

Country Paper – Supreme Chamber of Control, Poland.

Managing the State's Interests in Partly Privatised Companies

1. State Treasury-owned companies

1.1. State Treasury stocks and shares

The leading organ authorized to exercise all rights ensuing from ownership of shares and stocks by the State Treasury is the Minister of State Treasury (MST). In the banking and insurance sector the proper organ is the Minister of Finance, with transportation companies it is the Minister of Infrastructure, and with mining companies the Minister of Economy.

Until the end of 1999, the number of companies whose shares were exclusively owned by the State Treasury increased. In 2000, almost all state-owned economic entities took the format of single-holder companies [owned by the State Treasury], and this format still prevails among the largest Polish economic entities. At the end of December 2000 the State Treasury was an exclusive owner of 501 companies. Nominal value of shares in those companies amounted to 8,445,644 thousand Euros. In 2000, the State Treasury sold company shares amounting to 1,031,000 thousand Euros.. The character of privatization processes accounted for the fact that among single-holder companies owned by the State Treasury, entities from the infrastructure sector prevailed. In the first place, these are holders of property involved in manufacturing, sending and distributing electric power, natural oil and gas mining, oil transportation as well as artificial fertilizers manufacturing, steel manufacturing and brown coal mining.

The State Treasury also owns packages of stocks or shares in over 1300 other companies. Those companies are very diversified in terms of size, financial standing and attractiveness for investors. The State Treasury owns stocks and shares in companies primarily as a result of:

- capital privatization, when stocks (and shares) remain in the State Treasury's hands as a reprivatization reserve, leftovers from the pool of stocks originally set aside for employees, or are deliberately retained before completion of important investors' commitments;
- mergers of single-holder State Treasury companies with other companies with mixed ownership of shares;
- liquidated companies being carried into other companies;
- clearance of commitments towards the State Treasury.

The structure and value of State Treasury shares in 2000 is represented in the table below.

Type of company	Number of companies	Nominal value of shares owned by the State Treasury in thousand Euro.
Up to 10 % of shares	344	148,449
10.1 to 20 % of shares	186	213,409
20,1 to 50 % of shares	537	1,234,813
50,1 to 75 % of shares	43	288,533
75,1 to 99.9 % of shares	40	250,233
Companies with one part of State Treasury shares under liquidation or in bankruptcy.	173	197,608
Total	1,321	2,184,840

1.2. Representatives of the State Treasury in company bodies

The State Treasury as an owner of all (or one part) of company stocks (or shares) is authorized to have representatives in company bodies. The number of members in company Supervisory or Executive Boards is defined in the Statutes of such companies. The Minister of State Treasury, (who as an organ of state administration, carries out ownership functions towards a vast majority of companies), has a separate database of candidates eligible to become members of such bodies. They are obliged to represent State Treasury interests, following the authorizations received, and submit reports of such bodies' activity to the Minister.

2. Statutory scope of Supreme Chamber of Control (SCC) audits

Following the 1994 SCC Act, the SCC audits, among others, the activity of Government administration organs, State legal entities and other public structural units from the viewpoint of legality, economic efficiency, efficacy and integrity.

The SCC (*Najwyższa Izba Kontroli*,) is also authorized to audit the activity of other structural units and economic entities (entrepreneurs) to the extent to which they make use of communal property or resources and meet their financial commitments towards the state. Audits could also be designed just to study legality and economy.

The SCC can therefore audit to a full extent those State administration organs which exercise their rights stemming from the State Treasury's ownership of stocks or shares, as well as single-holder companies owned by the State Treasury.

3. Audited areas

In the last two years, the SCC carried out 25 coordinated audits to study the privatization of economic entities. In each audit exercise, one of the important subjects was the degree to which organs of state administration exercise their ownership functions. These include their responsibility for the oversight of investors' price-related and other commitments towards the State Treasury, the privatized entity, or employees.

4. Some audit findings and recommendations

The SCC audits the owner's responsibilities, as carried out by organs representing the State Treasury. In terms of time span, the audits cover the activities prior to privatization and the course of privatization, as well as the period following the sale of 100 % of an entities' stocks (or shares) to the investor. In the three examples quoted below (presenting findings from three audits), irregularities in the activities of organs acting as owners are highlighted at the stages of developing and implementing privatization concepts and setting up the structure of ownership supervision, along with irregularities resulting from the incorrect performance of the owner's oversight functions.

