper to Secretary of State, outlining the history of Forest Holidays

15/06/18 Project Bluebell's proposed Heads of Terms and Framework Agreement were submitted to FC's Board of Commissioners for approval

20/06/18 FC submission for information to Minister Rutley - to note the Heads of Terms for the revised Framework Agreement and the material improvements they represent

26/06/18 FC sent an information note to HM Treasury

21/06/18 FC's Board of Commissioners approved Project Bluebell's proposed Heads of Terms

25/06/18 Secretary of State responded to the submission of 20/06/18, stating that he was not content

26/06/18 Exchequer Secretary to the Treasury (XST), replied to Philip Dunne MP

27/06/18 Treasury told FC that XST was not content to approve the proposed Heads of Terms

26/07/18 Secretary of State refused approval to the leases and framework agreement forming part of Project Bluebell

Objective 1: Treasury approval was obtained as required before committing to transactions.

As reported at Section 5 (pages 29-30), we consider that statutory Treasury approval under section 24A of the Countryside Act 1968 may have been required for the 2017 refinancing. Given that (also in our opinion) the 2018 renegotiation was corollary to the 2017 refinancing, we have therefore concluded that statutory Treasury approval may have been a requirement for the 2018 renegotiation too. FC did not seek Treasury approval for the 2018 renegotiation, although (as reported below), they did inform the Treasury.

Moreover, we consider – given that it was, or should have been, evident by this time that aspects of the joint venture were a matter of public speculation and controversy – that the renegotiation might reasonably have been considered potentially contentious, and that Treasury approval was therefore also a requirement of Managing Public Money.

FC have told us that, in the normal course of business, they would not seek Treasury approval of proposed changes to the Framework Agreement. And indeed, FC did not formally seek Treasury approval on this occasion. However, FC told us that, given the level of Ministerial interest and the need to ensure complete transparency, FC gave Treasury the opportunity (20/06/17) to review and approve if necessary.

HM Treasury stated in their reply (27/06/17):

> "In your email yesterday and as we discussed, we talked of this being an 'information note'. However, given the recent interest on this matter, on reflection we consider that this meets Managing Public Money criteria of being potentially contentious, and hence needing HMT approval. Therefore, I put advice to the Exchequer Secretary yesterday. Unfortunately, based on the information he has seen the Exchequer Secretary is not content to approve the Heads of Terms."

We conclude that – notwithstanding that the Exchequer Secretary to the Treasury gave a decision anyway – Treasury approval was not formally sought, when this was a requirement of Managing Public Money. In our opinion, FC should have appreciated that the matter might reasonably be seen as potentially contentious and that Treasury approval was therefore a requirement of Managing Public Money. However, we also conclude that the Treasury was appropriately informed.

Objective 2: The approval of Defra Ministers was sought and obtained when appropriate.

As the landlord of the forest estate, the approval of the Defra Secretary of State would have been required to Project Bluebell or, if the statutory scheme permitted such a delegation, such consent power could have been delegated to FC. In addition, given that Treasury approval was required in this case, we consider that Ministerial approval would appropriately and prudently have been sought. We say this from a common-sense and good governance standpoint, because we do not know of any written compliance framework which sets out when the approval of Defra Ministers is required for these decisions. In our view, if this proposal had been taken to Treasury Ministers for approval (as it should have been), it would have been inappropriate for Defra Ministers not to have been asked for their approval also. But Ministerial approval was not sought (although the Secretary of State has anyway given a decision on the 2018 renegotiation).

Objective 3: Decisions were subject to an appropriate level of Ministerial oversight.

In view of our findings at Objective 2, it is our opinion that the 2018 renegotiation was subject to an appropriate level of Ministerial oversight. For this purpose, we understand the term 'oversight' to mean "making sure something is being done correctly". In our opinion, oversight can be said to have been appropriately exercised by Ministers when – even though they were not asked for a decision – they took the opportunity to say 'yes' or 'no'. Even so, we consider that a decision should have been sought from Defra Ministers.

The submission of 20/06/18 to inform Ministers of the 2018 renegotiation contained no present valuation of the net benefits of the proposed new terms or evaluation of alternative courses of action. It is good practice, and consistent with Treasury guidance, to do this whenever proposals may have a material financial impact. It later fell to Defra's commercial law group to remedy this deficiency. It is clear that FC was keen to take advantage of a rare opportunity and felt under pressure to agree the renegotiated Heads of Terms quickly. But, in our opinion, an assessment and comparison of the available options, similar to that presented in the commercial options paper of 29/06/18, should have been made before the submission of 20/06/18 and annexed to it.

