

COUNTRY PAPER

**PRIVATISATION OF STATE
ACTIVITIES – ROLE OF SAIs**

ZAMBIA

Introduction

Countries around the world are undertaking administrative and government reforms to improve the performance and accountability of public sector management. In order to respond effectively, SAIs need to consider the roles they can assume during the planning and implementation of these reforms. Privatization is one such reform where the SAI can play an important role in ensuring its success.

Privatisation should not be seen as an end in itself, but a powerful instrument to promote economic growth through further restructuring and developing the most important sectors. The reasons for privatising are - among others - to encourage private sector participation in running businesses and to attract private sector investment. It is envisaged that when this happens, economic growth is achieved.

In some countries, governments have had a greater say in the sale of State Owned Enterprises through Cabinet decisions, while in certain instances, sale has been through negotiations with minority shareholders who had pre-emptive rights. In a number of countries, privatisation is being undertaken through agencies created by the respective governments through Acts of Parliament.

In many countries where privatisation has taken place, there has been a need to establish institutions to regulate the privatised industries, to ensure the objectives of privatisation are achieved.

II Definition

The INTOSAI Committee on the audit of privatisations defines privatisation as “transfer by central or local government of a business and its assets from state to private ownership.”

The General Accounting Office (GAO) defines privatisation as “any process aimed at shifting functions and responsibilities in whole or in part, from the Government to the private sector. Privatisation can take various forms. The most common is contracting, which typically entails private bidders performing government activities. With contracting, the government remains the financier and has management and policy control over the type and quality of service to be provided. Another form of privatisation occurs when a government transfers ownership of assets, commercial type enterprises, or responsibilities to the private sector.”

III Role of the SAI

The SAI is the auditor of the business when in state ownership. It is therefore important that the SAI considers examining the privatisation process on implementation - after implementation may be too late. However, each SAI will determine when to get involved as per its mandate.

Therefore the role of the SAI is to give an assurance that the privatization process has been carried out in the most beneficial manner, and that the tax payer has received value. The SAI will provide this assurance through carrying out audits of the privatisation process and the after-privatisation status.

IV. Planning Stage

As stated in the INTOSAI guidelines, audit planning is an essential discipline. This includes ascertaining the objectives of the sale, including any unstated objectives, and clearly identifying the key parties to the sale, the risks and possibilities in the sale, and whether obligations to keep parliament informed were fully met. The SAI should seek to identify lessons, which may be of relevance in future sales.

Knowledge of the client

It is important for the SAI to be acquainted with the enabling Acts. In addition, the SAI needs to ascertain other procedures established by the government to ensure the privatisation process is completed in the most beneficial manner. In certain cases, the privatisation programme is undertaken through a privatisation agency created through an Act of parliament.

Before embarking on the privatisation audit, the SAI needs to understand the privatisation programme;

a) Information to be collected

- **Mandate-** what is the mandate of the privatisation agency? If the area to be audited is a separate unit from the agency, how does its mandate relate to the mandate of the agency?
- **Privatisation programme-** what elements of the privatisation programme are to be the subject of the audit? What were the overall Government objectives when embarking on the privatisation programme? Which clients are served by the privatisation programme? How does the agency implement the privatisation programme? What resources are used? What outcomes are achieved? And what outputs are achieved?
- **Performance information-** What performance information exists and how is it used? How is the agency assured of economy, efficiency and effectiveness in the implementation process? How is performance reported to the government and what is the reaction?
- **Organizational relationship-** What are the major responsibilities in the organization and how do they relate to the programme.
- **Environment-** Who are the potential and actual stakeholders in the privatisation programme? Is the environment simple or complex, static or dynamic, certain or uncertain?
- **Sale agreements-** Were sale agreements entered into and the provisions in the agreements complied with? Are there any penalties for non-compliance?

- **Modes of sale-** Are the modes of sale used in the privatisation process fully documented?
- **Valuation reports and audited financial statements-** Were the companies valued before being sold? How were they valued and who was responsible for the valuation? Were there any audited financial statements at the time of sale?
- **Assets-** Did the privatised companies maintain any fixed assets registers prior to privatisation?
- Is there any published information on all the State Owned Enterprises to be privatised?
- Does the agency responsible for privatisation have information on the registered consultants, valuers, lawyers, public accountants, and merchant banks dealing with the privatisation process?
- Are there guidelines regarding the use of proceeds from the privatisation programme?

