

**Shan Morgan**  
Ysgrifennydd Parhaol  
Permanent Secretary



Llywodraeth Cymru  
Welsh Government

Mr Nick Ramsay AM  
Public Accounts Committee Chair  
National Assembly for Wales  
Cardiff Bay  
CF99 1NA

16 January 2018

Dear Mr Ramsay,

### **The Initial Funding for the Circuit of Wales**

You wrote to me on 14 December seeking further clarification in respect of seven issues which have arisen out of the Committee's hearings on the Circuit of Wales and the subsequent correspondence between the Committee and officials, principally Mr James Price, over the past few months.

Please find overleaf an annex prepared by colleagues from the relevant Economy, Skills and Natural Resources teams and Central Finance teams of the Welsh Government setting out a response to questions 1 to 6 in your letter.

In question seven, you have asked for my own expectations of the operation of the Assurance Group and my assessment of the extent to which they operated effectively in relation to the Cabinet's decision on the Circuit of Wales project. Given the complexity and profile of this project, I welcome the fact that James Price as Additional Accounting Officer brought together a group of senior colleagues who spanned Welsh Government departments to provide challenge and scrutiny of this work. I was briefed on the work of the Assurance Group and I understand that colleagues involved found it to be a valuable approach, bringing together a range of expertise to ensure rigorous scrutiny of the project proposals. I am satisfied that the Assurance Group provided a level of challenge and assurance appropriate to this project, and will draw on the good practice lessons for the future.



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**MEWN POBL | IN PEOPLE**

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We welcome receiving correspondence in Welsh. Any correspondence received in Welsh will be answered in Welsh and corresponding in Welsh will not lead to a delay in responding

As Principal Accounting Officer, I am satisfied that the due diligence work conducted in relation to the Circuit of Wales was taken very seriously and provided the Cabinet with robust advice on which to draw in making their decision.

I hope that the additional details contained in this letter will provide the clarification the Committee is seeking.

Yours,

A handwritten signature in black ink that reads "Shan Morgan". The signature is written in a cursive style and is positioned above a long, thin horizontal line that extends to the right.

**Shan Morgan**  
Ysgrifennydd Parhaol/ Permanent Secretary  
Llywodraeth Cymru/ Welsh Government



## Annex: Responses, Questions 1-6

### 1. The Statistical Classifications Forum minutes from the 12 June 2017 state:

*“Wales: Circuit of Wales, currently under due diligence. If classification related issues arise then will inform ONS.”*

**The Committee would therefore welcome clarification on whether the official present at this meeting was either not aware of any balance sheet classification issues raised by the due diligence reports by 12 June reflecting a cross-departmental view at that point in time; or simply not aware of classification issues that were being discussed by Welsh Treasury or other Departmental officials?**

The official present at the meeting was aware of potential classification issues arising from consideration of the Circuit of Wales proposition. On 12 June 2017, at the time of the meeting of the Statistical Classification Forum, that consideration was ongoing.

The Minutes allude to the fact that the ONS would only have been informed following a decision in principle to offer Welsh Government support and when contractual documentation was in near-final or final form. These conditions were not present at that time.

### 2. There was reference in the Assembly's Plenary debate (27 June 2017) on the Circuit of Wales decision and in the media to an e-mail sent by a Senior Official to Aviva Investors on 14 June 2017 outlining that they had spoken to lawyers about complying with EU state aid rules. It goes on to state that there were 'no showstoppers' with regard to project. Was the Senior Official also not aware, at that point, of the new advice on balance sheet classification that was to be a significant in the Cabinet's decision to decline funding on 27 June (13 days later)? And if they were not aware on 14 June 2017, at what point did they become aware of this advice?

The senior official was aware of potential classification issues arising from consideration of the Circuit of Wales proposition. However, the discussions on 13 June and subsequent email related solely to compliance with EU state aid rules. The full text of the email, dated 14 June 2017, which was sent to Aviva Investors states:

*“As we are drawing towards the close of our project appraisal process we had a conference with Counsel yesterday on state aid. The good news is that at the moment there does not appear to be any showstoppers but there is one point that I would like to discuss with you in relation to deal structure.”*



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Subsequently there was a telephone call between officials and Aviva to discuss the issue in relation to deal structure that was referred to in the email. As a direct consequence of that telephone call there was a change to the proposed Aviva funding structure to make the proposal compliant with State Aid. This revised structure was issued to Welsh Government on 16 June and this new structure was subsequently fed into the Balance Sheet analysis.

The advice provided by Welsh Treasury on balance sheet classification was issued on 20 June 2017 to the Officials preparing the Cabinet Paper. This advice took into account the updated financial structure provided on the 16 June 2017.

- 3. Were the two officials that were unable to attend Public Accounts Committee on the 26 June, due to 'ensuring the completion of the rigorous due diligence process and associated work' ensuring that 'the Cabinet has the right information to consider the project comprehensively' and 'takes its decision in a thoroughly informed way', aware of the advice from Welsh Treasury officials that was due to be tabled before the 27 June and if so when?**

The two officials unable to attend the Public Accounts Committee on 26 June 2017 were provided with the advice from the Welsh Treasury team on 20 June 2017 following discussion between departments.

- 4. Was the then Deputy Permanent Secretary aware of the balance sheet classification advice that was to be presented to Cabinet before he appeared at the Public Accounts Committee meeting on the 26 June?**

Yes, the then Deputy Permanent Secretary was aware of the balance sheet classification advice provided by Welsh Treasury on 20 June 2017. However, as Mr Price stated at the Public Accounts Committee meeting on 26 June, as Cabinet had yet to make a decision on the provision of the guarantee for £220m, it was inappropriate to provide any details on the live project at that time.

