

**The General Auditing Bureau
Kingdom of Saudi Arabia**

***Country paper on
Experience on the Audit of
Privatization***

I : Background

A : The General Auditing Bureau

The General Auditing Bureau (GAB) is the supreme audit institution of the Kingdom of Saudi Arabia. According to the Constitution of the GAB, it is responsible for the execution of comprehensive post-auditing on the state's revenues, expenditures, movable and fixed assets and to exercise auditing control to ensure proper utilization and maintenance of these resources. For the implementation of these provisions, the GAB shall achieve the following objectives:

- (1) To provide assurances that all the state's revenues and due amounts have been collected and entered into books according to the prevailing regulations and those expenditures have been disbursed in accordance with the provisions contained in the annual budget and the prevailing financial, administrative, and accounting standards and regulations.
- (2) To provide assurances that the state's movable and fixed assets are being employed to achieve the objectives of their allocation and that the concerned agency possesses the ability to preserve the integrity and proper usage of such resources to remain immune from theft or abuse.
- (3) To ensure that the GAB Auditees comprehensively realize the application of their internal financial and accounting regulations and that their financial actions comply with the internal financial accounting regulations.
- (4) To establish a follow up strategy to ensure the competency and viability of the Financial and accounting rules and regulations enforce and their potency to cope with any possible managerial developments that might take place in the Kingdom and to identify areas of inadequacies together with the relevant proposals for modification or with the

propose substitute rules and regulations.

According to the Constitution of the GAB the following institutions are subject to the auditing control of the GAB:

- (1) All Ministries, Government Departments and their branches.
- (2) The Municipalities and Water Resources Departments.
- (3) The Public Corporations and the other bodies with independent budgets but recipients of allocated funds from the state for subsidy or investment purposes, Companies in which the Government participates as an investor along with other investors, and Companies to which the Government guarantees a minimum profit.

B : Saudi Telecom

It was an establishment owned 100% by the Saudi Government. It provides all kind of communications.

It was operating under the umbrella of Ministry of Post, Telephone and Telegraph (MoPTT), to achieve the government's objectives and was not intended to make a profit. This establishment was financed entirely by the Government capital and it had a separate budget. It was recording its expenses on a cash basis and revenue on a collection basis. It was subject to rules, regulations, and procedures that apply generally to ministries except rules, regulations and procedures that modified by the charter under which it was operating. Assets of this establishment were Government assets.

In 21st of april 1998 a royal decree was issued, which approved its privatization in accordance with the By-laws attached to the royal decree and the council of ministers resolution No. 213. Pursuant to resolution No. 135, the council of ministers decided to transfer the telecommunications division, with its various components, including fixed telephone, data transmission, paging, Mobile, public telephones and the public telephone network, to a Saudi Joint Stock company, to be

established under the name of "Saudi Telecom Company (STC)". Its capital is SR 12, 000,000,000 divided into 240,000,000 shares of equal value, the nominal value of each share being SR 50. STC registered in Riyadh under No. 1010150269 dated 29/6/1998. STC's privatization effectively started in May 1998.

The duration of STC is 50 years. STC is authorized to provide communications services in Saudi Arabia and to and from Saudi Arabia, in exchange for charges to be collected from the beneficiaries of those services. STC has the right to perform all necessary tasks related to its objectives.

Since STC was operating under the Ministry of Post, Telephone and Telegraph (MoPTT) 's umbrella, it required restructuring in different areas before it was sold in order to achieve Privatization objectives. Some of these areas were:

1. Organization
2. Network
3. Marketing
4. Customer Service & Sales Management
5. Finance
6. Information Technology
7. Human Resources

STC contracted with some eligible experts firms to carry the above tasks.

After privatization STC should use the accrual accounting system in recording expense and revenue. It became subject to rules, regulations, and procedures that apply generally to companies, such as the labor regulations, instead of government employment, retirement benefit, and income Zakah (tax). In addition, it must comply with any rules requested by the telecommunications regulatory committee, which is recently established.

C : Privatization objectives:

- To develop the telecommunications sector in terms of service availability, quality, and network coverage with the objective to meet the social and economic requirements of the Kingdom

- To promote economic efficiency of the sector in general and the incumbent telecom operator in specific, and as a result, improve the overall financial performance
- To translate the achieved operating efficiencies into efficient tariffs for the provision and usage of telecommunications services to end customers
- To improve employment opportunities for national talents after the privatization, primarily through the rapid expansion of the telecommunications sector and its multiplier effect on other facets of the economy
- To withdraw the government's active engagement (financing, strategic planning, operating) from the telecommunications sector, which is better suited to private enterprises
- To spread and democratize share ownership, and contribute to the expansion of the local capital market.

II : Auditing the Privatization procedure of STC :

Before the Privatization, as a project operating under the umbrella of (MoPTT) it had been audited by GAB. But the auditing of Privatization procedure started after STC registered as accompany by the Ministry of Commerce at 29/6/1998.

A : The audit objectives:

- (1) To ensure that the evaluation of all assets and liabilities was at fair value as of 2/5/1998, because STC was not recording its assets according to accrual method, but it was using the cash method.
- (2) To ensure that the STC created the opening balance sheet as a Privatized Company. The opening balance had to accurately capture the value of the assets, the outstanding payments, accounts receivables, paid-in capital, and all the other important balance sheet items.

