PUBLIC AUDIT COMMITTEE

Wednesday 2 December 2009

Session 3

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PUBLIC AUDIT COMMITTEE
18th Meeting 2009, Session 3

CONVENER

*Hugh Henry (Paisley South) (Lab)

DEPUTY CONVENER

*Murdo Fraser (Mid Scotland and Fife) (Con)

COMMITTEE MEMBERS

*Willie Coffey (Kilmarnock and Loudoun) (SNP)
*Cathie Craigie (Cumbernauld and Kilsyth) (Lab)
*George Foulkes (Lothians) (Lab)
*Bill Kidd (Glasgow) SNP
*Anne McLaughlin (Glasgow) (SNP)
*Nicol Stephen (Aberdeen South) (LD)

COMMITTEE SUBSTITUTES

Derek Brownlee (South of Scotland) (Con)
Linda Fabiani (Central Scotland) (SNP)
James Kelly (Glasgow Rutherglen) (Lab)
John Farquhar Munro (Ross, Skye and Inverness West) (LD)

*attended

THE FOLLOWING ALSO ATTENDED:

Caroline Gardner (Audit Scotland)
Carolyn Smith (Audit Scotland)

THE FOLLOWING GAVE EVIDENCE:

Sandy Brady (Highlands and Islands Enterprise)
Keith Bryers (Highlands and Islands Enterprise)
Douglas Yule (Highlands and Islands Enterprise)

CLERK TO THE COMMITTEE

Tracey White

SENIOR ASSISTANT CLERK

Joanna Hardy

ASSISTANT CLERK

Jason Nairn

LOCATION

Committee Room 5

Scottish Parliament

Public Audit Committee

Wednesday 2 December 2009

[THE CONVENER *opened the meeting at 10:01*]

Decisions on Taking Business in Private

The Convener (Hugh Henry): Good morning. Welcome to the 18th meeting in 2009 of the Public Audit Committee. All attendees should ensure that electronic devices are switched off, so that they do not interfere with the recording equipment. I welcome members of the public, staff of Audit Scotland and the witnesses for the second item on our agenda, to which we will come in a minute.

Does the committee agree to take items 5 and 6 in private?

Members *indicated agreement*.

The Convener: Does the committee agree to consider in private any draft reports on the Cairngorm funicular railway?

Members *indicated agreement*.

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.

11:50

On resuming—

"Commonwealth Games 2014: Progress report on planning for the delivery of the XXth Games"

The Convener: Item 3 is on a further section 23 report. I invite Caroline Gardner to brief us.

Caroline Gardner (Audit Scotland): This progress report on planning for the 20th Commonwealth games was published on 19 November. It is the first in a series of reports that we plan to produce on preparations for the games, and it provides an early indication of progress up until August 2009. We prepared it on behalf of both the Auditor General and the Accounts Commission.

The games are due to start in July 2014, which is just under five years from now. They are a major event for Scotland, and they will affect its international reputation and profile significantly. They bring particular planning challenges, which need to be managed: the deadline, which cannot be moved; the involvement of many different partners from across Scotland and further afield; and the vulnerability of the games to environmental conditions, including our unpredictable weather.

Hosting the games involves significant amounts of public money, together with investment from the private sector. Since Glasgow won the right to host the games in 2007, there has been a major decline in the global economy, and funding is much tighter and harder to come by.

The arrangements for delivering the games are complex, and I will run through the four strategic partners. First, the Scottish Government is responsible for introducing the legislation that is needed for the games, co-ordinating national security and delivering the legacy for Scotland as a whole. Secondly, Glasgow City Council is responsible for delivering most of the venues that are needed for the games. Thirdly, Commonwealth Games Scotland is responsible for preparing and selecting the Scottish team for the games. Finally, Glasgow 2014 Ltd, also known as the organising committee, is responsible for everything else that is needed to plan and deliver the games.

The organising committee holds the games delivery budget. It was initially set at £373 million, and it was increased to £454 million on 16 November, following a detailed budget review. Our report refers to the initial budget, rather than the revised budget, which was agreed to after our report was finalised and went to print.

The Scottish Government is contributing 80 per cent of the public funding—which is now estimated at £297 million—and Glasgow City Council is contributing 20 per cent, which is now £69 million. The organising committee expects to raise the balance, which is currently estimated at £88 million, from broadcasting rights, licensing, ticket sales and sponsorship. The Scottish Government is the primary guarantor for the games and has underwritten any potential shortfall in the budget.