4.1. Privatization concepts - selection of privatization paths by the owner in the pharmaceutical industry - examples from audits carried out in pharmaceutical industry

In 2001, the SCC carried out an audit of privatization in the pharmaceutical industry. The audit findings can be used to illustrate how the selection of this privatization path affects companies' further activity in the manufacturing and trading of pharmaceuticals.

In the second half on the 1990s, the pharmaceutical industry sector included 65 state-owned companies, employing in total approximately 25,000 people. Among those, there were 14 companies manufacturing synthetic medicines, 14 manufacturing medicines from plant raw materials and 20 wholesale dealers in pharmaceuticals. In the period before privatization, financial results achieved by all pharmaceutical plants had deteriorated.

The SCC found that only the synthetic medicine manufacturing companies had been covered by sector analyses. Following the analyses, a privatization path was proposed, in the first place designed to find strategic investors. The path was expected to lead to the modernization of companies' production potential.

According to the assumptions, the path was used to privatize six companies where the Minister of State Treasury represented the State. The SCC had no comment on the contents of privatization contracts or prices achieved in return for stocks. Investors in general managed to meet conditions specified in the privatization contracts.

The SCC was more critical about privatization of companies where the assumptions had not been followed. The characteristic negative example of the consequences of not implementing privatization assumptions was the sale of one company located in the Skierniewice voivodship. Following the Minister of State Treasury's agreement to give up the capital

privatization path, the company director generated debt with one of the company's clients, which reduced the value of the company. The client was a potential investor who, in effect, purchased the company. Resignation by the voivod from services offered by privatization advisors, debt with the future owner, and the lack of privatization analyses accounted for the fact that the future investor vividly dominated sale negotiations. The SCC estimated that the privatization contract failed to properly secure the interests of both the State Treasury and the company. Four years after the privatization exercise was completed, the investor liquidated the enterprise and moved production assets to a different plant.

Absence of a common privatization policy in the first place brought about failure in privatizing all the companies that it was planned to sell. Instead of looking for strategic investors removed from the companies, organs representing the State Treasury agreed (in four cases) four-year managing contracts with physical persons. Such contracts excluded the possibility for the Ministry of State Treasury to take the privatization initiative, while the managers were not interested in having new owners buying their companies.

The failure to implement the privatization concept had a particularly detrimental effect upon the sales and later functioning of enterprises dealing in pharmaceuticals. In the SCC's opinion, the absence of a privatization policy accounted for the fact that the privatization exercises in question had been carried out by the Minister of Health, Minister of State Treasury and 13 voivods. In view of one decision made by the Government to select the privatization path for companies dealing in pharmaceuticals, subsequent decisions made by privatized entities constituted the basis for further action, with the necessary authorizations ensuing from early decisions made by voivods and the Minister of State Treasury. In spite of the fact that the Government had made the decision to privatize by way of selling stocks to strategic investors, and with objections from companies' bodies, that group of entities was ultimately privatized by way of giving away company property for paid use by small employees' companies. This accounted for the fact that the weak and scattered companies, void of capital inflow, failed to find market space - their deteriorating financial results reduced the original value of the company. The SCC's audit also highlighted numerous cases of undervalued companies and State Treasury interests in privatization contracts not being properly secured.

4.2. Responsibilities carried out by State Treasury representatives in companies

Following the 1998 audit, the SCC assessed the responsibilities carried out by State Treasury representatives both in companies which constituted State Treasury property, and in privatised companies. While auditing the organizational set up for performing the owner's function by the Ministry of State Treasury, the SCC issued a positive opinion on:

- grouping companies in departments according to the branch,

- preparation of procedures for nominating State Treasury representatives on Governing Boards,
- reporting responsibilities.

Unfortunately, the Minister failed to ensure the fulfillment of particular responsibilities by his representatives, or carry out an assessment of their work. He had not even established in advance the criteria for carrying out such an assessment.

