OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit and Post-legislative Scrutiny Committee

Thursday 1 October 2020

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Thursday 1 October 2020

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PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
21st Meeting 2020, Session 5

CONVENER

Jenny Marra (North East Scotland) (Lab)
*Anas Sarwar (Glasgow) (Lab) (Acting Convener)

DEPUTY CONVENER

*Graham Simpson (Central Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Neil Bibby (West Scotland) (Lab)
*Bill Bowman (North East Scotland) (Con)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Alex Neil (Airdrie and Shotts) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Stephen Boyle (Auditor General for Scotland)
Graeme Greenhill (Audit Scotland)
Derek Hoy (Audit Scotland)
Edward Mountain (Highlands and Islands) (Con)

CLERK TO THE COMMITTEE

Lucy Scharbert

LOCATION

The Mary Fairfax Somerville Room (CR2)

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 1 October 2020

[The Acting Convener opened the meeting at 09:00]

Decision on Taking Business in Private

The Acting Convener (Anas Sarwar): Good morning, and welcome to the 21st meeting of the Public Audit and Post-legislative Scrutiny Committee in 2002. I welcome Edward Mountain, who is attending our evidence session with the Auditor General.

Before we begin, I remind members, witnesses and staff that social distancing measures are in place in committee rooms and across the Holyrood campus. I ask everyone to take care to observe the measures during the course of this morning's business, including when exiting and entering the committee room. I also remind members not to touch the microphones or consoles during the meeting.

Agenda item 1 is a decision on taking business in private. Do any members object to taking agenda item 3 in private? As Bill Bowman is joining the meeting remotely, he should raise his hand if he objects.

That is agreed.

Section 23 Report

"Highlands and Islands Enterprise: Management of Cairngorm mountain and funicular railway"

09:01

The Acting Convener: Agenda item 2 is a section 23 report on the management of Cairngorm Mountain and funicular railway.

I welcome our witnesses: Stephen Boyle, the Auditor General for Scotland; and, from performance audit and best value at Audit Scotland, Graeme Greenhill, senior manager, and Derek Hoy, audit manager. The Auditor General will make a brief opening statement.

Stephen Boyle (Auditor General for Scotland): Good morning.

This section 23 report was published in June 2020, and is the last performance audit that Caroline Gardner published as Auditor General. I am delighted to be with the committee to support its consideration of the report.

Cairngorm Mountain is a vital asset to the local economy of Badenoch and Strathspey and to the wider winter sports industry in Scotland, as it provides jobs and supports many local businesses. However, the commercial success of Cairngorm Mountain is dependent on good weather conditions for winter sports. Turnover varies from season to season, and previous operators have all suffered financial losses.

On top of those difficult operating conditions, Cairngorm Mountain's commercial performance has been hindered by the closure of the funicular railway due to structural issues. In 2014, Highlands and Islands Enterprise sold the operating company, Cairngorm Mountain Ltd, to Natural Assets Investments Ltd. CML went into administration soon after the closure of the funicular in 2018, leaving HIE to step in and rescue the business for the second time in a decade.

One of my predecessors reported in 2009 on the funicular and HIE's management of Cairngorm Mountain. The new report focuses on events since then and provides an independent assessment of HIE's decision to transfer CML to NAIL and how HIE managed the contract with the operator. It also looks at how HIE reacted to the closure of the funicular and CML going into administration in 2018, and at how HIE is planning for Cairngorm Mountain's future.

Overall, we found that HIE acted appropriately throughout but that there are lessons to be learned and areas for improvement. The tendering process to find a new operator in 2014 was comprehensive. HIE identified risks that came with appointing NAIL and took steps to mitigate those risks. However, HIE should have monitored NAIL's financial situation more closely. There was also disagreement on aspects of the obligations and responsibilities of HIE and the operator in relation to repairs and maintenance at the resort. That issue forms part of on-going legal action involving HIE and NAIL, which could mean that we are unable to answer all the committee's questions with regard to that this morning.

We also found that HIE acted quickly to protect the business and jobs at Cairngorm Mountain when CML went into administration in 2018. HIE set up a new subsidiary as operator, and progress was made in addressing some of the immediate issues at the resort.

HIE and the Scottish Government now face difficult decisions on the future of Cairngorm Mountain, including how they fund reinvestment of the funicular railway and secure long-term financial sustainability. It is crucial that the full range of options is considered and that the views of stakeholders and communities are taken into account. Decisions need to be taken in the context of the Scottish Government's thinking on the future of winter sports and its wider economic priorities.

As ever, my colleagues and I will do our best this morning to support the committee's consideration of the report.

The Acting Convener: Thank you, Auditor General.

I remind members that, as discussed in the report and noted by the Auditor General in his opening remarks, the report covers a number of areas that we will be unable to explore today, due to on-going legal proceedings. Members will wish to be careful about their lines of questioning, in order to avoid any perception of trying to influence the outcome of those proceedings or pre-empt any decision of the courts.

Colin Beattie (Midlothian North and Musselburgh) (SNP): Good morning, Auditor General.

I would like clarification about the procurement process. The report refers to a "competitive dialogue procurement process". I have been involved in a lot of procurement, but I have never heard that terminology. I can guess what it means, but, for the sake of clarity, will you give a definition?

Stephen Boyle: Good morning. I will do my best; I may ask Derek Hoy to come in in a moment. He has worked closely on some of our audit work on the procurement process.

