

Állami Számvevőszék
 State Audit Office of Hungary

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Using the INTOSAI Privatisation Audit Guidelines
- The Hungarian case -


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1. Guidelines on Best Practice for the Audit of Privatisations

1.1. The INTOSAI Working Group on the Audit of Privatisation

- Set up in 1993
- Terms of reference:
 - to identify and examine problems
 - to exchange information
 - to facilitate the provision of information
- Publication of the Guidelines in 1998


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1.2. Structure of the Guidelines

- Eight areas of particular concern
 - The skills required by the SAI (2 guidelines)
 - Guidelines which are general in character (10 guidelines)
 - Guidelines relating to specific issues concerning trade sales, management and employee buy-outs, mass privatisations, auctions, flotations (25 guidelines)
 - Guidelines relating to the audit of the costs (3 guidelines)
- There are four parts to each guidelines: the issue, why the issue matters, the guidelines itself and the reasons for the guideline.

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1.3. Guide to Privatisation Terms and Concepts

1.3.1. Key stages of Privatisation

- Reviewing Options and Preliminary Planning
 - Objectives of privatisation
 - Evaluation of options
- Pre-Sale Considerations
 - Establishing a sales team
 - External advisors
 - Reforms and restructuring
 - Establishing a timetable
 - Pre-sale valuation
 - Defining bid criteria


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1.3.1. Key stages of Privatisation (continued)

- Methods of Sale
 - Trade Sale
 - Management/Employee Buy-Out (MBO/MEBO)
 - Auction
 - Flotation/Public Offering
 - Voucher sales

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1.3.2. Generic Privatisation (straightforward trade sale) Issue Analysis

Was the privatisation good deal (i.e. Value for Money)?

- Was the correct privatisation strategy chosen?
- Was the privatisation process well managed?
- Was the best price achieved?
- Is the deal likely to meet its objectives?

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2. Privatisation in Hungary

2.1. Privatisation- reforms versus transition

Role of privatisation in the reforms of market economy:

- to decrease of number of state owned public utilities
- to limit usage public funds to deliver collective goods
- to force competition in public sector
- to follow DPM paradigm


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2.2. Economic Policy and Privatisation

- **General Requirement: to ensure favourable environment for privatisation**
 - to define the state entrepreneurial assets to be sold (1859 companies having book value of HUF 1700 billion in 1990)
 - to define the objectives of privatisation
 - to ensure a smooth balanced process of privatisation over time

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2.3. Economic Policy Objectives of Privatisation

Based on: Property Policy Principles and Privatisation Law (1995)

- establishment of market economy based on private property
- introduction of new, modern technologies and methods of management
- widening the circles of players in the domestic market
- development of capital market, the inclusion of foreign capital
- decreasing the economic role of the state
- maintaining and establishing jobs

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2.4. The Cyclicity of Privatisation

Two forms, due to changing demands over time and election periods

- Phases of privatisation over time
 - „Spontaneous” privatisation (1989-1990) } First Phase
 - Priv. under economic pressures (1991-1995) } Second Phase
 - Mature phase of priv. (from 1996) } Third Phase
 - Priv. of partnership type (from 2001) }
- Cyclicity of privatisation linked to election periods

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2.5. Methods of Hungarian privatisation

Key questions were:

- Market focused v. voucher privatisation?
- Foreign v. Hungarian investors?
- To prefer the financial or professional investors?

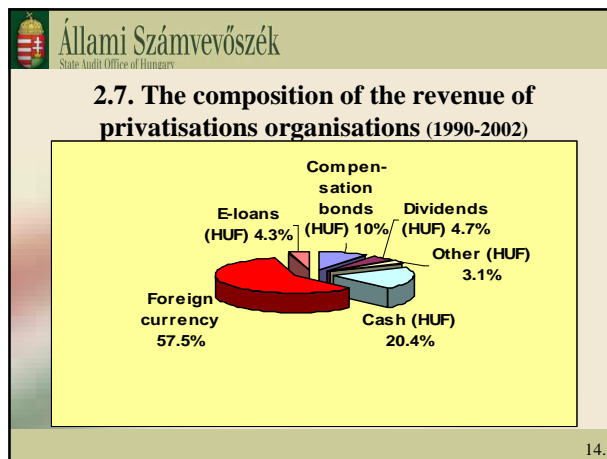
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2.6. Method or technique applied

	Distribution according to the number of transactions (%)	Distribution according to the contractual value of transactions (%)
Tenders	52,6	38,7
Public auction	1,6	4,3
Capital market methods	5,0	41,1
Compensation bonds	3,0	10,88
Sales to employees	24,3	2,8
Management buy-outs	0,5	0,1
Simplified privatisation	3,4	0,37
Other	9,6	1,75
Total	100	100

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2.8. The balance of privatisation

Type of transactions concerning state assets	%
Privatisation prorevenue	27,4
Liquidation, full settlement, winding up	9,5
Transferred to the local government	1,6
Transferred to soc. sec.func. self-governments	0,3
Transferred to privat asset management agencies	9,2
Transferred to other state asset management agencies	2,1
State owned companies	6,2
All registered transactions	56,3
Missing assests	43,7
All	100

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2.9. Structural change of the registered capital of companies by main types of owners (%)

	1992	1995	1998	2002
State owned	59	29	13	13
Privately owned	10	12	12	13
Company owned	13	20	27	26
Foreign owned	10	28	36	38
Others	8	11	12	10
All	100	100	100	100