This submission reported that facilitating the exit of Evans as an investor in Forest Holidays would cost the company £69m but save them £1.4m per annum. By our calculation, this implies a payback period of approximately 70 years. It also says that "there are no financial costs or risks". In our opinion, these two statements are, to some extent, mutually contradictory, and the submission does not say whether independent financial advice was taken on this point. When we discussed this finding with FC managers, they told us that (i) these numbers did not tell the whole story, and (ii) this was a decision for Forest Holidays, not for FC. We accept that these are valid points.

Objective 4: Decisions were informed by independent, expert advice as appropriate.

The decisions under review were appropriately informed by sufficient, independent, expert financial, commercial and legal advice.

Objective 5: Decisions were not manifestly inconsistent with Defra's and the Forestry Commission's obligation to secure value for money.

In our opinion, the Project Bluebell proposals for the 2018 renegotiation of the framework agreement clearly represented better value for money than the 2012 framework agreement. The question of whether they were the best achievable value for money is unanswerable. We were unable to form a view on the 2017 refinancing deal because: (i) in our view, the latter is part of the consideration for the former; and (ii) the renegotiation was not completed, the necessary approvals having been denied.

Objective 6: There were no other substantive deficiencies or departures from good practice in decision-making processes.

We noted no other substantive deficiencies.

Implications and recommendations: Renegotiation of the framework agreement in 2018

Ministers may not always have been sufficiently and accurately informed by the “for information” submissions we reviewed. This may have given rise to high reputational and financial risks. When a proposal is likely to have a material financial impact, a present valuation of the net benefits of the proposal and of the available alternative options should be provided as part of the proposal or, if this is not done, an explanation should be given. Authors and sponsors of submissions should think twice before stating that a commercial proposal has “no financial risks or costs”. We **recommend (6)** that Defra group issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff.

Annex 1: Management action plan

Risk	Defra and the Forestry Commission cannot demonstrate that key decisions were adequately informed and appropriately overseen and approved by Ministers in accordance with their statutory responsibilities, resulting in loss of confidence, reputational damage and exposure to legal challenge.
Opinion	**Unsatisfactory**

Recommendation		Priority	Management response	Target date	Action owner
1	Defra group should issue clear direction on this point to the Accounting Officers of all of its sponsored bodies: Only the courts can definitively interpret the law and decide whether Treasury approval is required as a matter of law for any particular transaction. But investments in bodies corporate, whether share purchases, share exchanges or loans, are highly likely to require approval from HM Treasury. Rollovers and other significant changes to existing investments may also require Treasury approval. Even when there is no statutory requirement for Treasury approval, Managing Public Money requires that Treasury approval be sought and obtained for transactions which may potentially be novel, contentious or repercussive. Box 2.3, on page 18 of the current edition of *Managing Public Money*, gives examples of such transactions. For investments, it is likely that they may fall within the scope of "unusual financial	**High**	Recommendation accepted. Defra already refer all novel and contentious cases to HMT and have a clear process in place to ensure that happens. We will look to see if there are any gaps in our processes (i.e. significant investment / commercial decisions) and rectify these in conjunction with our network bodies.	30/09/18	Heather Smith

Recommendation		Priority	Management response	Target date	Action owner
	transactions, for example, imposing lasting commitments or using tax avoidance". We would expect, and HM Treasury have told us that they would expect, management to err on the side of caution, seeking HM Treasury's consideration and approval in any case where it may reasonably be considered that there is room for doubt on whether Treasury approval is required, whether by statute or by Managing Public Money.				
2	Defra should seek legal advice on the implications of our findings, particularly as they relate to the regularity of the transactions we have reviewed.	**High**	Recommendation accepted. The Government Legal Department has already provided initial advice on the current agreement between FC and FH. As we take forward the other recommendations in this report, especially recommendation 8, we will seek further legal advice, including from Counsel, as necessary.	30/11/18	Sonia Phippard
3	Defra group should issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff: From a standpoint of common sense and good governance, if a commercial investment decision requires (or appears likely to require) Treasury approval, a similar need for approval by Defra Ministers is indicated, and should be presumed.	**High**	Recommendation accepted. Defra review all commercial and policy decisions through a variety of processes such as the Investment committee, the Gateway Panel and ExCo. In addition, we will work with our network bodies and the ministerial offices to ensure	30/09/18	Heather Smith

