Public Audit Committee

2nd Report, 2010 (Session 3)

Review of Cairngorm funicular railway

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The Scottish Parliament
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Public Audit Committee

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The Scottish Parliament
Pàrlamaid na h-Alba

Public Audit Committee

Remit and membership

Remit:

The remit of the Public Audit Committee is to consider and report on—

(a) any accounts laid before the Parliament;

(b) any report laid before or made to the Parliament by the Auditor General for Scotland; and

(c) any other document laid before the Parliament, or referred to it by the Parliamentary Bureau or by the Auditor General for Scotland, concerning financial control, accounting and auditing in relation to public expenditure.

(Standing Orders of the Scottish Parliament, Rule 6.7)

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The Scottish Parliament
Pàrlamaid na h-Alba

Public Audit Committee

2nd Report, 2010 (Session 3)

Review of Cairngorm funicular railway

The Committee reports to the Parliament as follows—

INTRODUCTION

1. This report sets out the Committee's findings in relation to the report *Review of Cairngorm funicular railway* which was prepared by Audit Scotland for the Auditor General for Scotland (AGS) and published in October 2009.

BACKGROUND[1]

2. The Cairngorms are the main location for skiing in Scotland, catering for around two-thirds of total skiing demand between 1960 and 1990. A funicular railway began operating on Cairngorm in 2001 and has been the subject of public and media interest since it was first proposed. The operator, Cairngorm Mountain Limited (CML)[2] struggled financially since the funicular opened and, in May 2008, Highlands and Islands Enterprise (HIE) took CML over.

3. Downhill skiing first began on Cairngorm in 1961. The site is also used for hill walking, scientific research and rock climbing. Large parts of it are protected under UK and European legislation for conservation.

4. In 1992, faced with increased competition and ageing chairlifts, CML approached HIE and its local enterprise company (Moray, Badenoch and Strathspey Enterprise (MBSE)), with plans to modernise facilities.

5. CML, MBSE and HIE jointly commissioned consultants to carry out a feasibility study on the options for replacing the main chairlifts. The consultants

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[1] Information in this section of the report is taken from the Audit Scotland report *Review of the Cairngorm funicular.* Audit Scotland. (2009). Available at: http://www.audit-scotland.gov.uk/docs/central/2009/nr_091008_cairngorm_funicular_railway.pdf
[2] Before 2001, CML was known as the Cairngorm Chairlift Company. For consistency, we refer to CML throughout this report.

considered five options including the ‘do nothing’ option. The funicular scored highest against the assessment criteria used.

6. Over the next few years HIE and CML consulted stakeholders, developed design options, assessed likely costs and secured planning permission. In 1997, consultants estimated that the project would cost £14.8 million to build. HIE and MBSE agreed to contribute £9.4 million (63 per cent of the total cost) with the remainder coming from CML (through a £2.5 million bank loan) and the European Union (EU) (£2.9 million). As part of the funding arrangement, CML would pay rent to HIE for the funicular and land.

7. HIE required Scottish Office[3] approval for the funding as its delegated authority for an individual project was £500,000. The Secretary of State for Scotland gave his approval in November 1997, subject to the project securing the other funding necessary and to there being no further financial contribution to the project from the Secretary of State, whether through HIE or otherwise.

8. The EU funding also came with conditions, which meant that HIE would have to repay the full grant if any condition was breached. The key conditions were that:

- all contracts relating to the project must be let by December 1999;
- the funicular must operate for a period of 25 years from commencement with no change of purpose allowed;
- visitors must be prevented from accessing the mountain from the top station outside of the main skiing season to protect the fragile summit area;
- all construction must be complete by the end of December 2001.

Committee consideration

9. On 4 November 2009, the Committee received an initial briefing from the AGS on his report. The Committee then took evidence on 2 December 2009 from—

10. Sandy Brady, Acting Chief Executive and Director of Strategic Planning, Douglas Yule, Operations Director, and Keith Bryers, Head of Property and Infrastructure, Highlands and Islands Enterprise.

11. The Official Report of the Auditor General for Scotland’s briefing to the Committee and that of the HIE oral evidence are contained at Annexe B.[4]

12. The Committee’s focus was on the following areas—

[3] Prior to April 1999, the Scottish Office was the administrative department of the UK government with responsibility for Scottish affairs. The Scottish Executive took on some of these responsibilities after devolution. After September 2007, the Scottish Executive became known as the Scottish Government.

[4] The Committee notes that the statement by a witness from HIE that “Mr Blackshaw is one of a number of people who have been critics of the Cairngorm funicular project from its conception, right through its planning and construction and up to the present day.” (Col 1349) is disputed by Mr Blackshaw.

- risk identification and evaluation;
- costs and benefits;
- timing of HIE's actions;
- future plans.

These areas are explored in further detail below.

RISK IDENTIFICATION AND EVALUATION

Evaluation of risk

13. The AGS found that there were a number of risks facing the project at its outset such as climate change, the complexity of the project, re-instatement costs (potentially triggered by the EU condition regarding continuous operation for 25 years) and CML's weak financial position.[5] His report also found that a number of important changes affecting some of the project planning assumptions took place early in the life of the project which were likely to affect its viability but that HIE did not review and adjust the business case before construction started in 1999. The Committee sought more information on HIE's approach to these risks.

14. Sandy Brady outlined HIE's approach to the risks involved in the construction costs stating that—

> "We took a considerable amount of professional advice and, in the way in which we constructed and procured the railway, we tried to learn from the experience of other skiing resorts in Europe. We were very much aware of the fact that we were breaking ground."[6]

15. He stated that a project of this scale, initiated today, would be subject to the Scottish Government's Gateway Review process.[7] (Gateway reviews are carried out at key decision points in projects by experienced practitioners independent of the project team and aim to identify and address risks at key points in the process. The process provides assurance and support to responsible officers and should lead to more effective delivery of benefits, together with more predictable costs and outcomes.)

16. **The Committee believes that HIE's failure to review and adjust the business case before construction began reflected bad practice and was unacceptable. It is of the view that, as a result, considerable sums of public money were committed without a sufficiently rigorous process to evaluate the risk to those funds.**

17. **The Committee notes that current practices and procedures should ensure that business cases are re-examined at each key decision point in a project.**

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[5] CML's profits declined in the late 80's and it made losses in the early 90's.
[6] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, Col 1337.
[7] http://www.scotland.gov.uk/Topics/Government/ProgrammeProjectDelivery/Gateway-Review [Accessed 17 December 2009].

Visitor numbers and the business case

18. A key assumption in the business case was the number of visitors to Cairngorm. HIE used visitor number estimates in its business case for the project and took advice from independent consultants. However, these figures were not revisited in the light of new evidence which suggested that numbers were in further decline. In the funicular's early years, the numbers were broadly achieved but have declined in more recent years. Visitor numbers are made up of both skiers and non skiers. Sandy Brady said that "the numbers of skiers are considerably lower than we hoped for"[8] and attributed this to the availability and quality of skiing conditions on the mountain. He added that "we depend on snowfall and on the quality and length of the season that we can generate"[9].

19. With regard to the decline in skier numbers at Cairngorm and across Scotland, the AGS's report states that "HIE did not review the business case to take account of the changing situation before construction started"[10]. In explanation, Sandy Brady said that—

> "We were up against some tight deadlines, notably the deadline imposed by the European funding."[11]

20. He added—

> "Looking back at the skier numbers, one can see a pattern that perhaps suggests that we were not enjoying the numbers that we had enjoyed in the 1980s, but it was by no means clear at that stage that there was a long-term pattern."[12]

21. Sandy Brady also described the political environment in which HIE was operating at that time—

> "We had been given every political encouragement by the Secretary of State for Scotland. He wished to support the project and see it happen, particularly as the Government had committed £8 million to the redevelopment of the Aviemore centre and saw the two developments as very much complementary."[13]

22. **The Committee considers that HIE's failure to take account of the risk associated with trends in visitor numbers at the point of commitment to the project is indicative of the determination locally to proceed with the project and the political interest in the local economy which existed at the time. The combination of these factors meant that the project was pushed forward without proper regard to the risk to the public purse.**

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[8] Scottish Parliament Public Audit Committee. *Official Report 2 December 2009*, Col 1338.
[9] Scottish Parliament Public Audit Committee, *Official Report* 2 December 2009, Col 1338.
[10] Auditor General for Scotland's report: *Review of Cairngorm funicular railway* (AGS/2009/8), page 23.
[11] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, Col 1338.
[12] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, Col 1338.
[13] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, Col 1339.

23. **The Committee does not believe that the timetable imposed by the conditions of European funding excused project managers from taking all possible measures to protect the public purse from risk.**

24. **The Committee notes the Auditor General for Scotland's findings that HIE has improved its procedures for managing major projects.**[14]

25. **The Committee acknowledges the positive impact that the recent heavy snowfalls should have on visitor numbers, which should improve the financial position of the facility at the end of the current financial year. However, the Committee is also aware that the same weather patterns have, on a number of occasions, either prevented access to or caused closures of the facility, thereby preventing it from maximising its full potential in terms of visitor numbers and income.**

COSTS AND BENEFITS

The tendering process

26. The funicular railway project was divided into three main contracts or lots: for the train and systems; for the buildings; and for the civil engineering works.[15] The Committee wished to establish the details of the tendering processes which were employed at the outset of the construction. HIE had considered the use of a guaranteed maximum price (GMP) contract in order to gain protection from escalating costs but—

> "it became clear that a GMP contract was not achievable as the premiums required by tenderers to take on all the complex risks in the project were clearly going to be more than the remaining financial approval could accommodate."[16]

27. Morrison Construction Ltd won the contract for the civil engineering works. An Austrian company, Doppelmayr, was the successful bidder for the trains and systems lot. Three contractors bid for the buildings contract and all exceeded the available budget by a large margin. HIE asked all three tenderers to find savings to meet its budget but only Morrisons fully accepted this request. HIE decided that the lots for the buildings and the civil engineering works should be merged in an effort to find savings. Following advice from its project managers, Turner and Townsend, HIE entered into negotiations with Morrisons for a combined tender for the civil engineering works and the buildings.[17] Sandy Brady told the Committee that—

[14] Auditor General for Scotland's report: *Review of Cairngorm funicular railway* (AGS/2009/8), page 13.
[15] Auditor General for Scotland's report: *Review of Cairngorm funicular railway* (AGS/2009/8), page 15, para 52.
[16] Letter from Sandy Brady, Chief Executive of HIE to Convener, Public Audit Committee, dated 22 December 2009.
[17] Auditor General for Scotland's report: *Review of Cairngorm funicular railway* (AGS/2009/8), pages 15-16, para 58.

> "a package of changes was made, which included reducing the specification of the buildings, removing the proposed middle station building and considering suggestions from Morrisons about how it could tackle this unique project. That was undertaken in partnership with the company and with our professional advisers at the time."[18]

Cost overruns

28. As stated earlier in this report, consultants estimated in 1997 that the project would cost £14.8 million to build. However, because the EU funding award was £267,000 lower than expected, HIE set a target cost of £14.6 million.

29. The AGS's report stated that "as work progressed, Morrison's notified the project managers that they were incurring additional expenditure due to the complexity of the project and the need to find ways to limit damage to the mountains." In May 2001, Turner and Townsend indicated that total costs had increased to £15.2 million. By the time the final payment was made, in 2007, the total cost had increased to £19.54 million.

30. HIE outlined some of the key reasons for cost overruns on the project—

> "The major difficulty probably related to the replacement of the proposed steel beams on the rail track with concrete beams. Morrisons made that proposal with its tender. Construction of the tunnel was another challenging engineering issue, given the weather conditions, the altitude and the various environmental considerations."[19]

31. A shorter construction period than initially envisaged was necessary as a result of delays brought about by a judicial review into the project and a deadline imposed by the European Regional Development Fund deadline that all construction work be complete by the end of December 2001. Keith Bryers explained that—

> "by the time the job started, the contractor had a huge amount of work to do in less time than we had originally envisaged. The construction took place in a very constrained environment, in terms of getting materials up the hill, because the type of access road that you would usually expect was not available. The construction company had the use of an access road, but it was very constrained…helicopters had to be used to move concrete up the hill. All those things caused the project costs to increase."[20]

32. Sandy Brady stated that "we worked very hard throughout the construction process to try to find ways of ensuring that the overrun was contained."[21]

Contingency

33. The AGS's report stated that the contingency for the project, originally set at £645,000, was reduced to £7,667 following the higher than anticipated cost of the buildings.

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[18] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, Col 1342-1343.
[19] Scottish Parliament Public Audit Committee, *Official* Report 2 December 2009, Col 1342.
[20] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, Col 1345.
[21] Auditor General for Scotland's report: *Review of Cairngorm funicular railway* (AGS/2009/8).

34. During oral evidence, Sandy Brady said: "with hindsight, I have to agree with you that having a contingency of £8,000 is not the way in which we would normally approach the situation"[22].

35. **The Committee considers that the contingency for the project was inadequate and unrealistic.**

36. **The Committee accepts that there are inherent difficulties in accurately estimating the costs of such a novel project. Given this uncertainty, it was particularly important that an appropriate level of contingency was in place.**

37. **The Committee believes that proceeding with this level of contingency is another indication of HIE's determination to proceed with the project at any cost.**

Other costs associated with the project

38. As previously stated, the final total construction cost of the funicular came to £19.54 million. In addition to the cost of construction, costs were incurred on consultancy and marketing, support to CML for the company's running costs and for the purchase by HIE of buildings from CML. Witnesses confirmed that a total of £26.75 million of public money had been spent on the project to date. The sources of this funding break down as follows—

- HIE - £19.417 million
- Bank of Scotland ("the bank") - £3.618 million
- European Union - £2.613 million
- Highland Council - £1 million
- Cairngorm Trust - £0.101 million
- TOTAL from all sources - £26.749 million.

The Secretary of State's limit on public funding

39. When the Secretary of State gave his approval to HIE's contribution to the project in November 1997, it was subject to a limit of £9.39 million.

40. Witnesses explained that, as costs rose beyond this limit, authorisation was sought from the then Scottish Executive. HIE provided the Committee with a copy of a letter from the Scottish Executive's Enterprise and Lifelong Learning Department which stated that—

> "We do not…envisage any particular difficulty with the general proposal to raise HIE's delegated authority levels or the specific proposal for a revised funding package for the Cairngorm Funicular Railway Project."[23]

[22] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, Col 1346.
[23] Letter from Michael Lowndes, Director, Growing Business Group, Scottish Executive, to Douglas Macdiarmid, HIE, 7 August 2001

41. **The Committee notes that HIE sought and received the Scottish Executive's approval to spend more than the initial limit of £9.39 million imposed by the Secretary of State for Scotland in 1997.**

Cost per job

42. The project's business case anticipated a net employment impact of 115.5 jobs[24] created or retained which would produce a resulting net grant equivalent cost-per-job figure of £11,000 using Treasury formulas employed at that time. In 2006, an economic impact assessment commissioned by HIE indicated that the net employment impact of the facility was 174.5 jobs created or retained[25].

43. The Committee was interested to know what cost-per-job figure was actually achieved through the project. Sandy Brady said that—

> "We have not done the calculation in those terms. It was a Treasury formula that…is no longer in use.
>
> "We have focused on trying to understand whether the economic benefits that we set out in support of the project at the outset have been realised."
>
> "The original project approval paper proposed an output of something like 135 jobs from the project[26]; according to the most recent review, which was undertaken in 2005, employment of 232 full-time equivalents has been achieved in the Badenoch and Strathspey area, falling to something like 174.5 full-time equivalents at the wider Highlands and Islands level where, of course, displacement begins to come into effect. We are…very satisfied that the scale of economic benefits that we sought from the project have, in fact, been realised."[27]

44. He went on to explain that—

> "Although cost per job was one of the criteria that we employed in our appraisal processes in 1997, in line with Treasury guidance, the means by which projects' economic impacts and outcomes are assessed is now more sophisticated."

45. Mr Brady added that—

> "it is important to look at a facility that has now been in place for eight years and realise that it has created a stream of benefits over that period. The real value of that investment is the stream of benefits that it will create over the lifetime of the asset. To date, the indications are that, in relation to capital costs of £19.5 million, the stream of economic benefits has been, and will

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[24] The business case included a figure of 135 jobs, which included 19.5 FTE construction jobs, which would cease to exist once construction was complete.
[25] Auditor General for Scotland's report: *Review of Cairngorm funicular railway* (AGS/2009/8) Page 22, exhibit 11.
[26] The figure of 135 jobs in the business case included 19.5 FTE construction jobs, which would cease to exist once construction was complete.
[27] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1350.

> continue to be, well worth while, provided that the funicular railway can operate as a summer and a winter attraction."[28]

46. **The Committee notes HIE's view that the benefits of the Cairngorm funicular have outweighed the cost.**

47. **While the Committee accepts that cost-per-job is no longer used by the Treasury to assess the economic impact of projects, it is frustrated that no analysis exists which would allow a comparison to be made between the predicted outcome of £11,000 net grant equivalent cost-per-job and the outcome which was finally achieved.**

48. **The Committee believes that the absence of an outcome figure to compare with the project's anticipated cost-per-job figure inhibits its ability to understand fully what has been achieved in exchange for the investment by the public purse.**

HIE's current procedures for appraising the economic benefits of projects

49. Sandy Brady described the steps which are now taken by HIE prior to making decisions on major projects. These include an economic impact assessment which aims to provide "a clear estimate of the benefits that would be realised from the project[29]." The economic impact assessment is then compared with the proposed funding for the project—

> "We look in the round at the economic benefits that we expect to get from a project and at how we will ensure that those benefits are driven out in reality, if the project is implemented. We then consider whether we can justify the level of funding that we have been asked to provide, either individually or in partnership with other public agencies."[30]

50. Mr Brady stated that "every project officer in HIE goes through considerable project appraisal training to ensure that they apply consistent and up-to-date standards[31]".

51. **With regard to current practices on making major investment decisions, the Committee notes HIE's assurances on the deployment of latest evaluation techniques and training for project officers.**

52. HIE described a recent decision to invest in the European Marine Centre in Orkney which would have failed a traditional cost-per-job analysis but could have a significant potential positive impact on the Scottish economy.

53. **The Committee accepts that some worthwhile projects may fail a traditional cost-per-job test but remains concerned that the relationship between capital input and job creation and retention is no longer measured.**

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[28] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1352.
[29] Scottish Parliament Public Audit Committee. *Official Report 2 December 2009*, Col 1353.
[30] Scottish Parliament Public Audit Committee. *Official Report 2 December 2009*, Col 1353.
[31] Scottish Parliament Public Audit Committee. *Official Report 2 December 2009*, Col 1353.

