

The outsourcing of “Cairngorm Mountain” by Highlands and Islands Enterprise – what went wrong (2)

Description

Table 2: Financial standing test results for NRUK

Dunn & Bradstreet rating: risk
Assessment of financial statements
Score awarded
PQQ minimum threshold score

As detailed above, NRUK fails the financial standing testing scoring 6 against 8.5. The result is, however, adversely affected by the long term creditors' be treated as shareholder loans / quasi-equity as discussed above. The moderation of the score to take account of such matters. In effect, the shareholder loans / quasi-equity and as such the net assets position would if this moderation is applied coupled with an improvement to the classification, then the moderated score would be 9.0 compared with the n

Extract from Board Paper 12th Feb 2014 on the outsourcing of Cairn Gorm obtained through Freedom of Information

This is the second, in a series of posts ([see here](#)), about HIE's mismanagement of Cairn Gorm based on their latest response to my questions about the procurement process which led to Cairn Gorm Mountain Ltd being outsourced to “Natural Retreats”.

In 2013 Highlands and Islands Enterprise excluded Cairngorms Snowsports, a sound local company with a great deal of relevant experience, from the tender process to operate Cairn Gorm because it did not meet the minimum £500k turnover threshold they had set ([see here](#)). The paper approved by the HIE Board in February 2014 shows that Natural Retreats UK also FAILED the financial standing test set by HIE (see above). This shreds HIE's argument that their failure to evaluate Natural Assets Investment Ltd, the company to which they sold CML, did not matter as they had evaluated Natural Retreats UK:

As part of the evaluation of tenders, HIE evaluated the economic and financial standing of those organisations which bid to HIE to assume overall operational responsibility for operations at Cairngorm Mountain. As noted above, it was NRUK, rather than NAIL, which was the company which bid to HIE to assume responsibility for operations at Cairngorm Mountain. Although it was agreed that CML would be acquired by NAIL, NAIL did not have any day-to-day operational responsibility for CML. Accordingly, in evaluating the proposals for future operation of Cairngorm Mountain, HIE evaluated the economic

and financial standing (including turnover) of NRUK rather than NAIL.

(Email from HIE to Mike Shepherd, former Managing Director of Cairngorm Snowsports, 24/2/19 ([see here](#)))

While there is still a question about whether HIE was right to evaluate one company, Natural Retreats, and then appoint another, NAIL, what the FOI response shows is that NRUK failed the financial standing test scoring 6, well below the minimum of 8.5. HIE, however, then manipulated the result by “moderating the score” and arguing that the loan (£3,434,406 March 2013) from one of the owners, David Michael Gorton should be treated as quasi-equity. That brought the score up to 9, a pass. That provides clear evidence that HIE broke their own rules to allow NRUK through.

This was corrupt. There is a clear difference between debt and equity as is shown by what has happened since CML was put into administration. Had NAIL invested in CML in the form of equity, NAIL would have LOST all they had invested. However, by LENDING CML money, they are likely to end up getting back a significant proportion of what they lent ([see here](#)) as one of the main creditors of the company.

How did this happen?

The information on Natural Retreats' financial standing is not in the sections of the Board Report which deal with the Procurement Process or overview of bids received which stated (wrongly) that:

NR passed all the pass/fail questions, and achieved a score of 71 out of 100 which exceeded HIE's minimum threshold score and was the higher scoring bidder. On this basis it is recommended that NR is appointed Preferred Bidder and the project team seek to finalise the contractual arrangements with NR.

Instead, later on in the Board Paper is a section headed “Basis of Contracting with Natural Retreats” that includes a section on the Financial Standing Test. One sentence in this says it all and should have been a red light to the Board:

NRUK continues to exhibit weak trading performance, owing largely to its high administrative expenses. It has net liabilities of circa (£1.9m) and similar to NAIL appears fully reliant on the financial support of D Gorton for its immediate future.

No explanation was given about WHY Natural Retreats administrative expenses so high. Had this been investigated HIE might have stopped money being siphoned out of CML for the last four years.

