

Key messages

# Review of Cairngorm funicular railway



Prepared for the Auditor General for Scotland  
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# Auditor General for Scotland

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## Acknowledgements:

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# Key messages

## Background

**1.** A funicular railway began operating on Cairngorm in 2001. The funicular has been the subject of public and media interest since it was first proposed. The operator, Cairngorm Mountain Limited (CML) struggled financially since the funicular opened and, in May 2008, Highlands and Islands Enterprise (HIE) took CML over.<sup>1</sup>

**2.** In October 2008, the Auditor General for Scotland decided to undertake a specific review of the project and examine HIE's plans for the future operation of the facility.

**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 the 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 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 approval for the funding as its delegated authority for an individual project was £500,000.<sup>2</sup> The Secretary of State for Scotland gave his approval in November 1997, subject to the project securing the other funding necessary and 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.

## The study

**9.** Our study examines HIE's involvement with the funicular over 17 years. The funicular was the first such facility in Scotland. It was built in a remote area, at high altitude, to exacting environmental standards and within a narrow timeframe. The elapsed time and the unique and complex nature of the project are important factors when considering this report.

**10.** Although the project was initiated before devolution, our review looks at the key decision-making stages from the funicular's inception and how public funds were used and monitored.

**11.** In gathering our evidence we:

- reviewed relevant documents from HIE, the Scottish Government and the EU
- analysed the cost of the funicular and funding sources
- analysed CML data on use of the funicular
- held interviews with HIE and Scottish Government officials, and other individuals involved in the project.

## Key messages

**1** The business case was subject to appraisal by HIE, the Scottish Office and the EU, and met requirements at the time.

**12.** HIE's Business Growth team developed the business case in 1996 and 1997. The team considered options to replace the chairlifts and tested the impact of different projections for visitor numbers. HIE used consultants to supplement its own expertise, estimate visitor numbers and to assess the likely economic impact of the funicular.

**13.** In 1999, the National Audit Office (NAO) examined how the project appraisal was conducted and found that it covered the expected examination of the economic, environmental and financial impact of the project as required at the time. As no funds had yet been committed

<sup>1</sup> Before 2001, CML was known as the Cairngorm Chairlift Company. For consistency we refer to CML throughout the report.

<sup>2</sup> Prior to 1 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.

to the building work, the NAO review focused on the process.

**14.** Although HIE was not required to prepare a formal risk assessment at that time, it was aware of a number of risks facing the project:

- The effects of climate change.
- The low level of private sector funding.
- The complexity of the project, in particular in meeting environmental requirements.
- The need to reinstate the land and dismantle the facilities if skiing ceased.
- CML's weak financial position.

**15.** Recommended good practice in project appraisal and management has improved significantly since the 1990s and has been adopted by HIE. At the time, HIE's appraisal of the funicular met the standards expected.

**2** A number of changes took place in the early stages of the project. HIE did not review and adjust the business case before construction started, to take account of the increased risks.

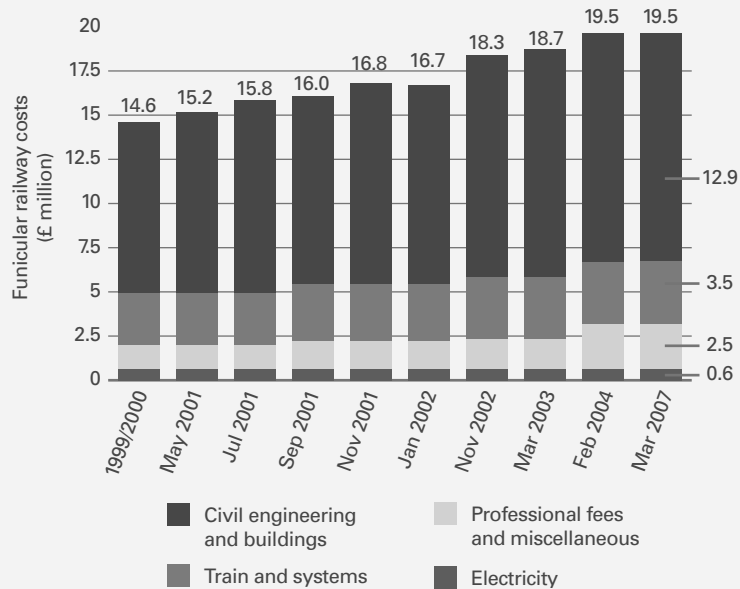
**16.** Further challenges emerged in the period leading up to construction:

- The EU funding required all contracts to be let before the end of 1999 and for the building work to be completed by the end of 2001. Building work could not begin until July 1999 because of delays in the planning process and in getting formal EU funding approval.
- The approved EU funding was £267,000 lower than expected. This led HIE to reduce the budget to £14.6 million to match the available funding.