Over and above the £454 million budget for the games, further investment of about £1.9 billion is being made in a range of infrastructure developments, including new and existing venues and transport infrastructure improvements such as those to the M8. That does not include the cost to the private sector of constructing the athletes village, which is still to be agreed as part of the contract.

There are five areas of findings in our report, which I would like to run through briefly before we answer any questions that members have.

First, we found there to be a complex but very clear high-level governance structure, and the strategic partners that form it understand their responsibilities. That is set out on page 9 of our report, in exhibit 2. The structure is headed by a strategic group, which has representatives from each of the four partners and which is chaired by the First Minister. The group is responsible for monitoring the spending of the games delivery budget. As part of the governance structure, the strategic partners have set up a number of joint working groups, but their status, responsibilities and decision-making powers have not all been formalised, and the partners cannot yet demonstrate how they all fit together as part of the wider governance structure.

Secondly, we found that the partners are learning from the experience of previous games in a number of ways for what is a big and complex project. That includes the use of specialist consultants who have been contracted by the Commonwealth Games Federation, as well as liaison with people who are doing similar work in the organising committee for the 2012 Olympic games in London and with staff who have been involved in other Commonwealth games. We know from experience elsewhere that there is a high risk of losing experienced staff in the run-up to the games, particularly people who are on fixed-term contracts, so it is important that the partners have contingency plans for managing that risk as we head towards 2014.

The third area is programme management. The four partners are developing programme plans to manage their separate responsibilities for the games. They are at different stages, although they are all due to be finalised by March 2010. At that stage, the Scottish Government intends to consolidate the key milestones from the four separate plans into an overall programme plan and use that to monitor and report on progress. The overall plan will need to take account of interdependencies between the plans. For example, Glasgow City Council is responsible for constructing or refurbishing most of the venues, and that work needs to be completed in time for the organising committee to make any other changes that are needed specifically for the games to take place. The links between the plans need to be built into the overall plan.

Fourthly, the organising committee is co-ordinating risk management overall and has involved the other partners in setting up an overall games risk register. The organising committee still has to refine the risk register and particularly to cost the actions that are agreed to manage each risk. The partners must ensure that they each have their own internal risk management systems, which are at different stages of development.

The fifth and final area is costs. The Scottish Parliament approved the organising committee's initial budget of £373 million to deliver the games in January 2008. That budget was based on 2007 prices, and our report as published highlights the risks that the budget might be insufficient to deliver the current plans for the games. That was the top risk identified in the games risk register when we carried out our audit. Since then, the partners have increased the games budget by £81 million to £454 million, which is also at 2007 prices.

I mentioned the additional £1.9 billion of mostly public money that is being spent on infrastructure projects, but there are indications that the initial cost estimates for some of those venues were too optimistic. That is summarised on page 26 of the report, in exhibit 6. Any further increases in the budget will be challenging for the Scottish Government and Glasgow City Council, particularly in the current economic climate. It is crucial that the partners establish very tight control over the budget to minimise the risks of that happening in the next five years.

As ever, we are happy to try to answer any questions that the committee might have.

The Convener: The project is of huge significance to Scotland, not just for 2014 but, we hope, beyond that—we all hope that there is a legacy, as has been discussed in the past few years.

I have two questions on the budget. You spoke about your worries about the risk to the budget and said that an additional £81 million has been added. Is that amount sufficient to allay the fears or worries that you had?

Caroline Gardner: The increase of £81 million that was announced last month followed a detailed budget review that was carried out by the organising committee. Early in 2009, it reviewed at a high level the plans that had been put in place for the 2007 bid and then commissioned a detailed review that reported back in October. That review identified areas in which more detailed information led the organising committee to change the estimates.

At this stage, the process looks robust, but it is not possible for us to say that there will not be further changes because, five years from the games, there are significant areas of uncertainty. You will have seen detailed media coverage on issues such as the value and cost of broadcasting rights. That process is not yet complete so we do not know what the cost might be. Similarly, the contract for the athletes village has not yet been let and we do not know what the public spending commitments on that might be.