In general, as we have noted in the report, we think that the procurement worked effectively. On the process that was followed from the pre-qualification questionnaire to the competitive dialogue process, we have seen that terminology in our work in different places. Derek Hoy can say more about the specifics of that part of the procurement.

Derek Hoy (Audit Scotland): I think that it is fair to say that HIE looked at the various options and took on board some external advice on the approach to take when it came to procuring the service.

There is a short definition of the competitive dialogue process on page 11 of the report, which says that it is a

> "Public-sector procurement process that allows the contracting body to negotiate with bidders to arrive at the best solution for the body."

In essence, it is about negotiating with a small number of bidders to get to the best possible solution. A lot of negotiation and talking are involved. Rather than HIE setting out exactly what it wanted the solution to be, it wanted the bidders to come forward and give their ideas, and to use the negotiation process to get to where it wanted to be.

Colin Beattie: Thank you. Will you talk us through the key concerns in relation to NAIL's finances?

Stephen Boyle: There are a number of aspects to that. NAIL was one of a very small number of bidders—I think that NAIL and one other made it through to the competitive dialogue process. In that process, and indeed prior to that, as part of the pre-qualification questionnaire stage—much of which has a pass-fail element—HIE looked at the financial standing of potential bidders and identified that there were concerns about the level of debt in NAIL's finances. In itself, it is good that HIE recognised that; that can be identified as an adequacy of the assessment process.

We think that HIE took appropriate steps to test that further. It arrived at an unlimited guarantee from NAIL itself and a personal guarantee from NAIL's main shareholder. HIE identified those steps in looking to secure its interests in taking NAIL forward into the further stages of the procurement.

Colin Beattie: In all of that, was there any concern about NAIL's expertise—in its ability to actually deliver?

Stephen Boyle: Derek Hoy may be able to say a bit more about NAIL's background. Through our audit work, we have seen that NAIL did not have a history in the snow sports industry but had experience in providing leisure industry services.

There is a distinction between those two things. I ask Derek Hoy to say a little more on how that manifested itself in HIE's considerations.

Derek Hoy: It is fair to say that HIE recognised that NAIL did not have much in the way of previous experience in the snow sports industry. HIE took some reassurance from the fact that many of the technical staff at Cairngorm Mountain Ltd were going to transfer over to NAIL and that, therefore, the knowledge and expertise that were already in place were expected to continue.

HIE recognised the concern, and it was taken into consideration, alongside the various other factors that HIE was looking at throughout the appraisal process. As the Auditor General pointed out, only one other bidder got through to the final stage, and, from memory, I do not think that it had a particularly strong track record in the sector either.

HIE was aware of the risk, but it took some reassurance from the fact that many of the key staff would still be in place.

Colin Beattie: Were the steps taken by HIE adequate?

Stephen Boyle: That is the conclusion that we have reached. Looking back through the procurement arrangements, we reached the conclusion that HIE took appropriate and adequate steps in the procurement process. The presence of the two guarantees is an indication that, at the start of the procurement process and during it, it sought to secure its interests.

In general, however, the procurement process showed that there were not many options with regard to a private sector operator. The point that HIE got to was that it was left with NAIL and one other bidder. The early market assessments suggested nine potential operators, but that did not come through in the number of bidders or indeed the number that managed to pass the pre-qualification assessment, so there was not much choice. However, with regard to the steps that HIE took to arrive at NAIL, we are satisfied that the work that it undertook was adequate.

Colin Beattie: The number of interested parties dropped very quickly from nine to two. Was the initial market testing exercise fit for purpose?

Stephen Boyle: I will ask Derek Hoy to say a bit more about the steps that HIE took on that.

Derek Hoy: It is quite difficult to say. The initial part of the options appraisal process involved looking at different business models. Following that, the HIE board decided that a private provider would be the best option, and it tested the market at that stage.

I am not entirely sure why there was such a drop-off from there being initially nine interested parties at the market testing stage to two at the final stage. Four parties participated in the PQQ stage. One did not meet one of the financial criteria, which was a minimum turnover threshold for the previous year, so it dropped out at that stage. One other party decided not to continue into the competitive dialogue stage, having got through the PQQ. Therefore, of the nine, almost half came forward to the PQQ. I cannot tell you why there was such a drop-off from the market testing stage, but I am happy to try to find out a bit more and to feed that back, if that would be helpful.

Colin Beattie: The report refers to stakeholders' concerns about the transfer from CML to NAIL. What was the nature of the concerns raised by stakeholders, and what steps did HIE take to engage with them?

Stephen Boyle: You are right that there were concerns. There is a wide range of stakeholders who are vocal about and interested in the future of Cairngorm Mountain—rightly so, given the resort's position in the local community in terms of its environmental and economic influence. We found that HIE did not communicate in a way that allowed stakeholders to understand NAIL's financial position—it did not communicate in a way that allowed that level of openness. We are sympathetic to HIE's position to an extent, because much of what we have seen and are now reporting in terms of the financial guarantees and the nature of the procurement process was bound up in commercial confidentiality. There was a limit to the extent to which HIE was able to be open, as we are now being in the report.

Colin Beattie: At what point were the stakeholders brought in? At what point did HIE engage with stakeholders? Was it well into the process or at the beginning of it?

Stephen Boyle: It happened at various points in the process, and some of that is captured in the timeline in the report. As part of our audit work, we met stakeholder groups to hear their experience. Derek Hoy was part of that work, so perhaps he can say how that is played out in the report.