## Exhibit 1

### Timeline of cost increases for the project

Costs increased from £14.6 million to £19.5 million between 1999 and 2007.



Source: Audit Scotland

- The initial tenders for the building work were much higher than expected; the lowest tender was 52 per cent (£2.2 million) more than the budget set for this element. As a result, some aspects of the project were redesigned. The contingency was also reduced to an exceptionally low level to keep within the budget.<sup>3</sup>

**17.** During construction, costs began to increase due to the complexity of the project and the need to find ways to limit damage to the mountains. For example, the contractors transported some materials across the site by helicopter because surface transport would cause too much damage.

**18.** In May 2001, the estimated cost increased to £15.2 million, compared with the target cost of £14.6 million. Costs continued to increase despite HIE's efforts to stay within the budget. HIE made the final payment for the construction work in March 2007. The total construction cost had

increased to £19.5 million (34 per cent more than the target cost) (Exhibit 1).

**19.** Up to 2001, HIE focused on project design and controlling costs but there were other changes affecting the viability of the project. For example, falling numbers of visitors and CML's weakening financial position (Exhibit 2). HIE did not review and adjust the business case to take account of the changing situation before construction started.

**20.** A review of HIE's project appraisal manual shows that HIE has already improved its procedures for the management of major projects, and now uses, for example, risk and benefits analysis tools, risk registers and appraisal and implementation plans. Audit Scotland has prepared a good practice checklist on the management and governance of major capital projects, which can be found on our website.<sup>4</sup>

<sup>3</sup> The contingency was under £8,000 (less than one per cent). In 2001, HIE suggested a contingency of £2 million (15 per cent) would be appropriate for a project of this type.

<sup>4</sup> This can be found at [http://www.audit-scotland.gov.uk/docs/central/2008/nr\\_080624\\_major\\_capital\\_projects\\_checklist.pdf](http://www.audit-scotland.gov.uk/docs/central/2008/nr_080624_major_capital_projects_checklist.pdf)

**3** Although HIE provided ongoing support, CML continued to struggle and HIE took CML into public ownership in May 2008.

**21.** During construction, CML needed further financial assistance to keep operating. HIE employed consultants to help it consider how it could assist CML. The result was that, in 2001, HIE, the bank and the Highland Council agreed a revised funding package. HIE contributed £3.5 million and the Highland Council loaned CML £1 million. The bank also agreed to extend CML's overdraft facility to £2 million.

**22.** HIE's additional funding was used to pay for the building work as CML could no longer fund this. As a result, in 2001, HIE became sole owners of all the assets on the site, with CML as the tenant.

**23.** The increased investment by HIE was possible due to post-devolution changes in the levels of responsibility given to HIE by the Scottish Executive. This meant that the Secretary of State's limit on funding from HIE no longer applied.

**24.** The Highland Council's contribution of £1 million was used for fitting out the exhibition centre at the top station. The exhibition centre was included in the business case for the funicular, but fitting it out was not part of the funicular contract.

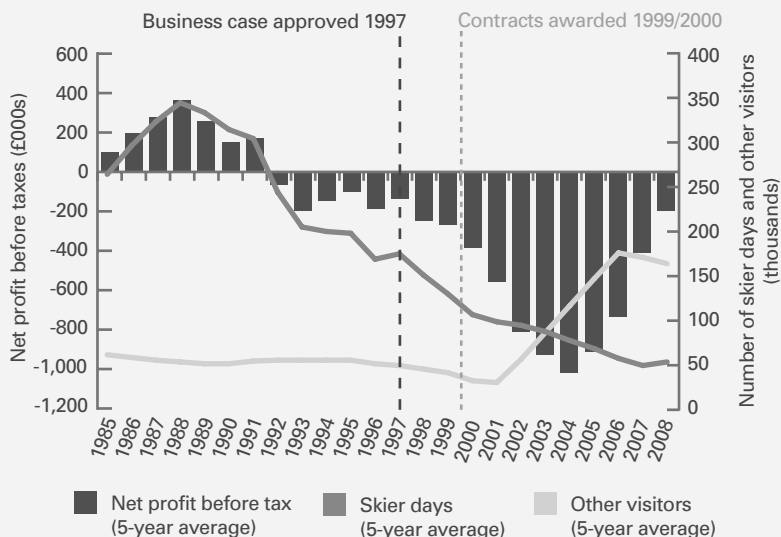
**25.** HIE monitored CML closely after the funicular opened in December 2001 and provided further support:

- In 2002, HIE, CML and the bank developed a survival and recovery plan for CML.
- In 2004, HIE reduced the base rent from £513,000 per year to £100,000 per year to better reflect the commercial potential of the buildings.<sup>5</sup> The outstanding rent

## Exhibit 2

### CML financial performance and visitor numbers

Falling visitor numbers affected CML's long-term viability.



