Across the Board news

ISSUE 192 **15 August 2006**

Editor Erica Vowles

Survey assesses success rate Takeovers Panel

¶1192 Survey assesses success rate of Takeovers Panel

A study into the effectiveness of the Takeovers Panel has found that, compared to its predecessor, it is a quick and efficient adjudicator of takeovers disputes, with few of its decisions being the subject of applications for review.

The research report was written by Chris Miller, Rebecca Campbell and Professor Ian Ramsay, all of whom are from the Centre for Corporate Law and Securities Regulation (CCLSR) at The University of Melbourne. Professor Ramsay is also a member of the Takeovers Panel.

Since its establishment in 2002, the Takeovers Panel has been the primary forum for resolving disputes about a takeover bid while the takeover is underway. It replaced the earlier panel which the authors of the study noted was widely regarded as ineffective, hearing very few matters and the extent of its powers being subject to extensive litigation in the courts. The authors of the study noted that the new Takeovers Panel was given enhanced powers by parliament with the objective of enabling the panel to replace the courts as the primary forum for the resolution of takeovers disputes.

According to the CCLSR, it was expected that the new panel would be able to facilitate resolutions to takeovers disputes more rapidly, informally and cost-effectively than the courts.

> “The Panel has been prepared to negotiate with bidders and targets — often to obtain additional disclosure of material information to target shareholders — rather than too frequently stop takeover bids so as to achieve the objective of ensuring that takeover bids are decided by informed shareholders”, the authors of the study noted.

The authors also noted that despite the increased powers handed to the panel, there has been controversy about the new panel. According to the authors, some parties to takeovers disputes have still endeavoured to resort to the courts during a takeover bid and it has also been argued in litigation before the courts that the Takeovers Panel is unconstitutional.

The study found that the primary power of the panel is its ability to make a declaration of unacceptable circumstances. The panel may make a declaration upon application by the bidder, the target, ASIC or any other person whose interests are affected by the relevant circumstances. The panel may declare circumstances to be unacceptable if it appears to the panel that the circumstances: are unacceptable having regard to the effect of the circumstances on the control, or potential control, of the company or another company, or the acquisition, or proposed acquisition, by a person of a substantial interest in the company or another company; or the circumstances are unacceptable because they constitute, or give rise to, a contravention of the takeovers legislation.

When the panel makes a declaration of unacceptable circumstances, it has the power to make one or more of a broad range of orders including stopping the takeover bid, divesting the bidder of improperly acquired shares, extending the time for the takeover bid and ordering additional disclosure by the bidder or target.

Researchers at the Centre for Corporate Law and Securities Regulation examined all decisions of the Takeovers Panel during the first five years of its existence (2000–2005) in a bid to provide an insight into how the panel has operated since 2000 and how effective it has been in terms of matters such as the time taken to reach decisions.

The study found that during the first five years of its operation (2000 to 2005), the new panel made 153 decisions and as of 31 July 2006, the panel had published 189 decisions. This is a significant difference to the old Takeovers Panel. The old Takeovers Panel was established in 1991. Between 1991 and 1999, it made only four decisions.

Applications were made mainly by bidders (42% of all applications). Targets made 31% of applications. Shareholders made 20% of applications and ASIC made 5% of applications.

According to the authors of the study, the panel has proved to be a very efficient decision-making body. The median time for the panel to dispose of an application was only 14 days.

Of the 153 matters that were examined, 112 of these were applications by a party for a declaration of unacceptable circumstances. The panel made 21 declarations of unacceptable circumstances. In another 21 applications, the panel refused to commence proceedings. In 63 of the 112 applications the panel conducted proceedings but refused the application.

The ground most frequently raised in submissions of parties or discussed by the panel in its written reasons was that shareholders were not given enough information to enable them to assess the merits of the takeover bid.

The takeovers legislation allows for a review by the panel of an earlier decision of the panel upon application by ASIC or a party to the original proceedings. The study found only 13% of the applications to the panel involved a review of an earlier panel decision.

Source: Study by the Centre for Corporate Law and Securities Regulation at The University of Melbourne, released 8 August 2006.

PUBLIC SECTOR

¶1193 Poor accounting, worse security, led to Iraqi reconstruction cost blowouts

By Erica Vowles

Poor fiscal management of Iraqi reconstruction projects and a deteriorating security situation prompted the US State Department agency in charge of projects to use accounting techniques to hide cost blowouts, an audit has found.

The audit, completed by the Special Inspector General for Iraq Reconstruction (SIGIR) looked at the ballooning of costs and completion dates for one hospital being built in Basrah, Iraq, but referred to a raft of problems related to how $1.4 billion in reconstruction funds were being spent and monitored.

Released at the end of July, the audit found the US Agency for International Development (USAID) had failed to establish an appropriate program management structure. Overseeing the 20 reconstruction projects under USAID control, representing $1.4 billion in funds, were just one administrative contracting officer and one technical officer.