54. **The Committee recommends that the Scottish Government considers whether there would be merit in reintroducing an output measure which would assess the relationship between capital input and job creation and retention with regard to major investments.**

TIMING OF HIE'S ACTIONS

HIE's decision to take over CML

55. HIE took over the funicular's operator (CML) in May 2008, although the decision to do so was taken in August 2007. During the years between the completion of the facility (in 2001) and the takeover, CML had suffered substantial losses. The company returned a profit during the 2007-08 financial year with modest profits and losses in the preceding three years.[32]

56. The following figures for CML's losses and profits were provided by HIE to the committee:

Year	Profit/Loss £k
1996	9
1997	-607
1998	-625
1999	-110
2000	-583
2001	-793
2002	-1876
2003	-1246
2004	-612
2005	28
2006	32
2007	-263
2008	174
2009	-43

57. Given CML's earlier poor financial performance, the Committee wished to ascertain why HIE had taken the decision to take the company over at a time when its financial performance had seen some recent improvement.

58. Douglas Yule described how the company's losses escalated because of interest charges on its borrowing and the pressures of running the new facility. He said—

> "A co-operative creditor arrangement was entered into in 2004, whereby the bank reduced the interest rate, Highland Council deferred interest on its loan and HIE adjusted the rent. In that co-operative manner, we were able to improve the business model and the return to the bank was pushed out for a number of years until sustainability was achieved.

[32] Letter from Sandy Brady, acting Chief Executive of HIE to Public Audit Committee. 22 December 2009.

> At the same time, the snow conditions were having a significant effect on the trading performance of the company. During that period, skier numbers fluctuated, but costs continued to rise and the overdraft limit continued to increase until, in 2007 and 2008, the bank began to exert a little more influence and pressure. At one point, it decided to change the interest rates unilaterally. That led us to further discussions with the other creditors, because we felt that that was a breach of the previous creditor arrangement."[33]

59. In 2007, negotiations took place between HIE and the bank and a figure was agreed to release the bank's security over the asset. Douglas Yule said—

> "We agreed a figure with Highland Council for its debt and for releasing the standard securities. We gained control of the asset, bought out all the debt, provided stability to the company, and protected the local creditors. In the round, we felt that that was a positive outcome at that moment, especially given the external factors."[34]

60. **The Committee understands that HIE faced the risk that it could lose control of an asset in which it had invested considerable sums and notes HIE's explanation that its actions were precipitated by the bank's changing attitude.**

61. Highland Council received £1 for the £1 million it was owed and the Cairngorm Mountain Trust also received £1 for its remaining shares in the company. (Its initial stake was £101,000). Douglas Yule stated that HIE paid the bank (who had invested £3.618 million in the project) a sum of money for its security over the asset. The exact nature of this sum was the subject of a legally binding confidentiality agreement due to reasons of commercial confidentiality.[35] In justifying this arrangement, Douglas Yule said—

> "We went into the arrangements with the best advice from some of the best insolvency practitioners. The negotiations were based on their advice. That advice went before the HIE board, which has the authority to decide on such issues."[36]

62. Mr Yule confirmed that the board of HIE and HIE's sponsor team within the Scottish Government were aware of the arrangement and the sum of money involved. The Committee understands that the figure was also available to HIE's auditors.

63. HIE gave an undertaking to request permission from the Bank of Scotland to release the figure to the Committee. As a result of this request, the bank agreed to the disclosure of the sum. In a letter to the Committee[37] Sandy Brady stated that HIE paid the bank £145,000 for the assignation of its rights in the debt in Cairngorm Mountain Ltd and the subsequent discharge of its securities.

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[33] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1356.
[34] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1358.
[35] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1358-61.
[36] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1361.
[37] Letter from Sandy Brady, acting Chief Executive of HIE, 22 February 2010.

64. **The Committee accepts that HIE entered into a confidentiality agreement with the bank, based on advice from insolvency practitioners, in order to secure the best value for public funds.**

65. **However, the Committee considers that this type of arrangement prevents it from fully holding HIE to account for the use of public money. The Committee considers that there should be a general presumption of disclosure of transactions.**

66. **The Committee welcomes the decision by the bank to waive the confidentiality agreement in this instance.**

67. **The Committee recommends that the Scottish Government considers producing guidance on how public bodies, working in partnership with private organisations such as banks, can approach issues of financial confidentiality in a way which will promote transparency in the use of public funds.**

FUTURE PLANS

68. The board of HIE considered options for the future operation of the funicular railway at its board meeting on 8 December 2009. On 9 December, HIE announced that that it will spend up to £4 million over the next three to four years on the funicular with the intention that it would be brought up to a standard that would attract a new operator from the private sector.

69. Witnesses confirmed that CML is a "highly marginal business"[38] which has returned a loss in most years since 1995. Douglas Yule informed the Committee that the company was running at a loss in the current financial year but that this was in line with budgets laid down for the year. The company aimed to break even at the year end or return a surplus.

70. Douglas Yule added that—

> "The challenge for the future is how to increase the numbers of non-skiing visitors throughout the year, given the uncertainty of snow and skiing conditions. That remains an opportunity for us."[39]

71. Sandy Brady told the Committee that HIE's consultants had advised HIE that there is potential to grow the business. He added that—

> "as the owner of the operating company as well as the railway, HIE faces the further challenge of devising a suitable business model to ensure the future viability of the attraction as a business in its own right and a driver of the wider economy."[40]
>
> and

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[38] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1362.
[39] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1362.
[40] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1334.

> "We need to work hard with the company over the next couple of years to be able to develop a business entity that will take on the railway and run it on behalf of HIE, as the owner of the infrastructure on the hill."[41]

72. Sandy Brady envisaged a lease arrangement in the medium term, with the option to sell the business should it prove attractive to a buyer in the longer term.[42]

73. The AGS's report[43] made a number of recommendations regarding the development of a new business model for the funicular. These centre on the identification of new user groups for the facility with the aim of creating a sustainable and attractive business opportunity. The recommendations also focus on clarity of objectives and full assessment of risks and constraints facing the facility.

74. **The Committee considers that the weak financial position of CML was not properly addressed in the project's original business case and that the company's losses have created a call on public resources which was not foreseen.**

75. **The Committee is concerned that, given the history of loss-making by the business, HIE's commitment to the project appears to be open-ended.**

76. **The Committee believes that the potential for HIE to reduce or conclude its responsibility for the facility clearly hinges on its ability to transform the business.**

77. **The Committee concurs with the Auditor General for Scotland's recommendations for the development of a new business model for the funicular.[44] In particular, HIE must ensure that its plans are based on sound, realistic performance information and employ rigorous financial control measures**

78. **The Committee asks that HIE is absolutely clear about the extent of its financial support for the facility and that this support is not open-ended. In doing so, HIE must have regard to the impact on other priorities and projects within its portfolio.**

79. **The Committee wishes to be kept informed of the future plans for the funicular and to have sight of a detailed business plan once it becomes available.**

80. **The Committee asks that the AGS, through the audit process, maintains his scrutiny of the future business model for the funicular.**

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[41] Scottish Parliament Public Audit Committee, *Official Report 2 December 2009*, col 1363.
[42] Scottish Parliament Public Audit Committee, *Official Report* 2 December 2009, col 1364.
[43] Auditor General for Scotland's report: *Review of Cairngorm funicular railway* (AGS/2009/8), page 26.
[44] Auditor General for Scotland's report: *Review of Cairngorm funicular railway* (AGS/2009/8), page 26.

CONCLUSION

81. **The Committee concludes that HIE failed to properly evaluate a number of significant risks - such as the viability of CML and the possibility of a decline in skier numbers - at the outset of the project.**

82. **The Committee considers that the decision to proceed with the project even after its contingency was all but exhausted is symptomatic of the momentum which such projects gather and the inability to call them to a halt when costs begin to exceed expectations.**

83. **Given HIE's open-ended commitment to the project, the Committee considers that the new business model for the funicular must be founded on a realistic assessment the future viability of the facility.**

84. **The Committee asks HIE to provide evidence to demonstrate that its current procedures and control systems produce dependable budget estimates and reduce the risk of cost overruns of this nature for major projects.**

85. **In terms of the public sector more generally, the Committee asks the Scottish Government to provide evidence to demonstrate that its current procedures and control systems produce dependable budget estimates and reduce the risk of cost overruns of this nature for major projects.**

ANNEXE A – EXTRACTS FROM THE MINUTES

16th Meeting, 2009 (Session 3) Wednesday 4 November 2009

Section 23 report - Review of Cairngorm funicular railway: The Committee received a briefing from the Auditor General for Scotland on his report entitled "Review of Cairngorm funicular railway".

Consideration of approach - Review of Cairngorm funicular railway: The Committee considered its approach to the Auditor General for Scotland's report entitled "Review of Cairngorm funicular railway". The Committee agreed to invite the Accountable Officer to give oral evidence on the report.

18th Meeting, 2009 (Session 3) Wednesday 2 December 2009

Section 23 report - Review of Cairngorm funicular railway: The Committee took evidence on the Auditor General for Scotland's report entitled "Review of Cairngorm funicular railway" from— Sandy Brady, Acting Chief Executive and Director of Strategic Planning, Douglas Yule, Operations Director, and Keith Bryers, Head of Property & Infrastructure, Highlands and Islands Enterprise.

Consideration of evidence - Review of Cairngorm funicular railway (in private): The Committee considered the evidence received at agenda item 2. The Committee agreed to write to Highlands and Islands Enterprise to seek further information on points raised during evidence. The Committee also agreed to consider the next steps in its inquiry at a future meeting.

1st Meeting, 2010 (Session 3) Wednesday 13 January 2010

Consideration of approach - Review of Cairngorm funicular railway: The Committee agreed to defer this item to a future meeting.

2nd Meeting, 2010 (Session 3) Wednesday 27 January 2010

Consideration of approach - Review of Cairngorm funicular railway (in private): The Committee considered the next steps in its inquiry in the light of evidence received on the Auditor General for Scotland's report entitled "Review of Cairngorm funicular railway". The Committee agreed to consider a draft report at a future meeting.

3rd Meeting, 2010 (Session 3) Wednesday 10 February 2010

Section 23 report - Review of Cairngorm funicular railway (in private): The Committee considered a draft report on the Auditor General for Scotland's report entitled "Review of Cairngorm funicular railway". The Committee agreed the contents of the report, subject to a number of revisions to be agreed by correspondence

4th Meeting, 2010 (Session 3) Wednesday 24 February 2010

Section 23 report - Review of Cairngorm funicular railway (in private): The Committee agreed the contents of and publication arrangements for its report on the Auditor General for Scotland's report entitled "Review of Cairngorm funicular railway".

Section 23 Report

"Review of Cairngorm funicular railway"

10:06

The Convener: Item 2 is consideration of a section 23 report entitled "Review of Cairngorm funicular railway". I ask the Auditor General to give us a briefing.

Mr Robert Black (Auditor General for Scotland): Good morning. My report on the Cairngorm funicular railway was published on 8 October and looks at the involvement of Highlands and Islands Enterprise—which, if members do not mind, I will call HIE from now on—with the funicular over the 17 years since the start of the project. It looks at the appraisal of the business case, the building of the funicular and HIE's role in trying to secure the benefits from it, including the decision last year to take over the operating company, which is called Cairngorm Mountain Ltd.

There has been a great deal of public interest in the funicular since it was first proposed. From the correspondence that I understand it has received, the committee will be aware of the continued interest in the subject. As the committee will appreciate, the report covers a long period. The initial stages of the funicular project took place before the post of Auditor General for Scotland or Audit Scotland existed. However, we have included a commentary on the earlier stages to provide as full a picture of events as possible.

The project's life cycle spans the systems of government that existed before and after devolution and the different administrative arrangements between HIE and its sponsor body. Also, HIE has changed its methods of operating, in particular the way in which it appraises major capital projects. Audit Scotland has tried to take account of those factors in preparing the report.

As the committee will recall, I had hoped that my report would review the plans for the new business model that HIE is developing for the funicular. I delayed publishing my report earlier this year to accommodate delays in HIE's work on that. However, as further delays were expected and would have prevented me from publishing until spring or summer next year, I thought that I should publish my findings to date. I have not included any assessment of the future business model. Audit Scotland will review HIE's work on that when it becomes available.

I would like to highlight to the committee three key areas of the report: first, the appraisal of the business case and the risks facing the project; secondly, the costs and benefits of the project; and lastly, the support that HIE has provided to the operator to protect the public investment that has been made so far and to keep the funicular open.

I turn first to the business case and risk assessment. The business case for the funicular was subject to appraisal by HIE's board, the then Scottish Office and the European Union in 1997. The appraisal and approval process met the expected standards and requirements that existed at the time. The National Audit Office examined the process in 1999 and found that the appraisal covered the expected examination of the economic, environmental and financial impact of the project that was required at the time. HIE was aware that the project faced risks such as the complexity of constructing the funicular and the need to meet strict environmental requirements, but thought that the funicular would bring economic benefits to the area. Ultimately, its decision to invest was a matter of judgment.

However, early in the project, there were a number of important changes that were likely to affect its viability. HIE did not review or adjust the business case before construction started in 1999 to take account of, for example, the declining number of skiers and the evidently weak financial position of the operating company. On page 17 of the report, exhibit 9 illustrates the downward trend in visitor numbers and in the financial performance of the operating company between 1997 and 1999.

Since the 1990s, there have been significant improvements in how projects are appraised and managed, and HIE has improved its procedures in line with that. It is perhaps worth noting that some of the findings on the funicular are similar to those that I presented to the committee in our review of major capital projects last year.

I turn now to the benefits of the funicular and its cost. HIE saw the funicular as a key development in the regeneration of the Strathspey area, and the business case identified a number of economic and other benefits to which the funicular was expected to contribute. Before I discuss that further, it is worth noting that assessing economic benefit is widely recognised as being hard. It is a challenging task because of the difficulty in attributing impacts or benefits to a single event.

In 2006, consultants reported that the funicular had delivered the expected employment and economic benefits. The consultants estimated that, across the Highland area, the employment impact in 2006 was 174.5 full-time equivalent jobs created or retained, compared with the expected 115.5 jobs created or retained when the funding was approved. In addition, the consultants found that there had been significant new investment in the Aviemore area and greater use of the area by tourists. In keeping with our usual approach, we did not independently review the consultant work. However, the final cost of the funicular was also much higher than expected. It cost £19.5 million to build, which was almost £5 million more than planned. HIE and the European Union funded that, with HIE contributing £16.9 million, which is 87 per cent of the total building cost.

Finally, I would like to say a little about the other support that HIE provided to the operator to help to secure its continued operation and to protect the public sector's investment.

In addition to the sums that I have just mentioned, HIE provided a further £2.5 million to the operator, as well as other support to develop the funicular and to keep it running. HIE bought the existing buildings from the operator and later reduced the rent to be paid by the operator for the use of the funicular. HIE also provided funding to improve the marketing and health and safety of the facility. In addition, Highland Council, the Bank of Scotland and the Cairngorm Mountain Trust provided funding of almost £4.7 million. That brings the total cost to date of building the funicular and supporting the operator to £26.75 million, of which £23 million was from the public purse.

HIE invested a great deal of money, time and effort in the project to try to ensure that it delivered the benefits that were anticipated in the business case. However, despite HIE's assistance, the operator struggled financially following the opening of the funicular. It made a loss of more than £262,000 in the year to April 2007.

In 2008, HIE took over the operator to protect the public sector investment and to keep the funicular running. HIE employed consultants to assist it to develop a new business model for the funicular, but the report was delayed until September of this year, and I understand that HIE expects to discuss options at its board meeting next month.

Although HIE hopes to find a new operator for the funicular, that might prove difficult in the current economic climate. It is important to state that, if HIE cannot establish a viable business model for the funicular, and it ceases to operate, HIE might have to reinstate the land, repay the EU's money and meet any other costs. I emphasise that we do not know at this stage whether that is likely, but the scenario carries those risks, so I feel obliged to mention it to the committee.

The committee will note that the report includes a number of recommendations for HIE, such as that it needs to consider rigorously and fully the risks and challenges that the funicular faces and to ensure that any prospective operators are fully aware of them. I am sure that HIE will take those recommendations on board in developing the new business model, which it is shortly to consider.

As ever, the Audit Scotland team, who are masters of the detail of the report, will help me to answer any of your questions.

10:15

The Convener: It would certainly be useful for any consideration that we might make if we had access to the future business model and your comments on it. What is the likely timescale for that?

Mr Black: To some extent, we are in the hands of HIE and its decision-making timetable. The latest indication is that it will consider its options in December. What happens after that is unclear. I have asked that the auditor continue to review that, which I can guarantee to the committee. I expect the audit for the current financial year of 2009-10 to include an audit review of HIE's business model as and when it becomes available, and I expect it to be mentioned at the conclusion of the audit of 2009-10 at the very latest. We cannot offer a guarantee if the committee wishes to have something sooner than that, because we are in the hands of HIE and its decision-making process, but I can certainly give an undertaking that the matter will be covered in the audit of the current financial year.

The Convener: Thank you. On page 7, in part 1 of the main report, you say:

"The appraisal and approval process for the funicular met requirements at the time."

Did you consider whether the decision was correct?

Mr Black: It was a policy decision for HIE and the Scottish Office to make. The Scottish Office, the EU and HIE took a policy decision to commit to the investment. It would not be appropriate or possible for us to revisit that.

James Kelly (Glasgow Rutherglen) (Lab): You have looked back over a long period of time. It is clear that, at the outset of the project, the risk assessments and monitoring were not as robust as they are now—Audit Scotland is now in place, which I am sure reassures people. One of the things that really concerns me, which has already been alluded to, is the amount of time that HIE has taken to consider its options. That is noted in the submission from the local conservation group. HIE commissioned the consultants in December 2008 to examine the business model, which is crucial in order to assess whether it is sustainable in the longer term. For some reason, the report was not available in March 2009. It became available in September 2009, but it will be December before the options are considered. Given that the project is crucial to the local area, I am concerned that it has taken a full year for HIE to commission the work and to start to consider the options.

The Convener: Do you want to comment on that?

Mr Black: I absolutely acknowledge Mr Kelly's point. As I said earlier, I would be surprised if HIE were not facing considerable challenges in getting a business plan together with private sector involvement, given that, as we note in the report, in the past financial year the draft accounts for the 11-month period ending March 2009 showed a loss of almost £43,000 before tax—that is from the unaudited accounts. There is still the problem of a loss-making facility against the background of no change in the overall business environment within which the funicular operates.