The SAI can determine other information that it will consider necessary for its purpose.

b) Sources of information

Sources of information to assist in understanding the business include:

- Enabling legislation
- Cabinet submissions and decisions
- Ministerial directives in the records of audited organizations
- Ministerial statements
- The agency's mission statement, strategic plan, corporate plan, management plan and annual reports
- Performance statements by the agency
- Organization charts
- Policy files held by the agency
- Internal guidelines and procedures established for the purpose of ensuring a successful privatisation programme
- Evaluation, monitoring, and internal audit reports prepared by the agency.
- Management reports and board minutes and
- Management information systems
- Returns filed at the company registry

c) Audit plan

After a thorough understanding of the operations of the agency and the sale processes has been developed, the SAI should then draw up a detailed audit plan indicating the audit objective, scope and methodology on each mode of sale. The plan should clearly indicate the perceived risks on each mode of sale and the audit tests to be carried out to ensure such risks were guarded against by the agency.

The plan should also indicate the resources required to undertake the audit including identifying whether the SAI has the adequate skills to undertake the audit and whether there is a need to bring in outside skills.

c) Establishing research questions and the audit criteria

From a thorough understanding of the sale process and a detailed risk assessment, the SAI should develop research questions to determine how the sale process was handled.

The SAI should also develop the audit criteria to determine whether the sale process met the expectations. The criteria will normally be developed by reference to laws, regulations, and procedures established to ensure the privatisation process met Government expectations.

e) Developing the audit programme

The audit objectives and criteria will normally be tested by an audit programme of procedures which include:

- Observing
- Interviewing
- Documenting
- Testing, checking and analysing

The audit programme should :

- Relate to, and test the audit objectives and audit criteria
- Be clearly stated and has sufficient detail so as to be understood by those carrying out the audit
- Be organised in a logical manner

The audit programme should be developed for each mode of sale and will include matters such as:

- Reviewing the sale agreements entered into with the Vendor
- Checking if there are any specific targets to be met annually and establish the attainment levels achieved
- Modes of payment and channelling of the privatisation proceeds
- Tendering procedures to ensure the transparency of the whole process
- Modes of valuation of the companies to be privatised

V. Execution stage

At this stage, the audit programme will be executed bearing in mind the audit objectives on each mode of sale and the criteria developed. The audit work done at this stage will entail performance of detailed compliance and substantive tests – for example checking whether established laws and regulations and laid down procedures have been complied with. All conclusions should be supported by relevant, reliable and sufficient audit evidence.

VI. Reporting Stage

The format of the report will differ and it will be up to the SAI to decide whether to include recommendations or not. However, it is good practice to

prepare a draft report, and discuss the findings with the auditee before the final report is produced.

The final report should incorporate any comments from the auditee. The report should highlight all the conclusions. The conclusions should be linked to the specific audit objectives in the audit plan and the overall objectives of the privatisation programme.

VII. Economic Regulation

The SAI should establish whether procedures have been put in place to monitor the privatised companies to ensure the objectives of the privatisation programme are achieved. This is often done through economic regulation.

Planning Stage

Knowledge of the business of economic regulation

It is important for the SAI to be acquainted with the laws creating the institutions responsible for economic regulation. In addition, the SAI needs to ascertain whether other procedures were established by the Government to ensure privatisation does not become an end in itself but a vehicle for economic growth, and whether the obligations to keep parliament informed in this regard were met. Therefore, government objectives in embarking on the privatisation programme should be clearly understood, and all the risks and possibilities in the post-privatisation era should be identified.

Before embarking on the audit of economic regulation, the SAI needs to understand the business of economic regulation, how the economic regulators are created and what they intend to achieve.

a) Information to be collected

- **Mandate-** What is the mandate of the economic regulators? What rules and procedures have been put in place to ensure the post-privatisation process is monitored?
- **Economic regulation-** What elements of economic regulation are the subject of audit? What were the general objectives of the privatisation programme? What clients are served by the privatisation programme? How does the economic regulator monitor the privatised industries? What resources are used? What outcomes are achieved? And what outputs are achieved?
- **Performance information-** What performance information exists and how is it used? What milestones were set at the commencement of the privatisation programme? How is performance reported to government and what action is taken where targets are not achieved?
- **Organizational relationships-** What are the major responsibilities in the regulatory bodies and how do they relate to the programme? Is there a clear understanding of the objectives, and functions of such institutions in order to monitor how effectively they are carrying out their mandates?
- **Environment-** Who are the potential and actual stakeholders in the business of economic regulation? Is the environment simple or complex,

static or dynamic, certain or uncertain?