As part of the ongoing reconstruction effort in Iraq, USAID was tasked with the construction of a 50-bed pediatric facility at Basra, and was given $50 million in funds by the US congress to complete the facility.

The project was awarded to Bechtel International, who agreed to complete the project by 31 December 2005 at a cost of $37 million. When the completion date slipped several times, the SIGIR conducted an audit. During the course of the audit it was finally revealed that the project would in fact not be completed until 31 July 2007. Based on data received from USAID, the SIGIR audit determined that under the current management/contracting structure the actual cost of the hospital would be between $149.5 million and $169.5 million.

> On this the audit noted that: “Oversight and management of the Basrah Children’s Hospital project schedule and cost has been hampered by the lack of effective program management and oversight by the Department of State and USAID.”

The USAID contracting official in charge of overseeing the project noted that the delays towards construction completion — the result of “subcontractor design flaws, lack of subcontractor focus on critical path activities, and security concerns” — were not reported because the contractor produced several recovery plans.

However, by December 2005, none of the plans had actually resulted in construction being accelerated to meet the original deadline of December 2005.

The former head of the State Department’s Iraq intelligence team, Wayne White, told *Across the Board* that several factors had contributed to cost and time blowouts of Iraqi reconstruction projects.

He said the impact of the deteriorating security situation was making it extremely difficult to complete projects.

> “Security costs have increased the amount needed to complete projects. Where security costs haven’t increased the amount of the contract, they have eaten into the funds needed for the project itself. Security issues have [also] slowed the completion of such projects — some projects have simply never been pressed to completion because funds ran out, areas became too insecure”, said Mr White.

Mr White — who now works as an analyst with the Middle East Institute in Washington — said that the precarious security situation had also increased the costs of materials in a number of perverse ways, leading to a hike in the cost of building materials.

> "Security problems also have increased the price of materials needed for projects as suppliers face increased costs for convoy security, etc. In addition, because of the appalling security situation (and theft from construction sites by criminal elements, even in areas where security is better), many projects are not even close to where they should be with respect to completion. In addition, insurgents have deliberately destroyed some completed projects. Although we know this has occurred in predominantly Sunni Arab areas, I don't think that anyone knows the magnitude of this problem."

However, he also noted that the biggest issue is that "security is so bad that there are billions of dollars for projects in Iraq that have not even been spent".

Poor accounting practices, that sought to hide some of the cost blowouts, were partially a result of cultural attitudes introduced into the reconstruction efforts at an early stage of the US occupation, he added.

> Mr White said: "During the 2003–2004 CPA (Coalition Provisional Authority) period… accounting was extraordinarily poor and companies felt they were able to spend and report (or not report) as they wished. Some of this attitude doubtless influenced the behaviour of contractors well beyond the end of CPA in June 2004."

The US and Iraqi governments announced recently that Bechtel had been forced to drop the hospital project. Also, as a result of the SIGIR audit, the body now intends to review USAID's overall Bechtal contract and all USAID-managed IRRF projects to determine whether similar reporting problems around projects have occurred.

Sources: Special Inspector General for Iraq Reconstruction, "Review of the US Agency for International Development's Management of the Basrah Children's Hospital Project", released 31 July 2006; email interview conducted 5 August 2006; NYT report dated 29 July 2006.

FINANCIAL REPORTING

¶1194 CFOs face ongoing challenges

A forum, hosted by the Institute of Chartered Accountants in Australia in Canberra last week, revealed the need for innovation in both public and private sector finance.

The meeting brought together some of Australia's top CFOs to discuss the challenges they face within the finance profession, with panellists including Lindsay Tanner MP, shadow Minister for Finance; Ian McPhee, Auditor-General, Australian National Audit Office; Jane Holton, secretary of the Australian Department of Health and Ageing; Phillip Prior, CFO Department of Defence; Robert Parker, CFO of IBM and Geoffrey Applebee, senior partner, Ernst & Young.

The conference covered issues such as the appropriate movement of internal and external resources; the need for collaboration with academia and business partners to create innovation; as well as the trend towards becoming more specialised; and the need to attract non-typical graduates into the profession, to bring with them alternative thinking and innovation.

Dr Martin Fahy, director of development (Asia Pacific) at the Chartered Institute of Management Accountants, provided a keynote speech, where he stated that public sector finance functions needed to focus on leadership and required improvements in productivity.

> "The only way for the Public Sector CFOs to move forward is to move away from being entrenched in operational work and towards playing the role of a leader and strategist.
>
> "The answer is unfortunately not some magic bullet — it's not even new. Its about old fashioned leadership, hard work and good management", Dr Fahy said.

