

Failed Privatizations – State Treasury’s Management of Property of Liquidated Enterprises

From the onset of ownership transformation, i.e., from 1990 to 2002, the number of state-held enterprises continued to decline. The total number of state-held enterprises in 1996 was 3,561, with 2,470 active. However, in 2002, there was only 1,464 state-held enterprises with 363 still active. The reduction of the number of active enterprises was the result of ownership transformations, the liquidation of enterprises for economic reasons and their bankruptcies.

In the period from 1990 to 2002, the Minister of State Treasury decided to liquidate 1,786 enterprises to be wound up due to their bad financial standing. The liquidation of enterprises allows the State Treasury to recover some assets of the entity remaining after the satisfaction of creditors. Among those enterprises, the liquidation was unsuccessful in more than 1/3 and those enterprises went bankrupt.

In the opinion of SCC, there are three important issues:

- Institution of liquidation at the right time and preparation of a realistic program of liquidation;
- Efficient and effective carrying out of the liquidation; and
- Management of property remaining after a liquidated enterprise by the State Treasury.

1. Institution of Liquidation Processes.

According to the Polish law, the supervision body of an enterprise may institute liquidation proceedings when inter alia:

- 1) The enterprise has been sustaining losses on business activities for six successive months;
- 2) More than one half of total assets of the enterprise:
 - a) consists of shares, other interests or bonds;
 - b) was let for use to third parties under civil law contracts.

Each liquidation decision is preceded by preparatory proceedings carried out by a team appointed by the founding body. The purpose of preparatory proceedings is to issue an

opinion on the causes, objective and desirability of liquidation. If the liquidation is decided, the preparatory team is required to draft a program for it. The liquidation procedure contemplates the satisfaction of all creditors.

The audits have shown that the decisions on liquidation were made by the bodies too late, when the remaining property of the enterprise was insufficient, even to satisfy creditors. In such cases, the enterprise usually went bankrupt several months after its liquidation.

The supervisory bodies refrained from making the decisions to file declarations of bankruptcy of those enterprises, treating the liquidation procedure as the last attempt to prolong the enterprise's existence in order to protect jobs. SCC has shown that the attempts to remedy the enterprises' business through liquidation proceedings were unsuccessful and the delaying of liquidation decisions led to the degradation of property of those enterprises.

Another reason behind the unsuccessful liquidations were the omissions during preparatory proceedings carried out by the founding bodies. The teams applied for institution of liquidation without having information on whether or not the property of enterprises would be sufficient to satisfy the creditors, and they failed to estimate proceeds from disposal of property or to draw the plans and set the dates of liquidation. The plans of liquidation failed to specify amounts realizable on disposal of property of the enterprises nor the expenses associated with liquidation. In the planning, they also failed to take into account the obstacles in the disposal of real estate due to their unclear legal status or the deadline for completion of those processes. There were also rare cases where the deadline for completion was not specified at all in the programs of liquidation.

2. Carrying Out of Liquidation.

More than one third of liquidations instigated were discontinued due to the declaration of bankruptcy of the entities subject to liquidation. Only a part of liquidations resulted in the satisfaction of creditors and remittance of funds to the State Treasury. The amount remitted to the State Treasury after 335 completed liquidations was as little as ca. 30% of the book value of the property of liquidated enterprises.

None of the liquidations subject to auditing was completed within the scheduled time and the average duration of that process was 3.7 years. In more than 27% of enterprises under liquidation at the end of 2002, this process has taken more than five years already. Only two Voivods¹ (2 out of 16) exercised efficient supervision over the liquidation processes. In those voivodships, almost all liquidations ended with the sale of property and some were completed while maintaining, at the same time, the employment and operating activities of the companies undergoing liquidation.

The Supreme Chamber of Control was very critical about the notorious prolongation of the time for completion of liquidation as compared to the deadlines set in liquidation programs, that was found in all audited bodies. The course of liquidation proceedings differed from the assumptions made in the preparatory proceedings and deviated from the schedules set by the liquidators. The prolongation of the duration of liquidation was the reason causing increased expenses and led to the impossibility to satisfy creditors. The supervision over the liquidators by the Voivods was insufficient and they committed a number of irregularities in the course of liquidation. The liquidators sold the property of enterprises without tender, although tendering was compulsory; and they gave ungrounded discounts, in particular on the price of real property. The absence of proper oversight resulted in the accumulation of liabilities of the enterprises in liquidation. The above irregularities were caused by the insufficient monitoring of the liquidators' activities by the supervising authorities. Although the liquidators were obligated to report on their activities, the supervising authorities failed to enforce this obligation. As a result, they received only laconic reports omitting important processes taking place within the company. Still, even such reports were not analyzed by the state agencies.