The first table gave the HIE Board every reason they needed NOT to approve Natural Retreats:

Table 1: Financial ratio analysis for NRUK

		31 March 2013 (£000's)	31 March 2012 (£000's)	31 March 2011 (£000's)
A	Turnover	2,636	2,377	642
B	Operating profit before exceptional items	(317)	(74)	(978)
	Operating Profit Percentage (B/A)	(12%)	(3%)	(152%)
B	Operating profit before exceptional items	(317)	(74)	(978)
C	Net interest payable less interest receivable	275	207	58
	Net Interest Cover Ratio (B/C)	-	-	-
D	Current Assets	2,345	1,446	1,346
E	Current Liabilities	(1,005)	(743)	(441)
	Current Ratio (D/E)	2.33	1.95	3.05
F	Net Assets (excluding intangible assets)	(1,910)	(1,318)	(1,036)

This was a company that was effectively bankrupt. Procurement advice is consistent on one point, you don't contract with bankrupt companies and yet that is what the HIE Board did.

NAIL to whom the HIE Board agreed to sell CML was even more bankrupt. The Board paper reveals that they were made fully aware of this:

“Financial Standing Test

EY has re-performed the financial standing test on NRUK and the key issue remains that this company and NAIL and its subsidiaries are fully reliant on the support of Gorton to continue operations. The ability of the group to continue is therefore fully contingent on the ability and intention of Gorton to fund these businesses.

Comment: correct! So why, despite the very high risks, did EY recommend the appointment of NRUK/NAIL? As we now know those risks had very real consequences for the public purse when Gorton decided to cease “funding” CML last October (despite just a few weeks before having certified in the Annual Accounts that he would support the business for another year).

At present, NAIL has insufficient funds to repay these loans should they be called and repayment could only be facilitated through the sale of NAIL's assets. The value of NAIL's investment properties as at 31 March was c£18.4m, whilst development property had a net book value of c£5.4m. Accordingly, should Gorton call the loans he would face an estimated shortfall of c£8m in respect of his loans to NAIL taking account of the liabilities secured (c£1.8m) by NAIL's other long term creditor. Whilst there is a risk of Gorton being able to call the loans as they fall due, the asset values at present do not make this attractive and his financial wealth would suggest this is not of immediate concern.

The message to the Board, however, appears to have been, disregard what the figures are telling you and trust the hedge fund manager.

This was an extraordinary failure in critical oversight and governance. It was led by Charlotte Wright, who is now Chief Executive of HIE, on the advice of Ernst Young, one of the big four accountants “. Unfortunately, the publicly available Minute of the Board Meeting ([see here](#)) – at which interestingly the then Cabinet Secretary for Finance John Swinney was in attendance – contains NO record of the key

governance issues. It does not indicate whether there was any discussion about either the validity of the procurement exercise or the risks of contracting with companies which appeared effectively bankrupt.

What's gone wrong

The best that can be said about the procurement exercise which led to CML being sold off is that it was pockled and the HIE Board hid behind their staff, who had no basic procurement expertise, while their staff in turn hid behind Ernst and Young, who had very little procurement expertise either. The Paper to the HIE Board recommending the appointment of "Natural Retreats" could best be described as designed to cover backs. To the people involved the £368k EY charged for their "work" was no doubt a small cost.

This type of governance failure is all too prevalent in neo-liberal Britain – it easily leads to much greater corruption – and is well explained by Atul Shah, in a recent article on the Competition and Markets Authority report on the big four accountants:

The other major contributor to audit failure is the UK's system of corporate governance. My research into the 2008 collapse of HBOS, the largest corporate failure in British history, shows that the bank's board and audit committee failed to adequately question the business strategy and risk-taking or to police the quality and conduct of audits.

Most non-executive directors rarely challenge the executives they ostensibly oversee. Instead, they have become habituated to rely on auditors to provide them comfort, and the auditors have in turn relied on management.

(Extract from Financial Times)

I will come back to this failure in further posts. The revelation, however, that Natural Retreats as well as NAIL failed HIE's financial standing test should give the Scottish Parliament every reason they need to set up an investigation into what has gone wrong at Cairn Gorm.

Category

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