Source: Audit Scotland

of £585,000 was converted into a loan to be repaid, with interest, over ten years.

**26.** These changes had a positive effect and CML recorded a small profit in 2006. However, 2007 was another poor year for ski visitors and CML reported a loss of £262,500.

**27.** HIE took CML into public ownership in May 2008 to ensure that the funicular remained operating and protect its investment. At this time CML's total debt was over £5 million. HIE:

- bought the Highland Council's loan of £1 million for £1
- bought the Cairngorm Trust's loan of £101,312 for £1
- bought the bank's security on CML. The bank wrote off £3.62 million.

**4** Consultants report that the funicular has delivered the anticipated employment and wider benefits to the Strathspey area.

**28.** To date, £23 million of public money has been invested in building the funicular and supporting the operator, most of which was provided by HIE (Exhibit 3, overleaf).

**29.** The EU set a target that CML should employ 105 people on a full-time equivalent (FTE) basis in July 2002 and 2007. The target was met in 2002 when CML employed 116 staff, but does not appear to have been met in 2007.<sup>6</sup>

**30.** The business case contains a number of assumptions on wider employment, visitor numbers and the funicular's performance. It also predicted wider benefits through the funicular's 'catalytic role in the redevelopment of Aviemore and Strathspey... attracting the private sector to invest in other facilities' and 'maintaining and improving

<sup>5</sup> The rent was revised after a few years of operation to reflect the value of the buildings to CML. The initial rent had assumed a more profitable business.  
<sup>6</sup> The EU carried out an audit in 2002 but not 2007.

the attraction of Scotland as a tourist destination in an increasingly competitive international market'.<sup>7</sup>

31. A consultants' report in 2006 on the economic impact of the funicular concluded that the wider economic benefits anticipated at the outset have been realised. These benefits include:

- significant new investment in the Aviemore area. This includes the Aviemore Highland Resort which opened in 2004 providing a hotel, exhibition hall, ballroom and auditorium
- the creation of a year-round operation at CML providing continuous employment for staff
- greater use of the area by tourists.

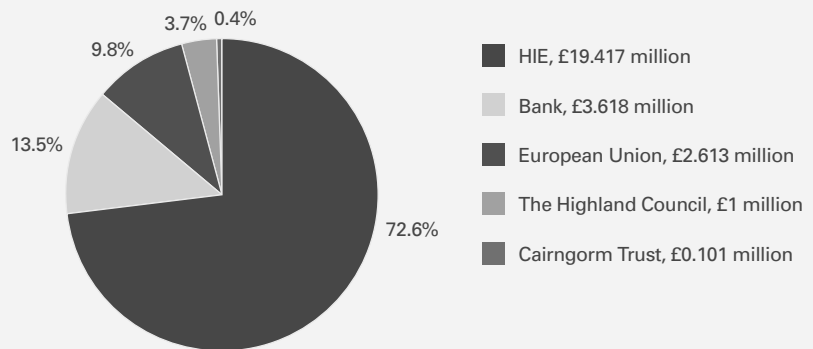
32. Some of the business case assumptions proved to be inaccurate:

- The consultants found that the funicular had resulted in an estimated 174.5 FTE jobs in the wider HIE area. This is significantly higher than the 115.5 FTE jobs expected when the funding was approved.<sup>8</sup> However, the final cost was also significantly higher than expected.
- Use by skiers is well below the anticipated level, averaging between 30-55 per cent of the predicted total. However, the fall in skier numbers is in line with wider trends across Scotland (Exhibit 4).
- Use by non-skiing visitors has been broadly on target in recent years. However, it is not clear whether the business case forecasts allowed for concessions, which accounted for 12 per cent of visitors in 2005. It is possible that the predicted income from non-skiing visitors in the business case may have been overstated.

### Exhibit 3

#### Total cost broken down by source

The public sector has spent £23 million on the funicular and operator to date, most of which was provided by HIE.