The Convener: I think that you said that the estimates for the infrastructure costs of some of the big building projects that are associated with the games were optimistic. Is that right?

12:00

Caroline Gardner: That is right. I referred to page 26 of the report, where we set out the changes that have been seen since the bid was put together in 2006 and agreed in 2007. There are both some cost changes and some changes to the timing of venues, which are important. There has been some slippage. None of the venues is yet behind schedule, but several are closer to the deadline of 2014 than they were when the bid was originally put together.

The Convener: Do you think that the stated figures are optimistic?

Caroline Gardner: The estimates that are being worked on currently vary in certainty between projects. Some of the venues are now complete or close to completion, but others are much further from completion. The further from completion they are, the more uncertainty there is. That makes it hard to be certain about the quality of the estimates.

The Convener: Okay.

Murdo Fraser: I echo what has been said about the importance of the project, which everyone wants to be a great success. At the same time, we are anxious to keep a tight lid on costs. The convener asked about the risks to the budget and mentioned the additional £81 million that was allocated just two weeks ago.

I was struck by footnote 39 on page 23, which provides figures for the increase in operating costs of similar projects. It states:

> "Manchester Commonwealth Games 2002 increased by 120 per cent, Delhi Commonwealth Games 2010 latest forecast increase of 280 per cent … and London Olympics 2012 latest forecast increase of 300 per cent."

Those figures are terrifying. Paragraph 64 of the report states:

> "there is a high risk that the budget may prove insufficient."

I want to probe further in relation to the £81 million that the convener asked about. How would you categorise the level of the risk that further increases in the budget will be required? Is it high, medium or low?

Caroline Gardner: The context that I can provide will help you to draw a conclusion about that. The first important point to stress is that the Commonwealth Games Federation says that it put in place a much more rigorous bid process for the 2014 games than for any previous games, partly because of the concerns that you have outlined from footnote 39 of the report. It is in no one's interest for cities and countries to bid for games without a clear picture of the cost. The federation has tried hard to reduce uncertainty for the future, so the starting point should be better.

The increase of £81 million in the budget reflects a two-stage review that was carried out during 2009 on behalf of the organising committee. The review tested the figures in the bid against the current economic circumstances and experience to date of letting contracts and so on. There is a good chance that it has identified the most significant areas in which there has been change since 2007.

However, we know that the global economic climate has changed significantly since October 2008. It is still possible that that will affect cost and income, both upwards and downwards. For example, if in 2014 we are still facing reductions in visitor numbers on the scale that we have seen this year, that will have a significant impact. There is also uncertainty about the BBC's willingness to enter into long-term commitments in relation to the costs of broadcasting and broadcasting rights. I am not sure that much more can be done to pin down those elements of risk at this stage. We are satisfied that the processes in the budget review and reaching the figure of the additional £81 million were robust, but there are still five years to go. A great deal can happen in that period.

Murdo Fraser: Although you did not say so explicitly in your answer, it sounds to me as if the level of risk is high. You may wish not to comment on that.

Caroline Gardner: I am not sure that it would be helpful for us to give you such an estimate. All that I will say is that, over a five-year period, there is a lot of risk that simply cannot be managed. We think that the risk that is being managed is being managed reasonably well, but there are big uncertainties that have not yet been pinned down. I have mentioned broadcasting costs and rights and the athletes village, both of which have the potential to have a significant impact on the overall costs of the games.

Murdo Fraser: Has it been possible to quantify a worst-case scenario of what would happen if all the aspects that you mentioned were to come together at once?

Caroline Gardner: We have not done that at this stage. We plan to carry on monitoring the games and report back to you on at least one occasion before 2014 because we know that the risks will keep on changing. A better question to ask of the strategic partners might be about what planning they are doing for 2014 in that regard.

Murdo Fraser: I have just one more question. For interest, when do you intend to do your next report on spending?

Caroline Gardner: We have not set a date yet, but 2011 feels about right. We do not want to keep pulling up the plants to see whether the roots are growing, but a couple of years feels like long enough to see what the risks look like at that stage.

Bill Kidd: You mentioned in your preamble that the loss of key staff in the organisation could prove problematic. I think that it is mentioned at least three times in the report that that is a possibility—on pages 6 and 8. It says on page 6 of the "Key Messages" document that strategic partners should

"develop and continue to review plans for managing staff continuity and ensuring that knowledge is retained in the organisation following any changes in key staff."