Willie Coffey (Kilmarnock and Loudoun) (SNP): Let us turn to the initial financial planning stages that are outlined in the Auditor General's report. The report says that all the correct practices at the time were followed. However, the comments on page 2 of the key messages report relating to contingency set-aside for the project show that, even in the early stages, the project was woefully short. Standard practice was to set aside 15 per cent of the contract value for contingencies, which would have given the project a £2 million set-aside. However, even in the early stages, only £645,000 was set aside and that figure fell to a paltry £7,600 contingency set-aside, so even in the early stages, sadly, alarm bells were ringing about the financial planning for the project. Was Mr Black involved at that stage or were his predecessors? The evidence shows clearly that there was something seriously wrong with the financial planning for the project.

Mr Black: We are not well placed to assist the committee on the detail of the factors that were taken into account in making the initial decision. It was a long time ago and we do not have all the information that was available. A contingency provision was made, and we know that it was significantly reduced when HIE received tenders that were higher than the estimated amounts. HIE drew back the contingency provision, which would have been a warning sign. I imagine that, at the time, HIE was focused on trying to contain the overall cost to the public purse to the cash limit that the then Secretary of State for Scotland had indicated would be the absolute limit.

Does Mark MacPherson want to add to that?

Mark MacPherson (Audit Scotland): HIE's internal audit team carried out some work subsequent to the construction of the funicular railway that identified that very issue. It said that the contingency level was too low for a project of that scale, especially when it was reduced to the figure of around £7,000, to which you referred.

Willie Coffey: I have another question. The committee has seen reports on other projects in respect of which the estimates for visitor numbers or whatever were inaccurate. The VisitScotland report, for example, showed that the estimates were hugely optimistic about the number of visiting skiers and that such optimism was not borne out. I wonder what kind of rigour is applied in making estimates for such projects. The more optimistic a project is in the early stages, the more viable the business plan appears to be. How do we challenge such assessments and estimates and get better at making them? Obviously, 10 years ago we were woefully wide of the mark again.

Mr Black: As we noted in the review of major capital projects and how they were managed last year, the world has moved on significantly in the years since devolution, and project appraisal and management are now significantly stronger than they were in the early days. However, that is not to say that no risks are associated with those processes. It is important that those who make the principal decisions on such matters prepare their analyses thoroughly, and that those analyses are subject to independent challenge and testing for their robustness before funds are committed. That goes without saying, but there can never be guarantees in such matters.

Willie Coffey: If that kind of rigour had been applied at the time, would the project still have been given the go-ahead, or is that inviting you to comment on something that you would rather not comment on?

Mr Black: I would prefer not to comment on that, if you do not mind.

Murdo Fraser (Mid Scotland and Fife) (Con): I thank Audit Scotland for its report, which is extremely useful and informative. It shines a light on a project that has disclosed some serious weaknesses, for which we should be grateful to Audit Scotland. I have several questions through which I will try to probe the facts behind the report.

First, I wish to ask about the business case. Exhibit 9 on page 17 shows visitor numbers. When the business case was approved in 1997, it was against a backdrop of eight or nine years of sharply falling skier numbers at Cairngorm, as far as I can tell. By 1997, the number of visitors seemed to be roughly half what it had been 10 years previously. Mr Black, you said that HIE did not review the project at that stage to consider the effects of the decline in skier numbers on the project. Do you regard that as a serious weakness on the part of HIE?

Mr Black: My short answer is that it was a weakness. It is reasonable to expect HIE to have revisited the business case at that point and to have recalibrated some of its calculations, taking into account the fact that the operator was struggling financially. With the operator struggling financially in that climate, it would have been reasonable for HIE to take full account of what that implied for the company as a future going concern. We do not have full access to the records from that time, but on the basis of the information that is available to us, it is our understanding that there was no reappraisal at that point.

Murdo Fraser: That is helpful.

Let me go on to a slightly different tack, with some questions about the cost to the public and the economic benefit of the project, which is covered in exhibit 11, on pages 21 and 22 of the report. I am not sure whether you have had access to the submissions that committee members have received from Ramblers Scotland and the Badenoch & Strathspey Conservation Group, but they question some of the assumptions behind Audit Scotland's report, which are in the Burns and Westbrook consultants' report, on which I think you base some of your findings.

On the cost to the public, paragraph 13 of the Audit Scotland report says:

> "since 2001, the total cost is £26.75 million",

of which £23 million is public funding. However, as you say in paragraph 99, there was an additional cost to HIE from acquiring the operation, and,

> "For reasons of commercial confidentiality",

it is not possible for you to disclose what that sum was. The committee has been here before. You will understand our frustration that we cannot get a complete picture of the expenditure of public funds where commercial confidentiality prevents such a disclosure. Do you accept that the additional costs will be higher than what is in your report? Do you also accept that there is a cost to Government of borrowing £23 million to fund the expenditure, which also requires to be accounted for?

Mr Black: I will ask Mark MacPherson to help us with this, but I re-emphasise one point to the committee first: we did not re-perform any of the calculations that were undertaken by the consultants. We say in our report that the costs and benefits were from the findings in the consultants' report. None of the numbers that are reflected in our report are our numbers. I ask Mark MacPherson to help with the background.

Mark MacPherson: It is worth clarifying that the outcome figure of £19.54 million that is given in exhibit 11, to which Mr Fraser refers, is the total construction cost. Elsewhere in the report, we highlight the other support that was given to the operator to assist it to make the business viable.

On the point about disclosure, the full amount, including the payment that was made by HIE to the bank, is included in the overall figure of £26.75 million; it is just that we cannot provide the breakdown of how that was paid for by HIE in buying the debt.

Murdo Fraser: It is helpful to get that clarity.

Let me also ask you about "Employment impact", which is covered at the foot of page 22. The final line of exhibit 11, at the bottom of that page, gives the net grant equivalent cost per job, according to the business case, as £11,000. According to calculations provided by Ramblers Scotland, if it is a simple matter of dividing the total cost of £23 million by the 174.5 jobs created, the average cost to the public per job is more than £131,000. I know that exhibit 11 has no outcome cost to the public purse to compare with the cost in the business case, but do you accept that the outcome cost is higher than the £11,000 in the business case?

10:30

Mark MacPherson: We cannot say with absolute certainty that the outcome figure is higher. It is clear that the figure of £11,000 was not calculated simply by dividing the original expected total cost of £14.8 million by the expected number of jobs—doing that would have produced a much higher figure. I understand that the cost-per-job calculation that HIE used took account of other factors, such as the type of financial assistance that was to be provided and comparative interest rates.

It is unfortunate that HIE has not calculated the outcome cost and no longer uses such a measure. We have been unable to secure the data that would allow us to perform a similar calculation. HIE used a spreadsheet to calculate the figure but we have no access to the detail of that and HIE no longer has it.

Mr Black: To support what Mark MacPherson said, I will say that I would have been far happier had we been able to access the original spreadsheet and look at the numbers, but time has moved on and the original calculations are no longer available. All that we had for the report was the figure that HIE supplied to us.

Murdo Fraser: We should pursue the issue with HIE, convener. The committee will discuss that later.

Mark MacPherson: You also referred to the cost of borrowing. We have no evidence to suggest that borrowing was undertaken specifically to fund the investment.

Nicol Stephen (Aberdeen South) (LD): The trading position of any ski operating company in Scotland is vulnerable and weather dependent. I am interested in the figures on pages 24 and 25, which go into detail about what is in the graph on page 17, to which Murdo Fraser referred. Paragraphs 92 to 94 and paragraphs on page 25 go into greater detail about the financial position.

I will ask about the company's trading position and its losses. Some figures from the early part of this decade are truly staggering. The losses were £1.875 million in the year to April 2002, £1.209 million in 2003 and £576,000 in 2004. Paragraph 95 says that in the middle of the decade, the position stabilised at

"a small loss of £36,000 in … 2005 and a small profit of £32,000 in … 2006."

However, a larger loss of £262,500 in 2006-07 seems to have triggered HIE's intervention.

Year after year of major losses in the early part of the decade triggered lots of action but no intervention—HIE did not bring the company into public ownership. Yet once things started to stabilise—as reflected in the graph on page 17 on the trading position and visitor numbers and as shown by the fact that in 2008, when the company was taken into HIE's ownership, it reported a profit of £173,000—HIE intervened.

Today, we are talking about the possibility, which I very much hope does not occur, of removal, reinstatement and repayment to the EU. Can we be given greater insight into the simple question of why now? Why did HIE intervene in 2008, when the position was levelling out for the first time? The poor trading position—the loss—in 2007 is attributed to a poor year for skiing visitors, rather than a new development that affected the funicular railway. I ask a simple question.

Mr Black: I invite Mark MacPherson to give a full and detailed answer. As context, I hope that the committee finds exhibit 9 helpful, because it demonstrates that CML's financial performance was such that it did not make profits in any year after about 1991. The trend after that up to the very recent past has been one of year-on-year failure to make a net profit.

I was asked whether it would have been appropriate for HIE to revisit some of the risks before it committed the funding. In paragraph 75 on page 18 of the report, we start the story by describing how

"CML was struggling financially. In 1997 and 1998, CML reported losses of £607,000 and £625,000 respectively".

That was a high percentage—between 33 and 48 per cent—of its annual turnover. The problem goes right the way back, to well before devolution. As Mr Stephen indicated, we attempt to give a résumé of what has happened subsequent to devolution. I invite Mark MacPherson to answer Mr Stephen's questions.

Mark MacPherson: It is important to recognise that HIE provided support, including financial and other support, throughout the period, which probably helped the position in the short term. The improvement in the overall position was not all of CML's making. Mr Stephen asked why HIE acted when it did. HIE was concerned that, given that it was not the only body that had an investment in the funicular and its operator, the operator's position would be threatened if it did not manage to turn matters around. For example, the bank had an on-going interest because of a loan that it had made to the operator; we understand that it may have wanted to pursue that. HIE decided that, in the circumstances, it needed to take further action to secure the future of the funicular and the public investment that had been made in the asset.

Nicol Stephen: When HIE took the asset into its ownership, was it aware that in the trading year concerned a profit was about to be made? Mr Black, did you say that that was the first profit that had been made ever, or the first that had been made in many years?

Mr Black: The first in many years.

Nicol Stephen: I think that you said that, after punitive losses in previous years, it was the first profit that had been made since 1991. The report states that the management accounts for an 11-month period in 2008-09 show a loss of £42,000. Do we have the full-year position, now that matters have moved on from March?

Mark MacPherson: CML has moved to match HIE's financial year, so that is now the end of the financial year. We will not know the overall yearly position until the end of the next financial year.

Nicol Stephen: Okay, but it would not be unreasonable to expect that the company's full-year position would be a loss of £40,000 to £50,000.

Mark MacPherson: It is difficult to say. We know, for example, that in the month that followed the end of the financial year there were a further 19,000 visitors, which might have had a positive impact on the figures. We cannot say that without seeing the financial statements for the period.

Nicol Stephen: I come back to the basic principle that the figures tend to support the suggestion that the situation has stabilised significantly compared with the early part of the decade, when multimillion-pound cumulative losses were racked up.

Mark MacPherson: It is difficult to say. We know that the increase in visitor numbers throughout the rest of the year—non-skiing visitors—has had a positive impact on the position, because those visitors generate income. However, the funicular is still very dependent on skiing visitors. If last year was a good year for skiing, that may have influenced the position. If the following year is a poor year for skiing, income could again take a significant dip. No one knows for certain what the weather will be.

Nicol Stephen: Is it fair to say that the figures in the graph in exhibit 9 indicate that skiing numbers have continued to decline, as Murdo Fraser highlighted, to 50,000 visitor days—if that is how the numbers are calculated—whereas, because of the funicular, the figure for non-skiing visitors has risen to more than 150,000 visitor days?

At Cairngorm, we now have a visitor attraction, if we want to look at it in that way, and 75 per cent of visitors are non-skiing. Only 25 per cent of the total is dependent on skiing, in broad terms. If the funicular element of the Cairngorm centre was removed, the skiing would clearly not be viable.

Mark MacPherson: There are other methods of uplift on the mountain, but the funicular takes passengers straight to the top of the slopes. If they ski down part of the mountain, they can then use other methods to return to the top from another point. However, the funicular is the primary uplift method for skiers. It has the greatest capacity on the site.

Nicol Stephen: Yes, but as Murdo Fraser said, the number of skiing visitors has halved since the funicular was introduced in the early part of the decade. I find it hard to believe that any alternative skiing proposition or company could have a remotely profitable and sound trading position at Cairngorm. The funicular is now heavily dependent on non-skiing visitors.

Mark MacPherson: Of course, it needs the skiing visitors as well. Without them, it would be in a far worse position. However, I cannot comment on whether there is a viable skiing opportunity there. That is one of the challenges that HIE faces in its overall consideration of what to do with the funicular.

Willie Coffey: That brings us nicely back to the business model, which we are eagerly awaiting but which is taking almost a year to deliver. Nicol Stephen's remarks probably give us a hint as to why it is taking so long. In my view, it cannot be based on skiing as the core business activity. Given the figures in the report, it seems clear that it will be based on the related business activity.

Is there any more information about why it is taking a year to put the business case together? I know that Mr Black felt compelled to publish his report before the business case was produced, and members have suggested that we are desperately keen to see it. Why is it taking so long?

Mr Black: We do not have access to that information. You would require to put that question to HIE.

The Convener: Can I take you back to a comment that was made in passing? If HIE decided to close down the operation and financial support was withdrawn, what would be the costs to the public purse through HIE and the European funding that you mentioned? If the decision was made to close it, what would be the associated costs?

Mr Black: I invite Mark MacPherson to help with that. I hope that you do not mind me saying this, convener, but we would not want to start any rumours about that, because we do not know whether it is a remote possibility or a significant risk.

Mark MacPherson: The major financial risk to the public purse is the cost of the reinstatement that would be required by the conditions under which the funding was approved. We mention that in paragraph 105 of the report, on page 25. HIE was at pains to stress to us that the £30 million to £50 million figure that is quoted in that paragraph is purely speculative. It has done no detailed validation work, and nor have we, on the likely cost of reinstatement. However, it is likely that there would be a high cost associated with that.

There would also be a requirement to repay the EU grant of £2.6 million to £2.7 million, and there might be other costs such as redundancy costs if the terms and conditions of employment required that.

The Convener: If previous experience is anything to go by, £30 million to £50 million could be a conservative estimate.

10:45

Mr Black: That highlights the difficulties of exit strategies from major projects, which one comes across from time to time in the public sector. This is a classic case of that problem. Once one is committed, it can often be difficult to get out at a reasonable cost. It might well be that we are now facing that risk, and it might well explain in part the care that HIE is taking in developing a business model for the future.

The Convener: HIE is in a difficult situation. There is no suggestion that the plug should be pulled but, if the worst came to the worst, huge costs would be associated with doing that, although we do not know exactly how much they would be. I presume that one thing that has been considered is how the lessons can be applied to other projects, as we have tried to do with other reports. I also presume that consideration has been given to where improvements can be made to this specific process. The future business model is critical if we are to come to any sensible conclusion about what should happen, so we are at a slight disadvantage in that we do not have access to it at present. However, we can consider that when we discuss the issue later.

As members have no further questions or comments for the Auditor General, I thank him and his team for that briefing. We will return to the issue later in our agenda.

Section 23 Reports

"Review of Cairngorm funicular railway"

10:02

The Convener: Following a report from the Auditor General for Scotland, the committee decided to take evidence on the "Review of Cairngorm funicular railway". I welcome to today's meeting Sandy Brady, the acting chief executive and director of strategic planning at Highlands and Islands Enterprise; Douglas Yule, operations director at HIE; and Keith Bryers, head of property and infrastructure at HIE. Mr Brady has indicated that he would like to make some opening remarks.

Sandy Brady (Highlands and Islands Enterprise): Cairngorm funicular railway is a unique Scottish visitor attraction and one of the most challenging projects ever undertaken by Highlands and Islands Enterprise. The project's planning, construction and operation have been thoroughly reviewed by Audit Scotland. HIE accepts in full the findings of that review. In particular, we note that although HIE followed accepted practice on project appraisal and management when the funicular was designed and built, those standards have now moved on. Our current procedures are more rigorous, as the review indicates.

We are pleased with the review's conclusion that the funicular succeeded in creating employment and achieving the wider economic benefits that it was designed to deliver. It has triggered significant further investment in Aviemore and Strathspey, created a year-round operation that provides continuous employment at CairnGorm Mountain Ltd, and attracted a greater number of visitors to the area.

Today, as the owner of the operating company as well as the railway, HIE faces the further challenge of devising a suitable business model to ensure the future viability of the attraction as a business in its own right and a driver of the wider economy. We have worked with external consultants for much of this year to prepare for that purpose a detailed options appraisal, which our board is due to consider on Tuesday 8 December.

The history of the funicular goes back more than 15 years and is, naturally, quite complex. My colleagues and I have reviewed the available documentation thoroughly and will do our best to recall the key issues from the early 1990s right through to the present. We are happy to answer questions that the committee may have on the historical or current aspects of the funicular.

One final, further point that I should make is that Keith Bryers and I worked for HIE throughout the period in question. For part of the period, from 1999 to 2001, Douglas Yule was employed by Morrison Construction Ltd, which was one of the contractors on the project. Keith Bryers and I will therefore try to cover any questions that relate to that period.

The Convener: Can I just clarify something, Mr Brady? Will the board consider a new business plan next Tuesday?

Sandy Brady: It will consider a series of options that arise from the independent work that we commissioned from Johnston Carmichael.

The Convener: Right. When will your new business plan be ready?

Sandy Brady: I suspect that the business plan will be implemented at some time following the board meeting, during the course of 2010.

The Convener: How close are you to having a considered business plan?

Sandy Brady: The business plan will be prepared in the light of the HIE board's decision on which of the three options it wishes to take forward. They have not yet been debated by the board.

The Convener: So it will be some time next year before we are able to see a business plan.

Sandy Brady: That is correct.

The Convener: Okay. You said that your procedures are now more rigorous. Does that suggest that your previous procedures were not rigorous?

Sandy Brady: The procedures at the time were different. They were appropriate to that time, but a number of steps that are now undertaken in project appraisal were not undertaken then. The Audit Scotland review looked at those and at current best practice and concluded that the procedures were appropriate and of the standard that was expected at the time when the funicular project was put together.

The Convener: In the light of what we now know and the standards that now pertain, could it be suggested that a less-than-rigorous approach was taken at the time? You said that the procedures were different, but was the approach less rigorous?

