

The 2018/19 audit of Highlands and Islands Enterprise

Cairngorm mountain and funicular railway



AUDITOR GENERAL 

Prepared for the Public Audit and Post-Legislative Scrutiny Committee by the Auditor General for Scotland
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Introduction

1. I have received the audited annual report and accounts and the independent auditor's report for Highlands and Islands Enterprise (HIE) for 2018/19. I am submitting these financial statements and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.
2. The auditor issued an unqualified opinion on HIE's financial statements for 2018/19. I have prepared this report to draw to the attention of the Scottish Parliament the circumstances related to HIE's establishment of a subsidiary company, Cairngorm Mountain (Scotland) Ltd (CMSL), to take over the operation of the Cairngorm Mountain ski resort, including the funicular railway. This was in response to the previous operator, Cairngorm Mountain Ltd (CML), entering administration in November 2018.

Background

3. Cairngorm Mountain range is regarded as an environmental and economic asset for Scotland, playing a key role in underpinning the local tourism industry, which is a vital component of the economy around Aviemore and Strathspey. HIE is the long-term owner and custodian of Cairngorm Mountain. This comes with responsibilities to ensure there are effective arrangements in place to manage and maintain the mountain environment and provide a stable operating environment for the business within the ski area.
4. HIE began the construction of a funicular railway to serve the Cairngorm Mountain ski resort in 1999. It expected the funicular railway would benefit the area by:
 - helping to strengthen its economic base
 - encouraging others to invest in the area
 - providing more secure employment
 - improving the appeal of the area as a tourist destination
 - improving the controlled use of the area to minimise environmental impacts.
5. CML assumed operation of the funicular railway in 2001 under a lease agreement with HIE which owns the land, buildings and facilities including the funicular railway. HIE took CML into public ownership in May 2008, after CML reported financial losses, to ensure the resort remained operating and to protect its investment. At the time, HIE stated that it did not envisage itself as the most appropriate long-term owner of the operating company and that it would plan to seek an alternative ownership arrangement in due course. The then Auditor General published a performance audit report about the funicular in October 2009.¹
6. HIE transferred ownership of CML to Natural Assets Investments Ltd (NAIL) in June 2014, following a competitive dialogue procurement exercise. CML thus became a wholly-owned subsidiary of NAIL.

¹ <https://www.audit-scotland.gov.uk/report/review-of-cairngorm-funicular-railway>

Events leading to the establishment of Cairngorm Mountain (Scotland) Ltd

7. In July 2018, CML's consultant engineers undertook a routine annual inspection of the funicular railway and a more detailed inspection shortly after. Following receipt of the engineers' report, which raised potential safety concerns, CML took the funicular railway out of service in September 2018. At the same time, HIE and CML commissioned a specialist engineering company to undertake initial structural assessments. HIE subsequently commissioned additional assessments and peer reviews to include options and costings for any repairs that may be needed.
8. In October 2018, CML requested a working capital loan of up to £1.8 million from HIE in order to ensure the continuation of winter sports activities while the funicular was closed. At its October board meeting HIE rejected CML's request because it concluded that CML could not afford to repay the loan and because CML's parent company, NAIL, was not offering any security if CML defaulted.
9. At the same October meeting, the HIE Board considered wider challenges relating to operations at Cairngorm Mountain and approved expenditure of £1 million to purchase snow-making and snow-spreading equipment in order to provide access to lower level ski areas. It also agreed that HIE officials should consider options to ensure the sustainability of the resort as a viable business and employment provider if CML was unable to continue.
10. On 29 November 2018, CML directors placed the company in administration due to mounting cash flow and creditor pressures. It considered that the suspension of the funicular, with a consequent downturn in business, was a key factor in this. HIE announced in December 2018 that it had established a new subsidiary, Cairngorm Mountain (Scotland) Limited (CMSL), and had reached agreement with the administrators for CMSL to acquire the business and assets of CML. Staff of CML were also to transfer to the new company.

Treatment in HIE's financial statements

11. HIE invested £0.461 million by way of share capital in CMSL to fund the purchase price of the business and assets of CML acquired from the administrator. This investment has been impaired to £0.046 million in HIE's accounts to reflect HIE's valuation of its subsidiary as at 31 March 2019.
12. HIE's 2018/19 accounts value the total ski resort, including the snow-making and snow-spreading equipment, at £0.7 million. A loan of £0.7 million, made to CMSL to provide working capital, has been impaired by 90 per cent in HIE's 2018/19 accounts to reflect the uncertainty of the amount and timing of the loan repayment. HIE has also included an accounting provision of £9.6 million to reflect its obligation to repair the funicular railway on Cairngorm Mountain, a net debtor recoverable from CMSL of £0.111 million for rent, insurance and other expenses incurred on its behalf, and a creditor of £0.287 million relating to CMSL's operations at Cairngorm Mountain.

