

A REPORT BY THE AUDITOR GENERAL FOR SCOTLAND UNDER SECTION 22(3)
OF THE PUBLIC FINANCE AND ACCOUNTABILITY (SCOTLAND) ACT 2000

THE 2007/2008 AUDIT OF HIGHLANDS AND ISLANDS ENTERPRISE

1. I have received the audited accounts of Highlands and Islands Enterprise (HIE) for the year ended 31 March 2008. The auditors' report on the accounts is not qualified but I have decided to issue this report to bring to the Parliament's attention events surrounding HIE's decision to take over Cairngorm Mountain Limited, the operator of the Cairngorm Funicular Railway ('the funicular').
2. I submit these accounts and the auditor's report in terms of sub-section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under sub-section 22(3) of the Act.
3. HIE announced its decision to take over Cairngorm Mountain Limited (CML), the operator of the funicular, in May 2008. However, the funicular has been the subject of public and media interest since before it opened. Options to replace the ageing chairlift that transported skiers and visitors up and down the Cairngorm Mountain had been considered since 1989. In February 1996, the HIE Board agreed to recommend that the Secretary of State approve funding for a funicular railway project. The Secretary of State approved HIE's recommendation in November 1997.
4. Construction for the project was delayed when, in 1998, the Royal Society for the Protection of Birds and the World Wildlife Fund issued a writ against the planning decision. The subsequent judicial review led to the action being dismissed and construction commenced in August 1999, at which time the cost to HIE was estimated at £19.702 million.
5. HIE entered into a 30-year lease with CML to operate the funicular and it opened to the public in December 2001. CML was required to pay HIE an annual rent of £513,000 for the use of the infrastructure. HIE's monitoring of the performance of the funicular between November 2002 and March 2004 indicated that CML was not achieving the anticipated visitor numbers. As a result, CML had been unable to make rent payments and had accumulated arrears of £585,000. HIE undertook a number of initiatives to assist CML in improving its operations and, having taken independent professional advice, lowered the minimum rent to £100,000 per annum and converted the outstanding rent into a loan at a commercial rate of interest.
6. We understand that, despite this support, CML has failed to cope with rising debts and has been unable to generate sufficient profit to deliver a successful business model. HIE reviewed the value of investments held in CML, along with the likelihood of collection of loan payments. In May 2008, HIE announced its decision to take CML into public control, and gave a commitment to put in place a more viable business model for the funicular.

7. HIE's audited accounts to 31 March 2008 include a provision for non-payment of CML's outstanding loan totalling £455,711. HIE's investment in CML's preference shares is included at nil value.
8. HIE is currently considering alternative business models for the funicular and an announcement on this is anticipated in summer 2009.
9. The project has been subject to ongoing monitoring by both HIE and Audit Scotland. However, due to the long-running difficulties with the operation of the funicular, culminating in HIE's decision to take CML into public control, I have asked Audit Scotland to undertake a specific review of the project. The review will examine both HIE's plans for the future operation of the funicular and relevant historical events and activity. I intend to report to the Parliament in 2009.



Robert W Black
Auditor General for Scotland

24 October 2008