Sandy Brady: It was equally rigorous. The documentation that goes back to that period is considerable. Not only had we to satisfy the Secretary of State for Scotland that we should commit such a sum of money to the project, but we had to apply for European funding under the objective 1 programme, and both of those processes in the project appraisal were exceedingly rigorous.

The Convener: Have the reasons that justified the investment changed? Do we now have a different set of reasons for continuing it or are the fundamental aspirations the same?

Sandy Brady: The aspirations are the same. We always saw the investment in the Cairngorm funicular as part of a series of investments in the Strathspey and wider Highland area. We have invested heavily in the redevelopment of the Aviemore centre, which is part and parcel of that, and we now have the Cairngorms national park in the area. We have always seen those three elements together as the three legs of a stool, if you will—the investment in the skiing facilities, the investment at Aviemore, and the investment in the national park.

The project built on the momentum that was created in the area by the investments that were made in the 1960s. A skiing development and an all-year-round tourism industry were created in the Strathspey area during the 1960s, and we saw the further investment that was required during the 1990s as taking that momentum forward.

The Convener: Was that economic investment in infrastructure, which you hoped would boost jobs and tourism, properly balanced against environmental issues?

Sandy Brady: We believe that it was. At the beginning of the 1990s, a two-year piece of work was done by the Cairngorms working party, which was a multidisciplinary group that the secretary of state set up to look at the balance of recreational, environmental and economic interests in the wider Cairngorms area. The working party's report in 1993 indicated that it favoured the continuation of the balanced approach, and much of that thinking was incorporated in the subsequent move to a national park, but it recognised that downhill skiing was a key part of the attraction of the Cairngorms area, that it had been in place since the early 1960s, and that it was part and parcel of what went on there.

Clearly, there are significant environmental pressures and concerns, because we are operating in a high mountain environment. As the owner of not just the funicular but the Cairngorm estate, we have tried hard to be a good landowner and to recognise, with our neighbouring landowners, the natural heritage value of what we have in the Cairngorms.

Anne McLaughlin (Glasgow) (SNP): Early on, HIE identified a number of risks including climate change and, if required, reinstatement costs. What plans were put in place to deal with those risks? How did HIE plan to tackle them at the time?

Sandy Brady: We tried to do so in a number of ways. One of the greatest risks was the financial cost of constructing the funicular railway. There were some parallels with the gondola at Aonach Mòr, but a funicular railway had not been built in Scotland before. We were aware that it was a ground-breaking development and that we would learn a lot of lessons as we went along. We took a considerable amount of professional advice and, in the way in which we constructed and procured the railway, we tried to learn from the experience of other skiing resorts in Europe. We were very much aware of the fact that we were breaking ground.

Turning to other risks, we considered the impact on the environment. A key part of that was the section 50 planning agreement, which was drawn up in obtaining planning consent. The parties to that included ourselves, Scottish Natural Heritage and the Highland Council, as the planning authority. A key part of the agreement was the closed system for non-skiers at the top of the funicular, which was a considerable environmental benefit of the funicular. We effectively replaced an ageing chairlift, at the top of which there was free and unfettered access to the Cairngorm plateau. As a result of the funicular being built, that access has been removed. One of the key things that we have achieved—which is in line with the Cairngorms working party's view—is the re-establishment of the long-walk-in principle, so that people who wish to go to the plateau can no longer take mechanised uplift to a very high level.

Anne McLaughlin: You said that the procedures that were in place were appropriate at the time, but that current procedures are more rigorous. What approach do you take now when you assess risk in major capital projects? How does your current approach differ from the way in which risks were assessed and dealt with 15 years ago?

Sandy Brady: One of the most important differences is in the use of gateway reviews. That technique has been widely introduced across the public sector over the past five to 10 years. Gateway reviews, as such, were not in place when the Cairngorm funicular project was brought forward. Were we doing a similar project today, it would undoubtedly go through that process, which is a cool, dispassionate and objective look at the project from its inception and initial planning, through the appraisal stage and on to the construction period. It ensures that the project's benefits are realised. We recognise that we would have a more focused team to deliver the project. The work was done by a number of officers, who worked on the project as part of their wider portfolio of work. These days, we would install a senior responsible owner, who I suspect, for a project of such a scale, would work virtually full time on the project. We would probably also go for a project board, members of which would challenge the team procuring the project to ensure that we were on track to deliver what we were trying to achieve.

Anne McLaughlin: How robust were the visitor number estimates on which the business case was based?

Sandy Brady: We estimated that the non-skier visitors would probably number around 165,000 per annum. The figures were examined by independent consultants, who took views from comparable attractions elsewhere. In reality, we more or less achieved those figures in the early years of the funicular, although they have drifted slightly downward since then. One of the challenges that we face is to re-establish the attractiveness of the funicular for the non-skier.

The numbers of skiers are considerably lower than we hoped for. I guess that the numbers are explained by the availability and quality of skiing conditions on the mountain. Looking back at the Cairngorm figures over a long period, we note that there have been some bumper years and some very poor years. Unfortunately, we have suffered more of the poorer years within the past five to 10 years than we have done historically. The numbers of people who come in each year are subject to factors that are beyond human control. We depend on snowfall and on the quality and length of the season that we can generate.

Anne McLaughlin: That is why I am surprised that, when construction started in 1999, HIE did not review the project again, because by then you knew that skier numbers were declining. Why did you not take that into account?

10:15

Sandy Brady: We considered the skier numbers closely in the 1997 appraisal when we decided to commit funds to the project, and the issue featured as part of the discussion of the European funding. A period of about 18 months then elapsed before construction began on the funicular. One finding of the Audit Scotland review is that we ought to have paused at that stage to re-evaluate the assumptions. We did not do so. We were up against some tight deadlines, notably the deadline imposed by the European funding. When the final agreement on that funding was reached in 1999, we proceeded immediately with the funicular.

Looking back at the skier numbers, one can see a pattern that perhaps suggests that we were not enjoying the numbers that we had enjoyed in the 1980s, but it was by no means clear at that stage that there was a long-term pattern. Although the debate on climate change has continued, the important point to stress is that what matters at Cairngorm are the winter weather conditions, which can change remarkably from year to year. There is no reason why we will not have a good year again in the future, but it seems that the incidence of poor years is higher than it was back in the 1980s.

Anne McLaughlin: You said that one thing that stopped you reviewing the assumptions was the pressure to meet deadlines to qualify for European funding. If you had not been under that pressure, would you have done things differently and reviewed the case?

Sandy Brady: It is difficult to say. There was a momentum to the project. We had been given every political encouragement by the Secretary of State for Scotland. He wished to support the project and see it happen, particularly as the Government had committed £8 million to the redevelopment of the Aviemore centre and saw the two developments as very much complementary. The effect of the European funding deadline was to squeeze the number of construction summers that we had on the project, broadly from three to two. If we had not had that deadline, we might have had a slightly longer construction period, but that is conjecture. We dealt with the situation that was before us. We had to try to open the funicular within the window of two summers, and that is what we did.

The Convener: At the time, who owned the Aviemore centre?

Sandy Brady: I ask Douglas Yule to answer that.

Douglas Yule (Highlands and Islands Enterprise): In the late 1990s, it was owned by a company called Aviemore Mountain Resort Ltd, which was a predecessor of the organisation that subsequently acquired it—Aviemore Highland Resort Ltd. That consortium owned the centre until recently; it changed hands again within the past 12 months.

The Convener: In the organisations that owned the centre in the late 1990s and subsequently, which individual or company was the driving force? Would we recognise any of the names?

Douglas Yule: The main consortium that carried out the redevelopment of the Aviemore centre was Aviemore Highland Resort Ltd, which involved Macdonald Hotels, David Sutherland and the Tulloch Group, and HBOS and HIE as investors.

The Convener: So Macdonald Hotels has been a consistent player all the way through.

Douglas Yule: Only from the time that it acquired the interest in Aviemore Mountain Resort from the previous owners, which was in the late 1990s.

George Foulkes (Lothians) (Lab): Hello, Mr Brady. I am a bit new to all of this. Am I correct in thinking that you are acting chief executive of HIE?

Sandy Brady: That is correct.

George Foulkes: Why is there no substantive chief executive?

Sandy Brady: The substantive chief executive is Sandy Cumming, who is currently recovering from Bell's palsy, which he has had since August. He is about to return to work on a part-time basis and hopes to resume his duties some time in the new year.

George Foulkes: How long have you been acting chief executive?

Sandy Brady: Since 10 August.

George Foulkes: And how long have you been with HIE?

Sandy Brady: Since its establishment in 1991.

George Foulkes: So you know the background to the issue.

Throughout the papers, there is talk about the high altitude, but surely there are funiculars at much higher altitudes in the Alps.

Sandy Brady: There are indeed funiculars at much higher altitudes. The Cairngorm one runs from roughly 2,100ft at the bottom station to about 3,600ft at the top, so by Alpine standards it is not particularly high. It is the climate and environmental factors that make the difference. The degree of exposure, particularly to wind and chill, on the Scottish mountains means that the conditions are comparable with those at a higher altitude in Europe—at 6,000ft, 7,000ft or 8,000ft in the Alps, for example.

George Foulkes: Did you, anyone from HIE or anyone connected with you have a look at how things were done in the Alps or anywhere else in the world?

Sandy Brady: Yes, we did. Back in 1992-93, we conducted several reviews of possible alternatives to replacing the aging chairlift system. Our consultants at that time—which I think were led by CairnGorm Mountain Ltd—considered comparators from elsewhere in Europe and North America. They looked at more modern chairlift systems with two or four chairs, at gondola systems and at funicular railway systems. On balance, they recommended the funicular railway system.

George Foulkes: That was recommended by the consultants.

Sandy Brady: That is correct.

George Foulkes: You then decided to go to tender. What kind of tender was it?

Sandy Brady: I ask Mr Bryers to give you the detail of that.

Keith Bryers (Highlands and Islands Enterprise): In addition to the visits that Sandy Brady mentioned, a number of staff, including me, visited several funicular installations in Europe to learn from them when we were putting together the tender proposals for Cairngorm. The tendering for the funicular package was based on three lots: lot 1 was the train, lot 2 was the civil engineering works and lot 3 was the buildings. Those were all procured through the *Official Journal of the European Communities*, as was required at the time, on a competitive basis. I think that four different funicular manufacturers tendered for lot 1.

George Foulkes: What form did the tender take? It was not a fixed-price tender.

Keith Bryers: No, it was not a fixed-price tender. It was a design and specification tender.

George Foulkes: Why did you not opt for a fixed-price tender?

Keith Bryers: I cannot remember exactly why.

George Foulkes: That is a crucial point. If you had opted for a fixed-price tender, you would not have overrun on costs as you did.

Sandy Brady: One of the things that we struggled with at that time was the fact that our professional advisers on the procurement indicated that they thought it highly unlikely that any contractor would commit to a fixed price because of the uncertainties involved in the type of construction.

George Foulkes: So you did not even try.

Sandy Brady: We had advice from our consultants that the best route to go down was the competitive tender. I am not sure whether we tried a fixed price—I can check that for you. I think that the advice was that that was not appropriate for a project around which there were so many construction unknowns.

George Foulkes: How many tenders did you receive for the three packages?

Keith Bryers: As I mentioned, we received four tenders for lot 1. I think that we received about 14 expressions of interest in the civil engineering works at the initial interview stage, which was narrowed down considerably to a much smaller number. I think that about four companies submitted tenders for the building works.

George Foulkes: In each case, did you accept the lowest tender?

Keith Bryers: We do not consider only price when we are considering tenders nowadays; we consider price and quality. In that sort of contract, quality means the ability to comply with environmental protection measures, to build within very restricted timescales and to deal with the weather. All those things are put into the mix when we consider who offers the best deal. The lowest price was not always the most appropriate criterion.

George Foulkes: Can you remind me who offered the best deal for each of the three lots?

Keith Bryers: For lot 1 it was an Austrian company called Doppelmayr, which is now known as the Doppelmayr Garaventa Group, and for lots 2 and 3 it was Morrison Construction.

George Foulkes: That is a coincidence.

Keith Bryers: The aim was always to award the civil engineering and building work as one package, if possible, to avoid two contractors trying to do a job on the same site.

George Foulkes: In each case, was the Morrison Construction bid the lowest or did the company just offer the best deal?

Keith Bryers: As I recall, it offered the lowest bids.

George Foulkes: The lowest in each case?

Keith Bryers: I think that that is correct, yes.

George Foulkes: Where was the major cost overrun?

Keith Bryers: The major difficulty probably related to the replacement of the proposed steel beams on the rail track with concrete beams. Morrisons made that proposal with its tender. Construction of the tunnel was another challenging engineering issue, given the weather conditions, the altitude and the various environmental considerations.

George Foulkes: Morrisons proposed changes to both those aspects of the original tender specification.

Keith Bryers: That is correct.

George Foulkes: Having won the contracts out of 14 companies in one case and four companies in the other, Morrisons persuaded you to change the specification.

Sandy Brady: That was done as part of a cost-saving exercise.

George Foulkes: A cost-saving exercise?

Sandy Brady: We agreed to merge the two lots and to seek savings because Morrisons had won the two contracts. A package of changes was made, which included reducing the specification of the buildings, removing the proposed middle station building and considering suggestions from Morrisons about how it could tackle this unique project. That was undertaken in partnership with the company and with our professional advisers at the time.

George Foulkes: Had Morrisons constructed a funicular before?

Keith Bryers: Nobody had constructed the civil works for a funicular before, but the funicular manufacturers had constructed many funiculars, which is why they were visited in the years before the railway was constructed. It was important for the selected civil contractor to feed into the tender documentation for the award of the train works, so that the two could merge.

George Foulkes: There are funiculars elsewhere in the world.

Keith Bryers: Absolutely.

George Foulkes: Yet Morrisons had never been part of any of that construction elsewhere in the world.

Keith Bryers: It had not, and nor had any other tenderer for the civil or building works.

The Convener: I want to clarify an issue that has developed in the course of questioning. Lots 2 and 3 were awarded to Morrisons. HIE's chair, who was present at board meetings in 1996 and 1997 when the project was discussed, was Sir Fraser Morrison. HIE's chief executive left in September 2000 to go to Morrisons as its director for corporate development. You tell us that Mr Yule joined HIE from Morrisons. Might some members of the public perceive an unhealthy relationship between Morrisons and HIE?

Sandy Brady: That is possible. Media coverage in 2000 implied that. We are happy to found on the review that Audit Scotland conducted as part of producing the section 23 report. The documentation that was provided to the Minister for Enterprise and Lifelong Learning in 2000 when the public concerns were expressed is available. He satisfied himself that no impropriety whatever was involved.

The Convener: Why is the relationship so close and why does such movement take place between the company and HIE? Is it because there is not much choice of expertise in the area? Were Morrisons and the people associated with it so way ahead of the expertise that was available in the rest of Scotland that going for them was a no-brainer?

Sandy Brady: That question is difficult to answer, but I will do my best. At the time, Morrison Construction was without question one of the leading construction companies in the Highlands and Islands. It had expanded from a small family firm into a major national and international player. The company had done well at obtaining contracts in the Highlands and Islands, the rest of Scotland and beyond throughout the 1980s and 1990s. It is no surprise that Morrison Construction has been responsible for a significant proportion of the infrastructure investment in the Highlands and Islands in the past 20 years.

The Convener: The contracts were not awarded only on the basis of price; Mr Bryers tells us that they were awarded on other factors. Once they were awarded, Morrisons suggested that certain changes had to be made. However, Morrisons had very close connections with HIE—for example, Sir Fraser Morrison was chair of the HIE board and Morrisons recruited the HIE chief executive, who would have known the fine detail of what was being discussed. Is it just a flight of fancy to suggest that there was an unhealthy relationship?

10:30

Sandy Brady: It would be very unfair to the integrity of the individuals involved. Sir Fraser Morrison left as chair of HIE in 1998, before the contracts were let. We had moved on: we had a new chair at that time and a different board. Iain Robertson, the HIE chief executive, left in September 2000. I have no doubt that he was a good friend of Sir Fraser Morrison and that Sir Fraser sought to recruit somebody who was bright and able into his company. Those matters were entirely separate from the procurement of the funicular railway.

George Foulkes: I just want to check one thing. You said that the documentation was provided to the enterprise minister in 2000. Was that Henry McLeish?

Sandy Brady: It was Henry McLeish.

George Foulkes: Thank you.

Cathie Craigie (Cumbernauld and Kilsyth) (Lab): Continuing on the theme of the funicular's construction, you state in your written submission to the committee that Morrisons and Doppelmayr won the competitive tenders, but you go on to say:

> "Partly because of the shorter construction period than originally envisaged—spanning only two summers rather than three—construction costs rose".

I am no expert in construction, but normally when construction is done in a shorter period of time the costs at least remain stable. There is only a rise if construction goes on and on. Can you explain the reason for that?

Sandy Brady: Yes, indeed. I will ask Keith Bryers to kick off, then I will come in.

Keith Bryers: Essentially, we were trying to do a three-summer job in two and a half summers, because we lost half of the first summer through the European regional development fund delays, following the judicial review. We also had an ERDF deadline, which meant that we had to complete the job by the end of December 2001. By the time the job started, the contractor had a huge amount of work to do in less time than we had originally envisaged. The construction took place in a very constrained environment, in terms of getting materials up the hill, because the type of access road that you would usually expect was not available. The construction company had the use of an access road, but it was very constrained. The company installed a cable crane, but that was subject to a number of delays and the tonnage that it could take up the hill was restricted—helicopters had to be used to move concrete up the hill. All those things caused the project costs to increase.

The Convener: Before I bring in Willie Coffey I want to clarify something that relates to the previous questions. Mr Yule, which post did you hold with Morrisons before you joined HIE?

Douglas Yule: I was development manager with the Morrisons developments division, which was located in Inverness in the Morrison Construction group offices in Harbour Road.

The Convener: Did you have any involvement with the funicular?

Douglas Yule: No, none whatsoever. When I came to HIE in August 2001, I was specifically excluded from any discussions, meetings or decisions on the funicular or Morrison Construction for the subsequent 12 months.

Willie Coffey (Kilmarnock and Loudoun) (SNP): Mr Brady, you said in your opening remarks that you thought that the planning of the project at the initial stages met all the standards in place at the time, and that, of course, standards move on, but I want to challenge you on something.

We read in the Audit Scotland report that the budget for the project had to be reforecast, which led to the setting aside of a sum of only £8,000 for contingency in a project budget of about £15 million. Most industry standards recommend that a figure of around 15 per cent of the overall budget is set aside. I am not aware of any other standard that would recommend setting aside a contingency of less than 1 per cent, or of any project that would do that. How can you say that that met standards at the time?