It seems that the third (after bad programs and insufficient supervision) reason behind the ineffective liquidations was the selection of liquidators and the way of their employment and remuneration. SCC observed the absence of criteria for selection of liquidators-to-be; the founding bodies failed to employ such mechanisms of remuneration that would motivate the liquidators to handle liquidations on a timely and efficient basis. The liquidators were employed for an unspecified period of time or their employment contracts were extended repeatedly. The absence of uniform criteria and rules of remunerating the liquidators and the repeated extension of their employment contracts led to the prolongation of liquidation

¹ governor of a province

processes and also the growth of associated costs. The ungrounded prolongation of the duration of liquidations was also furthered by the fact that the liquidators' remuneration was raised after the deadline set for liquidation expired and a new deadline was set. Accordingly, the liquidators were not motivated, neither by the term of employment contract nor by the remuneration system, to complete the liquidation effectively and smoothly. The contracts made with the liquidators of enterprises failed to provide for any sanctions for the breach of any conditions or deadlines contemplated by the contract or for default or negligence in the fulfillment of obligations.

The state agencies were legally able to inspect the activities of liquidators but rarely did. In one voivodship, only one inspection was carried out in 14 liquidations. In another voivodship inspections were carried out but no conclusions were drawn in spite of the failures that were found.

SCC turned its conclusions into recommendations submitted to the Minister of State Treasury for standardization of liquidation procedures; requirements before institution of liquidation procedures; and submission of precise and reliable programs of liquidation. SCC recommended that, in the course of liquidation, the supervision authorities should monitor the liquidators so as to be able to identify any irregularities in their work as soon as possible. SCC also pointed out the need to develop an incentive-based system of remunerating the liquidators.

3. Management of Property Remaining after Liquidated Enterprises by the State Treasury.

The Supreme Chamber of Control raised no objections as to the management of property taken over by the State Treasury after the liquidated state-held enterprises. The management of those property proceeded according to the plan approved by the Minister of State Treasury. The management of those property consisted in transferring them to the local stocks of property owned by the State Treasury.

The liabilities of liquidated enterprises and the costs of liquidation usually exceeded the value of property of liquidated enterprises. In some cases, the State Treasury obtained money as a result of liquidation, and in rare cases – tangible assets.

The money left after the liquidation of enterprises were accumulated by the Minister of State Treasury in a separate account. This money was used to finance other liquidation proceedings.

4. Letting the Enterprises for Paid Use.

Apart from selling an enterprise to an investor, as a whole or partial interest therein, or selling out its assets, there is another method of privatization in Poland, namely the so-called privatization by employees. The employees of the state-held enterprises establish a company that uses that enterprise and pays the rental fee to the State Treasury. If the employees-held company does not pay its liabilities, the Minister of State Treasury can terminate the agreement with that company and recover the enterprise.

The effectiveness of management of the property returned after the termination of the so-called lease agreements (agreements for letting the State Treasury property for paid use) was poor and the Ministry of State Treasury failed to develop a concept of efficient management of that property. Between 1997 – 2002, the Minister of State Treasury terminated 56 agreements.

The main reason of termination of those agreements were the delays in payment for the use of the State Treasury's property by the lease companies. The aggregate arrears in payment by the companies whose agreements were terminated or expired, amounted to ca. 26 million EUR.

The claims of the State Treasury, despite of requests for payment made to companies, filing their estate for bankruptcy and attempts of enforcing collection, were often uncollectable due to the lack of property of the company for their satisfaction. The Ministry of State Treasury delayed the termination of those agreements, mainly for social considerations, fearing the loss of jobs and in view of the attempts made by companies in order to improve their liquidity position. Such delays were also justified by the problems with the management of the property, i.e., it was necessary to secure funding for their maintenance, security, compliance with the time-consuming public procurement procedure, and again privatization.

SCC did not question the importance of social aspects that can inspire softer terms of contracts for letting property for paid use in the event of those companies whose financial position might improve. Nevertheless, the social considerations cannot excuse the failure to

enforce the terms of contracts or tolerating the companies' failure to fulfill the obligations that were voluntarily assumed by them.

The problems of managing the property of the State Treasury remaining after the terminated or expired lease agreements tend to gain in importance in a situation when 24 lease agreements were terminated in 2002 and ca. 50 companies experienced problems with fulfillment of their contractual obligations, with 19 of them qualifying for termination. SCC recognized the attempts made by the Ministry of State Treasury in order to alleviate the consequences of the deteriorating financial situation of companies that use the State Treasury's property against payment.

5. Conclusions.

The results of the audit that was carried out pointed out the need to strengthen supervision over the institution and carrying out of liquidation proceedings.

Also, it seems advisable that the founding bodies should pay more attention to the economic and financial situation of enterprises supervised by them and to decide earlier on their liquidation in situations where there are chances for viable business. In the opinion of SCC, it is inadvisable to decide on liquidation when the enterprise's property is not sufficient to satisfy creditors and, in such situations, the founding bodies should decide to file petitions for declaration of bankruptcy.

SCC also recommended the intensification of measures intended to limit the adverse – for the State Treasury – effects of deterioration of the financial position of lease companies.

As regards the Voivods being the bodies of direct supervision over the liquidation processes, SCC recommended that the preparatory teams should:

- draw up the programs and schedules of liquidation in due consideration of the special nature of enterprises to be liquidated and to revise them in those cases when the process of liquidation is prolonged, and also
- add an obligation to the contracts with liquidators, and its subsequent enforcement, of their duty and dates of submission of reports and their analyses, also in the context to the approved programs of liquidation.