b) Sources of information

Sources of the information to assist in understanding the business of economic regulation:

- Enabling legislation
- Cabinet submissions and decisions
- Ministerial directives in the records of audited organizations
- Ministerial statements
- The economic regulators' mission statement, strategic plan, corporate plan, management plan and annual reports
- Performance statements by the regulatory bodies
- Organization charts
- Policy files held by the agency
- Internal guidelines and procedures established for the purpose of ensuring a successful privatisation programme
- Evaluation, monitoring and other reports prepared by the regulatory bodies
- Management information systems.

Audit plan

After a thorough understanding of the operations of economic regulators has been developed, the SAI should then draw up a detailed audit plan indicating the audit objectives, scope, and methodology of the audit of the economic regulator. The plan should list the risks in the post privatisation process and whether such risks were guarded against.

Identify and secure the core in-house skills needed to carry out the post - privatisation evaluation and explore the possibility of engaging expert advice where skills are insufficient within the SAI

Establishing research questions and the audit criteria

From a thorough understanding of how the regulator is to monitor the privatised industries, the SAI should develop research questions to determine how the post privation process is being undertaken, and to evaluate the results of such monitoring.

The SAI should develop audit criteria to determine whether the privatised industries are meeting Government expectations. The criteria will normally be established from established laws and regulations, procedures and other established international standards.

Developing the audit programme

The audit objectives and criteria will normally be tested by the development of an audit programme of procedures which include:

- Observing
- Interviewing
- Documenting
- Testing and checking and analysing.

The audit programme should:

- Relate to and test the audit objectives and criteria
- Be clearly stated and has sufficient detail so as to be understood by those carrying out the audit
- Be organised in a logical manner

Execution

The SAI should execute the audit programme and carry out compliance and substantive tests to examine:

- Whether the rules and procedures established to monitor the post - privatisation programme are being complied with
- What steps the institutions charged with the responsibility of monitoring the post-privatisation process have taken to ensure that it has competent staff and access to expert advice to carry out post-privatisation monitoring
- Whether the institutions charged with the responsibility of monitoring the privatised institutions are able to obtain sufficient information to enable them to carry out their functions efficiently and effectively
- Whether arrangements are in place to ensure that suppliers provide at least the basic statutory services, and that consumers are compensated if failures of supply occur
- Whether the regulator has sought to secure consumer access to services and whether suppliers are prevented from discriminating unfairly between different groups of consumers
- How the institutions charged with the responsibility of monitoring the post-privatisation process comply with their statutory obligations to provide access to vulnerable groups
- What the regulator has done to establish standards of service to the consumers, to monitor the performance of the suppliers, and to secure improvements when suppliers' performance falls short of the standards required.
- Whether regulators and suppliers have set up well established procedures to enable consumers' complaints to be satisfactorily addressed
- How the regulator is discharging any responsibilities it may have for checking that suppliers are meeting any obligations laid upon them for the protection of the environment
- Whether the regulator has the responsibility for controlling the prices charged to the consumers by the suppliers. The SAI should examine whether the regulator has implemented a well designed and transparent pricing policy in line with the regulatory framework
- Whether the regulator has sought to ensure that the price consumers are required to pay is matched by the quality of service provided
- Investigate whether the suppliers have sought to encourage suppliers to reduce their costs and improve their efficiency
- Whether in setting price controls or other limits on suppliers income, the regulator has examined the likely cost to suppliers of raising capital, including both debt and equity capital, having regard to factors such as the proportions of suppliers' balance sheets made up by different sources of finance, and taxes on profit and finance

- Whether the regulator is monitoring supplier investments, checking in particular that suppliers are fulfilling any investment requirements and undertakings, and the investment is having the desired beneficial effects for consumers
- Whether the regulator has the objective of promoting competition in order to reduce monopoly and market domination. The SAI should examine what has been done in pursuit of that objective and with what results
- What has been done to assess whether consumers have scope to change suppliers, whether there is sufficient information for them to make rational decisions about which suppliers they choose, and whether there are effective arrangements for those consumers who want to change suppliers
- Whether the regulator seeks to identify and deal promptly with alleged anti-competitive practices.

Reporting

The SAI should prepare a draft report which should be discussed with the auditee before a final report is produced. The final report should contain comments from the auditee.

