

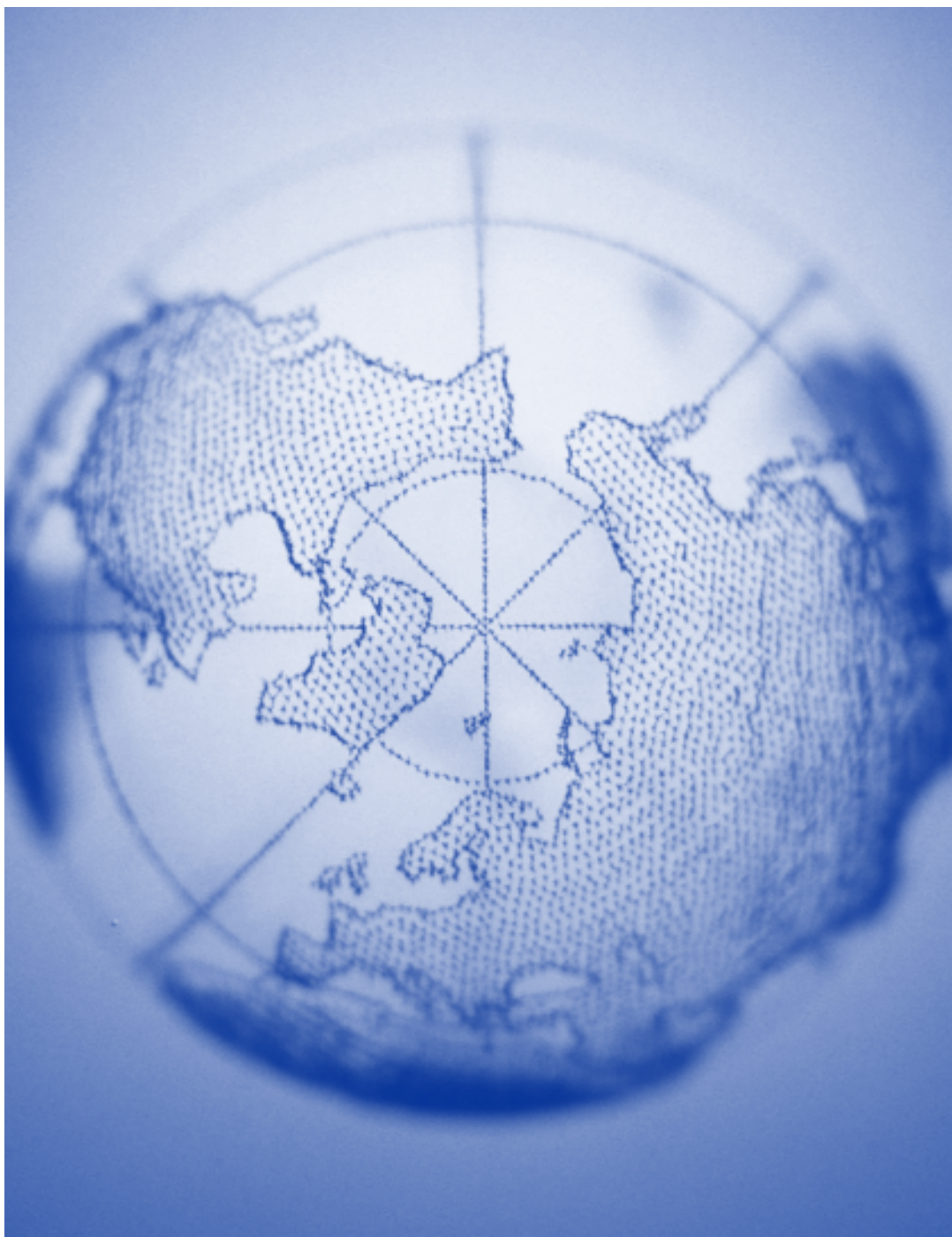
INTOSAI



Privatisation: 10 years on

Achievements and lessons from the first 10 years of the
INTOSAI Privatisation Audit Working Group

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The Privatisation Working Group is 10 years old this year. Much has changed since then, and now seems a good time to consider what the Working Group has achieved, and to reflect on the lessons member SAIs have learned that will help improve privatisation audit in the future.