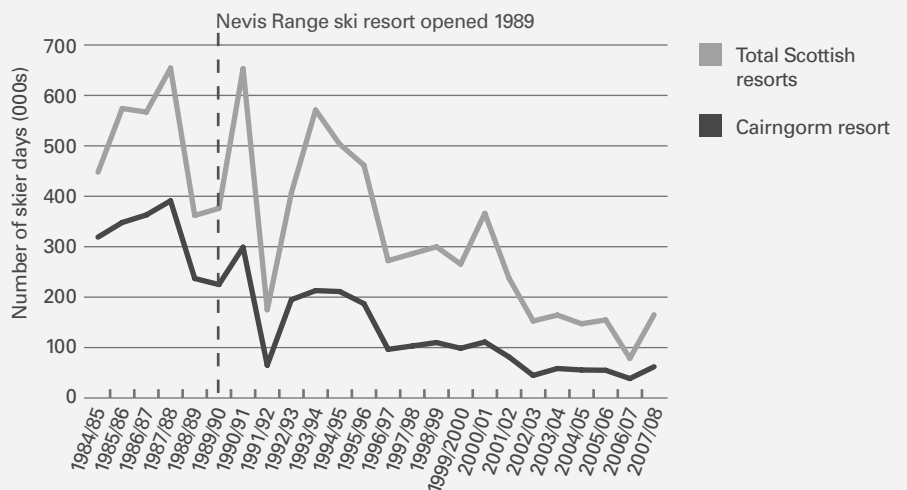


Note: We have not included within our estimates the cost of any of the time spent by HIE network staff in monitoring and supporting the project, although this is likely to be significant. The cost to HIE includes £629,000 owed by CML for unpaid rent and dividends, which HIE could have used for other purposes, and £85,989 which was repaid by the Scottish Government to the EU following an audit. The total for HIE excludes the amount paid to the bank to purchase the bank's security. This figure is commercially sensitive. As such, the figure shown for the bank is higher than it should be. Source: Audit Scotland

### Exhibit 4

#### Skiers in Scotland and at the Cairngorms

Cairngorm is the most used of the five skiing resorts in Scotland, but use has fallen in recent years.



Source: Ski Club of Great Britain and Cairngorm funicular business case 1997

7 From the Cairngorm funicular business case, 1997.

8 We have excluded 19.5 FTE construction jobs from this total to provide a fair comparison with the consultants' estimate.

- The funicular closes for an average of 19 days per year due to high winds. It was expected to close for only five days per year.
- The public sector funded the entire cost of building the funicular. HIE paid £16.93 million (87 per cent) of the final cost of £19.54 million.

**5** HIE is working with CML to develop a new model for the business.

**33.** Since taking over CML in May 2008, HIE has worked with the company to develop action and risk management plans. It has also dealt with a number of other operational issues such as recruiting new directors and progressing with health and safety and maintenance work.

**34.** CML's draft accounts for the 11 months to 29 March 2009 show a loss of £42,728 (before tax).

**35.** In December 2008, HIE commissioned consultants to consider the robustness of the current CML business model and to recommend a future model. The consultants' report was due in March 2009 but the final version was delayed until September 2009. At the time of writing this report, we had not seen the consultants' report. The HIE Board will consider the options arising from the consultants' work at its meeting in December 2009.

**36.** HIE hopes to seek a new operator for the Cairngorm funicular but this may be difficult in the current economic climate. HIE is aware of this and, if this proves to be the case, HIE will consider alternative options.

**37.** The planning permission granted for the funicular requires HIE to reinstate the land if the facilities do not operate for any period of 12 months.

**38.** In addition to potential reinstatement costs, HIE would need to repay the EU funding of £2.6 million if the funicular ceased to operate, and cover any resulting redundancy costs.

### Recommendations

In developing a new business model for the funicular, HIE must learn from its experience to date and ensure it:

- fully assesses and manages all the risks and constraints facing the facility
- reviews current performance against capacity
- considers likely demand from different user groups
- develops a clear set of objectives for the business, with measurable outcomes
- provides prospective operators with a detailed analysis of the challenges faced, drawing on experience to date
- considers changes in market, environmental and financial conditions
- creates a sustainable and attractive business opportunity for any new operator.

When assessing bids for the business, HIE should ensure that prospective operators:

- are aware of the current risks and make adequate provision for them
- will offer activities that have a positive impact on the surrounding area, taking account of possible displacement
- will observe any requirements in place to protect the fragile and unique environment of the area
- have developed a financially sustainable model for the business.

HIE should continue to review and update its project appraisal processes to ensure it is adopting good practice.

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