09:15

Derek Hoy: That is an area in which we did not see a particular strength in HIE. We did not see what HIE told us about how it was engaging with stakeholders as being proper engagement at the time of the procurement process. HIE was good at putting out information probably after the event to communicate decisions that had been made, but we did not see an awful lot of evidence of stakeholder engagement before decisions were made. We are maybe slightly critical of it for that.

A lot of the concerns that were raised came through after the event. Some stakeholders who knew how to read and understand a set of accounts looked at NAIL's accounts, and took from that that the picture did not look too great in terms of the level of debt and operating losses. However, they were not privy to the additional information that HIE had received throughout the procurement process, which explained why NAIL was carrying that level of debt and operating losses. That was not communicated. That stage of engagement was not quite there and maybe it could have been—although, as the Auditor General said, that would have been quite difficult in the context of commercial negotiations.

Stephen Boyle: One of the key recommendations that we make in the report in relation to future decisions that are taken around Cairngorm Mountain is that there is a need to have genuine, effective communication and consultation with the wide range of stakeholders on what is next for Cairngorm Mountain.

It is stating the obvious to say that there is no consensus on what is next for Cairngorm Mountain. However, it matters that people's voices are heard and that there is the opportunity for effective and open communication about the next stages.

Colin Beattie: I have a final question. Given what you have said about commercial confidentiality, could HIE have done more to bring in stakeholders meaningfully at an earlier stage?

Stephen Boyle: There is always a balance in these processes to allow for negotiations to happen properly—to be respectful of commercial confidentiality with regard to what is the commercial interest of a private operator. However, we reached the conclusion that, as Derek Hoy said, there was space available for more consultation and engagement with stakeholders during the procurement and award process.

Much of what was in the public domain suggested that NAIL's financial position was at risk, for the reasons that we outline in the report. HIE recognised that, which is why we think that it was right to seek to put in place the guarantees.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Good morning. I will ask about the £1.9 million for management fees that is referred to in paragraph 46. A number of players are involved, so forgive me for providing context by reading out that part of the report:

> "Included in CML's costs in the period to the end of December 2017 was £1.9 million in respect of management fees. At the start of the contract, NAIL negotiated with HIE that CML would pay an annual management fee to Natural Retreats UK Limited (NRUL), although this was not included in any of the legal agreements."

First, why did such a substantial fee not appear in any legal agreements?

Stephen Boyle: I will ask Derek Hoy to talk us through that in more detail, but in the report we tried to capture the range of players that were present. As part of the original contract, HIE transferred CML to NAIL, and it ran the mountain.

As we note in the report, Natural Retreats UK is not part of the NAIL group, but there are close connections between it and NAIL, and they share significant shareholders. We can say a bit more about the nature of the sums involved and how typical that is for leisure industry services and the nature of the services that Natural Retreats has provided. Derek can talk us through that.

Derek Hoy: The rate that was agreed before the contract began was 13.5 per cent. HIE had undertaken some benchmarking work to ascertain whether that was an acceptable level, and it decided that it was. That said, the total management fee payable for the length of the contract came in at slightly under 13.5 per cent, so it was not as much as it could have been.

Why that was not included in the legal agreements is probably a question for HIE. I could not really answer that one, to be honest. There were obviously conversations at the beginning of the process, but I am not entirely sure why it was not captured in the legal agreements.

Willie Coffey: We might want to follow up on that, convener.

I have a question for Stephen Boyle. CML was the subsidiary; it was sold to NAIL in 2014. Why was CML still paying that management fee for the following three years, after it had been sold to NAIL?

Stephen Boyle: That is correct, Mr Coffey. Indeed, the committee may wish to pursue aspects of this with HIE. As you describe, HIE was sold to NAIL as part of the conclusion of the tender process—

Willie Coffey: CML.

Stephen Boyle: Apologies—CML was sold to NAIL—

Willie Coffey: But it still paid those substantial fees.

Stephen Boyle: Indeed. Some of the staff moved from HIE to NAIL as part of the CML transfer, but management services were still required. Some of the detail that we talk about includes sales and marketing, finance, and human resources services. As Derek Hoy mentioned, HIE undertook some benchmarking of the appropriateness of that fee relative to what was consistent with other industry practices and it was not untypical. In the audit, we did not make an assessment of whether that was appropriate or whether, in itself, it was a reasonable fee amount. The committee may wish to explore that area further.

Willie Coffey: Do you know whether HIE considered delivering some of that service in-house? It might sound like a reasonable fee for an external service provider, considering the market and so on, but did HIE consider managing some of the services in-house, to save some of that substantial cost?

Stephen Boyle: HIE took a fundamental decision at the start of the process that it was not its role to be an operator of that service. Having considered the merits of remaining the operator right at the start—bearing in mind that it was the operator from the end of the 2000s right up to 2014—it took the view that that was not its function as an enterprise agency. Its role is to facilitate and support economic development rather than to deliver services.

That fundamental decision led it to secure a private operator. Part and parcel of that was that the private operator would be the one to provide those ancillary services.

Willie Coffey: Thanks very much.

The Acting Convener: Bill Bowman joins us remotely.

Bill Bowman (North East Scotland) (Con): Thank you, convener, and good morning, all. Auditor General, on page 6 of your report, you set out your recommendations for HIE; I think that there are five bullet points. I will just quote from them, briefly:

> "consider fully the options available before deciding on a new operating model ... consider carefully the long-term sustainability ... identify the operational and financial risks ... put in place contractual agreements ... that clearly set out the obligations ... consider carefully the impact of any decision ... on its wider activities, finances and staff."