The Working Group's achievements

Achievements in the first 10 years of the Group include:

- 4 sets of guidelines
 - Guidelines for Best Practice in the Audit of Privatisations (November 1998)
 - Guidelines on Best Practice for the Audit of Public/Private Finance and Concessions (July 2001)
 - Guidelines on Best Practice for the Audit of Economic Regulation (July 2001)
 - Guidelines on Best Practice for the Audit of Public/Private Partnerships (August 2004)

All the guidelines are available at

<http://www.nao.org.uk/intosai/wgap/menugu.htm>

- Dissemination of around 100 papers on member SAIs' experiences in auditing privatisation and the post-privatisation environment (economic regulation and Public Private Partnerships). Copies of papers delivered since 1999 are available at <http://www.nao.org.uk/intosai/wgap/digest.htm>
- Surveys of "The Role of the State as Minority Shareholder in Private Businesses" and "Economic Regulation" – see <http://www.nao.org.uk/intosai/wgap/surveys.htm>
- The development, in partnership with the INTOSAI Development Initiative and ASOSAI, of a training course in the audit of privatisation.
- By 2004, membership of the group had grown to 39 SAIs.

Learning lessons - Increased understanding, new insights

This paper examines what member SAIs have learned from sharing experiences in the audit of privatisation, and reaches the following conclusions:

- 1 General application of the guidelines: Context is crucial.
- 2 Evaluating a privatisation deal: SAIs can determine whether a privatisation was a good deal by examining i) the preparation of the business, ii) the sale process, and iii) the timing of the sale, in the context of the privatisation objectives.
- 3 Auditing the post privatisation environment: The SAI still has a role to play after privatisation.
- 4 Improving audit skills: SAIs recognise they need to continuously improve their audit competence.

The examples quoted in the paper are drawn primarily from papers that member SAIs have delivered to the Working Group since the Group's inception in 1993.

Context is crucial

1.1 Member SAIs report that the guidelines on privatisation and post-privatisation audit are very useful

At annual meetings of the group, various members have explained how the privatisation guidelines have helped them undertake privatisation audits, e.g. presentations by the SAIs of Bangladesh (Prague, 2003), Norway (Oslo, 2002), and Zambia (Oslo, 2002), while SAIs have also concluded that the Group's guidelines on the audit of economic regulation and public/private concessions aid them considerably in auditing state activities in these areas, e.g. presentations by the SAI of Argentina (Buenos Aires, 2000), Brazil (Prague, 2003), Hungary (Budapest, 2001), and Poland (Budapest, 2001).

1.2 But there are some limitations to the application of the guidelines

While recognising the utility of the guidelines, SAIs have encountered certain contextual obstacles in applying them in full.

- The constitutional powers of SAIs to conduct privatisation audits differ – In some countries, SAIs do not have a remit to audit all aspects of a privatisation, e.g. the laws in the Czech Republic are such that the SAI has restricted powers in auditing the state's asset stakes in joint-stock companies, even when the state holds 100 per cent of the shares. The SAI cannot, for example, examine the necessary financial ledgers in order that the SAI can assess the accuracy, cost-effectiveness and efficiency of the privatisation process. In a similar way, the SAI of Bulgaria is limited by statute to basing its privatisation audits around an examination of the proceeds of privatisation, and the way in which the state spends this revenue.
- Member SAIs use diverse audit methodologies – In a report to the Group in Budapest in 2001 about their privatisation audit work, the SAI of Poland concluded that there are “differences in tradition, scope and methodology of the auditing process, and even in basic terminology that may hinder a direct and effective use of the guidelines”. For example, the Polish Supreme Chamber of Control structures its audits based on the Act on the Supreme Chamber of Control, executory provisions to this Act, and audit practice. There are a range of approaches for developing audit questions and answers, including a framework developed in recent years by the UK NAO – the Issue Analysis/Dinner Party approach (IADP™).