Sandy Brady: It is to do with the timing. In the project envelope of £14.5 million at the outset, there was a significant contingency. Lots 1 and 2, which Mr Bryers has described, came in from the competitive tender process very much on budget and were let. The challenge arose when lot 3—the buildings—came in at significantly more than was available in the planned budget. At that point, we had to drain down the contingency in recognition of the fact that the buildings were going to cost significantly more. With hindsight, I have to agree with you that having a contingency of £8,000 is not the way in which we would normally approach the situation. However, it was to do with the timing of how we let the lots.

Subsequently, as the facts have shown, the cost of the funicular railway project came out at £19.5 million in all—a third higher than the original envelope. We recognise that that is regrettable and have said so since we announced the figure and in our responses to the Audit Scotland report. However, that is what it cost to put a funicular railway on a Scottish mountain for the first time ever.

Willie Coffey: But do you still stick to your point that, as costs rose, setting aside a ridiculously small amount for contingency reflected good practice at that time?

Sandy Brady: It did not reflect good practice at the time. We had a significant contingency in place, but the requirement to find further funds for lot 3 of the project caused us to drain down that contingency. When lot 3 was let, the contingency had declined to around £7,000 or £8,000.

Willie Coffey: What measures did the company employ at that point to try to meet those escalating costs? Members have asked about the various tendering mechanisms that were used and whether they were fixed price or variable. The costs ultimately escalated to—I think—£26 million, all told. How did you deal with those mounting costs at the time? What measures did you deploy to try to keep the costs in line?

Sandy Brady: The construction cost of the funicular railway was £19.5 million, and the original funding envelope was £14.5 million; so, in round figures, the extra cost was £5 million. The key focus was on trying to ensure that, when lots 2 and 3 were merged by Morrison Construction Ltd, we sought the savings to which we have referred. That resulted in a reduction in the specification of the buildings, the removal of the middle station and so on. We did everything that we could. We took legal advice at the time on how the thing had been set up, as the third lot was let. However, the challenge remained that we could not find a contractor who was able to undertake lot 3 for anything close to the £4.2 million that was allocated for it. The reality is that we worked very hard throughout the construction process to try to find ways of ensuring that the overrun was contained. We did our best and got it down to £5 million, or 33 per cent. We note that Audit

Scotland picked up that point in the section 23 report and concluded that HIE had done everything reasonable to contain the costs, given that we were faced with a situation in which there was no prospect of stopping short once the works had started—effectively, we needed to complete all three lots to have a functional railway.

Willie Coffey: Effectively, with the costs escalating as they did, there was no real protection within the model to contain costs. It was ultimately going to cost what it was going to cost, was it not?

Sandy Brady: That is a fair comment.

Willie Coffey: The cost was just escalating to whatever level it was going to reach and that was it, frankly. Obviously, the public purse had to pick up the tab.

Can I move on to the next question, convener?

The Convener: Before you do that, I want to ask a question about the costs. In response to Willie Coffey, Sandy Brady said that the construction overrun was £5 million. However, the total cost of the project came to £26.75 million. What other support was provided to the operator that resulted in the additional £7 million beyond the £19 million?

Sandy Brady: Those costs relate to the funding of the operations of CairnGorm Mountain Ltd. I ask Douglas Yule to say a bit about that.

Douglas Yule: I am sorry, convener; unfortunately I do not have the detail on the £4.7 million.

Sandy Brady: The funding—

The Convener: Sorry, but it is not £4.7 million; it is £7 million. The budget figure was £14.61 million. Sandy Brady said that the construction costs rose to £19.54 million. However, the notes that we have say that the total cost became £26.75 million, with the public sector contributing more than £23 million. In other words, the additional £5 million took the construction costs up to £19 million, but why is there another £7 million somewhere in the total costs? What was that for?

Sandy Brady: That related to the costs of the operation of CairnGorm Mountain Ltd over the period since the completion of the funicular. The funding for that came from the public sector—from ourselves and from Highland Council—and from Bank of Scotland, which was the company's banker.

The Convener: Would such costs not be annual revenue costs? How many years' operating costs are contained in the £7 million?

Sandy Brady: That would be the accumulated deficits from the operating costs over the period from 2001 to the present day.

The Convener: So £26.75 million is what the funicular has cost to the present day. Is that correct?

Sandy Brady: Broadly speaking, that is correct.

The Convener: Okay. We can check that out.

George Foulkes: My question arises from the convener's questions. Do you know Alan Blackshaw from Newtonmore?

Sandy Brady: Indeed we do.

George Foulkes: Do you know that Alan Blackshaw has written to Sir John Elvidge about the funicular?

Sandy Brady: Yes. Mr Blackshaw has written to a number of people about the funicular over a long period.

George Foulkes: In his letter to Sir John Elvidge, Alan Blackshaw claims that HIE had authorisation to spend £12.356 million of public money and that it spent beyond that without any authority. Do you accept that?

Sandy Brady: Authorisation for the construction costs was sought from the Secretary of State for Scotland at the time. As cost escalations on the project came in, we kept our sponsor department within the Scottish Executive fully informed. Each of the escalations was authorised.

George Foulkes: Who were they authorised by?

Sandy Brady: By the Scottish Executive.

George Foulkes: Do you have documentation to prove that?

Sandy Brady: Yes, we have documentation. Audit Scotland saw that documentation as part of its section 23 review.

George Foulkes: So why has Mr Blackshaw got this wrong?

Sandy Brady: I could not hazard a guess on that. Mr Blackshaw is a passionate observer of the Cairngorm funicular project. He was a board member of the local enterprise company back in 1997, when the project was approved. He has been a long-term critic of the procurement of the funicular. We respect his views, but we simply do not agree with them.

George Foulkes: Could you provide documentation to the committee to confirm that all the expenditure was properly authorised by ministers?

Sandy Brady: Yes, we could do that.

The Convener: You said that you respect Mr Blackshaw's views but you just do not agree with them. Would it be reasonable to say that he has been proven to be correct?

Sandy Brady: I do not think so. Mr Blackshaw is one of a number of people who have been critics of the Cairngorm funicular project from its conception, right through its planning and construction and up to the present day. Just as a number of people were disappointed with the decision to proceed with the funicular, the funicular project also has many supporters. A large number of businesses in the Strathspey area believe that the Cairngorm funicular investment was vital to regenerate the local economy. Thousands of Scottish skiers—some of them of international standard—are very grateful for the continued investment that has been made in the area over the past four or five decades. Any development project in an environmentally sensitive area such as the Cairngorms is bound to attract both supporters and detractors.

The Convener: Let me return to the issue of the cost overruns that developed. You said that you kept the Scottish Office fully informed and that approval was given by the Scottish Office at each stage as problems developed. Is that correct?

Sandy Brady: The Scottish Office approved the £14.5 million envelope for the project. As the escalations came in, we kept the department notified. Its view was that the escalations were a matter for the HIE board, which had to decide whether it wished to commit resources to them.

The Convener: So no further approval was sought from the Scottish Office or from ministers either for extra funding or funding for such a significant overrun.

Sandy Brady: No authorisation for further funding was sought. HIE assured Scottish Executive ministers that the funding could be found from within HIE's envelope of resources. The Scottish Executive expressed itself satisfied with that and said that that was a matter for the HIE board.

10:45

The Convener: So ministers—at the Scottish Office, I presume—did not contribute any more funding, and all the cost overruns up to the £26 million were fully met by HIE. Were ministers content to bear the financial implications of that use of what was a substantial draw-down from a limited budget?

Sandy Brady: The £26 million includes a £1 million contribution to the project from Highland Council and several millions from the company's banker, the Bank of Scotland. As a result, the total cost to HIE was around £22 million or £23 million. If you want details, we will produce a very precise table showing exactly how those figures are made up.

The Convener: That would be helpful. You said, however, that the bank contributed several millions.

Sandy Brady: That is right.

The Convener: But if the project's total cost was £26.75 million and the public sector contributed £23 million, that leaves a gap of £3.75 million.

Sandy Brady: HIE contributed £23 million and the Highland Council £1 million.

The Convener: All right. The public sector contributed £24 million. That still leaves a gap of £2.75 million, which was contributed by the bank. That is hardly "several millions".

Sandy Brady: We will confirm the figures for the committee but I have to say that £2.75 million sounds to me like several millions of pounds of private sector money.

The Convener: It is a couple of million rather than "several millions". I am not going to engage in semantics, but I think that the figure is probably on a different scale.

George Foulkes: What's a million between friends?

Willie Coffey: With regard to the jobs that it was hoped the project would create, the Audit Scotland report says that there was an estimate of £11,000 net grant equivalent cost per job as a result of the project. What did that figure turn out to be?

Sandy Brady: We have not done the calculation in those terms. It was a Treasury formula that was in use in 1997. The formula, especially the way in which net grant equivalent is calculated—which, I should say, is what allows you to do the calculation that you have referred to—is no longer in use.

We have focused on trying to understand whether the economic benefits that we set out in support of the project at the outset have been realised. As the Audit Scotland report points out, we have commissioned an independent review of the project's real economic benefits for the Strathspey area and the wider Highlands and Islands.

The original project approval paper proposed an output of something like 135 jobs from the project; according to the most recent review, which was undertaken in 2005, employment of 232 full-time equivalents has been achieved in the Badenoch and Strathspey area, falling to something like 174.5 full-time equivalents at the wider Highlands and Islands level where, of course, displacement begins to come into effect. We—and, as its report suggests, Audit Scotland—are very satisfied that the scale of economic benefits that we sought from the project have, in fact, been realised.

Willie Coffey: That is interesting. So the net economic benefit is entirely separate from the net grant equivalent cost per job that the benefit creates, no matter how high that cost gets.

Sandy Brady: At the time, cost per job was an important factor in the way in which we looked at all kinds of projects. However, I point out that it is a static thing. We have managed to keep those jobs on the hill for eight years now; if the funicular railway continues to operate for the remaining years of its design life that level of employment benefit will have persisted in the Strathspey area for the best part of 25 to 30 years. Given those terms, the scale of investment is not inappropriate.

Willie Coffey: Perhaps I can help with the figures. When the initial budget was £14 million, the cost per job was £11,000; however, as the outturn cost was £27 million, the cost per job became about £22,000. That is simple arithmetic. Are you saying that, regardless of that value and no matter how high that cost goes, the net economic benefit to and impact on the area have still been worth while?

Sandy Brady: The point is that the costs of the Cairngorm funicular have been borne and the railway exists. All the scenarios for taking the resort forward require us to take a hard look at the use of further public money, whether revenue support or capital investment, with regard to the on-going benefits that those jobs bring to the area each and every year.

The Convener: We accept that the funicular is now there. However, we are not investigating whether it should continue to be there and what the financial implications of that might be; we are looking at the process and other historical aspects of the development.

Murdo Fraser (Mid Scotland and Fife) (Con): I apologise for my late arrival, which was the result of traffic problems.

I want to follow up on Willie Coffey's questions about the cost per job. If we take the total public sector contribution, which I understand is roughly £23 million, and divide it by the net amount of employment that it is estimated will be created, we end up with a figure per job of £131,000. Do you think that that is an accurate assessment of the return?

Sandy Brady: I do not think that it is an accurate assessment of the return; it is a figure that one can come up with by doing the arithmetic that you described. We would have to take economic advice on what the costs are in relation to the benefits over time. Cost per job is a concept that implies that a job is created at one point in time and that is it, as if we would be happy regardless of whether the job went away after one year, 10 years or 15 years. Although cost per job was one of the criteria that we employed in our appraisal processes in 1997, in line with Treasury guidance, the means by which projects' economic impacts and outcomes are assessed is now more sophisticated.

I come back to the point that the funicular project creates the equivalent of 232 full-time equivalent jobs in the Badenoch and Strathspey area each year that passes, and has done since 2001. Our hope and expectation are that it will continue to do so. If it is viewed in those terms, the investment remains quite reasonable.

Murdo Fraser: But as you will appreciate, the difficulty that we have, as the Parliament's Public Audit Committee, is that our role is to ensure that public funds have been properly spent and value for money for the public purse has been obtained. The business case set out that the net grant equivalent cost per job would be £11,000. We do not know what the outturn is because you have not done the calculation. I have suggested to you that, on one reading, it could be as high as £131,000. You dispute that, but you are not able to give me an alternative figure.

When we took evidence from Audit Scotland on the issue, it told us that it felt that it was unfortunate that HIE had not calculated the outcome cost and no longer used such a measure, so you will appreciate the difficulty that we have in trying to understand whether, from an employment creation perspective, the project represents good value for the public funds that have been spent on it.

Sandy Brady: I accept those points. We do not work things out on that basis any more, so I can only return to my point that it is important to look at a facility that has now been in place for eight years and realise that it has created a stream of benefits over that period. The real value of that investment is the stream of benefits that it will create over the lifetime of the asset. To date, the indications are that, in relation to capital costs of £19.5 million, the stream of economic benefits has been, and will continue to be, well worth while, provided that the funicular railway can operate as a summer and a winter attraction.

The Convener: You said that your processes for considering investment decisions are now more sophisticated. Are those processes entirely consistent with practice throughout the Scottish public sector, including practice in Government projects?

Sandy Brady: Yes, entirely. We have spent a lot of time and effort over the past five to 10 years on ensuring that that is the case. Our own internal team has worked closely with Audit Scotland to try to ensure that. We have taken a great deal of professional advice. Every project officer in HIE goes through considerable project appraisal training to ensure that they apply consistent and up-to-date standards when they consider the exceedingly diverse range of portfolio projects with which we are faced, which include hotel upgrades, investment in fish-processing facilities and the development of tourism facilities.

The Convener: I am not sure that I am entirely confident about what you say. This is not a criticism of you, but the huge overruns in some of the major projects that continue to be developed by public agencies in Scotland mean that I am not sure that we could say with any degree of certainty that that higher level of sophistication is leading to better performance on staying within budget. However, that is not an issue for you; it is a wider problem that the committee has encountered.

Nicol Stephen (Aberdeen South) (LD): I will turn the question round.

If you were establishing a project of this nature today, using the new, more sophisticated evaluation techniques that you use now, 10 years on, and which are consistent with the approach that is taken across the public sector, what is the maximum capital investment that would be justified by the number of jobs that were created directly and indirectly as a result of the project?

Sandy Brady: These days, we commission an economic impact assessment of each major capital project in which we are involved, to work out what all the benefits would be—the construction jobs, the direct employment impacts, the indirect and induced impacts and so on. That information is in the mix, so we have a clear estimate of the benefits that would be realised from the project. That approach has been applied to a string of large-scale projects in the Highlands and Islands on which we are working.

Next, we look at the cost envelope for the project. These days, we are involved much more in partnership funding of projects than was the case at the time of the Cairngorm funicular project. The economic impact assessment and the cost envelope are brought together, but we do not operate with fixed ratios of one to the other. We look in the round at the economic benefits that we expect to get from a project and at how we will ensure that those benefits are driven out in reality, if the project is implemented. We then consider whether we can justify the level of funding that we have been asked to provide, either individually or in partnership with other public agencies.

Nicol Stephen: So there is no longer a maximum figure.

Sandy Brady: There is no maximum figure. We do not apply a cost per job in those terms.

Nicol Stephen: When did your approach change?

Sandy Brady: Probably around the turn of the decade, when we started to look at projects on a different basis. In particular, we tried to relate economic benefits in the round to the cost envelope.

Nicol Stephen: As the Public Audit Committee, we might be concerned about that. What to you may be more sophisticated may to us be completely open ended. You can put any amount that you wish into a scheme. There is no relationship between capital input and job creation.

Sandy Brady: That is a fair comment on an issue that troubles us on marginal projects, in particular. In some cases, the amount of money that is requested from us is significant but the economic impact assessment indicates that, rather than creating jobs directly, a project will have benefits that are modest or largely indirect, requiring other people to do things—for example, tourists to spend money. We regard such projects as marginal. They are the projects on which we spend the most time agonising over the decision, to ensure that, when we commit funds that could be used for other purposes, we do so with full knowledge of what we will achieve.

Nicol Stephen: Do you no longer have a red light, alert or requirement for Scottish Government or Treasury approval of projects of this nature? Have such controls been removed?

Sandy Brady: Largely. We operate with the Scottish Government under a delegated authority regime. For most projects, that means that the decision is made at the hand of Highlands and Islands Enterprise.

I will give you a simple example. One of the most significant investments that we have made in the past few years is in the European Marine Energy Centre in Orkney. Alongside a range of public sector partners, we have invested millions of pounds in the centre. We believe that the benefits of that investment are potentially huge for Scotland. However, if we were to apply a traditional test, looking at the number of people who work at the test facilities, the project would fail, as the cost per job would be too high. The real upside of the project is the economic benefit that it creates in the renewables sector down the road. In our impact assessments, we try to consider the potential positive impact on the Scottish economy of wave and tidal energy devices working well at the Orkney test centre. We must take a more sophisticated view of projects whose benefits are indirect, rather than simply looking at jobs on the project.

Nicol Stephen: The counter-argument is that there was always discretion to go above the limit. However, you had to know that you were doing that, and there were checks to prevent you from doing it at delegated level. If you went beyond the standard assessment, you required approval from either the Scottish Executive or the Treasury.

Sandy Brady: Cost per job was never applied as a strict criterion project by project.

Nicol Stephen: Exactly—that is the point that I am making.

Sandy Brady: At the end of each year, we reported the cost per job of all of our projects. Within the portfolio, some projects had a high and some had a low cost per job. Normally, self-catering tourism projects had a high cost per job, whereas fish-processing projects had a low cost per job. We accepted that there had to be a mix of such projects in the wider portfolio.

Nicol Stephen: You are saying that that indicator has now gone—it is no longer considered or felt to be valuable.

Sandy Brady: That is correct.

11:00

The Convener: Does Anne McLaughlin still want to pursue the issue of employment and economic benefits?

Anne McLaughlin: No, I have said all that I wanted to say.

The Convener: Have the benefits that have come to the Highlands justified the investment? Have the benefits outweighed the costs?

Sandy Brady: We believe that they have. One benefit is employment directly within the project, which has been calculated. We also believe that the project has led to wider investment in many projects in the Strathspey area that we have not been directly involved in funding. We have increased confidence in the area—somewhere that surged forward in the 1960s and which had lost its place in Scottish tourism has been reinvested in. The facilities are modern and they attract new, younger visitors to the area. The range of attractions that we have in the area is also much greater than it used to be. Looked at in the round, we think that Badenoch and Strathspey, as one of Scotland's longest-standing tourism destinations, is now in a far better place because of the investment in the funicular railway, in the Aviemore centre and in other businesses.