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- ### 2.10. Roles of the State Audit Office
- Auditing the activities of State Assets Management Agency and Companies
 - Presenting opinion on their internal controls
 - Presenting opinion on their asset registry system
 - Auditing some larger state owned enterprises and their activities, maintenance and increase of the value of their assets
 - Preparing personnel decisions (making proposals)
 - State Assets Management Agency: Executive Director, Members of Board of Directors
 - State Assets Management Companies: President of Supervisory Board, Independent Auditors
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- ### 2.11. Experiences of the State Audit Office
- The SAO regularly informed the Parliament of its findings
 - Yet, parliamentary control was weak, due to conflicting political debates
 - Special Investigation Committees often benefited from SAO's reports
 - The SAO, focusing on regularity audits, made some hundred proposals for privatisation
 - Implementation lagged behind
 - A few court procedures were initiated only
 - In line with INTOSAI guidelines remarkable contribution to apply the best practices
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3. Guidelines on Best Practice for the audit of risk in public/private partnerships (PPPs)

3.1. The key risk areas

- Risk areas facing the state:
 - Clarity about partnership objectives
 - Negotiating an appropriate partnership
 - Protecting the state's interests as a minority shareholder
 - Monitoring the state's interest's in the partnership
 - The state's exposure in the event of difficulties
- The SAI faces risks relating to:
 - Examining the process and the results
 - Identifying worthwhile lessons
 - Following up their work

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3.2. Improving Fiscal Institutions for PPPs

- Goals to be achieved:
 - Risk awareness
 - Disclosure
 - Accounting, budgeting, and fiscal planning
 - Risk management

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4. PPPs in Hungary

4.1. Government's role

- Expressing intention subsidization
Gov. Decree on the usage of the new forms of the public and private sector development and service partnership
- PPP Inter-departmental Committee
(Ministry of Economy and Transport, Ministry of Finance, Ministry of Justice, Office of the Prime Minister, Central Statistical Office)
- PPP Coordination Department at the Ministry of Economy and Transport
- Starting Pilot projects

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4.2. Tasks of PPP Inter-departmental Committee

- Coordination of the necessary amendment of the regulation
- Expressing opinion on PPP project before decision of Government
- Following and evaluating of project realization
- Coordinating Government communication considering PPPs

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4.3. Main data of PPP-projects 2007-2010

Ministry	Project	Short description	(Expected) launch	Expected length of project (yrs)	Estimated present value of project (HUF bn)	Budgetary expenditures (HUF m)				
						(HUF bn)	2007	2008	2009	2010
Ministry of Economy and Transport	M5 1st section	Operation and maintenance	March 2004	27						
	M5 2nd section	Design, build, finance, operate (DBFO)	July 2004	27	242,8	33 977	34 503	34 800	35 080	
	M5 3rd section	Design, build, finance, operate (DBFO)	February 2005	26						
	M6 1st section	Design, build, finance, operate (DBFO)	October 2004	22	111,9	15 000	15 362	15 981	16 455	
Ministry of Justice	Prisons	Create 2 penal institutions in DBFO format	From November 2005 to January 2006	18	71,7	1 551	3 136	3 442	3 746	
National Sports Office	"Sport 21st Facility Development Program"	Design, build, finance, operate (DBFO), swimming pool, gymnasium	From 2006	15-17	30,1	486	1 700	1 756	1 809	
Ministry of Education and Culture	Accommodation in residential halls or educational infrastructure (DBFO)	Design, build, finance, operate (DBFO)	From 2004	construction: 20 years of operation	154,6	3 527	9 904	9 904	9 904	
	Garage of The National Museum				0,5	52	91	91	92	
Total						611,6	54 583	64 696	65 974	67 086
as a percentage of GDP						2,4	0,2	0,2	0,2	0,2
as a percentage of the expenditure total of the 2007 annual central budget						7,8	0,7	0,8	0,8	0,8

Source: State Budget of the year 2007

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4.4. Specific questions of audit of the PPPs

Audit Types:

- **Financial audit**
Regularity of accounts and records
- **Traditional performance audit (four pillars)**
- **New Value for Money audit**
 - Two dimensional matrix
 - Approach based on key life cycle themes
- **Comprehensive audit:**
Audit of public procurement and the evaluation of internal control system

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4.5. Six key performance themes*:

- Suitability to business needs
- Appropriateness of PPP
- Support of the project by partners
- Quality of delivery of project
- Optimal balance between cost and quality
- Effective risk allocation

* According to the NAO's methodology

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4.6. M5 motorway construction

Background – I. stage of construction

- Great demand on M5 in early 1990s
- Concession contract in 1995 contained state guarantee for income from usage of motorway
- Too high toll – less traffic than expected – high compensation demand from private partner
- Negotiation about further construction and contract modification stuck between 1998-2002

Bad contract, all risks belonged to the state and no step-out right

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4.7. Solution – II. stage of M5 motorway construction

- Government decided to buy 40% of the company and give the right for further construction
- This contract shares the risks between the public and the private partner
- Real partnership between the contracting parties

Real PPP but higher cost by I. stage heritage


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4.8. M6 motorway construction

- Off Budget Sheet PPP project
- Balanced risk allocation
- Technical and financial panels for conflicts
- State interest guaranteed by many sided control system
- But: comparison between PPP option and public sector comparator (PSC) was only after the contract
- Recommendations of SAO to Government:
 - conceptions of projects be based on financial plans
 - comparisons of costs are to be made earlier


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4.9. Test of key audit themes in cases of motorway construction

	M5 I. phase	M5 II. phase	M6
• Requirements	Yes	Yes	Yes
• Appropriateness of PPP	No	Yes	Yes
• Support of the project	No	No	Yes
• Management	No	Yes	Yes
• Optimal balance	No	No	Yes
• Risk allocation	No	Yes	Yes

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Thank you for your attention