



ROMANIA

COURT OF ACCOUNTS



THE ROMANIAN COURT OF ACCOUNTS EXPERIENCE ON AUDITING OF PRIVATISATION

Ours experience on the auditing of privatization reveals the existence of different aspects from one case to another, of the major risks to which the authority involved in the sale has to confronts also in the stage of planning and the settlement of its objectives, in organizing and carrying out its particular activity as well as after the concluding of privatization.

A significant example on auditing of privatization, in Romania is:

THE COMPANY: STEAUA ELECTRICĂ FIENI

Briefly description of the privatization process

STEAUA ELECTRICA had as a main object of activity the producing of electrical lamps and unloading gases lamps.

- The privatization process has aimed the sell of 51% of the company registered capital.
- The method of privatization which has been used was the directly negotiation with the selected bidder.
- There were two bidders: a Korean company and a Romanian one.
- It was selected as a winner the Korean bidder because he has offered a bigger price for the shares package than the Romanian one.
- *Subsequently, the public institution involved in the sale has negotiated with one bidder, the other one being totally ignored. In this way, it was eliminated any sort of competition or competitive tension.*

- The vendor has considered the cancellation of the agreement when the Korean bidder didn't pay 9.8 mil USD representing the shares price at the terms established in the contract.
 - *What is important to retain is the fact that at the time of the contracts cancellation, the vendor couldn't take back the negotiations with the second bidder because the legal term for the viability of the offer (180 days) has been expired.*
- This fact led to the resumption of the privatization process.
- The privatization process was resumed, having a delay of almost one year and a half.
- After this delay, there was a single bidder, a company from Holland, willing to pay the price for the shares, now a different price (0.25 mil USD), and to carry out an investments volume about 7.35 mil USD.
- This time, the price for the shares included in the buyer's offer was lower than the price from the vendor's offer.
 - *Analyzing the results of the negotiations, it comes out that the offer made by the Dutch purchaser, including price and investments, was in totally inferiority comparing with the unselected offer from the first phase of this privatization process.*
- To be more precisely we are giving as example the fact that the obtained price from the Dutch company was about 18 times lower, as well as the investments volume was about 2.66 times lower than those which were offered by the unselected bidder.
 - *Regarding the investor quality of the Dutch purchaser, the bonity department of the vendor has notified its management that is necessary a prudent approachment of this buyer because he had as a main object of activity the retailing trade of electrical goods.*
- It had also mentioned this is a complementary activity to the producing activity of the company.
 - *In spite of the recommendations of its own specialized department, the vendor has chosen further negotiations with the Dutch bidder.*
- STEAUA ELECTRICA has received a financial support from the ex State Property Found (the vendor in ours case) in total amount of 3.2 mil USD.
- In the initials contract it has been stipulated that those funds will be included in the shares price or will be repaid to the vendor in the next three years.
- During the negotiation between the vendor and the Dutch purchaser it has been established to not include the funds in the shares prices and to be repaid to the vendor in the coming 5 years.
- On the audit period, the auditors have found that this amount was not recorded as a debt in the vendor's financial statement, fact which has created reserves on the reality of these statements.

- *The lack of the competition concerning the negotiation and the concluding of the contract with the Dutch company has created the opportunity for the admission of this offer, even if it was under the price established by the vendor.*
- Through the contract the parts have agreed to set up a pledge of a number of 556.993 shares for the investments made by the purchaser, in the advantage of the vendor.
- The recording of the pledge at the competent authority has been done, having a delay of two years and a half comparing with the provisions stipulated in their agreement.
- As a consequence, this thing has created a litigation situation between the vendor and the buyer.
- The sentence was in the vendor favor, forcing the buyer to record the pledge.
- *It is very important to underline that the purchaser didn't fulfilled his contractual liabilities of carrying out the investments (5.5 milUSD) during a period of 4 years.*
- The vendor didn't follow the enforcement of the sentence, the recording of the pledge and the payment for the litigation expenses were done on the time of the audit , at the recommendations of the auditors.
 - *After the concluding the privatization , analysing the financial and economical indicators, the company had a major depreciation of its economical situation.*
 - *Comparising with the vendors objectives, it can be concluded that he has failed in this case, the privatization being not a success.*

**The Risks identified by the auditor
in the case of STEAUA ELECTRICA privatization**

PRE SALE STAGE

- The fact that the privatisation was not well timed , the sell process being not concluded in the wright time, which has created an overtaking to the legal terms (180 days)of the offers viability;
- The lack of a competitive tension through the embracement of an improper management politics regarding the negotiation with one bidder;
- The additional costs related on the resumption of the sale process;
- The increase of the uncertainty at management and the employments level concerning the viability of the company and their future, having negative effects on the performance of the company from economical view;
- The insufficiency of the marketing activity, leading to a failure in optimizing the value for money;
- The noncompliance with the market demands taking into consideration the overestimated value of the shares established by the vendor; the discouragement

and the removing of the new potential investors through this overestimated value that we already mention;

- The lack of prudence at the level of those in charge to take the decisions regarding the bonity of the investor in spite of the recommendations made by the own specialized department;
- The lack of the agreements between the parts, written in the papers with juridical power with reference at the solvability of debts in the states advantage;
- The none recording of these debts in the financial statements, being a major risk, because it didn't create the minimal premises for their monitorising and repayment, much more when there is the possibility of the extinctive prescription or limitation.

POST PRIVATIZATION STAGE

- the setting up of the non covering real guarantees, which didn't give to the vendor the reasonable assurance that the investments liabilities of the purchaser will be fulfilled, even if he was informed about the improper bonity of this;
- Not in all the cases, the admission by the public institution involved in the sale of an investments offer which can sustained a law price for the shares, can generate the optimizing of the value for money.

The recommendations of the Supreme Audit Institution in the case of Steaua Electrica

The public institution involved in the sale should consider:

- the importance of the planning and the utility of the available time, in order to establish an flexible privatization time;
- to avoid , as possible, the proceeding of the negotiation with one bidder;
- maintaining of the competitive tension, having the main purpose the optimizing the value for money;
- the settlement through a wright method ,the real and covering guarantees, in the purchaser duties, which can give the reasonable assurance that he will fulfilled his contractual liabilities, or on the contrary, to support all the expenses generated by the resumption of the sale process;
- to initiate alternative or different programs , as it is possible , to avoid this resumption and to maintain the investors interests;
- a better knowledge of the market, avoiding in this manner the overestimated value of the shares;

- in the negotiation process, it should take care about the verifying the investors bonity;
- taking the wright measures for the recording of its debts, in total amount, of 3,2 mil USD
- Identifying the similar situations, and to correct its financial statement.