Those seem to be basic, primary 1 steps that anyone making an investment should go through. Was HIE not a little bit concerned that you had to point that out?

Stephen Boyle: If we go back to first principles, the report was cleared for accuracy and those are the recommendations that we made based on our assessment of the evidence. Some of those recommendations are, perhaps, more complicated than they might appear as they are written on the page.

We would say that there is no straightforward outcome for the future; hence why many of the recommendations talk about the need for effective engagement and consultation with the community and users of the mountain. Indeed, that is also captured in effective options appraisal.

There is also the recommendation about this not being a short-term decision about the future of the railway and CML services but a much wider consideration. We talked about the need for a longer-term master plan and for thinking about what the future of Cairngorm Mountain for the coming decades is. All of that is made much more complicated by the Covid pandemic that we are now living through.

Bill Bowman: I have no problem with you making those comments, but it seems like the kind of thing that HIE would do normally when making an investment decision.

Can I also follow up on what Colin Beattie said about the number of interested parties falling from nine to two? I think that some issues came up with the remaining two, but those were mitigated. Now, "mitigate" does not mean "solve". Are you happy with the mitigations?

Stephen Boyle: If we are speaking in particular about NAIL's financial standing, that was the main focus. In the analysis of the procurement exercise, we saw that NAIL outscored the other provider in all the other categories. We felt that the assurances that HIE rightly sought from NAIL on its financial standing and the guarantees that it presented were adequate, based on our audit work. Mitigation comes under that category.

Derek Hoy: A part of the process is called qualitative moderation, which essentially amounts to the bidder providing additional information to explain elements of its financial standing. Obviously, as we know, there were some concerns about NAIL's financial standing and it provided some additional information.

The main concerns were about the level of debt that the company was carrying and the operational losses that it had experienced in previous years. NAIL explained that by saying that it was in a developmental and acquisitional phase, that those losses had been planned and that the debt was mostly to the company's main shareholder, which was, in essence, financing the company to get it through that period. HIE took sufficient assurance from that additional information to proceed with the contract at that stage, while also putting the guarantees in place to safeguard itself.

Bill Bowman: I know that, when an organisation is in a deal situation, it is probably worried that it will lose the last two interested parties and there is therefore a temptation to look for ways around the problem to make them appear appropriate.

Let me ask you about paragraph 37, which says:

> "As part of the lease agreement, CML was to make payments to an asset replacement fund and two sinking funds."

I have not heard about things such as the concept of a sinking fund since my training days, which were a long time ago. Would that be what I understand as a prepayment of a future liability, in which a payment is made into a bank account to protect it from being used for other things?

Stephen Boyle: There are a number of mechanisms. We are effectively talking about one and the same thing, whether it is called a sinking fund, a reserve or prepayment. It is really an acknowledgement of an obligation at some stage further down the line. As part of the lease agreement, CML, as the operator, was required to make arrangements for future provision of repairs and maintenance operations, as we set out in paragraph 37 and as Mr Bowman described.

Bill Bowman: Was that one of the mitigations, and did it work?

Stephen Boyle: There are four separate legal components to the report, which are set out in paragraph 26. Those captured the requirement on CML, as part of the lease agreement, to make payments to asset investment and the repairs and refurbishment sinking funds.

09:30

Again, this brings us into the territory of how difficult it is for us to comment on the effectiveness of the arrangements because, as we have mentioned, that is part of the on-going legal matters. However, we set out in exhibit 2 the quantum of sums that were captured, which was lower than had been anticipated by the lease agreements.

Bill Bowman: Exactly. Thank you.

Graham Simpson (Central Scotland) (Con): Auditor General, you mentioned earlier that there were concerns about NAIL's debt. Are you able to say what the level of debt was?

Stephen Boyle: I do not have that number to hand. Perhaps Derek Hoy can share that with the committee.

Derek Hoy: I do not have the figure to hand either, but we can certainly get it to you later.

Graham Simpson: You also referred to losses. It would be useful to have that figure as well, if you are able to provide it to us.

Stephen Boyle: We should be able to provide that. I expect that the disclosure of NAIL's financial position will be a matter of public record on Companies House.

Although we do not have that information to hand, HIE certainly did have it to hand as part of its assessment during the procurement process.

Graham Simpson: Right.

I have a wider question about the snow sports sector in Scotland. Are you aware of other centres experiencing the same financial problems?

Stephen Boyle: I will invite Graeme Greenhill to support my response in a moment. Our audit did not look at the sustainability of the snow sports industry in the round; it focused on the circumstances involving HIE and CML.

However, in trying to draw a wider conclusion, we talked in the report about the importance of the snow sports industry to the Cairngorm mountain and how integral it is to the business and economic models that have been part of the transfer of the assets into the private sector. There is a big decision to be made about the future of the industry. The variability of weather patterns and how challenging those have been for the industry in recent times makes the need for that wider assessment of its future all the more necessary.

I ask Graeme Greenhill whether there is any read-across to the other snow sports locations.

Graeme Greenhill (Audit Scotland): First of all, I return to Mr Simpson's earlier question about the level of NAIL's debt. I can give a little flavour of that. Paragraph 53 outlines that, at the end of December 2017, NAIL had an operating loss of £3.2 million and net liabilities £34.2 million. That obviously does not give you a full picture of the size of NAIL's debt, but it gives an indication of the sums that we are talking about.

