

***Audit of public utilities on the basis of the audit of privatisation processes  
in the thermal power sector***

***Case study for the meeting in Tunis in December 2006***

**Public utilities**

Traditionally, the notion of public utilities in Poland referred to entities that produced or provided services regarding water supply, waste and sewage removal, public transport, electricity and gas supplies, central heating, management of spas, services in the area of culture and funeral parlours. The status of public utilities was also given to airports, railways, postal services and telecommunications. Now the only entity of the type that has been still operating is the Polish postal service. Other entities operate now as companies whose shareholders are self-governments, the State Treasury or private capital. Power sector enterprises, which deal with supplies of gas fuels, electric energy and central heating, as entities functioning in the area of natural monopolies, are subject to the regulations of the Energy Regulatory Office.

At present, the majority of entities dealing with sewage and waste removal and water supplies are communal entities or private entities. The State Treasury has a majority stake in electrical power and gas enterprises. The most diverse ownership structure may be observed in production and distribution of warm water for communal and heating purposes.

In mid – 1990s, as a result of efforts aiming at reorganization of owner structures, local thermal power stations and heating networks were made over to self-governments, that independently made decision of sale. Almost all thermal power stations and heat and power stations, which are usually large entities, owned by the State Treasury have been privatised. The Supreme Chamber of Control (NIK) has examined the restructuring and privatisation processes in all said areas of the economy. In 2004, the NIK carried out a comprehensive audit of *privatisation processes in the thermal power sector*. The audit included 25 entities over the country.

## **Audit objectives**

The objective of the audit was to assess preparations for and implementation of privatisation in the thermal power sector. The NIK paid attention to:

- assessment of preparations for privatisation of thermal power enterprises,
- assessment of provisions of privatisation agreements and protection of interests of the State Treasury, municipalities and energy consumers,
- assessment of the implementation of provisions contained in privatisation agreements and the ways for supervising this implementation by the State Treasury and municipalities,
- assessment of economic and financial effects of the privatisation of the sector,
- assessment of assuring communal services supplies with regard to thermal energy by municipalities after privatisation of communal companies.

In the audit the following crucial issues were very important for NIK:

- implementation of government restructuring and privatisation programmes for the thermal power sector and of local programmes for providing energy for municipalities,
- regularity of activities of Minister of Treasury and local self-government entities with regard to privatisation procedures of thermal power enterprises,
- fulfilment of requirements stemming from provisions of privatisation agreements.

## **Quality of privatisation and restructuring processes**

The audit has disclosed discrepancies in the quality of restructuring and privatisation processes introduced by the Minister of State Treasury and self-government bodies. The NIK gives a positive opinion on the compliance with privatisation procedures by the Minister of State Treasury in the case of State Treasury companies. The assessment was, however, marked down due to:

- delays in the implementation of the privatisation programme for the electrical power sector which resulted in worsened market conditions for subsequent privatisations
- irregularities in the privatisation of the Heat and Power Station in Poznań resulting in worsening of the negotiation position of the Minister of State Treasury and in a decrease in the value of the transaction,
- irregularities in the privatisation of the Heat and Power Station Complex in Białystok.

The NIK has negatively assessed executive self-government bodies with regard to privatisation of communal thermal power entities. Despite numerous successful privatisations,

the scale of irregularities detected in case of the rest entities does not allow for a positive assessment of the performance of duties of public property owners by municipalities.

The NIK has positively assessed the effects of privatisation, especially with regard to State Treasury companies. The negative effects of the transformations resulted from mistakes made during privatisation.

### **Privatisation progress**

Privatisations of entities from the thermal power sector took place in the period of increasing competitiveness and decreasing demand for central heating, resulting from activities aimed at rationalizing its use. However, the majority of entities, especially those operating in small and medium-sized towns, have kept their monopolistic position. The dynamics of the privatisation of communal thermal power enterprises increased, it did not, however, coincide with development of strategies by boards of municipalities. Actions initiated in this area by the Minister of State Treasury proved unsuccessful. Out of 19 heating companies participating in the programme for support for privatisation of communal entities, only four were privatised, and one of these privatised entities declared bankruptcy less than three years after its privatisation.

Within eight years of the implementation of privatisation programmes in State Treasury companies, privatisation processes were completed in 10 out of 21 heat and power stations. Delays in privatisation resulted in implementation of these processes in deteriorating market conditions.