His six solutions included: getting the numbers right; applying technologies — using them, but not in isolation; applying systems — but not in isolation; delivering information users want and trust; focusing on efficiency to create the space for thinking; and focusing on better compliance and from this comes improved confidence and improved visibility in the organisation to help us improve performance.

Source: ICAA media release, 9 August 2006.

REGULATION

¶1195 Concern over misleading use of past performance information

The Australian Securities and Investments Commission (ASIC) has cautioned investment funds not to use past performance information in a misleading way in advertising and promotional material.

The warning follows concerns by ASIC that an advertisement for an investment product offered by BT Financial Group (BT) included past performance information which was potentially misleading.

According to the regulator, the advertisement's headline asked the rhetorical question: "Past performance isn't a reliable indicator of future performance, is it?", followed by past performance information showing strong returns.

ASIC noted that in its view, the advertisement was misleading because it encouraged consumers to believe that the past performance of the product was in fact a reliable indicator of future performance.

> "Past performance is not a reliable indicator of future performance. An undue emphasis on past returns can lead to consumers having unrealistic expectations and making poor investment decisions", ASIC's executive director of consumer protection, Greg Tanzer said.

Mr Tanzer said ASIC was particularly concerned that the BT advertisement reflected a flippant approach to guidelines detailed in its "Guide on the Use of Past Performance in Promotional Material".

> "ASIC expects that industry will take a responsible approach to its marketing activities. If you're going to use past performance information in your advertising, you must do it responsibly and without being misleading", he said.

BT has agreed to stop its existing advertising and refrain from using similar wording in future advertisements and is now also implementing measures to improve compliance in its advertising and other communications.

In 2003, ASIC commissioned a review of Australian, UK, and US academic studies into the correlation of past performance with future performance. The review concluded that good past performance is, at best, a weak and unreliable predictor of future good performance over the medium to long term.

ASIC's "Guide on the Use of Past Performance in Promotional Material" was released in July 2003. The guidance stipulates that advertisements using past performance information should include a five-year return figure (or the longest period available for newer funds) and information about returns should be balanced with information about risks.

Also, when using past performance figures all figures must be up-to-date and important information should not be buried in fine print.

Source: ASIC media release, 9 August 2006.

¶1196 Policy on super product disclosure revised

ASIC has issued its policy on how superannuation trustees can deliver product disclosure information about investment strategies to members.

Policy Statement 184 *Superannuation: Delivery of product disclosure strategies* is relevant to each trustee that allows members to instruct the trustee to follow a particular investment strategy, and offers at least some investment strategies to members that result in the members' money being invested into a specific accessible financial product.

Typically these kinds of trustees operate superannuation master trusts. According to ASIC, the policy deals with product disclosure about investment strategy choice within a superannuation fund; it does not deal with product disclosure about choice of superannuation fund.

> "The policy builds on the options under the law for trustees on giving information about particular financial products that form part of an investment strategy. The relief also reflects the intent of the law that members are provided with adequate information on which to base their decision to choose an investment strategy from the available strategies", said ASIC's director of policy and research, Mark Adams.

According to the regulator, the policy allows a trustee to deliver the required information about investment strategies with specific accessible financial products in two ways: by either preparing the information themselves in a product disclosure statement (PDS) for a particular accessible financial product (under the law, without relief, the trustee is not permitted to prepare this PDS as it is not the product issuer), or giving a member a PDS prepared by the issuer of the particular accessible financial product (as provided for in the law without relief).

The regulator has also given relief to limit the amount of information about particular financial products that must be included in the PDS for the superannuation entity prepared by the trustee. This relief applies whatever way the trustee chooses to give members a PDS about a particular accessible financial product.

The relief relates to both the s 1012IA disclosure obligation and to the general disclosure obligations in s 1013D and s 1013E of the Corporations Act.

> "The superannuation industry has an extended deadline until 30 June 2007 to comply with their s 1012IA obligation under Class Order [CO 03/1097] Deferral of s 1012IA. This deferred commencement will allow trustees to plan to comply with the law as affected by our final policy. Our policy will commence on 1 July 2007", Mr Adams said.
>
> "Our final policy takes into account comments received on our earlier relief proposals in the policy proposal paper, entitled *Superannuation: Delivery of product disclosure and investment choice* issued in November 2004. In particular, we have made some changes in our proposals to more closely fit with sound existing industry practices. ASIC thanks all those who provided feedback and made submissions on the proposals", he added.

Source: ASIC media release, 3 August 2006.

101 Waterloo Road, North Ryde, NSW 2113.

Postal address: GPO Box 4072, Sydney, NSW 2001.

Document Exchange: Sydney DX 812.

Head Office North Ryde Ph: (02) 9857 1300

Fax: (02) 9857 1600

CCH Customer Support Ph: 1 300 300 224

Fax: 1 300 306 224. For the cost of a local call anywhere within Australia.