On Stephen Boyle's comments about the wider snow sports industry, and the ski sector in particular, as he said, we did not look at the finances of the other ski resorts, which are, obviously, private concerns. As was mentioned, climate change is having an impact—there is a lot less snow than there used to be. I think it highly likely that the other ski resorts are suffering as a result of that and are having to think about how they operate.

Graham Simpson: That is fair enough. In relation to Cairngorm, given the history and where we are at, do you think that it is viable to run things as they have been run?

Stephen Boyle: Do you mean with a private operator?

Graham Simpson: Yes.

Stephen Boyle: The history shows us that it has been very challenging for private operators to make Cairngorm Mountain a successful commercial venture, given that, in the past 12 years, we have had two commercial failures with running the mountain with winter sports as the integral component for deriving profit. That has led us and indeed the other participants to identify the need for a long-term master plan for the future that addresses the economic and environmental concerns. The asset is a key one for the country, but it may not be able to rely on winter sports as the key provider of economic returns.

Graham Simpson: Given the repair costs for the funicular railway, which seem extremely high, is there any likelihood of it operating again?

Stephen Boyle: HIE has been really clear that its preference is to reinstate the funicular railway, and it has worked on a business case to arrive at that point. Reinstatement costs of around £15 million have been quoted, but the scale of the cost of removal and returning the land to a condition as if the funicular had never been on the site is only marginally smaller than that.

We note in the report that the financial sums that will be needed to arrive at reinstatement are significant. That is all the more reason why any business model that is associated with that is clear about where the economic returns are due to derive from, and the risks associated with them.

Graham Simpson: The costs are significant, and even if the funicular was to operate again, it could well operate at a loss again. In that case, the costs would just go up and up.

Stephen Boyle: Yes. Public subsidy has been required for delivery of the business models when it has been run by HIE, and there have been losses when the enterprise has been run as a commercial activity. That has led to a point where the sustainability of the business model in its current guise, whether the enterprise is run by the private or public sector, is very challenging.

The Acting Convener: Graeme Greenhill, who is joining us remotely, wishes to comment.

Graeme Greenhill: I want to build a little on what Stephen Boyle said. As he said, there is a final business case. We have not audited it, but it was considered at HIE's July board meeting, and it confirms that reinstating the funicular is still the preferred option. I am led to believe that negotiations with a contractor to carry out the work are at an advanced stage, so I need to be a little careful about how much I add, but I would like to think that, within a couple of weeks or so, HIE should be able to provide more information and a clearer picture of where it is with that.

Graham Simpson: That is interesting. I wonder whether we could have sight of that when it appears.

Stephen Boyle: Absolutely. We can provide that to the committee. Part of the reason for the delay is that we have been waiting for completion of the audit and HIE's certification of its annual report and accounts, which I understand is happening today. Once that hurdle has been cleared, we will certainly be able to provide the committee with any emerging material, and indeed I am sure that HIE will be able to do that as well.

The Acting Convener: Before I bring in Neil Bibby, I have a question that will follow up on Graham Simpson's questions.

You mentioned weather patterns and the long-term financial viability of the project, but Covid will, of course, also have a massive impact on the wider industry. How much has that been considered, given the impacts on the tourism and hospitality industries? Is it a viable project in the long term, given the context that we are living in?

Stephen Boyle: That is the key question. The model that existed pre-Covid was unable to deliver a profit or to survive without public subsidy. Now, because of Covid, people's reduced inclination to travel and engage in sporting activities, as well as social distancing requirements, make it harder. Therefore, any preconceived expectations of how the service would be enjoyed will have to be revisited in the light of Covid and the additional challenges, which are clearly unwelcome because they relate to a business model that was already under pressure.

The Acting Convener: Do you get any sense that HIE is factoring that into its business case in any meaningful way?

Stephen Boyle: Yes, we do. HIE is very alert to the implications of Covid—which any credible business case must be adjusted to take account of, of course. Through our audit work, we have seen HIE put proper structure and governance around the new subsidiary that it is now running—Cairngorm Mountain (Scotland) Ltd. It has enough of a track record in governance terms to take the proper decisions around that. However, it goes without saying that Covid has enormous implications for the industry.

The Acting Convener: Has there been an assessment of the local economic benefit of the project? There is the economic benefit of the project itself, but you can often make a case for a loss in a project because of the wider benefit to the wider community and geography. Has there been an assessment of that?

Stephen Boyle: I will turn again to Graeme Greenhill, who has been tracking development of the business case and the economic assessments that have taken place. We touched on that, in part, in the report.

Graeme Greenhill: As we say in the report, HIE is in the process of preparing a master plan for the Cairngorm Mountain resort. That is taking a bit longer than we might have hoped, largely because of Covid. However, one of the key objectives of the plan is to consider the economic benefits that might accrue from the resort and the local tourism benefits from the visitors that it generates. Stephen Boyle spoke earlier about the possibility of some kind of operator subsidy, so HIE needs to consider the economic benefits that might be accrued against the kind of financial subsidy that might have to be given to an operator.

At the same time, a balance needs to be struck between the economic benefits and the environmental sustainability of the mountain area. There is a lot going on in that regard. It is clear from speaking to local people and other stakeholders that there are different opinions about where the balance between economic development and environmental sustainability lies. Therefore, that is very much a feature of HIE's thinking as it seeks to develop its master plan.