Each SAI will determine the format of the report.

VIII Audit of Private/Public Finance and Concessions

Planning Stage

Knowledge of the business

It is important for the SAI to acquaint itself on how the contracting and concession deals were entered into. It needs to determine its remit in examining a public finance and concession deal. The SAI should clearly identify the key parties to deal with, and the risks and possibilities in such deals and whether obligations to keep parliament informed were met.

In planning the audit of private/public finance and concession contracts, the SAI should plan to cover all major aspects of the deal that have a bearing on value for money. It should identify the key parties to the deal and, where possible, take evidence from them, and to be alert to identifying lessons for the future.

a) Information to be collected

- **Mandate-** What is the mandate of the privatisation agency regarding public/private finance and concession contracts? How does the mandate of State companies or services privatised in this manner relate to the mandate of the privatisation agency?

Privatisation programme

- What elements of this type of privatisation are to be the subject of the audit?
- Is the privatisation agency responsible for this type of privatisation? If not, who is responsible and what is their mandate?

- How did the procuring organization decide the scope of a private/public concession?
- How did the procuring agency manage the process of awarding a public/private finance contract?
- How did the procuring organization select a private sector partner and how was the final contract negotiated?
- How did the procuring organization gain reassurance (before committing itself) that the deal met its objectives, was affordable and offered value for money?
- How have the procuring organizations managed the contracts once signed?

Performance information

- What performance information exists and how is it used? How does the agency or procuring organization ensure economy, efficiency and effectiveness in the implementation process? How is performance reported to the Government?

Organizational relationship

- What are the major responsibilities of the procuring organization in relation to this type of privatisation? How do these responsibilities relate to the privatisation programme?

Environment

- Who are the potential and actual stakeholders in the privatisation programme? Is the environment complex, static, or dynamic, certain or uncertain?

Sale agreements

- Were sale agreements entered into and the provisions in the agreements complied with? Any penalties for non-compliance?

b) Sources of information

Sources of information to assist in understanding the business include:

- Enabling legislation
- Cabinet decisions and submissions
- Ministerial statements
- The procuring organisation's mission statement, strategic plan, corporate plan, management plan and annual reports.
- Performance statements by the procuring organization
- Policy files held by the procuring organization
- Internal guidelines and procedures established for the purpose of ensuring a successful privatisation programme
- Evaluation, monitoring, and internal audit reports prepared by the procuring organization and economic regulators
- Management reports and board minutes of the procuring organization
- Management information systems and
- Returns filed at the company registry

c) Audit Plan

After gaining a thorough understanding of the operations of the procuring organization, and the contracting and concession process, the SAI should

then draw up a detailed audit plan indicating the audit objective, scope, and methodology on each mode of privatization. The plan should clearly indicate the risks for each type of privatization.

The plan should indicate the resources required to undertake the audit, including identifying whether the SAI has the adequate skills to undertake the audit and whether there is need to bring in outside skills.

d) Establishing research questions and the audit criteria

From a thorough understanding of the sale process and a detailed risk assessment, the SAI should develop research questions to determine how the contractual or concessions process was handled.

The SAI should also develop the audit criteria to determine whether the sale process met the expectations. The criteria will normally be developed by reference to the laws, regulations, and procedures established to ensure the contractual or concessions process met government expectations.

e) Developing the audit programme

The audit objectives and the audit criteria will normally be tested by an audit programme of procedures which include:

- Observing
- Interviewing
- Documenting
- Testing, checking and analysing

The audit programme should:

- Relate to and test the audit objectives and audit criteria
- Be clearly stated and has sufficient detail so as to be understood by those carrying out the audit
- Be organised in a logical manner

The audit programme should be developed for each mode of privatisation.

f) Execution

The SAI should execute the audit programme and carry out compliance and substantive tests as required by the audit programme. Generally, the following issues will be examined:

- Reviewing the contract agreements entered into by the procuring organisation and the vendor
- Examining how the audited body prioritised potential projects and whether it implemented projects in that order
- The SAI should examine whether the audited body states its requirements clearly from the start and expressed these in output terms
- The SAI should review whether the audited body made a preliminary assessment of the private sector's capabilities for delivering the requirements
- The SAI should examine whether the audited body made a preliminary evaluation of the benefits it sought