The creation of the Cairngorms national park has played a part in that. It has clearly been a step forward. It makes the area much more attractive, and it carries through the spirit of what the Cairngorms working party was looking for: a balance between recreational, economic and environmental issues.

The Convener: We will move on to the decision to take over CairnGorm Mountain Ltd.

Nicol Stephen: As we have discussed, in the period from the completion of construction through to your decision to take over the operating company and then the takeover some months later, very substantial losses were being made. Can you explain the extent of those losses and the action that HIE took as a result of those year-on-year losses?

Douglas Yule: During the past eight years, the losses were quite significant. The company had, of course, accumulated significant debt during the closure period while the funicular was being built and it did not come out of that in good financial shape, given that there was an extra year's construction period. The creditors at that time, who were us, the Bank of Scotland and Highland Council, were all working in quite close co-operation to try to help the company through this difficult period but, largely because of interest charges and the need to manage a new operation, the losses continued to escalate in that early period. As the period went on, the creditors all took a number of actions. A co-operative creditor arrangement was entered into in 2004, whereby the bank reduced the interest rate, Highland Council deferred interest on its loan and HIE adjusted the rent. In that co-operative manner, we were able to improve the business model and the return to the bank was pushed out for a number of years until sustainability was achieved.

At the same time, the snow conditions were having a significant effect on the trading performance of the company. During that period, skier numbers fluctuated, but costs continued to rise and the overdraft limit continued to increase until, in 2007 and 2008, the bank began to exert a little more influence and pressure. At one point, it decided to change the interest rates unilaterally. That led us to further discussions with the other creditors, because we felt that that was a breach of the previous creditor arrangement.

Nicol Stephen: That was an upward move, I presume.

Douglas Yule: Yes. We then went into further discussions about how we could sustain the company.

Nicol Stephen: I will press you on that stage and the bank's decision to increase the interest rate, as I want to understand it all a bit better.

Looking at the year-on-year losses, I see that the massive losses were in the early years. Am I correct?

Douglas Yule: Yes.

Nicol Stephen: Around this time, for the first time, the company started to trade profitably for a year, although the position was still marginal in that there were some years in which losses continued to be made. Why, then, did Highlands and Islands Enterprise take radical action? Did the bank take the action that it did because it saw some value returning to the company? Was that a reason for the surprising decision to increase interest rates in a company that was trading so poorly?

Douglas Yule: It is difficult for me to answer for the bank's motivations. We knew that it proposed to increase the interest rates on the loans and, in fact, it did so unilaterally.

Nicol Stephen: You must have discussed that with it.

Douglas Yule: We certainly did. It was a robust discussion.

Nicol Stephen: Was an explanation given?

Douglas Yule: The explanation that the bank proffered was that it needed a better return on the long-term debt in the company. We reminded it of the creditor arrangement that we had gone into earlier with Highland Council and stated that we felt that the increase was a breach of that agreement. There were some strong discussions. In principle, our position was that, if the bank continued to raise the interest rate, we would reinstate the original rent, which would bring matters to a head. There were many strong, robust discussions on these issues. The outcome was a further year's moratorium on the interest rate.

Nicol Stephen: When was that?

Douglas Yule: It was in 2007. There was a significant loss of about £262,000 in that year because of the poor number of skiers, which was down to about 38,500. That was a significant problem for the bank and that was part of the discussion.

As we moved through that period, the company was preoccupied with managing its cash. It was spending all its energy trying to balance the books and going to the bank to ask permission to write cheques as it bumped up against its overdraft limit. It was a critical moment for the company and, given the substantial investment that we had made and the company's exposure to the Bank of Scotland in particular but also to other creditors, we were deeply concerned that the danger was real.

We sensed a change in the bank's position and behaviour, which led us to conclude that we needed to find an alternative that provided a more stable position for the company and a more resolute future for the operation. At that point, we engaged with KPMG to discuss our options. We had detailed discussions with its insolvency division and gathered together what we felt was a reasonable position on what might happen if the company were to go into administration. There was no sense that that was not a real possibility.

We decided that we should see whether we could resolve the debt position with the bank and make it an offer. Based on the proposition that we were as prepared to let the company go down as the bank might be, we had conversations about that with the bank. We were also involved in discussions with Highland Council at that time because it had a lot at stake, too. Our biggest worry was that, if the company went into administration, the standard securities that had been granted by CairnGorm Mountain Ltd on the long lease could have resulted in an administrator excluding HIE as landlord from its own facility. Worse still, the administrators might have closed the facility until such time as they managed down the company's liabilities and created a phoenix or a buyer came along. In our mind, we were facing the threat of closure and a chaotic administrative situation. We had small creditors spread throughout the valley who would have lost out substantially.

For all those reasons, we felt that we had an opportunity to bring some stability back to the company, to eliminate the debt, to get rid of the standard securities that were held over the asset in which we had invested so much money, and to provide a stable environment in which the company might go forward and look at its operations differently. It was against that background that we concluded negotiations with the bank and agreed a figure. We agreed a figure with Highland Council for its debt and for releasing the standard securities. We gained control of the asset, bought out all the debt, provided stability to the company, and protected the local creditors. In the round, we felt that that was a positive outcome at that moment, especially given the external factors.

I am sorry that that was a long explanation.

Nicol Stephen: It was a good explanation, thank you. It was very helpful. What was the vost of that to HIE? What additional financial and other responsibilities do you now have as a consequence of having done all that.

Douglas Yule: We paid £1 to Highland Council for its £1 million debt. We paid £1 to Cairngorm Mountain Trust for its remaining shares in the company. We paid the bank a sum of money that is the subject of a legally binding confidentiality agreement, and I am afraid that I am not permitted to divulge it.

Nicol Stephen: Is it normal for a public body to enter into a confidentiality undertaking on this sort of issue of public interest?

Douglas Yule: It is not unusual for such agreements to be entered into. We certainly did so because it was in the interests of getting to and maintaining a result for the overall company, as I have suggested. When Audit Scotland pressed us on the point as part of its review, which it rightly did, we asked the Bank of Scotland whether it would relent and allow us to release the information as part of the Audit Scotland review, but it reasserted its rights under the legal agreement and said that it would not give its permission. That is the current position on the legal agreement and the purchase price of the debt and the standard security from the Bank of Scotland.

The Convener: When Audit Scotland was conducting its audit, it was not given that information.

Douglas Yule: It was not given the information about the sum of money that HIE paid to the bank for the standard security and the debt.

The Convener: Your auditors do not know how much you spent. The Scottish Government does not know how much you spent. No one knows how much you spent other than you and the bank. HIE is a public body, so how do those responsible from an audit or political perspective hold HIE to account for the use of the money when it can enter into agreements that no one will ever be told about?

11:15

Douglas Yule: We did, of course, seek approval from the HIE board at the time. It is aware of the details of the agreement that was reached. We also had discussions with our sponsor team, which is aware of the details of the agreement.

The Convener: I am sorry, but who is your sponsor team?

Sandy Brady: The Scottish Government enterprise division.

The Convener: Did it know how much you spent?

Douglas Yule: It was aware of the terms of the deal.

The Convener: Did it know how much you spent?

Douglas Yule: Yes.

The Convener: But your auditors do not know.

Douglas Yule: We certainly did not declare it in the audit report. That is clear.

The Convener: But it is not just that you did not declare it. Did you not say that you did not think that it was appropriate to give Audit Scotland that information?

Douglas Yule: I do not think that—

Sandy Brady: We would have happily given that information to Audit Scotland if the Bank of Scotland had relented.

The Convener: Yes, but I am not asking about that. You would have given the information to Audit Scotland if the Bank of Scotland had relented, but you gave it to your sponsor team. Did the Bank of Scotland okay that?

Douglas Yule: We discussed the matter in confidence with the sponsor team.

The Convener: The Bank of Scotland was not aware that you were discussing that with your sponsor team.

Douglas Yule: No, it was not.

The Convener: The bank said that you cannot tell anyone about the sum of money. Does your board know how much it was, or does it simply agree in principle?

Douglas Yule: The board is aware of the outcome of the negotiations.

The Convener: Yes, but does it know how much the sum was?

Sandy Brady: Yes, it does.

The Convener: So the board knows. The bank said that it did not want anyone to know. You cannot tell your auditors, who, in looking at how money is spent, are custodians on behalf of the public, because the bank will not allow you to do so, although you told your sponsor team in confidence. You gave a reasonable explanation of why you decided to take over CML in August 2007, but we do not know whether it cost £10, £100,000, £10 million or £100 million, and no one will ever find that out because the bank says that it does not want you to tell anyone.

Douglas Yule: I understand the point that you are making and appreciate what you are saying. Our legally binding agreement with the Bank of Scotland contains a clause that says that if legislation makes us release the information, we will be bound to release it. We have been requested to release the information under freedom of information legislation. We have so far resisted doing so, and we will continue to do that until the Scottish Information Commissioner instructs us to release it, if he does that. If the commissioner instructed us to do that, we would have no option. Under the legal agreement, we would be able to go back to the bank and say, “Sorry, but we now have to do this because the commissioner has instructed us so to do.”

The Convener: Yes, but do you understand why there could be a certain amount of unease when public bodies such as Highlands and Islands Enterprise—what I am saying could also apply to other public bodies—can decide to use public funds to enter into financial agreements with banks or other institutions that no one, including the auditors, will know about? How are public bodies held to account when such arrangements can be made?

Douglas Yule: We went into the arrangements with the best advice from some of the best insolvency practitioners. The negotiations were based on their advice. That advice went before the HIE board, which has the authority to decide on such issues.

The Convener: But I am not asking about that.

Douglas Yule: That is what happened, convener.

The Convener: I know that that is what happened, but I asked a question about a different matter.

Sandy Brady: We recognise the committee’s concern. Douglas Yule explained that there may be a route through which the information will come into the public domain. If you asked us to ask the Bank of Scotland again following our discussion, we would happily do so. I give a commitment on that. We recognise the public interest in the figure.

I believe that the bank was not holding the information for any purposes related to the funicular railway project. I suspect that the bank was having similar discussions regarding other situations elsewhere, and that it wished, for reasons of commercial confidentiality, for the figure not to be revealed. However, I would be happy to ask the bank one more time.

The Convener: It would be helpful if you did so. At the very least, the auditors should be given the information, even if no one else is given it. I find it astounding.

I have a further question for Mr Yule. You said that you believed that the bank was in breach when it tried to introduce the higher interest charges. Did you believe that the bank was in breach of a legal agreement?

Douglas Yule: No, it was a creditor agreement that we had come to. There was a co-operative creditor agreement at the time, which in effect allowed the company to continue trading. We felt that the bank had breached the spirit of that creditor agreement.

Nicol Stephen: When you entered into the negotiations with the bank, the company was technically insolvent. Is that the position?

Douglas Yule: It was trading with the support of its creditors, yes.

Nicol Stephen: Therefore, if there had not been a successful outcome, and if there had not been an agreement, the company would have gone into administration or liquidation—into some form of insolvency.

Douglas Yule: Yes. In effect, one of the creditors was breaking ranks. That circumstance led to the negotiations.

Nicol Stephen: How has the company performed since you took it over financially?

Douglas Yule: Until September 2009, this financial year, it was running at a loss of £150,000. That loss is in line with the budgets that are laid down for the year. The objective was to produce a balanced budget on the company by the year end. At this point in the year, pre-skiing season, that exactly follows the pattern that has emerged in previous years.

As ever, with the company’s particularly difficult and complex business model, the next few months through to April will be crucial for producing a balanced budget, or indeed a surplus, at the end of the financial year.

Nicol Stephen: The overall picture of the company, since its traumatic start, is one of a continuing loss of about £100,000 or £200,000 in some years and a small profit in others—the most being £170,000, I think—depending on the quality of snow and other weather factors. That continues to be the trend.

Douglas Yule: Yes.

Nicol Stephen: It is a highly marginal business.

Douglas Yule: Yes, it is.

Nicol Stephen: However, the scale of the losses is nowhere near what it was in the opening few years.

Douglas Yule: Absolutely. The period between now and April 2010 will make or break our year. The challenge for the future is how to increase the numbers of non-skiing visitors throughout the year, given the uncertainty of snow and skiing conditions. That remains an opportunity for us.

Bill Kidd (Glasgow) (SNP): The timescale of HIE’s commitment to the railway appears to be quite open ended. I understand that up to 232 full-time equivalent jobs are affected in Strathspey and Badenoch, where it is difficult to attract other forms of industry and employment. I understand that HIE has a duty to ensure that those jobs are not lost, because if they were they would have to be recreated somehow.

The takeover by HIE seems open ended particularly because, given the present world financial situation, it does not look as if many other companies would be especially interested in taking over a railway that has such poor returns on a regular basis.

How long are your projections? You have said that the railway might last about 30 years. How long would HIE have to operate the railway? Can you afford that? How much money will it cost HIE every year? Can you afford the commitment of resources, in terms of staff and finances, that will be required over that period? You must be committing a substantial proportion of your staff.

Sandy Brady: That is absolutely correct. In our work with Johnston Carmichael this year, we have taken time to carefully examine options that will enable us to reduce the call on HIE's resources directly and to set up a business model that will allow an enterprise to take forward the operation of CairnGorm Mountain. As Douglas Yule has described, we are in the process of stabilising the finances for the current time and gaining a much better understanding of the relationship of the summer to the winter trade, the operating cost base of the company and so on.

Johnston Carmichael's advice to us is that there is potential to grow the business, and that that potential is not being fully exploited, particularly in terms of the summer visitors—it recognises the variability of winter visitors, due to snow conditions. We think that a sustainable model is in place.

As Mr Stephen indicated, the operating losses and profits over the past few years have been encouraging to a degree, as the greatest losses were incurred early in the decade. We need to work hard with the company over the next couple of years to be able to develop a business entity that will take on the railway and run it on behalf of HIE, as the owner of the infrastructure on the hill. That entity might be the current company or it might be a new company; that will depend on the form that we come up with.

Bill Kidd: I understand the commercial sensitivity that exists with regard to the way that you are working with CairnGorm Mountain. However, have you worked out how long you will be able to sustainably maintain the company while waiting for a buyer to arrive?

Sandy Brady: There will not necessarily be a buyer; we are thinking more along the lines of having some kind of service agreement with a company that would come in and run the operation. Clearly, there would be a profit motive in it for such a company. I suspect that the arrangement would be in the form of a lease, at least in the short to medium term. After that, if the operation were successful, we might be able to sell it on, and we would be happy to do that.

Once we get the relationship right between the expenditure on the maintenance of the facilities and the estate itself, and the direct operation of the services to the public, we will have an entity that could go forward on a sustainable basis.

Bill Kidd: And you can afford the commitment of finances and staff for some years.

Sandy Brady: We can certainly afford that for the two to three years during which we will be trying the model out. If the model is successful, we will be able to reduce our commitment; if not, we will have to look carefully at the model.

In the section 23 review, Audit Scotland noted that that is a challenge for us and that we will have to be careful about how we format the business so that it is attractive to an operator who might want to come in and share some of the risk.

George Foulkes: Audit Scotland tell us that you helped to recruit new directors for CML. Who are they?

Douglas Yule: I do not have a list of those names with me, but I can provide it.

George Foulkes: Do you mean that the three of you do not know who you have appointed as directors of CML?

Douglas Yule: As I speak to you right now, I do not know their names.

The Convener: Is not that unusual? It is a very contentious project.

George Foulkes: I was going to ask what experience the directors have of tourism or of funicular railways.

I would have thought that the acting chief executive and two of his senior officers ought to know who they have appointed as directors of a company for which they have principal concern.

Sandy Brady: I apologise, Mr Foulkes. We should have that information, but we do not have it here today. The three new directors all have the expertise that is necessary for operation of the company.

11:30

The Convener: How do you know, if you do not know who they are?

Sandy Brady: I saw the materials that were put together for the spec for the directors, when that was done, but I was not directly involved in the recruitment process.

George Foulkes: Who appointed them?

Douglas Yule: A panel was put together, but it was done principally by the chairman of CairnGorm Mountain Ltd, Grenville Johnston, and his fellow directors. It is an arm's-length subsidiary and we are careful about shadow directorships in terms of our involvement with the company. It was, essentially, an issue for the company itself, although we contributed to the analysis in the run-up to the shortlist.

George Foulkes: Let us try another one. What are the terms of reference of the directors who were appointed?

Douglas Yule: The terms of reference are the same as those for any directors. Under company law, they are responsible for running the company properly and ensuring that they discharge their legal responsibilities.

George Foulkes: Do they receive remuneration?

Douglas Yule: Their remuneration is the equivalent of £400 a day.

George Foulkes: They get £400 a day?

Douglas Yule: That is the same as the HIE board and other public appointees get.

The Convener: Who pays that? Is it CML or is it HIE?

Douglas Yule: It comes from the company itself, from its trading.

George Foulkes: The company is trading at a loss, so how can it pay directors £400 a day?

Douglas Yule: CML is not trading at a loss at the moment.

George Foulkes: I thought you said that it was: you said that there was a loss of £150,000.

Douglas Yule: No, CML is working within its agreed facility. It is not insolvent; it is working within the agreed financial envelope with which it has been provided.

The Convener: Is that at a profit?

Douglas Yule: It has a balanced budget that it is working towards for the year end.

The Convener: As things stand just now, is it trading at a profit?

Douglas Yule: At the moment, it is in the middle of a financial year. It has a facility—in effect, an overdraft facility—from which it is drawing its working capital. It has a balanced budget. It is working to deliver a balanced position at the end of the year, and the costs associated with achieving that balanced budget include directors' remuneration.

The Convener: If skier numbers hold up, the company will either break even or make a profit. However, as things stand—as this meeting is taking place—the company is showing a loss.

Douglas Yule: At the moment, it is running a trading deficit of £150,000 with four months of the year to come including the big skiing time of the year, which is where the revenue comes from.

The Convener: So, the word should not have been "loss"; it should have been "deficit".

George Foulkes: I will conclude with a couple of questions. The directors get £400 a day. I presume that they also get travel and overnight expenses.

Douglas Yule: I think that most of them travel from within the area. They are within travelling distance for board meetings.

George Foulkes: The person responsible for appointing them—the chairman of CML—is Grenville Johnston. You mentioned earlier a company called Johnston Carmichael.

Douglas Yule: Yes.

George Foulkes: Is it the same Johnston?

Douglas Yule: It is. I believe that Grenville Johnston is a descendent of the founders of Johnston Carmichael.

George Foulkes: Is Grenville Johnston connected with Johnston Carmichael?

Douglas Yule: He is not connected with it any more. He is retired.

