14. Takeover Information

Under the Amendments to the N.S.W. Companies Act, companies must simply state the takeover consideration and net tangible assets of each subsidiary acquired and their interest in companies acquired.

At present companies can make acquisitions without disclosing the value of earnings acquired or the record of the company acquired. Analysts are thus in the dark and may never be able to assess the impact of an acquisition on a group's earnings or prospects as the company acquired may be integrated into a division of the parent or operating company before the next balance date.

We consider it essential that data on companies acquired should include a balance sheet at the date of acquisition and a summary of 5 years' profit and loss accounts.

Takeover documents should include a pro-forma consolidated balance sheet incorporating the company to be acquired or being bid for.

This balance sheet should be circulated to shareholders of the offeror company.

Conclusion

Disclosure is an evolutionary process and for this reason the list of items above cannot be viewed as exhaustive. Rather they are the most urgently required section of a much longer catalogue. All the information sought herein should be readily available to management in the course of maintaining adequate financial control.

The better the standards of disclosure, the more efficient will be the stock market.

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SHOULD ANALYSTS EMPHASISE QUALITY RATHER THAN QUANTITY OF FINANCIAL INFORMATION?

By Austin Donnelly, B. Comm. A.C.A.

At the portfolio Management Seminar in February, and in various publications, members of the Society have presented well reasoned cases for listed companies providing more financial information and some information on non-financial matters, such as numbers of employees, etc. In the main, this is very desirable but there is probably a more urgent matter to which analysts should be devoting their attention, namely the quality rather than quantity of financial information.

If I were forced to make a choice on whether the information already presented should be improved in quality, that is in reliability and objectivity, or there should be more information available, I would without hesitation come down on the side of improved quality.

Certainly the additional information suggested could be useful, but as a matter of priority shouldn't we be concentrating first of all on improving the quality of information presented. Before we go to a great deal of trouble in persuading people to give additional information, wouldn't it be nice when we looked at financial statements to feel confident that the profit figures were probably within half a million or a million or so of what would be the objectively measured result. Yet there are many cases in which reported results of Australian companies are hundreds of thousands, or millions of dollars away from figures which should be reported in a more objective measurement.

A few examples quoted in Chapter 21 of my book "Strategic Investing" which is headed "Accounting Risk" illustrate this point - not one cent of share of losses in a joint venture which cost a wellknown Australian group several million dollars was reflected in the earnings of any financial year; provision for depreciation understated by about $1½ million in one wellknown company; all sorts of expenses being written off against capital items or against profits of previous years by a number of companies so that earnings per share figures for various years are seriously overstated: assets which are in the nature of trading stock for certain financial institutions being valued at directors valuation even when objective market valuations are readily available with the result that in the highly geared circumstances of those companies a small element of wishful thinking in the directors valuation may increase the earnings per share by 25% or more.

These are just a few of the "accounting gymnastics" which are annually performed in the financial statements of many Australian companies. As I said elsewhere recently, if accounting gymnastics ever became an Olympic sport Australia would be sure to win a lot of gold medals.

In that situation I believe that the Society should lead the way in using all its forces of persuasion and in arguing strongly from every possible forum for more objective financial statements. What we need are statements which as closely as possible represent an objective reporting of what has happened, rather than the use of various accounting techniques to produce something which is a compromise between an estimate of what has actually happened and a reporting of what directors would have liked to have happened.

About three years ago when we revised our standards of financial and security analysis in Capital Services, we reluctantly found it necessary to include an assessment of accounting risk. We found that in addition to allowing for the generally accepted risks, namely business risk, market risk, financial risk, we had to allow for accounting risk. This is the risk that losses or disappointing results might arise from investments because the earnings figures and financial situation portrayed in the financial statements differed from the real situation.

As a person who served for many years as Chairman of the Accounting Research Committee of the Australian Society of Accountants, and who is aware of the efforts of many individuals in the Society and in the Institute of Chartered Accountants to improve accounting standards, this need to allow for accounting risk left me rather sad. However, it would not be realistic these days to make investment decisions without giving some regard to the accounting risk.

In "Strategic Investing" and elsewhere, I have advocated the need for an Accounting Principles Commission to lay down acceptable accounting standards. This Commission, I believe, should include representatives of the accounting profession, legal profession, directors, representatives of commerce and industry, certainly the security analysts who should speak on behalf of the users of financial information. One of the problems is that the number of people in the accounting or the legal profession and indeed among directors, who view financial statements from the outside so to speak as investment managers, investment advisers or security analysts do, is relatively small. This, coupled with inertia and a reluctance to agree to changes is one of the factors which has led to the unsatisfactory conditions in accounting standards for company reporting, not only in this country but overseas.

As a first step the Society of Security Analysts, which should be the leader in this field, should do everything it can to publicise both the need for more objective accounting standards in company reporting and to publicise the frequent departures from objective reporting.

There is a firm in New York which issues regular reports on the quality of earnings in company financial statements. These apparently are designed to give an indication of the extent to which the reported earnings can be relied on. These reports tend to highlight weaknesses or the development of newer accounting practices which the fertile minds of directors or financial executives tend to develop to produce a higher reported earning figure than would be warranted by an objective measurement of results.

Certainly there are some arguments against standardisation of accounting practices but in an imperfect world it is certainly the lesser of two evils. Whatever weaknesses there may be in practices being codified and laid down by an Accounting Principles Commission, these fade into insignificance compared with the massive unreliability in financial statements at present when the phrase "accepted accounting practices" covers a multitude of sins. There is a good deal of truth in the cynical comment made recently about a major problem for analysts - how to figure out what proportion of the profits were manufactured in the accounting department or the board room by some of the techniques mentioned above (or by the endless variety of accounting practices) compared with the proportion made in the factory or the shop or the place where the real business is carried on.