Enforcement of owner's oversight by the Minister of State Treasury and his representatives in company organs was marked by mistakes - both in preparing decisions for adoption by the General Assembly of members, and in the functioning of such company organs. This led to faulty organizational and economic decisions by companies, untimely summoning of the General Assemblies, failure to make necessary amendments to companies' Statutes, and the incorrect nomination of Governing Board members. Another difficulty in performing owner's functions was a lack of aggregate data concerning the financial results achieved by companies.

The SCC disclosed more irregularities in audits carried out at the voivods' level. In voivodship offices, no lists of tasks had been drawn up for Minister of State Treasury representatives (for example specifying their reporting responsibility or monitoring company results). It was disclosed that some nominations of Governing Board members infringed the law. Voivods also incorrectly registered State Treasury property.

As a result of the SCC's recommendations, the Minister of State Treasury implemented an IT system in order to register State Treasury companies and their financial results. An instruction was also issued, specifying the rules for registering State Treasury property, and such a register has been kept since 2000.

Subsequent SCC audits continued to disclose cases of failure to meet commitments by State Treasury representatives, and to present reports of their performance.

4.3. Oversight of the implementation of privatization commitments by the Minister of State Treasury.

On selling company stocks or shares, the State Treasury as a rule inscribes in privatization contracts a number of conditions. These are important from the viewpoint of the State Treasury, the privatized company, and the company crew. Investment commitments can be classified into 2 groups - price-related and non price-related. The first group covers conditions of payment, and specification of the installment payments to be made for sold stocks. Non-price related commitments in general define the size and type of investments that the purchaser of shares commits to (in financial, but also in technology transfer terms), and guarantees of employment and pay levels for the crew.

The follow-up audit carried out last year at the Ministry of State Treasury [MST] confirmed a significant improvement in enforcing the oversight of fulfillment of commitments made in privatization contracts. The SCC issued a positive opinion about the degree of organizational

preparedness at the MST to carry out monitoring and oversight of the fulfillment of non-price related commitments ensuing from privatization contracts, (including the use made of the integrated IT system at the MST, which also covered MST field offices). However, the same audit disclosed a number of irregularities in carrying out the activity studied, in spite of the proper organizational solutions which had been implemented:

- In 30 out of 111 contracts studied, irregularities were disclosed in feeding the data concerning implementation of commitments into the integrated IT system. As a result of the above, reports on the degree of implementation of non-price related commitments ensuing from privatization contracts, developed on the basis of the data collected in the integrated IT system, failed to fully represent the actual state of things. In consequence, certain commitments were reported as implemented, despite the occurrence of facts indicating incomplete implementation. That was true in the first place about the implementation of investments.
- MST field offices also carried out oversight of the fulfillment of commitments. That function was not properly executed because of untimely submission by the State Treasury of copies of stocks (and shares) sales contracts, as well as changes to the rules on submitting copies of privatization contracts to field offices.
- The audit of MST field offices disclosed one case of dishonest monitoring of non-price related commitment implementation by the purchaser of shares. This consisted of taking one commitment to maintain the employment level in a company (specified in a privatization contract) as being fulfilled, in spite of a failure to actually meet the commitment by the investor.

A separate group of irregularities ensued from the failure to properly supervise the execution of price-related commitments. Imprecise wording of contracts permitted the avoidance of interest payments on installments, or the considerable reduction of collectable amounts. Only the SCC audit showed the right way to calculate interest rates, and recommended consistent and reliable calculation of amounts due. Also, the actions pursued by the Ministry, (which aimed at agreeing the modes of decision making when implementing commitments and imposing contractual penalties on investors), were carried out in a dishonest way, and were marked by delays and infringements of the procedures specified in decisions issued by the MST.

5. Summary

Since the very beginning of systemic transformations in Poland, special attention has been paid to privatization processes. As indicated in the three examples above, proper performance of the owner's functions and oversight by state administration organs is necessary at the stage of developing privatization assumptions, carrying out the privatization exercise, as well as in the period following the sale of the company, if one part of stocks or shares has remained in the hands of the state. SCC notes with satisfaction that oversight of the implementation of privatization-related commitments is carried out in an increasingly more efficient and effective way. The SCC intends to carry out a future audit focused on defining and implementing State Treasury objectives in cases where the State Treasury remains an owner of privatized companies' stocks and shares.