- 5. (a) What specific 'rules' (eg accounting standards, requirements of the FReM, Treasury guidance, Office of National Statistics rules, 'Managing Welsh Public Money' or other guidance) are the Welsh Government required to apply to the inclusion / exclusion within its annual financial statements (whether on the face of the balance sheet or in a note to the accounts) of the public finance support that it makes available to large capital projects such as the Circuit of Wales?**

There are a number of "rules" and guidance documents relating to the potential accounting and budgetary impacts of schemes such as the Circuit of Wales.

The Welsh Government Accounts are prepared in accordance with the *Government Financial Reporting Manual (FReM)*. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. The FReM is maintained by HM Treasury and is amended following consultation and agreement from the Financial Reporting Advisory Board (FRAB). The FRAB members consider the

Public Sector context to determine if the IFRS standards should be directly applied or require interpretation.

Link to Government Financial Reporting Manual (FReM):

<https://www.gov.uk/government/publications/government-financial-reporting-manual-2017-to-2018>

In addition to any disclosures in the accounts of the Welsh Government, it is important to consider whether there are any additional budgetary impacts. The Welsh budget is part of the UK public expenditure framework and, therefore, the Welsh Government is required to comply with the Consolidated Budgeting Guidance published by HM Treasury. Much of this guidance is derived from principles applied by the Office for National Statistics in preparation of the National Accounts – a key element being the classification of entities to the public (Central Government) or private sector and whether they are considered to be market or non-market bodies. Entities determined to be within the Central Government sector, i.e. controlled by central government and not operating within the market, will be charged against the Welsh Government's budget as if it were part of the Welsh Government. Entities controlled by central government but operating as a market body are classified as public corporations.

There are a small number of public corporations in Wales. Public corporations are charged against the Welsh Government's budget on an 'external financing' basis. In both cases, any loans entered into by the entity will score against the Welsh Government's capital budget.

The classification of institutional units and their assets to the public or private sectors by the Office for National Statistics is the key determinant as to the accounting and budgeting treatment applied. In determining classification decisions, the ONS will apply the prevailing European legislation: the European System of Accounts (ESA) 2010 and its interpretative guidelines, the Manual on Government Deficit and Debt (MGDD) 2016. The 2016 update of MGDD includes revised sections on *inter alia* the delimitation of the general government sector, including the concept of government control; Public Private Partnerships; and debt related transactions and guarantees.

**(b) The process used by the Welsh Government when identifying and applying such rules to its funding decisions, and:**

**(c) Descriptions of the roles of the various Welsh Government officials / departments who are involved in such processes, and how / when they interact with other relevant non-Welsh Government bodies such as HM Treasury and the Office of National Statistics.**

In the Welsh Government, responsibility is delegated from the Permanent Secretary as Principle Accounting Officer to a number of Additional Accounting Officers (AAOs). In each Group, the AAO is supported by an operations team headed by a Director who is a qualified accountant. It is for the finance teams in each Group to support the process around all funding decisions. Where funding decisions involve risks and / or costs which cannot be accommodated within a Ministerial portfolio, or there are particularly complex financial issues, the Group

finance team is able to call upon the expertise in Welsh Treasury and the Welsh Government Finance Department on the application of accounting, budgeting and classification rules.

These central teams regularly interact with bodies such as HM Treasury and the ONS, both informally and through formal structures. Officials from these departments are represented on such boards and fora as the Financial Reporting Advisory Board and the Statistical Classification Forum. In addition, specific guidance is published by the ONS on the roles of participants in the classification process, and on how the process is applied. (See link below).

[www.ons.gov.uk/methodology/classificationsandstandards/economicstatisticsclassifications/ukeconomicstatisticssectorandtransactionclassificationtheclassificationprocess#key-roles-in-the-classification-process](http://www.ons.gov.uk/methodology/classificationsandstandards/economicstatisticsclassifications/ukeconomicstatisticssectorandtransactionclassificationtheclassificationprocess#key-roles-in-the-classification-process)

## **6. The role and use of 'Internal Assurance Groups' (as referenced at Q24 in James Price's letter of 11 September 2017 to the Committee).**

The Deputy Permanent Secretary, James Price, initiated the Internal Assurance Group as a "one off" measure for the Circuit of Wales. The use of such a group does not form part of the normal Project Governance or Approval Process. Given the scale and broad reach of the project, Mr Price concluded that the draft advice to Ministers prepared by the lead officials should be scrutinised and challenged as comprehensively as possible to ensure the advice given to Ministers fully addressed all key issues, including benefits and risk as well as policy alignment.

The Assurance Group did not form part of the formal approval process but provided assurance to senior officials that the project appraisal and due diligence covered all aspects of the proposal and, as a consequence, that the advice to Ministers would be complete.

Membership of the group was drawn from senior officials across Welsh Government who had particular areas of expertise or were potential stakeholders. This included Directors from the ESNR Corporate Leadership Team together with the Welsh Government Finance Director, Director Legal Services, Chief Economist and Director -Communities & Tackling Poverty.

This Assurance Group met on five occasions between February and June 2017, including one meeting with the Circuit of Wales management. The outcome of each meeting was communicated to the officials managing the due diligence process and preparing the advice for Ministers and Cabinet.

*End*