

The office of the Auditor General of Norway

Country paper on the Norwegian experience
on the Audit of Privatisation

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1. The role of the Norwegian Office of the Auditor General

Pursuant to the Norwegian Constitution the King (i.e. the Government) shall ensure that the state's interests in companies are utilized and administered in accordance with the decisions and intentions of the Parliament.

As the supervisory body of the Parliament, the Office of the Auditor General is thus assigned the task of monitoring that each individual ministry fulfils its administrative responsibilities. This includes the ministry's responsibilities with regard to the privatisation of state owned companies. Privatisation of a state owned company is a decision for the Parliament. The ministry's responsibility is to carry through the decision. The Ministry is the vendor.

The audit programme used by the Office of the Auditor General in the audit of privatisations is in compliance with the INTOSAI guidelines on the Audit of Privatisation. We would like to share some of our practical experience in the field.

1.1 State owned companies that have been privatised in recent years

Norway has taken part in the international trend of privatising state owned companies in areas in society that historically were operated or dominated by the state. The Norwegian Telecommunication Company went public in the year 2000 and is listed on the Oslo Stock Exchange and on NASDAQ Stock Market in New York. The state still holds 77.7 % of the shares, but is planning to sell itself down to 1/3 of the shares. The Norwegian State Oil Company is also listed on the Oslo Stock Exchange and the New York Stock Exchange (NYSE). This was done in 2001. The state still holds 82.5% of the shares. The state has also privatised companies in a number of other fields/areas such as medicine wholesale, production of articles of food, liquor production and mining.

This paper is based on the experiences which the Office of the Auditor General has gathered from the audit of these privatisations.

2. Planning the Audit

The starting point for auditing a privatisation process always is the decisions and intentions of the Parliament. These are ascertained by means of an analysis of documents that demonstrate the basis of the Parliament's deliberation of questions related to the privatisation and documents that describe the actual treatment of the matter in the Parliament.

The Office of the Auditor General is not the financial auditor in state owned companies, but executes a yearly corporate control in connection with the state's interests in the companies. The overriding objective in the corporate control is for the Auditor General to have formed an opinion as to whether the Ministry has performed its tasks as administrator of the state's interests in companies in accordance with the decisions and intentions of the Parliament.

Through the corporate control and the ongoing monitoring of the state owned companies, the Office of the Auditor General has considered itself to have the necessary in house competence and core skills to carry out its audit responsibilities in relation to privatisations.

2.1 Introductory letter

The Office of the Auditor General establishes contact with the appropriate Ministry once Parliament has decided to privatise a company. This preliminary contact is a letter to inform the Ministry about the Office of the Auditor General's role in the privatisation process. The Ministry is also encouraged to currently provide the Office of the Auditor General with specific information and documents that generally should be included in a privatisation process. The information gathered by the Office of the Auditor General in this initial phase is confidential and thus not available to third parties.

In order to maintain the Office of the Auditor General's independence the actual audit of the privatisation process takes place after the privatisation has been concluded. The gathering of information throughout the process gives the Office of the Auditor General a basis to plan the audit of the privatisation.

2.2 Materiality and risk

The Parliament's decisions and intentions give guidance to the materiality evaluations in the audit planning.

There are several risk elements that must be taken into account when planning an audit on privatisation. These risks may differ from one privatisation to another. Knowledge of the origin of the privatisation provides an opportunity to understand the different incentives of the participants and thereby locate elements of risk.

The objectives and intentions of the Parliament often targets at meeting many different wishes and fulfill a complexity of aims. The risk connected to the privatisation increases with the risk of competition between some of the objectives. A typical example in the Office of the Auditor General's experience

is that the Parliament sets a time for the privatisation, and also decides the market or buyer(s) and that the privatisation should obtain the maximum price.

In such cases the Ministry has returned to the Parliament and asked for an approval of their interpretation of how to solve the apparent difficulty in achieving these objectives to the same degree.

Other general risk factors include the Ministry's skills, knowledge and experience with regard to privatisation.

3. Preparing the privatisation

The Ministry's handling of the privatisation can be divided into two stages. First, the Ministry has to make the necessary preparations prior to the actual privatisation. Once the preparatory stage has been concluded, the actual act of privatisation may be carried out. The Office of the Auditor General monitors both stages.

3.1 Initiating the privatisation

In the experience of the Office of the Auditor General, the initiative to privatise is often originated from the companies themselves. E.g. the initiative may be a response to the conclusions in a report from a hired management consultant company.

In one instance the privatisation process was initiated by an offer from a competing company. There are also examples of instances in which the initiative is a result of political signals. Common to these sources of initiatives, is the fact that in some cases the company itself is opposed to the privatisation.