George Foulkes: But he was connected with it.

Douglas Yule: He was the senior partner in Johnston Carmichael for many years. He was also chairman of the Institute of Chartered Accountants of Scotland.

George Foulkes: There are an awful lot of coincidences of overlap between the organisations. Is that unusual or is it quite common?

Douglas Yule: In an area such as the Highlands and Islands, we try to get the best expertise that is available. Inevitably, because we are choosing from a smaller population, such coincidences tend to emerge from time to time. That is just a result of having a smaller business population in the area.

The Convener: Do you know whether there is any overlap in terms of membership of societies or organisations?

Sandy Brady: I could not comment on that, convener. All I can say is that we procured

Johnston Carmichael's services through the Office of Government Commerce—it was a pre-procured company. We did not procure the company directly; we took it that the Government had recommended it because of its expertise.

The Convener: I am not thinking just of Johnston Carmichael; I am thinking of George Foulkes's point about all the connections. I wonder whether these people tend to meet somewhere else at different times and whether they all know one another. When were the new directors appointed?

Douglas Yule: My recollection—it is only my recollection—is that they were appointed about 12 months ago.

The Convener: So—the new directors have been operating for 12 months, but three senior staff members of Highlands and Islands Enterprise still do not know who they are.

Douglas Yule: I have met them and have had discussions with them. However, as I sit here just now, not having a note about the members of the company, I cannot remember their names. I apologise to the committee, but that is the truth of the situation—I cannot remember their names.

The Convener: They clearly made a considerable impact on you.

George Foulkes: You look younger than me, Mr Yule.

The Convener: We look forward to getting the names of the directors. I invite Willie Coffey to ask about the business model.

Willie Coffey: Other members have briefly touched on the plans for the future. Why has it taken so long to put a revised business plan together? You said that you are preparing it for 8 December.

Sandy Brady: We worked very closely with Johnston Carmichael up to the beginning of September, when it submitted its final report. This is a complex and challenging task for us because it is a complicated business model. We wanted to ensure that we took great care to get the best advice, which meant that once Johnston Carmichael submitted its early analysis in spring this year, we had intensive engagement with it. We asked it to think again about some of the analyses and to bring in more international experience in respect of how such visitor attractions work on the continent. There was intensive engagement from about May through to September to ensure that we got the very best report.

Since that time, staff have in their turn been working on the report to understand the nuances of what Johnston Carmichael said and to consider some of the detailed appendices on costs and options for a new business model. Only on the basis of having done that very thoroughly, the internal project board agreed last month that the three options in the Johnston Carmichael report should go forward to the HIE board meeting next week. It has been an intensive process, but we took the view that it was better to get it right—given the complexities involved, which have been discussed over the past hour or so—than to jump to a quick decision.

There is no easy fix. The Audit Scotland report indicated that and said that HIE should try to ensure that we got it right, because the sums of money involved, the capital invested and the scale of the operating losses that had been incurred in the past required us to do the work very thoroughly.

Willie Coffey: I do not wish to pursue you too far in that direction, but I think that the committee has a legitimate interest in hearing from you that there is confidence for the future and that the project can remain viable. However, what happens if we do not get a new operator? Is the project viable without that?

Sandy Brady: We believe that the project is viable. The infrastructure on the hill is relatively young in its economic life. We believe that it is operating very satisfactorily as a summer visitor attraction and in supporting skiing operations in the winter. We therefore believe that there is something there that can be taken forward. The financial results of the past few years give us encouragement to believe that, if we can get the balance right between the landowner supporting the infrastructure, which is HIE's role, and CairnGorm Mountain Ltd—or a successor company—operating the visitor attraction, we can get it right. However, we are taking our time to ensure that we explore all the options that Johnston Carmichael put in front of us.

Willie Coffey: Convener, I think that we should get sight at some point of the plans and proposals so that we can give them some public scrutiny. They could either come directly to us or come through Audit Scotland.

Sandy Brady: We would be happy to submit them through either route.

The Convener: Thank you. I conclude by asking whether you are confident that the leadership of CML will be able for the next few years to run the business sustainably and viably.

Sandy Brady: We are. The new chief executive of CairnGorm Mountain is Ian Whitaker, who is very experienced in the company's operations. We are confident that he and his colleagues on the hill who run the resort day to day are capable of that. It is a challenge, because they operate in a difficult environment and have two different businesses there: they cater for family groups and holidaymakers coming in the summer, right through to the onerous duties of running a ski resort in the depths of winter, when they have to get a lot of people off the hillside very quickly if conditions change.

The Convener: Where did Ian Whitaker come from?

Sandy Brady: He had been working within the company and was promoted internally.

Douglas Yule: He was at Our Dynamic Earth before he went to CairnGorm Mountain.

Nicol Stephen: I have a final question. I am conscious that this is our last opportunity to ask questions and I am deeply concerned to hear about the bank's actions, which the committee may wish to follow up. When the bank was acting as the witnesses described, what would have happened financially if the company had gone into some form of insolvency? What would have been the consequences for Highlands and Islands Enterprise? Would a repayment to the European Union have been triggered and would other contingent liabilities have fallen on the public purse? Will the witnesses explain the situation?

Douglas Yule: The creditors would have been out by the amount that they were owed. That would have included a lot of small creditors. Repayment of the European moneys would not have been triggered unless the funicular ceased to operate. There is a period of time during which, if it is closed and not running, there is an obligation on us to remove it from the hill. That, too, was a motivation for us to ensure that it continued to operate. However, the most significant point is that we would have lost control because of the standard securities. That particularly motivated us as landlords and owners of the facility.

Nicol Stephen: Earlier, you said that the railway could have been shut down for a period not only because of standard securities, but if an administrator took over.

Douglas Yule: Yes.

Nicol Stephen: What repayment would that have triggered? What was the contingent liability?

Douglas Yule: A short-term closure would not have triggered a repayment. The funicular would need to have been closed for longer for that to happen. However, the short-term closure would have dented confidence among businesses in the valley and would have had a significant effect on the marketing and other tourism proposals for many businesses that employ a relationship marketing strategy around CairnGorm Mountain in selling their business opportunities. We had spent a lot of time building up that confidence over the previous eight years.

Nicol Stephen: Is it fair to say that the bank would have been every bit as aware of those issues as was Highlands and Islands Enterprise?

Douglas Yule: The bank had a lot at stake in the valley at that time.

The Convener: I thank Mr Brady, Mr Bryers and Mr Yule for their contribution to the meeting. We look forward to receiving the extra information that they said they would provide. Obviously, they will go back to the bank, as well. We realise that the project was fraught with difficulties and we do not underestimate the dilemma and challenges that it faces in the future. Everyone wants the project, which is clearly important to the area, to be successful but, as I explained earlier, our interest is in the historical events.

Sandy Brady: Thank you for those words, convener. We appreciate them and hope that we have been of assistance to the committee.

11:43

Meeting suspended.

WRITTEN EVIDENCE FROM HIGHLANDS & ISLANDS ENTERPRISE

CAIRNGORM FUNICULAR RAILWAY PROJECT

Origins of the project

Discussions on how to take forward Scotland's busiest ski resort can be traced back to the period 1991-93, when the Cairngorms Working Party reviewed and reported on the range of recreational, environmental and economic issues facing the area. It was recognised that any decision to replace the ageing chairlift needed to take account of both winter and summer management issues - among these, lowering susceptibility to wind during the skiing season and reducing easy walking access to the Cairngorm Plateau. The Cairngorm Chairlift Company concluded that a funicular railway offered the most attractive solution.

Economic development context

The construction of the Aviemore Centre, the growth of downhill skiing at Cairngorm and the development of a year-round resort in Strathspey during the 1960s were a major boost to tourism in the Highlands. It was decided by the Scottish Office in 1971 that the upper slopes at Cairngorm would be transferred from the Forestry Commission to the HIDB for the further development of winter sports. Since that time, HIDB/HIE has leased the skiing area to the Cairngorm Chairlift Company (now Cairn Gorm Mountain). The decline in the fabric of the tourism facilities in Aviemore over 30 years or so led the then Secretary of State for Scotland in 1996 to award HIE £8m of special funds to help re-generate the Centre. Against this background, HIE saw the need to re-invest in the skiing infrastructure and the incoming Secretary of State in 1997 supported the proposal to build the funicular railway.

Appraisal of the project

The Audit Scotland review summarises the appraisal process which took place, culminating in the award of European funding of £2.69m in December 1997 alongside the commitment of HIE funds. The review states that the appraisal met the requirements of the time. There then followed a delay before construction could begin of nearly two years while a Judicial Review of the planning decision took place and the detailed conditions attached to the European funding were agreed.

Project funding

The agreed funding for the project comprised HIE grant-in aid of £9,390k and European funding of £2,966k, the total project costs were £14.8m. The tender process indicated that this budget would be sufficient to allow the project to be completed in time for the European funds to be claimed inside the completion deadline of 31 December 2001. It was recognised, however, that the budget was a tight one and that the risks involved in undertaking a major construction project at high altitude were considerable. With the contingency largely committed, HIE agreed to proceed, judging that the political support for the project was clear and that the European funds were at risk from delay in the start of construction.

Construction of the funicular

Construction began in August 1999, with the works being divided into three lots: 2 civil engineering contracts and 1 for the railway itself. The former were won on competitive tender by Morrison Construction and the latter by Doppelmayer also following competitive tender. Partly because of the shorter construction period than originally envisaged – spanning only two summers rather than three - construction costs rose beyond the approved funding and consent was obtained from the Scottish Executive to allow HIE to raise its financial input. A second contributory factor was the degree of difficulty involved in the works, the project being the largest and most complex attempted in the Scottish mountain environment. Despite some savings being made from reductions in specification, the final cost of the project was £19.5m, which HIE met from grant-in-aid (alongside the £2.69m European contribution).

Operation of the facility

The funicular opened in December 2001 in time for that winter's skiing season. The Audit Scotland review traces the visitor numbers at Cairngorm over the life of the funicular. Summer visitor numbers of 160,000 in the first year were in line with projections, but have fallen since then. As an addition to the attractions offered by the Strathspey area, the funicular has proved popular, while at the same time contributing to the management objective of the 'long walk-in'. Skier numbers have varied from year to year according to the availability of good snow conditions, the annual average being around 50,000 skier days. The railway has been well-received by skiers and has achieved a very good availability record, noticeably in wind conditions which would have closed the chairlift.

Economic contribution

Studies commissioned by HIE have indicated that the economic benefits brought by the funicular have matched those aspired to in the original appraisal. The overall employment impact of Cairngorm Mountain in the HIE area was assessed as 174.5 Full Time Equivalents.

Ownership of Cairn Gorm Mountain

Cairn Gorm Mountain incurred operating losses over the years since 2001 to the point where significant creditors, namely HIE, the Highland Council and HBOS, existed. With pressure mounting on the company, and a decision to go into administration likely by the Directors of CML, HIE elected to take the company into its ownership in May 2008 to secure the continued operation of the infrastructure and its contribution to the local and regional economy.

Review of options for the future

Following close working with the company to understand fully the nature of the operations at Cairngorm, HIE undertook to seek independent advice on possible business models which would allow it to disengage from ownership. The review was placed with Johnston Carmichael (who reported to HIE in September) and the possible options which they have developed have been assessed by a project board and the HIE Management Team before going to the HIE Board at its meeting on 8 December. HIE's witnesses to the Committee will be pleased to outline the findings of the Johnston Carmichael work and to describe the options.

Highlands & Islands Enterprise
25 November 2009

LETTER TO SANDY BRADY, ACTING CHIEF EXECUTIVE, HIGHLANDS AND ISLANDS ENTERPRISE, FROM THE CONVENER OF THE PUBLIC AUDIT COMMITTEE, 8 DECEMBER 2009

AGS REPORT - REVIEW OF CAIRNGORM FUNICULAR RAILWAY

Thank you for your evidence to the Public Audit Committee meeting on 2 December on the Auditor General for Scotland report entitled "Review of Cairngorm Funicular Railway". The Official Report from that meeting will be available at the following link from 8 December:

http://www.scottish.parliament.uk/s3/committees/publicAudit/meetings.htm.

During evidence, you offered to provide the Committee with the following further information:

Tendering process
What advice did HIE receive in relation to the tender process at the outset of the project? Did HIE consider the use of fixed price tenders and other methods of tendering? If these were considered, what were the reasons for disregarding these approaches? How was tendering for the three lots conducted? What were the outcomes of each of the three tender competitions and what criteria were used? Has HIE conducted a review of its tendering process for this project and the financial outcome? What did this review show?

Authorisation of project expenditure beyond the Secretary of State's original limit
During evidence, you stated that you had documentation which authorised expenditure on the funicular beyond the original public sector funding limit of £12.356 million imposed by the Secretary of State in 1997. The Committee would be grateful if you would provide this.

Breakdown of funding provided for the project
During evidence, you offered to provide a table showing exactly how the total funding of the project to date is broken down. The Committee would be grateful for this table, which should show each type of funding (e.g. construction, purchase of loan etc) provided by all partners, to support the project since its inception, including all additional amounts since the completion of the facility.

Sum paid to the bank to acquire the asset
You indicated during evidence that the figure paid by HIE to purchase the bank's security over the asset is subject to a confidentiality agreement between HIE and the bank. The Committee consider that this information is a matter of public interest and key to its consideration of the report. The Committee would therefore be grateful if you would seek permission from the bank to release this information.

The new directors at Cairngorm Mountain Limited (CML)
The Committee would like to receive a list of those appointed to the CML board, along with information on their relevant qualifications and experience.

The future business plan for CML
The Committee would be grateful if you would report back on the outcome of the Board's deliberations on the options for the future of the funicular following the Board meeting on 8 December. The Committee would like to receive details of CML's new business plan as soon as possible and would be grateful for an indication of when it is likely to become available.

Assessment of CML's financial situation
Please confirm the financial losses and profits of CML in each year since 1995. Did HIE consider this information when it entered into the contracts for the funicular? Did HIE consider this information when it provided an assurance to the EU that CML was in 'a sound position' in 1999?

The Committee intends to consider the issues again at its meeting on 13 January. I would therefore be grateful for a response to this letter by 5 January 2010. If this timeframe presents you with any difficulty and should you require any further information please do not hesitate to contact the Clerk to the Committee, Tracey White, on 0131 348 5390 or by email at pa.committee@scottish.parliament.uk.

LETTER FROM SANDY BRADY, ACTING CHIEF EXECUTIVE, HIGHLANDS AND ISLANDS ENTERPRISE, FROM THE CONVENER OF THE PUBLIC AUDIT COMMITTEE, 22 DECEMBER 2009

AGS REPORT – REVIEW OF CAIRNGORM FUNICULAR RAILWAY

Following HIE's evidence to the Public Audit Committee on 2 December on the Auditor General for Scotland report entitled "Review of Cairngorm Funicular Railway" and your subsequent letter dated 8 December, I am now pleased to provide the following further information:

Tendering process

Initially a type of fixed contract, known as a guaranteed maximum price (GMP) contract, was considered. As the final design crystallised, following the outcome of the Lot 3 (buildings) tender coming in over budget, it became clear that a GMP contract was not achievable as the premiums required by tenderers to take on all the complex risks in the project were clearly going to be substantially more than the remaining financial approval could accommodate. Any form of fixed price contract was impractical because of the nature of the work with several areas of risk, notably, the effects of adverse weather, the restricted construction season, environmental restraints imposed on construction methodology and uncertainty arising from some of the technical solutions being proposed, e.g. use of a cable crane.

Competitive tendering of the works was undertaken in line with the rules relating to public works and HIE advertised each lot in the Official Journal of the European Community (OJEC).

Lot 1 comprised the manufacture, supply and installation of the funicular railway. Tenderers were invited to price a funicular railway to meet a baseline specification with variations for different alternative options and to offer additional alternative proposals if they wished. An assessment matrix was used to allow for the evaluation of the tenders on a balance of tendered price and quality. The outcome of the Lot 1 tender competition was that Doppelmayr Tramways Ltd was awarded the Lot 1 contract in August 1999 in the sum of £2.993m.

Lot 2 comprised the package of civil engineering works associated with the project and included new utilities, new sewage treatment plant and potable water system, installation of foundations for and erection of railway support structure, cut and cover 250m tunnel, excavation of top station basement, and associated special treatment and reinstatement of soils and vegetation. Some design information in the tender documents was unavoidably incomplete and could only be finalised once the Lot 1 (railway) contractor had been appointed and confirmed their design and methods of construction. Therefore, Lot 2 had to be a two stage tender with stage 1 involving the selection of a single contractor to proceed with early construction, including installation of the utilities under the mountain road and ordering of long lead-time materials. Stage 2 represented progressing conclusion of the final price. The bids were scored for price and quality and the analysis indicated that Morrison Construction should be awarded the Lot 2 contract. This was done by a Letter of Intent in July 1999 in the sum of £4.724m.

Lot 3 comprised the construction of the station buildings and associated works. The tenders were assessed on the basis of technical, financial and statutory compliance. To meet the EDRF funding requirements a contract had to be awarded by December 1999. The tenders were significantly over budget and further cost saving design proposals were made that still delivered the overall scope of the buildings. One and then a second tenderer declined to further assist with these tender clarifications. The remaining contractor, Morrison Construction, was then able to offer cost savings through the adoption of buildability variations and a direct combining of Lots 2 and 3 so that economies of overhead and Preliminaries could be taken. Some of the technically achievable buildability option for both Lots were accepted where these did not affect the overall quality of product or scope of project. For instance, the railway support bridge beams were altered from steel to concrete beams and the tunnel built with prefabricated systems. The revised tender amount for the combined Lots 2 and 3 contract was accepted by HIE in the sum of £9.642m.

In early 2002 HIE's internal audit team reviewed in detail the approval of the funicular project and associated payments to ensure that adequate controls were in place to protect public funds. The review concluded that there had been 'rigorous tendering procedures for the Lots 1, 2 and 3.

Authorisation of project expenditure beyond the Secretary of State's limit

I am enclosing letter dated 7 August 2001 from Michael Lowndes of the Scottish Executive's Enterprise & Lifelong Learning Department.

Breakdown of funding provided for the project

Breakdown of the funding for the project is as follows:

Cairngorm Mountain Ltd Project Funding	
	£m
HIE	19.417
Bank	3.618
European Union	2.613
Highland Council	1.000
Cairngorm Trust	0.101
Total	26.749

HIE Funding	
	£m
Construction costs	16.93
Consultancy, marketing, etc	0.774
Existing building	0.53
Other support	1.183
Total	19.417

Sum paid to the bank to acquire the asset

HIE wrote to the Bank of Scotland on 8 December 2009 to seek consent to release this information to the Committee but has not as yet received a response.