### **Quality of privatisation agreements**

In one case, the NIK has detected important irregularities regarding the procedures applied by the Minister of State Treasury at the stage of commissioning and developing pre-privatisation analyses and selecting privatisation methods, and irregularities regarding negotiation proceedings. However the NIK has given a negative assessment of flaws and irregularities in the implementation of the binding procedures by local self-government bodies, such as lack of qualified employees familiar with privatisation regulations and procedures. Consequently, violation of law were found in 15 (71%) out of 21 audited privatisation processes of

communal entities. Yet, no major irregularities were detected in the evaluations prepared, neither is those commissioned by the State Treasury nor by self-governments.

As it has been already mentioned, despite progressive diversity of heat sources, local thermal power stations are main providers of heat. The NIK has observed that the interests of heat consumers were not assured in sale agreements issued by heat providers due to the lack of provisions referring to the level of heat prices in the privatised entities, which may pose a serious threat to the interests of consumers on the monopolised market. The agreements on the basis of which communal entities were privatised contained various flaws. They set out payment terms that were incompliant with the binding regulations, and other irregularities mainly regarded understated transaction values or inappropriate protection of the interests of privatised entities, municipalities of heat consumers.

The privatisation of Heat And Power Plant in Poznań received a definitely negative assessment by the Supreme Chamber of Control. The audit disclosed important irregularities at the following stages: selection of the advisor to the Minister of State Treasury and development and reception of pre-privatisation analyses. The negative assessment also covered a failure to execute appropriate performance of tasks by the advisor stemming from the agreement concluded with the Minister, and a failure to take actions aimed at eliminating unfavourable effects of the Company Collective Labour Agreement. The provisions of the agreement, aimed at protecting the interests of the employees in privatisation (employment guarantees hedged with compensations, an increase in some remuneration constituents) were harmful to the company's interests.

The audit revealed that some of the said mistakes resulted from negligence in owner's supervision on the part of the Minister of State Treasury.

The Supreme Chamber of Control has issued a negative opinion on the activities of the company's Board in the process of preparing the company for privatisation, and on signing by the Board of the Heat And Power Plant in Poznań the Company Collective Labour Agreement which resulted in a considerable reduction of the Company's market value.

### **Meeting the provisions of agreements by investors**

The NIK has given a positive assessment to meeting price requirements by purchasers. No irregularities have been found with regard to a breach of terms for making payments provided

in agreements. The fulfilment of other obligations in companies privatised by the State Treasury has not given rise to any objections. Unfortunately, it does not apply to other obligations in privatised communal companies. In four audited entities, meeting investment obligations was incompliant with the provisions. In two cases, irregularities resulted from wrong activities of boards of municipalities that did not take advantage of their rights contained in agreements and failed to monitor the fulfilment of these obligations. Privatisations of the thermal power sector gave rise to many doubts on the part of both boards of municipalities and local societies. People feared that the new monopolist, to implement the policy of modernisation of thermal power stations, would aim at establishing high prices of heat for consumers. Those fears were justified as, according to the Polish law, justified increases in production and distribution of central heating may result in a growth in prices of central heating. The results of the audit and further observations of the prices on the central heating market did not, however, confirmed those fears. In 2005, the highest prices were observed in the group of state enterprises, where the biggest growth of prices also took place.

The NIK has given a positive assessment to the effects of the privatisation of the thermal power sector. This assessment refers, in particular, to State Treasury companies. In the case of communal entities, the effects of the privatisation varied. Implementation of investment obligations had a positive impact on the condition of the infrastructure and development of the distribution network. Investment activities were, however, mainly financed not by the investors but by the companies.

## **Conclusions**

The results of the audit of privatisation processes in the thermal power sector show that it was necessary to:

- have effective and efficient owner's supervision by the Minister of State Treasury;
- implement privatisation policies in the thermal power sector by local self-government bodies on the basis of owner's strategies and concepts for assuring central heating supplies to local communities;
- organize professional services for privatisation of communal properties in self-government institutions.

## **Present situation in the thermal power sector**

Despite substantial outlays on modernisation, the property of the private sector in the thermal power area in 2005 was more depreciated than the property of the public sector (59.4% against 55.6%). Moreover, the enterprises belonging to foreign capital in the private sector had a relatively higher depreciation rate (62.7%).

Impact of the implementations of social package provisions on economic results of companies, especially in the first year after privatisation, came as a characteristic phenomenon. This applies, in particular, to large entities, especially State Treasury companies.

In total, in 2005 in Poland, the public sector owned 53% of production forces, out of which 1/3 referred to entities owned by self-governments. Almost 2/3 of privately owned production forces belonged to foreign capital. Proprietary relations were different with regard to the heating network, where 70% of the network belonged to the public sector (mainly communal) and 30% to the private sector.