That does not appear to have been done across the board as yet, and strategic partners are not necessarily working in partnership on that.

Paragraph 32 on page 12 of the report states that the programme management office of Glasgow City Council

"has introduced measures to retain knowledge in the event of staff changing within the PMO. This includes overlapping the responsibilities and tasks of individuals so that all activities can be covered by someone else."

Considering the potential risk for something to go wrong if key members of staff are lost, has there been any move among the strategic partners to ensure that they are taking advantage of best practice and cross-cutting management techniques that will ensure that the whole programme is not landed in a bit of a mess if one or two people leave for job opportunities elsewhere?

Caroline Gardner: We do not think that that is happening yet across the four strategic partners. Each of them is at a different stage of development. As you picked up from the report Glasgow City Council is doing particularly well in that regard; the other partners are developing their plans to do the same thing and ensure that knowledge is shared effectively and they are not reliant on just one person for critical functions.

It is true to say more generally that the next step is for the plans and ways of working of all four partners to come together so that they work more effectively as a team. We expect the Government to pull together the overall plan for the games next March, and what you mention is one important element of that.

Bill Kidd: Are the full-time staff for the Commonwealth games going to be the focal point for drawing all the work together or, as the programme emerges, will strategic partners still work on their own areas to the exclusion of drawing together? I think that the staff will number up to 300 or so people. Will they be the control room for everything that takes place?

Caroline Gardner: I will ask Carolyn Smith to offer a bit more detail on that, but it is worth noting that under the structures for governance the partners have clear separate responsibilities as well as shared ones. It is important to make it clear who is doing what.

Carolyn Smith (Audit Scotland): The overall plan that is being pulled together will not contain every single detail of every one of the partners' responsibilities; it will focus more on the high level and be used for monitoring the partners' planning for the overall programme. Each of the partners will be responsible for their own more detailed plans, which should also link in with other partners at an operational level to make sure that they liaise on anything that crosses over.

Nicol Stephen: I understand that the extra public sector spending, particularly the extra Scottish Government funding, is more than £50 million.

Caroline Gardner: It has gone up by £59 million.

Nicol Stephen: Where is that extra cash coming from?

Caroline Gardner: That information was not included in the announcement and we have not looked at it yet; it was announced on 16 November.

Nicol Stephen: When new cash is found by the Government in that way, when do you expect to be told where the funds are coming from?

Caroline Gardner: The Government does not and is not required to tell us about every change in its spending plans at the highest level. That comes through the Parliament's budget process. We would expect to look at the gains as part of our continuing monitoring, in particular as part of the next update on progress in a couple of years' time or so.

Nicol Stephen: The Government—rightly, in my view—has criticised the United Kingdom Government for pulling the additional funds that have been made available to the London Olympics in 2012 from budgets that would have been invested in sport in Scotland and in other projects that affect children and young people in Scotland. I would be very concerned if the Scottish Government was pulling funding—at the current stage confidentially, without any public scrutiny taking place—from sport across other parts of Scotland to invest in the 2014 games.

Caroline Gardner: We have not looked at that at this stage.

In line with Lord Foulkes's earlier comment, £59 million is not a huge shift in the Scottish Government's overall budget across the timescale that we are looking at. When we next examine the matter we will look at where the funding has come from, but at this stage we would not expect to have been consulted on what funding streams were being changed to identify the shift. You may want to follow up the issue with the Government, but we have not done that so far.

Nicol Stephen: However, it could be a huge shift in funding for sport in Scotland. For example, it is more than the total annual budget of sportscotland; it is a significant amount of money and we do not know where it will come from.

Is it not a nonsense for the costs to be based on 2007 prices when the games will take place in 2014? Why do we keep doing that in public projects? We know that the 2007 costs will not be the real costs.

Caroline Gardner: Broadly, there are two ways of managing costs for long-term projects. The first method is to start with a cost base at the original price base and inflate it up; the other is to start at where one expects to finish and bring it down again. The Government and the partners have chosen to stick with 2007 prices for now. One consequence of that is that we know that when we reach 2014 the cash price will be higher, simply because of inflation, if nothing else changes. Treasury guidance is generally that inflation should be built into the cost estimates, but that has not happened in relation to the project. That is one of the reasons why tight cost control becomes all the more important.