The new Directors at Cairngorm Mountain Limited (CML)

I am enclosing a copy of a press release dated 15 June 2009 from Cairngorm Mountain Limited which provides details of the qualifications and experience of these Directors. I understand that my colleague, Maria Reid, provided their names to the Committee Clerk after our oral evidence session.

The future business plan for CML

I am attaching an extract of the draft HIE Board minute of its meeting on 8 December relating to consideration of the options for Cairngorm Mountain. You will appreciate that this minute remains a draft until it is approved at the next meeting of the HIE Board.

Assessment of CML's financial situation

Details of CML's losses and profits in each year since 1995 are as follows:

Year	**Profit/Loss £k**
*1996	9
1997	-607

1998	-625
1999	-110
2000	-583
2001	-793
2002	-1876
2003	-1246
2004	-612
2005	28
2006	32
2007	-263
2008	174
2009	-43

* 1996 listing covers a period of 18 months from 1 November 1994 to 30 April 1996. Subsequent year ends are 30 April.

HIE took account of the company's past and current trading position when it provided an assurance to the EU that CML was in a 'sound position' in 1999.

I hope that this information is sufficient for the Committee to consider the issues again at its meeting on 13 January but please do not hesitate to contact me if you require anything further.

SCOTTISH EXECUTIVE

Enterprise & Lifelong Learning Department

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Douglas Macdiarmid Esq
Director, Growing Businesses Group
Highlands and Islands Enterprise
Bridge House
20 Bridge Street
INVERNESS
IV1 1QR

Your ref:
Our ref:

7 August 2001

Dear Douglas,

REVIEW OF CAIRNGORM FUNICULAR RAILWAY PROJECT.

You will recall that following the HIE Board's consideration of the proposal that HIE should make an additional financial commitment of £3.5 million to the Cairngorm Funicular Railway Project earlier this year, the Board met with the Minister for Enterprise and Lifelong Learning on 16 May. At that meeting the Minister stated her view that the decision on whether to invest an additional £3.5 million in the project must be for the Board to take in the light of a thorough appraisal of the options, but that Ministers would not wish to second guess the Board's commercial judgement in this case.

We have not been able to formally confirm that HIE has authority to proceed with the revised funding package for the Cairngorm Funicular, because a decision in this particular case must await a general review of sponsorship arrangements between the Scottish Executive and HIE, and in particular, raising the present delegated authority levels. However, Ministers' intentions to proceed with such a change in the current sponsorship arrangements are clearly stated in both the Review of the Enterprise Networks document and the Smart, Successful Scotland document. We do not, consequently, envisage any particular difficulty with the general proposal to raise HIE's delegated authority levels, or the specific proposal for a revised funding package for the Cairngorm Funicular Railway Project.

While I recognise that this letter does not offer any absolute assurance, I hope nevertheless that it provides you with sufficient comfort for the present time. We shall submit comprehensive proposals to Ministers for changes in the present sponsorship arrangements later in August when Ministers return from their holidays.

I hope that this is helpful in the meanwhile.

Yours sincerely
Michael Lowndes

MICHAEL LOWNDES

CairnGorm Mountain Ltd

Press Release **15th June 2009 – Immediate Release**

Non-Executive Directors Appointed to CairnGorm Mountain Ltd Board

Following the transfer of ownership in May 2008 of CairnGorm Mountain Ltd to Highlands & Islands Enterprise three new non-executive Board appointments have been confirmed: Mr Keith Armstrong (Edinburgh), Mr Stewart Macintyre (Aviemore) and Major General The Hon Seymour Monro CBE (Moray). Together with existing non-executive Director Tim Whittome (Inverness), executive Directors Sandra Murray and Ian Whitaker and Chairman Grenville Johnston, the new CairnGorm Mountain Ltd Board is now complete.

Chairman Grenville Johnston explained;

"CairnGorm Mountain is now a wholly owned public company and as such it is important to recognise this new relationship and restate our public accountability. The new non-executive members bring with them a breadth and depth of individual experience and knowledge that complements the existing Board members and will serve the Company well for its future."

Mr Keith Armstrong is a partner in Scotland's largest commercial law firm, Dundas & Wilson. In his 15 years in private practice, he has specialised in projects where the public and private sectors work together on commercial ventures throughout Scotland and the UK. He also has extensive experience dealing with corporate governance issues. Having learned to ski on the mountain in the early 1980s, he returns whenever possible. In his spare time, Keith enjoys walking in the Cairngorms and mountain biking in the surrounding area.

Mr Stewart Macintyre has over twenty years' estate management experience across a broad spectrum of UK industry in both the public and private sectors including Forth Ports Property, National Grid and British Gas. He is currently a Director of Tombain Property, Land and Property Consultancy involved in advising clients throughout Scotland on land and property assets. He is an active skier and current Chair and Director of Snowsport Scotland, the National Governing Body, a member of the Snowsport GB Council, a former Chairman of Cairngorm Ski Club and a former BASI Instructor and is particularly interested in sustainable recreation within the mountain environment.

Major General Seymour Monro served in the Queen's Own Highlanders retiring in 2004 a Major General. He then became Executive Director of the Atlantic Salmon Trust until 2008. He was Chairman of the Prince's Trust in the Highlands and Islands from 2004 – 2007 and is currently the Adjutant The Queen's Body Guard for Scotland, Chairman of the Highland Heritage Appeal for the Highlanders Museum at Fort George and of the Findhorn, Nairn and Lossie Fisheries Trust. His involvement and commitment to a range of natural heritage, conservation and cultural heritage projects underpins his belief that as the current guardians of the Cairngorms we have a responsibility to ensure they are managed in a sympathetic and sustainable way. He first skied and walked on the Cairngorms in the early 1970's.

All new non-executive members attended their first Board Meeting at the end of May and took the opportunity to meet the CairnGorm Mountain Management Team and view the site.

For further information please contact:

Tania Alliod. CairnGorm Mountain Ltd. TEL 01479 861304 or Colin Kirkwood TEL 01479 861326

ENDS

ENC: Pictures of the new non executive directors are available on request and can be viewed on the web site.

Extract of HIE Board Minute (draft) – Meeting held on 8 December 2009

10 Cairngorm Mountain Options Appraisal paper (HIE 2008/01426)

Douglas Yule, Martin Johnson, Area Manager for the Inner Moray Firth and Archie McCreevy, Head of Operations at the Inner Moray Firth Area Office gave the Board a comprehensive presentation setting out the current issues facing HIE in relation to the HIE-owned land and facilities at Cairngorm Mountain. The Board discussed specifically the recommendations made in the recently commissioned independent assessment carried out for HIE by Johnson Carmichael on securing a sustainable business model for the operating facilities at Cairngorm. The full options appraisal report had been considered by HIE's Cairngorm Mountain Project Board and their recommendations were offered to the Board for comment. Both Lorne Crerar and Angus Mackenzie had been fully involved in the framing of these recommendations.

The Board agreed that there remained clear potential to improve the long-term sustainability of the facility by improving income streams and adjusting the cost base. One route to increase income was to achieve higher levels of summer visitors through improved marketing and promotion, recognising that ski-ing numbers were dependent on the quality and duration of snow conditions.

Following examination of the various options set out in the assessment paper, it was concluded that, if full potential was to be achieved, HIE would need to maintain ownership of Cairngorm Mountain Ltd in the short to medium-term. The Board endorsed the view that the case for further significant capital investment, as envisaged in Johnston Carmichael's second and third options, could not be justified at this time. However, it was also recognised that to do nothing was not viable and it was agreed, therefore, that a revenue enhancement model, based on Johnson Carmichael's option 1 but picking up some elements from Option 2, should be progressed.

Specifically, this would involve HIE in making further investments on marketing and car park upgrading, with the introduction of charging for parking to increase income. Also, HIE would take responsibility for ski infrastructure, mobile plant and funicular railway maintenance and undertake a planned programme of works over the next 2-3 years, with the current operator taking responsibility for maintenance of the buildings.

It was noted that discussions would now continue with the operator with a view to a new balanced budget being presented to HIE as part of CML's operating plan for 2010/11. A further paper would be brought to the HIE Board in February 2010 developing further an action plan outlining the way forward.

Andrew Ross
HIE Secretary
22 December 2009

The primary objective of the new business model is to increase both the numbers of people visiting Cairngorm and the average spend per person. No limitations were placed initially on the investment that might be required; the main aim was to identify if the business could become operationally and financially sustainable. In the latter stages of the review, it became evident that due to the UK economic difficulties, there was a consequent increase of urgent calls for HIE's resources. HIE were therefore faced with reductions in the available funds for capital investment at Cairngorm in the short-term. This resulted in us having to make a substantial re-assessment of the affordability of the solutions being proposed.

However, while having to re-assess the timing and extent to which HIE might be able to commit investment to the business, this change in circumstances did not fundamentally alter our conclusions on the strategy for delivering a sustainable business model. We did however have to consider an option in which there would only be a shorter-term "quick-fix" low cost solution which would be focussed on halting the decline in the number of people using the facilities.

We therefore considered four options for the business model:

- A "Do Nothing" option in which the business was run along existing lines with no new investment;
- A "Partial" option which provides a quick-fix solution to the decline in visitor numbers;
- A "Full" option which delivers the market development focussed design brief;
- A new build option which demolished and re-built the Base Station and the Ptarmigan.

The last option was discounted in discussion with HIE on the basis of the cost at almost £10m.

The capital investment required to meet the Partial and Full options is £1.475m and £5.975m respectively. (Section 6 – page 28)

We made assessments of the impact of the various options on the visitor numbers and spending patterns at Cairngorm. We sought the opinion of SVP who are specialists in the tourism and facility management sector and also in marketing and brand management. They provided a basis for calculating the increases in uplift numbers and spending which we used to translate into financial plans for the new business. The table below summarises the impact of the options on the visitor numbers in 2015.

CML Year 5 Comparison Visitors		Do Nothing	Partial Option	Change vs Do Nothing	Full Option	Change vs Do Nothing
Total Car Park users	No	400,000	410,000	10,000	440,000	40,000
Ski	No	46,522	50,212	3,690	50,902	4,380
Non-ski	No	120,246	165,166	44,920	179,207	58,961
Base Station only	No	-	20,000	20,000	40,000	40,000

Source: JC models

Both the Partial and Full options show increased numbers of both skier and non-skier visitors to Cairngorm after 5 years when compared to the Do Nothing option. We would emphasise that the numbers shown above are scaled back from those provided by the specialists in order that they represent a conservative business case. The specialists have expressed confidence that the increase in visitors could be higher.

The financial analysis of the options is summarised in the table below again using year 5 for comparative purposes. This shows that in both the Partial and Full cases, there is an improvement in the financial outlook for the business.

Our terms of reference were to develop a new business model for the operation of HIE's funicular railway which is both financially sustainable for HIE and the operator.

Our overall conclusion is that there is an overriding need for the business to develop a clear bold strategic vision of Cairngorm as a high quality, year round, exciting recreational-based experience. Without this it will prove difficult to develop a sustainable business model. We have defined a possible vision for the new business model as follows:

To position Cairngorm as Scotland's pre-eminent mountain adventure and innovative mountain experience by the creation of a dynamic year round visitor attraction, respectful of the natural environment and offering unique visitor experiences based on activities, education, entertainment and shared experiences.

The assets of the business are situated on Cairngorm which is an immense natural setting offering unparallelled features in the centre of an internationally recognised destination. It is estimated that there are 1.2 – 1.3 million visitors per annum visiting the Destination. A large percentage (approximately 400,000) visit Cairngorm but less than half actually engage with the business. There is also anecdotal evidence to indicate that the visitor numbers to CML are declining while the numbers in the Destination are increasing. There is consequently considerable potential to convert this captive market into users of the facilities.

The new business model requires a market-led solution and approach to the difficulties being experienced with the current business model. The target customers to focus on for growing the business are:

- Attracting more of the 1.2 million visitors to the wider Destination to visit Cairngorm
- Providing a service offering and facilities to attract people to spend on catering and retail at Cairngorm but who not wish to use the Funicular Railway
- Converting existing visitors to Cairngorm car park who might wish to use the Funicular Railway but do not currently do so as it is not perceived to be an attractive proposition.

To develop a sustainable business model, a strategic vision and direction has to be agreed for the business. An operator then has to focus on improving the experience at the mountain to attract, retain and get repeat custom from the far larger (and more consistent) numbers of non-skier visitors to Cairngorm. The operator will also have to provide activities of a nature, variety and interest to a range of age groups which will increase their average spend at the facilities.

To achieve the increase in uplift numbers necessary to make the business operationally and financially sustainable, the business needs to be repositioned with changes made to the whole operation. This repositioning involves a wholesale review of the branding of the business, changes to the physical infrastructure, changes to the culture of the management and staff and improving the whole "value for money" proposition by upgrading the quality of catering, retail and exhibition offerings.

None of the suggested changes carried out in isolation or on a piecemeal basis will create a business which is sustainable on a long-term basis. A number of the changes revolve around making a substantive change to the main infrastructure at either end of the Funicular Railway i.e. the Base Station and the Ptarmigan. We therefore prepared a market-led design brief from which a design team produced concept drawings and costings for the re-development of both the Base Station and the Ptarmigan. These concept drawings are included as part of this report.

CML Year 5 Comparison Financial	Do Nothing £	Partial Option £	Full Option £
Income from Visitors	3,196,735	4,321,418	5,079,008
HIE Deficit funding	314,200	-	-
Total Income	3,510,935	4,321,418	5,079,008
Gross profit	—	—	—
Profit/ (loss)	—	—	—

Source: JC models

This financial analysis shows the results of the business using the uplift assumptions. It also assumes that there is stability in the number of visitors to the operation. This is not always the case as the number of skiing visitors can change substantially from one year to another. This is a difficult financial risk for an operator to take on. We have therefore designed a financial mechanism within the business models which would provide for HIE to share in any "super-profits" made by the operator but which would provide a support mechanism for the operator in the event that the business suffers from a very poor snow-sports season. This is set out in more detail within the report.

We have confirmed that this mechanism is unlikely to breach the State Aid rules on the basis that it should fall within the *de-minimis* levels of State Aid. However, the State Aid rules will need to be tested by HIE based on the options chosen.

We are proposing that the operational structure should comprise a lease of the land and an operating agreement. All the operating assets (not the land, buildings, funicular railway and infrastructure) would be transferred into a new corporate vehicle run by the operator under the terms of an operating agreement. The length of this agreement will be determined by whether or not a private sector operator is willing to provide capital investment into the business or not. If an operator is prepared to invest capital then the operating agreement will require to be longer in order to allow the operator the opportunity to recoup the investment. If an operator is not willing to input capital investment then the operator agreement would be around 5-6 years.

The choice of operator has to be determined using a tender mechanism under EU procurement regulations. As there are a number of technical, legal and financial complexities relating to the tender, we believe that the most appropriate tendering mechanism to use would be the competitive dialogue procedure. This allows HIE to enter into dialogue with participants in the tender on all aspects of the proposed contracts before determining which solution (or solutions) best meets HIE's needs and thereafter seeking tender bids based on the resulting solution.

A timetable to achieve this is set out in Section 9. This timetable is short and assumes the appointment of a new operator in April 2010. The achievability of that objective will depend entirely on HIE promptly making the following vital decisions:

1. Whether to acknowledge that there is a need to redefine the strategic vision and to reposition the business model on the basis set out within this report;

2. Whether it is possible to commit to funding the Full or Partial options (or somewhere in between) over the next 3-4 years;

3. If HIE are **NOT** able to commit to the full option, whether they are willing to grant a concession of sufficient length (possibly greater than 10 years) to provide private sector operators with the incentive to invest in the business and aim to achieve a commercial rate of return on their investment;

4. The extent to which they are prepared to accept the cyclical maintenance risks and liabilities of the Funicular Railway and providing a support mechanism to the operator in the event of a disastrous ski season;

5. Whether to accept the competitive dialogue procedure as the most appropriate basis for seeking to put the operating contract out to tender and seek innovative solutions from across the range of potential operators in the private sector.

Should HIE determine either that there is not a need to reposition the business or that it should be repositioned differently from the way set out in the report then the fundamental tenet and conclusions of the report maybe diluted and long-term financial sustainability may not be achieved.

LETTER TO PETER GORDON, SENIOR MANAGER, LLOYDS BANKING GROUP, FROM CONVENER OF THE PUBLIC AUDIT COMMITTEE, 10 FEBRUARY 2010.

AGS REPORT - REVIEW OF CAIRNGORM FUNICULAR RAILWAY

The Public Audit Committee of the Scottish Parliament is conducting an inquiry into the AGS report entitled "Review of Cairngorm Funicular Railway".

During the course of its investigation, the Committee became aware that a sum of money was paid to the bank by Highlands and Islands Enterprise (HIE) for its shares in Cairngorm Mountain Limited and in return for it releasing its standard security. The Committee also understand that the nature of this sum is bound by a confidentiality agreement between the bank and HIE.

The Public Audit Committee's interest in this matter arises from its responsibilities to scrutinise and hold to account those who spend public money. The Committee understand that, following the Committee's meeting on 2 December 2009, HIE requested permission from you to disclose the sum but has yet to receive a response.

I would be grateful if you would let me know, as soon as possible, when you intend to respond to HIE's request.

Below is a link to the Official Report of the Committee's meeting which took place on 2 December. I draw your attention to columns 1358-1359.

http://www.scottish.parliament.uk/s3/committees/publicAudit/or-09/pau09-1801.htm

Should you require any further information please do not hesitate to contact the Clerk to the Public Audit Committee, Tracey White on 0131 348 5390, Room T3.60, The Scottish Parliament, Holyrood, Edinburgh, EH99 1SP, email pa.committee@scottish.parliament.uk).

LETTER FROM SANDY BRADY, ACTING CHIEF EXECUTIVE, HIGHLANDS AND ISLANDS ENTERPRISE, TO THE CONVENER OF THE PUBLIC AUDIT COMMITTEE, 23 FEBRUARY 2010.

AGS REPORT – REVIEW OF CAIRNGORM FUNICULAR RAILWAY

Further to my letter of 22 December 2009 in response to yours of 8 December, HIE has now received consent from Lloyds Banking Group to release the information requested by the Public Audit Committee.

I can advise that the sum paid by HIE to Bank of Scotland PLC for the assignation of its rights in the debt in Cairngorm Mountain Ltd and subsequent discharge of its securities was £145,000. The Bank did not own shares in CML and HIE acquired all the ordinary shares of CML from Cairngorm Mountain Trust for £1.

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