Recommendation		Priority	Management response	Target date	Action owner
	For this purpose, a reinvestment (or rollover) should be regarded as an investment.		appropriate decisions are taken to Ministers for approval.		
4	Defra group should issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff: (1) In cases when no decision is sought, Ministerial submissions on matters which are likely to affect the security or value of government investments in undertakings which have, at any stage, been funded or part-funded with public money should explain the reasons why no decision is being sought; (2) When "for information" submissions are made by arm's length bodies on matters which are likely to affect the security or value of government investments in undertakings which have, at any stage, been funded or part-funded with public money, the relevant policy owners should challenge the originators why no decision is being sought.	**High**	Recommendation accepted. Defra already make clear in ministerial submissions the rationale behind what approval or notation we are requesting from ministers. We will continue to ensure that this is the case across Defra alongside implementing the strengthened processes referred to above.	30/09/18	Heather Smith
5	Defra group should issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff: Failure to follow prescribed Treasury and Ministerial approval processes is likely to give rise to high-risk issues in the longer run, which may have serious consequences.	**High**	Recommendation accepted. Defra do not avoid HM Treasury or Ministerial approval processes for expediency's sake but will continue to apply the appropriate approvals as referred to above.	30/09/18	Heather Smith

Recommendation		Priority	Management response	Target date	Action owner
6	Defra group should issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff: When a proposal is likely to have a material financial impact, a present valuation of the net benefits of the proposal and of the available alternative options should be provided as part of the proposal or, if this is not done, an explanation should be given. Authors and sponsors of submissions should think twice before stating that a commercial proposal has "no financial risks or costs".	**High**	Recommendation accepted – Over the last few years Defra has improved its assurance processes considerably through the setting up of the Investment committee, the Gateway Panel and stronger business case review processes across the Group. There is a clear process in place which will be on the intranet shortly outlining what needs to be done and when for cases with a high financial impact. We are also working with ExCo and Ministerial offices to remind all about the importance of formal finance approval before a submission can be put forward.	30/09/18	Heather Smith
7	Defra group should issue clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff: Where there is no competition in the context of a commercial decision, that is highly likely to have a material impact on value for money in the outcome. So, whenever competing offers are not evaluated in parallel, the reasons why not should be well justified, exposed to challenge, authorised at a senior level and clearly documented.	**High**	Recommendation accepted. Clear guidance will be developed to support the direction following a review of current procurement, finance and wider policy advice, to identify how value for money might be evidenced for non-competed commercial activities.	30/09/18	Einav Ben-Yehuda

Recommendation		Priority	Management response	Target date	Action owner
8	In view of the scope for uncertainty and disagreement we observed over the level of oversight which the parties may or may not consider appropriate, a governance review of FC should be undertaken, which should consider (i) its relationships with Defra, Forest Enterprise England and Forest Holidays and (ii) whether FC should retain its interest in Forest Holidays. It is proposed that this review be led by Defra group Commercial and conducted by UK Government Investments.	**High**	Recommendation accepted. We agree with the necessity of a governance review of the Forestry Commission's decision-making in regards to its relationship with Forest Holidays. The review will focus on the effectiveness and appropriateness of the current governance arrangements within FC, Forest Enterprise England and Forest Holidays. We also accept the commission to review FCs current shareholding interest in FH. Please note initial advice on this have recently been sought from UKGI indicating limited benefit would likely be gained by an early exit at this point. Our review would seek to validate and/or update this advice.	30/11/18	Einav Ben-Yehuda
9	Defra group issue should clear direction on this point to the Accounting Officers of all of its sponsored bodies and to its senior staff: At all meetings where commercial decisions are considered or taken, members of Boards and other governance bodies should be explicitly asked to consider and declare any conflicts of	**Medium**	Recommendation accepted. The Accountability and Governance Team will arrange for this instruction to be issued.	30/11/18	Accounting Officer and Alexandra Cran-McGreehin