3.2 Appointing external contractors

As a principal rule the Ministries have appointed external advisors to support and facilitate the privatisation. External advisors are also used to evaluate incoming bids in instances where the privatisation has been initiated by an offer from a competing company.

The Ministry may regulate and restrict the advisors' mandate. In practice however, the advisors tend to deal with all issues connected with the privatisation.

In the same manner as with other public purchases, the contractors are selected in a competitive process. The Office of the Auditor General obtains copies of

written material with regard to the selection process and the agreement between the chosen contractor and the Ministry.

The Office of the Auditor General meets with the contractor after the privatisation in order to have the contractor's opinion about the privatisation process.

3.3 The timing of the privatisation

As a rule all privatisations have a time limit as to when they should be completed. In most cases this is set by the Parliament. In several privatisations the Ministries have returned to the Parliament to have the time limit prolonged. The reasons for the extension are mostly connected to the objective of a good price, such as negative market development and anticipation of a better price at a later date.

One of the documents that the Office of the Auditor General requests in the introductory letter to the Ministry is a time schedule for the privatisation. The Office of the Auditor General is normally also requesting a plan from the Ministry showing where major costs occur during the privatisation process.

3.4 Buyers and Ownership structure

When deciding to privatise a state owned company, the Parliament may comment on the desired post-privatisation ownership structure. This intention may limit both the buyer groups open to the privatisation and what kind of process to use.

The Parliament may also have comments on how much the state shall own as a minority shareholder in the privatised company. As a main rule the Parliament limits the sale to a point where the state withholds at least 1/3 of the shares.

The Office of the Auditor General's control shows that the Ministry is focused on the objectives of the Parliament. If they are unobtainable due to conflicting and competing objectives or other reasons, the Ministry has presented the problem to the Parliament and asked for alterations in the conditions for the privatisation.

In our experience the Ministry relies on its advisers to analyse which method of privatisation that will fulfill the aims of the privatisation in the most efficient way.

If the buyer group is preset, the method of privatisation will have to be chosen according to this. If there are no preset restrictions or objections connected to groups of buyers or the dispersion of ownership, the chosen method of privatisation depends on which buyers will put forward the best bid or who best fulfils other intentions with regard to the privatisation.

In the Office of the Auditor General's experience, the bidders on companies that have a competitive edge in an area have mainly been industrial investors that see synergy effects in connection with their own activity. This has also been the case if the companies have low earnings but have a market or profit potential. In the case of the latter, many of the bidders have strategic reasons for their interest. Examples of this include competitors or groups of subcontractors.

To attract financial investors, the companies being privatised typically have to operate within predictable market segments as well as having good and well-known performance records. If there are comparable companies that can be used in benchmarking there is an increased possibility of attracting financial bidders.

The Office of the Auditor General has no experience with direct sale of the privatised company to its employees.

3.5 Methods of Privatising

If the buyer group for the privatisation is chosen, this will limit the choice of the method that can be used in the privatisation. The preferred methods of privatisation have been trade sales and flotations. Methods such as auctions and management buy-outs do not seem likely to be used in Norway.

3.5.1 Trade Sales

This is a direct sale of a business in state ownership to another business. This includes joint ventures and part sales.

Trade sale to institutional investors have been the chosen method of privatisation when the Parliament has not given any special directions for the privatisation method. The Ministry's advisers have assessed that this method is the most efficient one, and leads to the most favorable pricing of the company. The companies privatised by trade sale are typically medium sized and are involved in mining, liquor, production of articles of foodstuffs etc.

It is the Office of the Auditor General's experience that auditing the trade sale method demands a comparatively large proportion of resources to obtain

sufficient information on the final stage of the sale in which the Ministry or its contractors negotiate with a preferred bidder.

3.5.2 Flotations

Privatisation through flotations has been used when privatising large state owned companies that are well known and that have published comparable results for several years.

Stock exchange introduction of the companies in connection with the flotation demands that the companies fulfill the listing requirements. These requirements do to a certain extent reduce the risk connected to the privatisation, and thereby allow the Office of the Auditor General to use fewer resources on its audit of the privatisation.

Some of the companies were listed on the stock exchange on privatisation.

Underwriters have been used when companies have been listed on the stock exchange.

3.5.3 Share Issues

The method of share issue has been used in several instances. Companies often prefer this method due to the fact that the income generated from the share issue is ploughed back into the company.

There are also examples of privatisations in which the intention of the privatisation was to combine the sale of the state's shares and share issue. Such a combination improves the company's equity situation, and at the same time gives the state an income from the privatisation.