SAIs can determine whether a privatisation was a good deal by examining...

i the preparation of the business

2.1 In examining the business, the SAI should seek to answer three key questions

The SAI should seek to examine a range of questions about the business, but the most significant questions are:

- Does the business have the necessary expertise? - The business must have the necessary expertise both internally - all necessary non-executives and finance posts are filled - and externally through bringing in appropriate specialist advice to deal with issues such as the valuation of pension funds, e.g. sale of the Stationary Office in the UK (insufficient non-executives); sale of the Royal Dockyards in the UK (lack of specialist advice to deal with pension funds issues).
- Has the business been restructured? - The impacts of any business restructuring should be considered, taking account of the timetable for the privatisation, e.g. with the sale of the Stationary Office in the UK, a business restructuring led to a reduction in the quality of management and non-executive posts that were not filled.
- Are the objectives for the privatisation clear? – Sale objectives include efficiency gains and encouraging wider share ownership. Without clear objectives, it is likely that the state will maximise the benefits and minimise the risks of the privatisation, e.g. while deciding on the initial public offering of the shares in AS Eesti Telekom, the Estonian government did not formulate clear and sufficiently specific objectives that it intended to achieve with the sale. Moreover, the state did not develop an action plan through which to meet its objectives. In this case, the state's key objective was to maximise share ownership, but the state's publicity campaign about the sale was targeted mainly to corporate investors and foreign investors, with little attention to potential small investors. Also, the state did not pay much attention to the general public's lack of trust in, and desire to invest in, the stock market.

ii the sale process

2.2 In examining the sale process, the SAI should seek to answer four key questions

The SAI should seek to examine a range of questions about the sale process, but the most significant questions are:

- Were bidders given sufficient information? - Bidder information should be sufficient for effective decision making; insufficient information will reduce competition, e.g. In selling 66 per cent shares in AS Eesti Raudtee (railways), the Estonian government did not fully resolve a number of key contractual terms (including which financial obligations the state would assume) until very late in the sale process, thereby creating uncertainty and a reduced number of potential buyers.

- Was the sale process competitive? - Competitive tendering should be used, where appropriate, to help ensure a good price and demonstrate propriety, e.g. in the sale of the UK rail operating companies there were only four bidders for three companies. Sale proceeds suffered as a result.
- Was the sale marketed effectively? - Privatisation by auction requires effective marketing in order to generate interest and stimulate competition among potential buyers, e.g. In the mass Albanian privatisation of 1995, the sale was not marketed effectively. The Albanian government issued share vouchers to the general public, but the voucher market collapsed, primarily because people had limited savings to fall back on. In other words, the government did not fully assess market demand before proceeding with the sale. The state also sought to complete the privatisation process quickly and in private, thereby limiting the opportunity to scrutinise buyers and increasing the possibility of corruption.
- Were bids evaluated objectively? – As the SAI of Australia identified at our annual meeting in 1999, states should establish tender evaluation committees to evaluate bids against specific criteria in order to demonstrate propriety - transparency, accountability and legality - and ensure that the privatisation fulfils its objectives.

iii the timing of the sale

2.3 In examining the timing of the sale, the SAI should seek to answer three key questions

The SAI should seek to examine a range of questions about the timing of the sale, but the most significant questions are:

- Was the timetable realistic? – e.g. Speedy privatisations in Hungary and Albania aimed to raise revenue for the state, but sales proceeds were less than might have arisen through more rigorous planning and the development of domestic capital markets.
- Were external factors that could affect the market monitored? - If a low price is expected to result due to external factors, then suspension of the sale should be considered, e.g. the price obtained in the disposal of state owned harbours was determined by variations in European Union fishing quotas. A second valuation may be required, as in the case of the part-privatisation of the UK National Air Traffic Services in 2001 to take account of revised air traffic and cost forecasts.
- Was the business valued before bids were received? - Thorough and up to date valuations should be carried out well ahead of bidding to assist bidders with their tenders, e.g. Privatisation of the Rolling Stock Leasing Companies in the UK.

The SAI still has a role to play after privatisation

3.1 The SAI should monitor the state's role if a privatised business provides essential services

If the privatised business becomes insolvent, the government may have to help provide essential services, thereby incurring liabilities. At the minimum, the SAI should monitor the impact of privatisation on essential services. For example:

- The new management may not invest in the privatised business and therefore fail to raise productivity, e.g. insider ownership and poor corporate governance in Russia, which meant that a number of privatised businesses failed.
- Inexperienced and/or poor management may lead to a decline in service to consumers and a reduction in turnover, e.g. leakage and sewer floods following the privatisation of water utilities in the UK.
- The privatised business may be unable to compete with overseas companies that enter the domestic market.