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13. As a company wholly owned by HIE, CMSL's financial results are consolidated into HIE's 2018/19 group accounts. CMSL generated income of £0.243 million and expenditure of £0.804 million between its establishment in December 2018 and 31 March 2019, an overall deficit for the period of £0.561 million.
 14. HIE spent £0.244 million during 2018/19 on professional legal and accountancy advice associated with establishing CMSL and considering options for the future financial sustainability of the ski resort. HIE has assessed the cost of staff time involved in responding to the situation to date as £0.262 million. Cairngorm Mountain is considered as high risk by HIE and is resulting in significant capacity and resource challenges.
 15. The Parliamentary Accountability Report on page 60 of HIE's accounts notes that the Scottish Government provided HIE with approval to overspend by up to £2.3 million in 2018/19 to cover the cost of operating CMSL. In the event, HIE's total overspend against its resource budget, across all its activities, was £1.8 million. HIE has subsequently confirmed that a similar arrangement has been put in place with the Scottish Government for 2019/20 if CMSL's operating costs result in an overspend. The extent to which the Scottish Government may authorise similar budget flexibility in the longer-term has still to be determined.
 16. HIE's 2018/19 annual report and accounts includes other references to the Cairngorm Mountain:
 - An overview of the circumstances of CML entering administration and its replacement by CMSL (Performance Report page 5)
 - Recognition of the significant financial implications for HIE in funding CMSL and in meeting the costs associated with a solution for the funicular railway (Governance Statement page 49)
 - Recognition that HIE, as owners of the Cairngorm Mountain ski resort, has responsibility for the costs of removing equipment and re-instating the site of the funicular railway to a natural condition (Note 22 Contingent Liabilities page 103).

Next steps for HIE

17. HIE continues to develop proposals for the future operation of the Cairngorm funicular railway, and a Cairngorm Mountain Programme Team has been established to oversee key operational, finance and technical issues. HIE's Director of Communities and Place leads the programme team, which includes staff with experience of business development and property management. One of the programme team's tasks is to work closely with the multi-partner Cairngorm Funicular Response Group to communicate with local communities and businesses over future plans.
18. The original HIE Board Cairngorm Sub-Group, established to consider the future of the resort when CML was expressing concerns about its ability to continue, has remained in place and is supporting HIE's Executive Team in considering issues relating to: the funicular railway, CMSL operations, legacy issues, communications and strategic engagement, and future strategy.

An Advisory Group was also put in place for a short period to support the establishment of CMSL and has now been amalgamated with the Cairngorm Sub-Group.

19. A key issue for HIE is the likely cost of bringing the funicular back to full working order and the development of a business strategy which will provide for the long-term sustainability of the resort. HIE has indicated that its approach will be subject to an options appraisal and a deliverable business case.
20. In early 2018, HIE appointed consultants to develop a five-to-ten-year vision for Cairngorm. The consultants' original report, in November 2018, identified potential for investment of £27 million to transform the resort over the next five-to-ten years. An addendum to the original report was published in June 2019 and provides immediate investment priorities while the funicular railway is out of operation. HIE has confirmed that the funicular will remain out of service over the 2019/20 winter.
21. HIE is seeking to recover amounts due from the previous operator of Cairngorm Mountain under guarantees. HIE has also taken action to protect its legal position as specialist engineering investigations continue in relation to the funicular.

Conclusions


22. The circumstances of CML entering administration and the future of the Cairngorm funicular railway have generated significant public and media interest. It is important that HIE can demonstrate that its decision to transfer CML to NAIL was robust, that it managed its relationship with CML well and that its decision-making around events leading to the company's administration was robust and well-founded. While HIE's intention is to repair and reopen the funicular, it is still not clear how much it will cost to do so, how it will be afforded, or what impact it will have on HIE's financial sustainability. HIE has recognised these risks and raised them with the Scottish Government. Tough decisions are likely to be required over the coming months. As a result, I have decided to prepare a further report on the Cairngorm funicular railway under section 23 of the Public Finance and Accountability (Scotland) Act 2000. I expect to present this report to the Scottish Parliament by spring 2020.

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