The Acting Convener: Neil Bibby, who joins us remotely, has a supplementary question.

Neil Bibby (West Scotland) (Lab): I will follow up on Graham Simpson's question about the funicular railway. It was mentioned that the cost could be up to £15 million, although I appreciate that you said that there is more work to be done on that. You also mentioned that there would be a different cost for a completely new build. How confident can we be that the costs will be contained within that figure of £15 million?

09:45

Stephen Boyle: We are not able to give the committee assurance on that number at the moment; it is not one that we have audited. We would absolutely expect HIE and the Government, in its consideration of the business case and the need for public funding for that, to be satisfied about the robustness of the figure.

A lot of public money would be needed. Given what we, and the committee, have seen in previous years in respect of the reliability and robustness of early capital investment requirements, and how they have sometimes been significantly more than was initially anticipated, we would expect close monitoring by the Government before it committed to such significant sums.

Neil Bibby: Thank you for that answer. That is helpful.

The Acting Convener: Do you have any further questions, Mr Bibby?

Neil Bibby: No. That is all, thank you.

Alex Neil (Airdrie and Shotts) (SNP): Can you confirm that completion of the current legal process is not required before additional plans can be proceeded with?

Stephen Boyle: That is our understanding. Our understanding is that it will be for HIE and the Scottish Government to decide how to proceed with reinstatement or removal of the railway, and to give consideration to delivery of services on the mountain.

Alex Neil: Would it be fair to say that there are two big policy decisions to be made? I go back to your original remarks about nobody in the private sector or the public sector having been able to make a profit year on year from operating the funicular railway. Is there a need just to bite the bullet and accept that a permanent public operating subsidy of one kind or another will be required to make the funicular sustainable? Getting a reasonable return for the private sector, in particular on capital investment of £15 million, is highly unlikely. I think that getting a private investor to put up that kind of funding is highly unlikely and that it will be very dependent on public money.

Stephen Boyle: Essentially, that is the nub of the issue. The committee will know that my role prohibits me from commenting on the appropriateness of policy decisions, but we have seen from our audit work that neither the private sector nor the public sector has been able to deliver a model that breaks even.

Alex Neil: So, the justification for future investment lies in the wider economic benefit to the area. Additional revenue would be brought into many other businesses in the area as a result of attracting people to the funicular.

Stephen Boyle: In the report, we touched on the fact that the model has to date relied on provision of winter sports services. In the master plan and the thinking to deliver an alternative for economic return, there might need to be much wider, and different, thinking about what future service provision at Cairngorm Mountain will be. However, as you have said, the current model has not delivered a return for the private sector or the public sector without subsidy of one kind or another.

Alex Neil: You have given an estimated cost for reinstatement of the funicular railway, and you have pointed out that there is a relatively small difference between that and the cost of reinstating the land if the funicular is done away with.

On the timescale, as the convener said, we have immediate issues to do with Covid. It is clear that the minute the Covid crisis is over—I hope that we will get a vaccine and that that will be fairly soon—it will be important to have such services available to regenerate tourism in that part of the Highlands. If the Scottish Government gave the project the go-ahead, what would the timescale be to get a new funicular up and running?

Stephen Boyle: I will check with colleagues whether we have seen indicative timescales for that. I am not sure. As with any such capital projects, we are not talking about months; there would be a longer period of reinstatement and recovery. I turn to Derek Hoy for an answer to that.

Derek Hoy: On the original timescale pre-Covid, I think that HIE hoped to have the funicular back up and running by this coming winter season. However, that was quite a tight timescale, and it was not certain that it would happen. Obviously, that will be pushed back with Covid delays.

I believe that there is quite a limited window for construction and development to take place on the mountain, given the weather conditions. Based on nothing other than the original timescales and what we have been told, if the go-ahead was given this year, work could probably not start before next summer.

Alex Neil: We are probably talking about a two-year gap before it was up and running.

Derek Hoy: I think so. That would be influenced largely by the Covid situation.

Alex Neil: What would happen if HIE was asked to fund the £15 million out of its capital budget? What is its annual capital budget? I imagine that £15 million would be a huge chunk of it, even over a two-year period.

Stephen Boyle: We do not have to hand the figure for HIE's annual capital budget, but we can confirm that £15 million is in excess of what it would typically have available. We understand that, as part of its business case development, HIE has identified that it would be able to fund part of the reinstatement costs through its activities, but it would be looking for support from the Scottish Government to fund the remaining costs.

Alex Neil: Do you know what proportion would be required from the Scottish Government?

Stephen Boyle: We would need to come back to the committee on the precise ratio.

Alex Neil: That would be helpful. I am very much in favour of public investment in order to get the funicular railway up and running again as quickly as possible, because I recognise how important it is to that part of the Highlands. However, as you said in your introductory remarks, it is also important to the wider Scottish economy.

The important point is about the opportunity costs relating to other investments that are no doubt planned by Highlands and Islands Enterprise. Even if it paid a third of the costs, I would have thought that that would be a substantial chunk of its capital budget. We do not want the cost of the work to take away from other worthwhile projects in the Highlands and Islands.

Stephen Boyle: That is a really important point, hence the need for a clear and robust business case that sets out the economic and environmental benefits of one decision or another. Whether to reinstate the Cairngorm funicular railway is a key decision for HIE and the Scottish Government. The basis for that decision needs to be clear in the business case. There is also the connection with the wider master plan for Cairngorm Mountain; there should not just be a single decision about the railway itself.