Recommendation		Priority	Management response	Target date	Action owner
	interest they may have and this should be minuted.				
10	Defra group should issue guidance to the Accounting Officers of Defra's arm's length bodies, highlighting the role of the Investment Committee and setting out the need for the committee's approval of commercial transactions which require Treasury approval.	**Medium**	Recommendation accepted. Defra is in the process of issuing clear guidance of how all business case assurance processes work within Defra. This will outline how cases need to be approves and the role of all key approvers including the Investment Committee	30/11/18	Heather Smith
11	The next version of FC's Framework Document (currently in drafting) should provide that proposals for FC or its controlled bodies to enter into commercial investments (including reinvestments) must be submitted to Defra ministers, the Investment Committee and HM Treasury for prior approval whenever there is either (i) a foreseeable prospect that HM Treasury might consider the proposed transaction potentially contentious or (ii) any doubt over whether the proposed transaction might reasonably be considered contentious. For the avoidance of doubt and considering the findings of our review, we recommend that investments and reinvestments in undertakings operating on the public forest estate should be presumed to meet this criterion.	**Medium**	Recommendation accepted. The Accountability and Governance Team will take this forward in the finalisation of FC's draft Framework Document.	30/11/18	Alexandra Cran-McGreehin

Annex 2: Objectives, scope and limitations

Objectives

The objective of the process under review is to enable effective, approved and informed decision-making and decisions, consistently with the Secretary of State's statutory obligations. The objectives of the engagement are:

1. To review documented evidence of the decisions and decision-making processes that resulted in the establishment of Forest Holidays and its governance arrangements in 2006 and subsequent restructuring in 2012 and refinancing in 2017.
2. To evaluate the regularity and appropriateness of these processes with particular reference to the prevailing statutory framework and the level of Ministerial oversight which was applied to those decisions.
3. To consider whether there were any substantive deficiencies or departures from good practice in decision-making processes.
4. To suggest improvement actions for the future.

Scope and Limitations

The engagement will evaluate whether key decisions were:

1. Documented clearly, sufficiently and availably to enable independent review of the decision-making process
2. Submitted for Ministerial approval or information as appropriate (having regard to the Secretary of State's statutory duties)
3. Submitted for Treasury approval where appropriate (having regard, for example, to the requirements of *Managing Public Money* on obtaining and issuing loans)
4. Informed by independent, professional legal, financial and/or commercial advice as appropriate
5. Not manifestly inconsistent with Defra's and the Forestry Commission's obligation to secure value for money.

The engagement will cover the decisions which resulted in:

1. the establishment of the original joint venture and its governance arrangements in 2006
2. the extension of cabin lease terms to 125 years in 2009
3. the restructuring, refinancing, £2m loan and framework agreement of 2012
4. the inclusion of favourable ground rent and exclusivity terms in the 2012 framework agreement
5. the refinancing of 2017
6. the renegotiation of lease terms in 2018 (to the extent that this has progressed).

Distribution

Clare Moriarty, Permanent Secretary and Principal Accounting Officer
Sonia Phippard, Director General, Environment, Rural and Marine (Defra lead sponsor)
Shirley Trundle, Director, Wildlife, International, Climate and Forestry
Fiona Harrison, Deputy Director, Climate and Forestry (Defra lead client contact)
[REDACTED]

Colin Day, Lead Non-Executive Director, Defra
Steven Condie, Deputy Director, Defra and DfE, Commercial Law Group, Government Legal Department
Einav Ben-Yehuda, Group Commercial Director, Defra
Heather Smith, Group Finance Director, Defra
Alexandra Cran-McGreehin, Board Secretary and Head of Accountability and Governance, Defra
Ian Gambles, Director, Forestry Commission (England)
Simon Hodgson, Chief Executive, Forest Enterprise England
Steve Meeks, Finance Director, Forestry Commission (England)
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Audit and Risk Committee
National Audit Office

Authors

Nathan Paget, Defra Group Chief Internal Auditor (engagement manager)
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Annex 3: Forestry Commission response

OFFICIAL SENSITIVE

Clare Moriarty
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Director England
Ian Gambles

3 December 2018

Dear Clare

I am writing on behalf of the Forestry Commissioners with our observations on the above report. I note that Defra have responded to the recommendations made, and that the proposed Governance Review led by UK Government Investments is now in progress. We have no difficulty with Defra's responses, and welcome the Governance Review, with which we are already engaged. I should note also that, with the kind agreement of Sonia Phippard, we have shared the report with relevant senior officials in the devolved administrations. Any consideration they may wish to make is a matter for them, and this letter represents solely the views of the Forestry Commissioners.

I begin with our observations on the report's Executive Summary. I will then add a few observations on the detailed findings, and conclude with our views on the handling of the report.