Nicol Stephen: So, on this project, Treasury guidance has been ignored or set aside—or, to put it in perhaps a more neutral way, it has not been followed.

Caroline Gardner: Treasury guidance has not been followed in relation to the treatment of inflation.

Nicol Stephen: On this project.

Caroline Gardner: Yes.

Nicol Stephen: On a more positive note, there are currently lower construction costs. I am told that, across the public and private sectors, bids are coming in about 10 to 15 per cent under estimate on major capital projects. Has that been factored in to the new costs for the Commonwealth games?

Caroline Gardner: It is one factor that has played into the detailed budget review. As I suggested in response to Mr Fraser's question, the effect is not straightforward. It is certainly true that there is evidence that some construction contracts are coming in lower than the original estimate, but in the current climate there is also a higher risk of contractors going into liquidation. Taking account of both the upside and the downside risk, I suggest that there is not a straightforward effect on the budget as a whole.

Nicol Stephen: So has it or has it not been factored in?

Caroline Gardner: It is one of the factors that we understand the organising committee's review has taken into account; it looked at the likely impact of that factor on the outturn costs come 2014. That has led to the budget increase of £81 million that has been announced. I think that it has also taken account of the downside risk associated with the current climate.

12:15

Nicol Stephen: Despite the better bidding climate for the pricing of major capital projects, the cost has still gone up by £81 million.

Caroline Gardner: It is worth me making it clear that most of the venue costs are being met separately from the £454 million budget cost at the moment. Those projects were planned by Glasgow City Council and others in advance of the bid, so changes in that regard will not make a tremendous difference to the games bid.

Nicol Stephen: So the key risk is the village.

Caroline Gardner: Yes, because it is big and because the contract is not yet let.

Nicol Stephen: Okay. Thank you very much.

Willie Coffey: As usual, the Audit Scotland report is as helpful as it is wise. It contains quite a lot of positive comments about the project management and risk management processes that are being undertaken.

I draw members' attention to exhibit 2 on page 4 of the main report, which highlights three facilities for which the completion date is only a few months before the games are due to begin. That might be sailing a bit close to the wind. I understand that constraints might apply to getting Hampden park ready for the games, but I am not sure why the other two facilities are sailing so close to the wind with regard to completion dates. I think that one of them might be the games village. Do you have any information to suggest that they might be begun a bit earlier to ensure that there is no slippage?

Caroline Gardner: That is a question about detail, which you might want to think about directing towards the organisers. Our understanding is that those facilities were always intended to be completed reasonably close to the start of the games. There is a detailed project plan for getting the entire infrastructure in place, because there are interdependencies and knock-on effects around it.

Our concerns are about three of the smaller venues that have already slipped by some way. They are the Glasgow Green hockey complex, Cathkin Braes cycling course and the swimming centre in Glasgow. They have slipped since the bid was put together. At this stage, none of them is expected to slip beyond 2014, but clearly the room for manoeuvre is reducing.

Willie Coffey: That is interesting. To be clear, three of the projects are due to complete in March 2014, which is only a matter of months before the beginning of the games. I can understand that there might be constraints on getting into Hampden to make changes, but I do not really follow the reasons why we might be sailing so close to the wind with the other two. However, Caroline Gardner is quite right: we can direct that question to the games management committee.

Caroline Gardner: Carolyn Smith might be able to give you a bit more information.

Carolyn Smith: It is to do with the activities that will take place in those venues. It would not make sense to have them prepared too early because operating costs would have to be picked up if the venues were to be ready at that earlier date. It would not be possible for them to be used for other things in the meantime and the operating costs would have to be picked up. There is a short window for the venues to be put in place; the report is saying that that risk needs to be managed and that contractors need to be available so that changes can be made to the venues in time. That will have to be monitored closely, because the venues are due to be ready so close to the time at which they will be needed.

Willie Coffey: That is helpful.

George Foulkes: I want to pick up on a couple of Nicol Stephen's points. Who do we challenge with regard to the 2007 figures that are to be updated? Who do we ask to update them properly?

Caroline Gardner: The four partners are jointly responsible for that. The Scottish Government is the biggest funder of public money, and the overall strategic group is chaired by the First Minister. The Scottish Government is the key player, but I imagine that it will want to involve its partners in Glasgow City Council as well.