Alex Neil: Is there not an even wider policy issue? The Scottish Government's commercial holdings now include Prestwick airport, Burntisland Fabrications and the shipyard on the Clyde, so we have a substantial and highly diverse portfolio of commercial operations.

I live in Ayr, so I am very familiar with the economics of Prestwick airport. If the airport were a business, we would probably not do a great deal to save it in its current mode, but closing the airport would cost about 15,000 jobs, directly and indirectly, in the Ayrshire economy. Particularly after the Covid pandemic, that would be an economic disaster for the area and the rest of Scotland, so the public investment in keeping Prestwick airport open is perfectly justified.

Many years ago, there was a proposal—in relation not to Scotland but to the United Kingdom—that all public sector operations should be under a holding company that is run professionally at arm's length from Government, in order to diversify the activity of such holdings and, over time, get them back on a more sustainable financial grounding. What we have been talking about is perhaps another example of the need for that. Is there a need to take a wider, panoramic look at the situation?

As you said, Highlands and Islands Enterprise rightly took the decision that its job and remit is not to be an operator of a commercial operation, whether it is making money or not; its job is to facilitate and support economic development. Similarly, Transport Scotland's job is not to run Prestwick airport and it is not the job of Fiona Hyslop's department to run BiFab. They do not have the skills to do so and it would not be the right thing to do.

From the point of view not of policy but of financial control, planning and audit, is there the need to create a commercial holding company with the relevant commercial expertise to bring all this together? If this was the private sector, everything would probably be brought under one holding company.

Stephen Boyle: You have made an interesting point, Mr Neil. It is also one with which the committee will be familiar, particularly from the work that my predecessor brought to it on the Scottish Government's investments in industries that it regarded as being of strategic importance. You mentioned examples of those, such as Prestwick airport, BiFab and Ferguson Marine.

In previous reports to the committee we have called for a number of improvements, one of which is greater transparency in such investment arrangements, including the opportunity costs of such investments—you alluded to the question why one company was chosen and not another—and what any anticipated exit arrangements might be for public funds, whether the investment was made in the short, medium or long term.

Last year, the section 22 report on the Scottish Government's accounts called for a clearer framework that the Government could use to make such choices and decisions. We know that it has made some progress on that, in the support for decision making that is provided to accountable officers through the "Scottish Public Finance Manual". However, we see all the more need for having that level of choice and for there to be clear and transparent decision making, especially in the current climate, given the challenges that it might present for public funds.

On your final point, regardless of whether the vehicle or structure is, for example, a single holding company, our focus is not so much on that as it is on the fact that there should be clarity and transparency in how such investments are made.

The Acting Convener: I now hand over to Edward Mountain, who is a visitor to our committee meeting.

Edward Mountain (Highlands and Islands) (Con): Thank you, convener, for allowing me to join you and to listen to this morning's very interesting questions, some of which I would have liked to ask myself; others have probably done so better than I would have.

Auditor General, you mentioned the importance of communication and, as an MSP who represents a region that includes the area that we have been discussing, I am absolutely aware of that. It is really disappointing that we will not see the business case for the repairs to the railway before the announcement will be made on what will actually happen. That has surprised local people.

If I might, I will take you back to the beginning. I have just looked at NAIL's company accounts for the year ended 31 March 2014. It turned a profit of £824,000, paid interest of £5 million and declared a loss of £7 million. From my training, it seems to me that, at that stage, it was therefore a company in distress. When HIE handed over the lease, was it satisfied that the terms of the lease made the enterprise a viable one for the party that was taking it on?

Stephen Boyle: In our report we make the point, which is absolutely related to your question, that there was scope for HIE to have had a closer interest in NAIL's finances for the duration of the contract. This morning, we have already touched on the fact that HIE sought financial guarantees, which we think it was appropriate for it to have done.

However, given all the uncertainty at the start of the contract, it would have been in HIE's interests to have carried out closer tracking and monitoring of NAIL's finances during the life of the contract. Although HIE was able to react at the time of the financial difficulties in 2018, it became clear that, had it had such closer tracking and monitoring of NAIL's financial position in place, that would have served it well.

Edward Mountain: My question is more about the fact that HIE handed over a lease in those circumstances. I want to know whether you think that HIE was convinced that the lease was viable. In other words, could it work under those terms, and was there a chance that the enterprise would make a profit? Alternatively, did it know that it would make a loss that would just add to NAIL's losses, which by that stage were already substantial?

Stephen Boyle: I will start to respond to that, then I might ask Derek Hoy to supplement my answer. Nothing in our audit work suggested that HIE thought that the enterprise would not be a viable entity or have a viable outcome. That is notwithstanding the fact that, as we have seen, during the mountain resort's history, it has struggled to deliver a financial return.

HIE put in place contract monitoring arrangements. As we touched on in our report, the frequency of some of those was reduced during the course of the contract. However, to answer your point directly, Mr Mountain, we have seen nothing to suggest that HIE did not consider the lease to be viable when it was awarded to NAIL.

Edward Mountain: Okay. In the evidence that you gave this morning, you said that you think that Cairngorm Mountain is no longer viable as a snow resort, and that it would probably need considerable Government subsidy. I would not argue about that, because the resort is so important to the area and to Scotland. However, why has your view changed in four years? Why have you gone from asking why HIE had changed its position that the resort was viable, to saying now, four years later, that it is not? Nothing has really changed. I accept that Covid is now with us, but let us put that to one side. We are talking about whether it was viable to run it as a snow resort.