3.5.4 Mergers

Mergers of state owned and private companies have similar effects and raise some of the same issues as privatisations. A merger with a private company brings in private shareholders and alternates the state's ownership in the merged company compared to what it was prior to the merger. This may affect the state's influence on the company. In theory the value of the state's shares should be the same after as before the merger. This however depends on whether the value of the merging companies is set correctly. We have an example of such a merger in Norway. The Office of the Auditor General monitored the merger.

3.6 Pre-sale evaluation

In all the privatisations that have been controlled by the Office of the Auditor General, the Ministry has obtained a pre-sale evaluation of the company. Even when presented with a direct offer from a competitor, the Ministry has hired an external adviser to evaluate the bid before reaching a conclusion to be presented to the Parliament.

The control of the Office of the Auditor General includes a confirmation of whether there has been a valuation. Included in this control is an evaluation of the methods used and the assumptions and inputs applied in the valuation.

3.7 Restructuring of the company and adapting the framework conditions

Generally speaking, there is usually a need for adjustments regarding the company's articles of association prior to privatisation. Legal changes have to be made in connection with the transfer from a state owned company to a privatised company.

If the company is performing social functions, the Ministry will keep the supervisory or monopoly functions apart from the privatisation proposal. Therefore, in these cases the companies have been restructured before the privatisation to ensure continuation of the social functions.

Restructuring of the company to ensure the preservation of the social functions may be an assumption set forward by the Parliaments when making the decision to privatise. The Ministry's advisors have always suggested some legal adjustments and restructuring of the company prior to the privatisation to show its underlying value.

4. Implementing the privatisation

In the Office of the Auditor General's experience, the marketing of the sale is closely connected to the privatisation method. In flotations and public share issues, the marketing of the sale has been widespread and professional, using many channels to attract potential investors.

In direct sales to industrial investors, however, the marketing has tended to be more limited and directed specifically at potential investors. The fewer potential bidders the Ministry approaches, the more reason to evaluate the price achieved. So far the Office of the Auditor General has found no cases in which there has been reason to criticise the marketing of a privatisation.

4.1 Handling of bids, final negotiations and agreement

In these concluding phases of the privatisation process, it is the Office of the Auditor General's experience that the Ministry operates in a more direct and oral manner than in the earlier stages of the process. This makes the process difficult to monitor. The result of the process in form of letters of intent, sale agreements or/and shareholders' agreements etc are written and can be evaluated in connection with the Parliament's purpose for the privatisation.

Particularly with regard to trade sales, it is common that the Ministry often makes an agreement with the chosen buyer on the condition that the Parliament accepts the agreement. The agreement is then presented to Parliament for approval.

The Office of the Auditor General's task in these cases is to ensure that the information to the Parliament is adequate and in accordance with the facts.

4.2 Pricing the shares

It is the Office of the Auditor General's impression that the Ministries are conscious of the necessity of competition to maximize the price of the shares. In cases in which privatisations have involved stock exchange introduction, book building has set the price. The following development in the companies' share price has given a good indicator as to whether the sale price was correct.

5. Privatisation costs

The Office of the Auditor General monitors the Ministry's handling of the costs in connection with the privatisation. In the Office of the Auditor General's introductory letter to the Ministry we ask whether a plan has been prepared to show when major costs occur during the privatisation process.

On completion of the privatisation, the Office of the Auditor General assesses the payment to the external contractors.

The Office of the Auditor General also evaluates whether the Ministry or the company itself should pay the costs associated with the privatisation. When the state is selling shares, the state shall pay for the privatisation. When a company is privatised by means of share issue, the company receives the income and should therefore pay the cost of the privatisation. Last year the Office of the Auditor General informed the Parliament about an instance where the state made a company pay the privatisation fees when the state received the income from the privatisation.

The responsibilities of the Office of the Auditor General include the monitoring of the entry of the privatisation income and costs in the states accounts.

5.1 The Ministry and the contractors' integrity

The contractor's gain from the privatisation is always connected to the price achieved from the privatisation. The Office of the Auditor General has not experienced any discrepancies connected to this risk.

6. Information to the Parliament

6.1 Information from the Ministry about the privatisation process

Among the Office of the Auditor General's audit responsibilities is the monitoring of whether the Parliament receives sufficient and correct information before, during and after the privatisation has taken place.

6.2 Office of the Auditor General's report to the Parliament

If the Office of the Auditor General wants to brief the Parliament about its findings in the audit of a privatisation, it does that in connection with its yearly report on the corporate control. If so, the document contains the auditors' proposed remarks concerning the results of the audit.

7. Conclusion

Our general impression is that the Ministries' attempt to fulfill the Parliament's decisions and intentions in connection with the privatisations.