- The SAI should review how the audited body assessed the impact any wider policy objectives might have on the project
- The SAI should examine whether the audited body examined alternative ways of meeting its needs, such as sector traditional procurement or privatisation, before choosing the private/public finance and concession option
- The SAI should review whether the audited body identified the room for innovation in advance in areas such as design and construction, operation and project financing
- The SAI should examine the extent to which the audited body considered, before starting the procurement process, whether the project was likely to be affordable and offer value for money.
- The SAI should examine whether the audited body prepared a proper business case to support the decision to begin the project's procurement.
- The SAI should examine whether the audited body assessed the skills it would need to deliver the project successfully and where it could obtain these (for example from in-house staff or from external advisers), and whether the body then assembled its project team in good time.
- The SAI should examine how the audited body investigated the market prior to beginning the formal procurement, to establish that there were suppliers who were willing to tender for the project.
- The SAI should examine whether the audited body identified the contractual issues that were likely to arise during the procurement and drew up a draft contract, setting out initial proposals on each issue.
- The SAI should examine whether the audited body prepared a tendering strategy, covering the number of tender rounds to be held, the number of bids to be invited at each tender stage, the body's approach to communicating with bidders, and a realistic timetable for the tender process.
- The SAI should examine whether the audited body prepared a credible project timetable which identified milestones against which progress could be measured, and points within the process at which the body was to review the project's continued viability.
- The SAI should examine whether the audited body assessed the project against any publicly funded alternative, and review the adequacy of this public sector comparator.
- The SAI should examine whether the audited body succeeded in creating a good tender list.
- The SAI should consider whether the audited body set out a clear specification of the requirements.
- The SAI should identify whether, the audited body established a competitive final shortlist, and managed the negotiations with the preferred bidder well.
- The SAI should identify whether during the procurement the audited body regularly reassessed that the project continued to offer value for money.
- The SAI should examine whether the audited body set realistic budgets for all project costs, including internal and external resources.

- The SAI should examine whether the range of solutions proposed by bidders included design variants.
- The SAI should review whether bidders put forward operational variants in their proposals.
- The SAI should investigate whether bidders' proposals included different ways of financing the project.
- The SAI should examine whether bidders suggested amendments to the requirements identified in the specification by the audited body.
- The SAI should identify whether bidders submitted different proposals for the allocation of risk between themselves and the audited body.
- The SAI should identify whether the audited body carried out an assessment of the financial aspects of bids.
- The SAI should examine how the audited body assessed the allocation of risk proposed by each bidder and its effect on the proposed contract price.
- The SAI should check the audited body's assessment of the financial stability of bidders and members of bidding consortia.
- The SAI should assess the audited body's evaluation of the quality of service proposed by each bidder.
- The SAI should review how the audited body assessed the results of the financial and non-financial evaluation so as to select the bid offering best value.
- The SAI should review how the audited body minimised changes to the terms of the deal during the final negotiations with the winning bidder.
- The SAI should examine whether the deal meets the project's original objectives, or the latest circumstances if these objectives changed during the procurement.
- The SAI should examine whether the audited body confirmed that the proposed deal offered best value for money, compared to reasonable alternatives, before awarding the contract.
- The SAI should review whether the contract's provisions on matters such as performance measurement and supplier remuneration will be likely to ensure delivery of the service required.
- The SAI should identify whether there are sources for any capital funds required to implement the project and for the ongoing payments payable under the contract.
- The SAI should examine the steps the audited body has taken to ensure that it manages the contract intelligently.
- The SAI should examine whether the audited body has monitored the contractor's performance adequately and paid the contractor accordingly.
- The SAI should review the audited body's management of changes during the contract period to its requirements and to the provisions of the contract itself.
- The SAI should examine whether the audited body has succeeded in maintaining the allocation of risk laid down in the signed contract and has managed effectively those risks it retained.
- The SAI should examine whether the audited body planned and managed effectively its exit from the contract on its expiry.

g) Reporting

The SAI should prepare a draft report which should be discussed with the auditee before a final report is produced. The final report should contain comments from the auditee.

Each SAI will determine the form of the report.

IX Conclusion

As can be seen from the above, the SAI has a very important role to play in the privatisation of State activities both in the short and long term. The oversight responsibility of the SAI makes it possible for it to provide guidance to the Government on how well the privatisation process is being implemented. It is up to the SAIs (and the mandates that they have) whether to audit the privatisation process up front or wait until the whole process has been completed. The costs of these decisions ought to be weighed.