10:00

Stephen Boyle: There are a number of parts to that. The committee might wish to explore the thinking in HIE about the viability of one business model over another.

In looking at the specifics of the lease, the issue is set out, in part, in the report; I am just turning to the correct analysis. We have seen the losses, but one of the key strands of the proposals that NAIL put forward with a view to better supporting its income generation scheme was the installation of a dry ski slope as a means of generating additional revenue. That did not proceed through the planning process before CML went into administration. It is difficult to speculate on whether that would have supplemented and therefore better supported the revenue stream.

The key point that we make in the report is that, given the history of unsuccessful operators and the need for public funds, a decision point has been reached. We have already talked about how the variability of the weather impacts on the viability of the model. Instead of revisiting what have been unsuccessful business models, a much wider look needs to be taken at the business case and the master plan to determine how we intend to use this economic and environmental asset for the country.

Edward Mountain: You mentioned the dry ski slope proposal. It would have been useful if the company had discussed it with the local planning authority before proposing it, because it might have found out that it might never have flown.

Do you believe that HIE, as the landlord's agent, understood the contractual conditions of the lease to NAIL? Did it have the skills to manage that lease effectively?

Stephen Boyle: I will ask Derek Hoy to address that in a moment. We have already talked about the various roles and responsibilities and HIE's awareness of those. In addition to having its own skills, HIE had employed the services of legal and financial experts to support it in navigating through the procurement process.

Derek Hoy: I think that that is fair to say. To someone who is not a lawyer and who therefore cannot understand a lot of the legal content fully, the lease arrangement appears to be highly complex, and I think that both parties acknowledged that as the contract progressed.

I think that HIE had conceded—internally and to NAIL—that there were parts of the lease that could have been tighter and clearer, especially on responsibilities and obligations in relation to repairs and maintenance. There were some shortfalls in the lease—it could have been tighter in places—but, as the Auditor General pointed out, HIE did the right thing in bringing in external expertise to guide it through the process and to help it to get the lease right in the first place. However, that was not enough to ensure that the lease was as watertight as it could have been.

Edward Mountain: As someone who spent 15 years managing leases in similar rural environments, I make the observation that I would be very worried if I was the agent who was responsible for the lease in question. The terms of the lease do not seem to have been followed and that does not seem to have been checked by the agent. Would you like to comment on that?

Stephen Boyle: If I were to say much more, I would probably be straying into some of the legal processes that are under way with regard to responsibilities and interpretation of the lease. Therefore, it might be difficult for us to go much further than we have done in the report.

The only point that I would like to make in addition to what Derek Hoy said is that the ambiguity of roles and responsibilities came through during the contract, particularly with regard to the mechanics and specifics of particular aspects of repairs and maintenance, which we touch on in the report. It is probably difficult for us to say much more than we have done in the report.

Edward Mountain: I have one more question, convener.

I have spent a huge amount of time looking at the structure and going through the company accounts of all the interested parties. Before I became a politician, I spent a long time looking at company accounts, and I think that I understand them.

My problem is that these particular accounts are incredibly complicated. They seem to link from one to another and then to another, and there is inter-reaction of directors between different companies, and a question as to who is standing for what and whether they are registered in the UK or outside it. I find that really difficult.

Is that the right way to structure a company that is running an asset that is managed for—because it is owned by—the people of Scotland? I am confused by it, and I guess that all other local people are too.

Stephen Boyle: For our specific example, it comes down to the adequacy of the procurement process—whether or not the pre-qualification questionnaire, the competitive dialogue, and the presence of the guarantees that HIE had sought from NAIL's majority shareholder and from the company itself, were enough to secure its investment. I appreciate that that is also now part of the legal process that is happening.

To give a direct answer to Mr Mountain's point, we are satisfied that HIE took adequate steps and appropriate advice during the procurement process, in the award of the contract. What we have said, in part of our conclusion in the report, is that, for all the reasons that led it to request guarantees from both the company and the majority shareholder, HIE could have done more to closely monitor NAIL's financial position during the running of the contract.

Edward Mountain: Just on that—and then I will finish, convener—will you point me, perhaps after the meeting, to where in the accounts those guarantees are? They should be shown as a liability. I would like to be able to see them in the accounts for each year, from the moment that they were made, because a guarantee from the director of a company should surely be in the company accounts.

Stephen Boyle: I will be happy to do that. Our responsibility as auditors resides with HIE's accounts, and not with NAIL's, but I would be happy to have a further conversation with you about that.

Edward Mountain: I have not been able to find it. Thank you.

The Acting Convener: Thank you, Mr Mountain.

Auditor General, for obvious reasons, members have had to be very carefully about their lines of questioning. Before we close the public part of the meeting, is there anything that we have not raised today that is worth putting on the public record? Do you have any final comment?

Stephen Boyle: Thank you for the offer, convener, but no. I think that the committee has explored as much as it has been able to, within the confines of the on-going legal action.

We have sought to leave with the committee the key point about the variability of the weather and the need for further consideration of the business model for Cairngorm Mountain, but also that it is important that that is connected to the longer-term master plan and what that means for the users, stakeholders and interests across the country in what is an important asset.

The Acting Convener: I thank the Auditor General, Derek Hoy and Graeme Greenhill for their evidence. I close the public part of the meeting.

10:08

Meeting continued in private until 10:58.

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Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

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