The Executive Summary

The Commissioners firmly reject the opinion given in the Executive Summary and the Summary of Findings on which it is based. There are in no sense fundamental weaknesses in our framework of governance. It is untrue to say that key approval and oversight controls failed to operate as prescribed. With two exceptions (not, as the report appears to suggest, at least seventeen) all the necessary approvals were obtained, and all those who should have been consulted were consulted. With one exception (omitting to seek Treasury approval for loans in 2012-13), which was addressed by the National Audit Office two years ago, it is wrong to cast doubt on the regularity of any of the transactions concerned. I would add that the stridently critical tone of the report is at best insensitive to the fact that the Commission has at every stage and in every transaction sought to protect and improve the taxpayer's interest in Forest Holidays and the benefits to the forest estate we manage on behalf of the Secretary of State, and we have been successful in that endeavour.

Interpretation of the law

There are a number of areas considered in the report where there are differences between GIAA and the FC in the interpretation of the applicable law. Only the courts can resolve such matters definitively, and in the absence of a court decision we consider that as the responsible public authority we have held to a reasonable interpretation of our legal obligations and acted appropriately in following it. In the most important instance, that of the requirement for Treasury approval for the 2012 and 2017 transactions, our view was endorsed by the National Audit Office.

Meaning of "contentious"

The report suggests on a number of occasions that our actions should have been guided by a recognition that decisions regarding Forest Holidays were "contentious". In our view this is wrong on two counts, both of which have important wider implications for ourselves and other public bodies.

- First, whether a matter is contentious must be evaluated in the light of the known facts at the time of the relevant decision, and cannot be informed by hindsight. There has been minimal ministerial, Treasury or Defra official interest in Forest Holidays for a decade, during the whole period of business growth, site development and changes in ownership. Media and public interest was almost exclusively local. It is difficult, therefore, to understand how prior to 2017 decisions regarding Forest Holidays could reasonably be regarded as contentious. It is worth noting in this context the June 2017 Treasury memo cited on p.36 of the report, in which they say that "given the *recent* interest in this matter, *on reflection* we consider that this meets MPM criteria of being potentially contentious" (emphasis added).

- Secondly, we would suggest that local contention over a planning application is insufficient for a matter to be considered contentious within the meaning of Managing Public Money. Otherwise the Treasury would be inundated.

Ministerial approval and oversight

Central to the criticisms in the report is the argument that FC failed to seek appropriate ministerial approvals. We consider all but one of these criticisms to be unwarranted.

- We maintain that the Forestry Commissioners had the authority to make all the decisions they did make without reference to ministers. The FC was established on a statutory basis and is a non-ministerial department. The report (p.22) appears to us to seek to undermine that position, and established practice in the interpretation of the Forestry Act 1967, by placing a weight on the mechanics of Vote funding which they simply will not bear.
- The reality of increasing ministerial oversight of FC's work, particularly since the parliamentary debates over the status of the public forest estate in 2011-12, has been recognised by FC by providing ministers with submissions for information where appropriate. Ministers have demonstrated by their actions (recording consent to the 2017 transaction, withholding consent to the 2018 transaction) that they are willing to override the Commissioners if they see fit, and that an information submission gives them every opportunity to do so.
- We accept (as indeed I accepted in my letter of 1 June 2016 to Peter Morland of the NAO) that it would have been advisable to seek ministerial endorsement for the 2012 transaction.
- We recognise that this is an area where greater clarity would be valuable for all parties, so we warmly welcome the current Governance Review.

The detailed findings

It will be apparent from the above remarks that we disagree fundamentally with the judgments made in this report. This is reflected in our disagreement in numerous respects with the detailed findings. At some points in the report, these disagreements are acknowledged. We are grateful for that, but are disappointed that GIAA have consistently stuck to the most negative possible view, sometimes in flagrant disregard of basic facts and ignoring the limitations of the Commission's rights as a minority shareholder. For example, it is seriously misleading to say (p.32) that "the 2017 refinancing deal was done without the approval of Defra Ministers", an error which casts something of a shadow over the otherwise prudent recommendation (5) derived from it.

I will not here seek to rebut the detailed findings point by point, as that would require a too lengthy document of perhaps limited utility, although we can add more detail if asked. There are, however, a few particular points not made above where we feel it is important from a forward-looking perspective to register our dissent from the report.