3.2 The SAI should evaluate the regulation of privatised industries

Upon privatisation, there may be negative outcomes for customers and taxpayers. The SAI should examine whether the government is addressing market imperfections, which would include:

- A privatised monopoly may have no incentive to offer good services to consumers, e.g. rail privatisation in the UK provided few incentives to invest in infrastructure that would improve train punctuality, which fell markedly following privatisation.
- A monopoly might abuse its market power by raising prices, e.g. In Argentina in 2000, the regulator needed to step in to order lower prices and facilitate competition in the interurban telecommunications market. Argentina is currently facing an energy crisis for similar reasons of monopolistic market abuse.
- A privatised company might find it cost effective to provide uneven levels of service, e.g. risk to consistent, universal service across the country by the Royal Mail in the UK if it is faces competition; uneven services between more and less affluent electricity consumers in Brazil.

The SAI still has a role to play after privatisation

3.3 SAIs are increasingly auditing other forms of partnering with the private sector

States are increasingly looking to the private sector to bear the capital cost of investment in new infrastructure. Where demand for the service is uncertain, the state may wish to share this risk with a private sector partner through a Public /Private Partnership (PPP), e.g. by establishing a joint venture, retaining a minority shareholding, entering into a franchise or concession arrangement. In all of these PPP models, the state delegates an element of day to day control over service delivery to a private sector entity. SAIs have an important role in examining whether the risks involved in PPPs are managed effectively, what quality of services the public receives through the PPP, and to disseminate good practice that promotes a culture of well-managed risk taking. At the same time, the SAI will need to ensure it has the specialist skills required to audit novel arrangements.

The Working Group has responded to these developments by generating guidelines on the audit of economic regulation, the audit of public/private concessions, and the audit of risk in PPPs.

See <http://www.nao.org.uk/intosai/wgap/menugu.htm> for copies of these guidelines.

SAls recognise they need to continuously improve their audit competence

4.1 SAls are learning through liaison with, and networking with, other SAls

SAl are learning from each other in various ways, such as:

- Sharing experiences at 11 Working Group meetings – Member SAls have delivered around 100 papers in the first 11 meetings of the Working Group about their experiences in auditing privatisation and the post-privatisation issues.
- Some bilateral co-operation agreements, e.g. pre- EU accession twinning between the SAls of Bulgaria and the UK; assistance by the UK NAO to SAl of Estonia in examining the privatisation on Estonia Telecom.

4.2 In partnership with the INTOSAI Development Initiative and ASOSAI, the Working Group has helped develop a training course in the audit of privatisation

Since 2001, the Working Group has helped the IDI and ASOSAI develop a course in the audit of privatisation that is designed to “train trainers” in the audit of privatisation. The Working Group provided Subject Matter Experts from the UK and the Czech Republic, and the privatisation audit guidelines around which the course is based.

4.3 Individual SAls have developed their own learning events in the audit of privatisation, economic regulation and PPP

Examples of learning events organised by individual SAls that cover these audit areas include:

- A two week course run by the SAl of Germany for Bundesrechnungshof auditors who are examining Public Private Partnerships.
- A Symposium on economic regulation in Brazil in November 2004.

Working Group guidelines, SAI papers and survey results

- Guidelines on the audit of privatisation, economic regulation, public/private concessions and Public-Private Partnerships - <http://www.nao.org.uk/intosai/wgap/menu.htm>
- SAI papers on their audit experiences – <http://www.nao.org.uk/intosai/wgap/digest.htm>
- Surveys of economic regulation and the state as minority shareholder - <http://www.nao.org.uk/intosai/wgap/surveys.htm>

SAI websites (for audit reports, mandates, etc.)

- Australia - <http://www.anao.gov.au>
- UK NAO - www.nao.org.uk
- A full list of SAI Websites - <http://www.idi.no/english/links-sais.asp>

Training

- The INTOSAI Development Initiative – www.idi.no



The Privatisation Working Group was set up by the International Organisation of Supreme Audit Institutions (INTOSAI) in 1993. This was in response to the increasing role of the private sector in providing what had previously been seen as "public services". Their involvement takes many forms, including privatisations, contracting out and public-private partnerships.

The Chairman of the Working Group is Sir John Bourn, Comptroller and Auditor General of the United Kingdom.

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