- (3) To ensure that STC set up an accounting system and a general ledger (GL) capable of transitioning to an accrual based accounting practice from a cash-based accounting practice. The general ledger needed to reflect a steady state structure, which will be able to capture expenses at the required levels of granularity both for the type of expense as well as at the right organizational level.
- (4) To ensure that the new organizational structures meet the need to support accrual based accounting in a corporatized setting, including setting up of the policies and procedures established to capture expenses properly, record revenues correctly, and track accounts payable and accounts receivable.
- (5) To ensure that the contractor firms who were assigned to do the restructuring and consulting the STC's management during the privatization process were doing what they paid for.
- (6) To ensure that the work done by the consultant complies with contract and will lead to meeting the privatization goals.

GAB achieved the above objectives through:

1. Regular audit.
2. Meetings.
3. Special assignments.

B : Audit results

Audit results were acceptable except the valuation of assets and liabilities, which has an extreme effect on the STC's capital, and which was less than the value calculated by the GAB's audit. This was a result of a different method of valuation of land, equipment, and receivable. Also the total valuation amount by Saudi Telecom's management was affected by Saudi Telecom's registered capital, which was SR 12,000,000,000.

Saudi Telecom with the assistance of an international consulting firms and local valuation experts, grouped and

categorized all assets, and evaluated the lands and buildings for market values. Useful life and replacement value for remaining fixed assets were also evaluated to obtain the opening balance of the telecom fixed assets. Tracking the cash assets and accounts payables has been relatively straightforward.

Subsequently, the financial statements showed the net asset value of the Company as of 2/5/1998 is approximately SR 9,819,000,000. This sum was less than the capital by SR 2,180,790,000. The minister of finance and national economy and minister of Post, and Telephone and Telegraph decided that the "shortage" in the amount of capital as stated in the Bylaws shall be paid up in cash by the Government. The council of ministers approved on 25/3/2002 capitalizing the amount of SR 2,180,790,000 from STC's accumulated profits for the year ending 1999. The council of ministers further resolved this matter on 10/9/2002 by increasing STC's capital from SR 12,000,000,000 to SR 15,000,000,000.

But the net asset value as calculated by GAB was still higher than the new capital after the increase. A constructive meeting was held between two teams one headed by the president of GAB and the other team headed by minister of MoPTT each team explained its opinions. An agreement was reached during the meeting to increase the selling price. The government accepted this as solution. Accordingly, Saudi Telecom with the assistance of an international consulting firm established a bad debt charge policy based on the cash collection rates for regular customers and on the basis of specific review of receivable accounts for International settlements. Specifically, amounts related to those individuals that are billed but not collected are excluded from the Company's revenue and therefore form the bad debt charge. As per the Council of Ministers decision, uncollected revenues from the government are offset against the government charge, therefore eliminating the need to set-up a related debt charge. Also they used two valuation techniques:

- The *discounted cash flow* (DCF) method values the company's operation. In this approach, the value of operations equals the discounted value of expected free cash flows (FCF) generated by the assets of the business

- The *trading multiples* method is based on comparative analysis of listed companies as traded on active stock markets and which have similar activities to the business being valued.

Common trading multiple techniques include:

- Company value per earning multiple.
- Company value per EBITDA multiple.
- Company value per sales multiple.
- Company value per book value multiple.

Following all the financial reviews, a decision was taken and approved by the Council of Ministers to float 30% of the company shares at a unit price of SR 170, while the nominal value of each share was SR 50. That makes the total selling amount of float equal SR 15,300,000,000.

Conclusion

When GAB started its audit work the opening balance sheet showed net fixed assets equal to SR 9,819,000,000. The auditors reviewed the policy procedures of fixed assets valuation. They found that some lands, some equipment either valued at zero amount or valued at low price. The reason was that some lands were a gift from the government. Some land was valued at a purchase price before 20 years or more. Some equipment was considered obsolete. In addition, the auditors reviewed the receivable accounts. They found a bad debt debited to the receivable accounts. The bad debt was the uncollected invoice of the government organizations.

GAB reported the situation to the Council of Ministers. Then the council directed the Minister of Communications to solve the situation with the minister of finance and national economy taking in consideration GAB finding.

- The *trading multiples* method is based on comparative analysis of listed companies as traded on active stock markets and which have similar activities to the business being valued.

Common trading multiple techniques include:

- Company value per earning multiple.
- Company value per EBITDA multiple.
- Company value per sales multiple.
- Company value per book value multiple.

Following all the financial reviews, a decision was taken and approved by the Council of Ministers to float 30% of the company shares at a unit price of SR 170, while the nominal value of each share was SR 50. That makes the total selling amount of float equal SR 15,300,000,000.

Conclusion

When GAB started its audit work the opening balance sheet showed net fixed assets equal to SR 9,819,000,000. The auditors reviewed the policy procedures of fixed assets valuation. They found that some lands, some equipment either valued at zero amount or valued at low price. The reason was that some lands were a gift from the government. Some land was valued at a purchase price before 20 years or more. Some equipment was considered obsolete. In addition, the auditors reviewed the receivable accounts. They found a bad debt debited to the receivable accounts. The bad debt was the uncollected invoice of the government organizations.

GAB reported the situation to the Council of Ministers. Then the council directed the Minister of Communications to solve the situation with the minister of finance and national economy taking in consideration GAB finding.