- Adequacy of ministerial engagement. The report concludes that, notwithstanding the five submissions we put up at the time, FC did not adequately engage ministers in the 2006 transaction, citing the proximity of the final submission to decision deadlines and the timing of a ministerial reshuffle. It seems to us that the effective conduct of public business would be undermined in numerous contexts if it was considered impermissible to put up submissions requiring urgent attention or if officials in delivery bodies were required to suspend commercial decision making and revisit urgent matters on each occasion of a ministerial reshuffle.
- Extent and continuity of ministerial authority. The report suggests that the 2006 agreement committing the minister as owner of the land to execute and deliver a lease as required by the contract inappropriately fettered ministerial discretion, and further suggests that the FC could not rely on a certificate of authorisation issued by the Secretary of State in a previous government. We disagree on both counts, but note that the fact that GIAA have come to this view does suggest some need for clarification as to how far ALBs are free to enter into contracts which bind subsequent administrations, and how far they may continue to rely on formal authorisations given by previous administrations (and not revoked).
- Redrafting of the FC Framework Document. It was disappointing that the report proposes (p.33, recommendation 11) a more restrictive redrafting of the FC Framework Document. We note in passing that this document has not yet been agreed by Defra and HM Treasury, despite FC providing a full draft in December 2016. Nevertheless we will gladly consider yet further amendments if they provide useful clarity, but we will not agree to a Framework Document which seeks to micro-manage FC operations or inappropriately restricts the Commissioners' ability to discharge their statutory duties.

Handling

The Forestry Commissioners recognise the particularly challenging circumstances surrounding Forest Holidays issues over the summer of this year, and appreciate the support shown by you and other senior Defra officials in handling the unexpected political prominence they attracted. They also recognise that some of the clarification which the GIAA report correctly identifies as necessary may well have material value for other ALBs as well as for the Forestry Commission, so it is entirely appropriate that these recommendations are considered by the core department. Nevertheless the Commissioners are disappointed that a

report so strikingly and in our view wrongly critical of the Commission was not addressed to them in any part, nor were they offered any formal opportunity to provide a response.

The Commissioners also expressed surprise that Nathan Paget was listed as the first author of the internal audit report and it was not disclosed that he had attended as FC's internal audit lead meetings of the FC ARAC at which decisions pertinent to the findings of the report had been made. In particular, the meeting of 5 December 2017 discussed the refinancing deal at considerable length and concluded that the required approval processes were being followed.

Next Steps

I understand GIAA remain open to considering further revisions of the report, and we would obviously welcome any constructive changes. I would, in any event, request on behalf of the Commissioners that this letter be retained in the department's records alongside the report and disclosed together with it whenever disclosure is judged necessary or appropriate. More immediately, the imminent conclusion of the Governance Review presents an opportunity in our view to clarify some of the key questions of interpretation which have been at the root of much of the difficulty, in particular the nature and limits of the Commissioners' powers under the Forestry Acts, the proper relationships between Commissioners and the Secretary of State, and the effect on those powers and relationships of circumstances where the Commission is bound by obligations set out in contracts or shareholder agreements. This is likely to require Counsel opinion, and we are keen to seek one such opinion on behalf of Defra as a group. I suggest that the Steering Group chaired by Sonia Phippard takes responsibility for commissioning this, so that legal advice can be taken fully into account in advising ministers on implementation of the outcomes of the Governance Review.

I am copying this letter to Sonia Phippard, Heather Smith, Tim Martin (UKGI), Peter Morland **(NAO)** and Nathan Paget **(GIAA).**

Annex 4: Our classification systems

Opinion

Substantial	The framework of governance, risk management and control is adequate and effective.
Moderate	Some improvements are required to enhance the adequacy and effectiveness of the framework of governance, risk management and control.
Limited	There are significant weaknesses in the framework of governance, risk management and control such that it could be or could become inadequate and ineffective.
Unsatisfactory	There are fundamental weaknesses in the framework of governance, risk management and control such that it is inadequate and ineffective or is likely to fail.

Recommendations

Rating	Definition	Action required
High	Significant weakness in governance, risk management and control that if unresolved exposes the organisation to an unacceptable level of residual risk.	Remedial action must be taken urgently and within an agreed timescale.
Medium	Weakness in governance, risk management and control that if unresolved exposes the organisation to a high level of residual risk.	Remedial action should be taken at the earliest opportunity and within an agreed timescale.
Low	Scope for improvement in governance, risk management and control.	Remedial action should be prioritised and undertaken within an agreed timescale.