George Foulkes: If we want those figures to be updated, which would seem to be sensible and in line with Treasury guidelines, we should take it up with the Scottish Government. Is that right?

Caroline Gardner: That would be the starting point, I think.

George Foulkes: That is your recommendation.

Caroline Gardner: Yes.

George Foulkes: My other point is about the extra cash going beyond the budget, and money being taken out of virement or contingencies or whatever. Does that not strengthen the case for what we discussed at our most recent meeting—having a report from you on outturn compared with budget, which we do not have for the Scottish Executive's expenditure? Where are you in your thinking on that? We threw that idea at you at our most recent meeting. Have you had time to think about it yet?

Caroline Gardner: Yes, we are thinking about it at the moment. The timing is extremely good, because we are finishing the Scottish Government's audit for 2008-09. The team is looking at what we could do currently and how we might be able to develop that for 2009-10 and future years. We will come back to you on that in 2010 to talk it through.

George Foulkes: When do you think that you will be able to let us know about that?

Caroline Gardner: After Christmas and new year would be a good time to come back and talk to the committee about it. We would probably do so informally, to start with, and would give you some options to ensure that we were on the right tracks as regards what you are looking for.

George Foulkes: That is something to look forward to—thanks.

Anne McLaughlin: You said that a number of joint working groups have been set up at operational level by the strategic partners, but that neither their status nor their lines of responsibility are always clear. Will you expand on that? Are the four partners aware of that? Will they do something about it? When are they likely to do that? At this stage, given that the games are four and a half years away, are you concerned about that, or are you satisfied that they are doing enough to deal with the issue?

Caroline Gardner: It is probably worth saying that we think that the working groups are generally a good thing and are necessary—they are ways of getting together the right people on matters such as finances, the venue and some of the people issues that Mr Kidd asked about, on which a mechanism will need to be available.

With such a complex project, it is really important that everyone understands where decisions are taken and who is accountable for them. We think that that has not yet been ironed out properly. In some ways, that is not surprising. The bid was approved in 2007, so there are still nearly five years to go. As the detailed planning is bedded down between now and March, we think that it is critical that those lines of accountability are clear to everyone. The partners have accepted the recommendation and know what is in the report, so I expect to see progress on that quite soon.

The Convener: Anyone else?

George Foulkes: I have one more question. Have we had any indication whether there are plans to send a delegation to the 2010 Commonwealth games?

Caroline Gardner: Carolyn, do you know?

Carolyn Smith: There will definitely be staff from the organising committee and I imagine that there will be staff from all the partners at the 2010 games.

George Foulkes: And no doubt Il Duce—I am sorry; I mean the First Minister—will go as well. Is that right?

Carolyn Smith: We do not know exactly who will go from the partners, but they will certainly be represented because of the closing ceremony, the handover and so on.

George Foulkes: Of course.

The Convener: As there are no other questions, I thank Caroline Gardner and Carolyn Smith for their contribution, which we will consider in due course.

"Improving public sector purchasing"

The Convener: We move on to item 4. We have a response from the accountable officer on "Improving public sector purchasing". Are there any questions or is the committee content to note the response?

Murdo Fraser: I raised the issue of the target date for standard terms and conditions of contract at our most recent meeting. The Scottish Government's reply is rather disappointing in that regard but, frankly, I see no merit in us pursuing the matter further at this time.

Bill Kidd: Is the ability of smaller and local businesses to put in tenders protected by a European ruling? Large companies may move in on smaller-scale procurement. If they do so on a large enough scale, it would be worth their while. Are small companies protected in that regard?

The Convener: Does anyone have any information on that?

Caroline Gardner: I think that we can provide some helpful background information that is not in the response from the accountable officer. The Government published a sustainable action plan in October 2009, which requires public bodies to commit to producing delivery plans for how they will purchase sustainably, including from smaller and local businesses. There are milestones for their doing so between this November and next December. That ought to give detailed information on how the public bodies intend to address the concerns that Bill Kidd has raised. The committee may want to consider asking for an update on that later in 2010, to see how they are responding to the concerns about smaller and local businesses.

The Convener: Okay. Do we agree to do that and to note the response?

Members *indicated agreement*.

12:25

Meeting continued in private until 12:48.

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