# THE IMPACT OF POOLING AND PURCHASE ACCOUNTING ON CORPORATE FINANCIAL STATEMENTS: A PILOT STUDY

Thesis for the Degree of Ph. D.
MICHIGAN STATE UNIVERSITY
Dean Spencer Eiteman
1967

THESIS



This is to certify that the

thesis entitled

THE IMPACT OF POOLING AND PURCHASE ACCOUNTING ON CORPORATE FINANCIAL STATEMENTS: A PILOT STUDY

presented by

Dean Spencer Eiteman

has been accepted towards fulfillment
of the requirements for

Ph. D. degree in Accounting

Richard Lawrence
Major professor

Date May 9, 1967

O-169

ABSTRACT

THE IMPACT OF POOLING AND PURCHASE ACCOUNTING ON CORPORATE FINANCIAL STATEMENTS: A PILOT STUDY

by Dean Spencer Eiteman

A variety of recording practices for business combinations have been held to be in accordance with generally accepted accounting principles. Because the criteria of Bulletin No. 48 are not sufficiently objective as standards in distinguishing between a "purchase" and a "pooling of interests," the decision to purchase or pool is influenced more by the subjective attitudes of management than by sound accounting theory. Considering the varying consequences arising from the application of alternative treatments, the reliability of financial information is questionable when management can select whichever method gives the most favorable results.

The primary objectives of this study were: (1) to examine the variety of pooling-purchase treatments in order to discover the rationale behind their existence; (2) to measure the consequences of various acquisition-merger accounting treatments on published financial statements of selected companies; and (3) to evaluate the changes in financial statement analysis resulting therefrom. From the findings, a rational approach to business combination accounting procedures was developed to lessen inconsistency in practice, thereby improving the general usefulness of financial statements as a basis for intelligent decision-making by outsiders.

The study found that existing combination accounting practices allow too much inconsistency in financial reporting. Financial statements of a business enterprise with an active history of acquisitions and mergers were affected substantially by the consistent application of alternative treatments. The manner in which business combinations are recorded had important consequences on selected financial data, many financial ratios, and in turn investment analysis. Alternative pooling-purchase accounting procedures were found, for example, to affect (1) the level of reporting earnings, (2) asset and equity values carried forward into subsequent financial statements, (3) efficiency ratios, (4) profitability ratios, (5) dividend payout ratios, (6) interest coverage ratios, and (7) growth rate analysis.

Some important conclusions of this research are:

1. Most business combinations represent "investment" expenditures from the point of view of a dominant acquiring enterprise. To promote sound and informative financial reporting, the acquisitions and mergers made by a specific business entity should be accounted for as purchases in the context of an investment decision--regardless of whether the combinations are effected by the payment of cash or other property or by the issuance of stock.

2. When consideration for a business combination is in the form of ownership equities, the shares of stock used by the acquiring corporation to effect the exchange should be valued at their implied cash cost, i.e., the amount of money which could have been raised through the

public issue of the securities to investors as indicated by the stock market. Recorded values of properties on the books of an acquired company generally are irrelevant to the investment decision and should not be assumed to express acquisition cost to the buying enterprise.

3. In general, pooling-of-interests accounting should be discontinued because it fails to account for all costs of buying a going concern. The significance of information presented in the financial statements of a dominant enterprise is distorted when meaningless historical cost data of acquired companies are injected into its record-keeping process. Useful analysis of accounting reports as a basis for intelligent decision-making by outsiders is not improved by the consistent application of the pooling technique.

4. At the time a business combination occurs, a careful process of investigation, evaluation, and reporting of results should be required to reflect as accurately as possible the fair value and true nature of the resources and property rights acquired. Tax aspects of the exchange transaction should not dictate allocation procedures for purposes of financial reporting. Any portion of the purchase price that can be reasonably identified with limited-term intangible assets should be amortized as expenses over their estimated service lives.

5. Amounts assigned to unlimited-term intangibles (such as goodwill) should not be charged to stockholders' equity at the date of acquisition; they should be carried at unamortized cost as long as there is no evidence that their value has been permanently impaired and/or that their term of existence has become limited. The general license to

amortize unlimited-term intangibles as production cost or expense over arbitrary periods makes financial statements less reliable to outsiders using them for analytical purposes.

6. A merger between separate and equal entities that has the characteristics of a genuine corporate marriage (similar to the conditions for a "fair-value pooling"), however, merits the pooling-of-interests treatment. Such a corporate amalgamation could be viewed as involving no change of economic substance since no dominant reporting entity is determinate; thus, accountabilities for the resultant enterprise may be reflected from the point of view of both constituent corporations as they were before combination.

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submitted to
Michigan State University
in partial fulfillment of the requirements
for the degree of

DOCTOR OF PHILOSOPHY

Department of Accounting and Financial Administration

1967

ACKNOWLEDGMENTS

It is impossible to acknowledge all those who contributed to the development and writing of this dissertation. Many companies provided annual reports, proxy statements, and other data. Although it is not feasible to list their names here individually, I wish to express my thanks to all of them.

The New York Stock Exchange and the Securities and Exchange Commission should be mentioned for supplying information pertinent to this study. The Price Waterhouse Foundation should be acknowledged for supporting part of the research financially.

My sincere thanks go to Dr. Charles Lawrence who, as a dedicated teacher and an inspiring advisor, provided continuous encouragement in the preparation of this thesis. My appreciation also extends to Dr. Roland F. Salmonson and Dr. Richard F. Gonzalez for the valuable assistance they gave.

My debt to Dr. James Don Edwards and the Department of Accounting and Financial Administration at Michigan State University is so great that mere acknowledgment cannot suffice. Some day I hope to repay this debt by offering to future graduate students the same kind of encouragement and kindness that I have received.

For the sacrifice made by my wife, Elfriede, and my parents, my debt is beyond comprehension.

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CHAPTER I

# THE IMPACT OF POOLING AND PURCHASE ACCOUNTING ON CORPORATE FINANCIAL STATEMENTS: A PILOT STUDY

## Purpose of the Study

The primary task here is to analyze the effects of alternative pooling-purchase accounting treatments on the presentation and interpretation of corporate financial statements. The research will demonstrate the consequences of various acquisition-merger accounting techniques on published financial statements of selected companies in three industries--chemicals, cosmetics, and drugs. The study will also evaluate the changes in investment analysis resulting therefrom. A logical body of accounting principles and procedures applicable to business combinations will be suggested by which the financial operations and condition of an enterprise may be described, thereby improving the general understanding and usefulness of financial statements.

## Introduction

Business combinations are found in a wide variety of forms. Examples are acquisition, merger, sale of assets, gentleman's agreement, pool, cartel, community of interests, cooperative, trust, and consolidation. In this study the term "business combination" will be used in a broad sense to include any type of transaction whereby the net assets

and operations of two or more previously unrelated enterprises are purchased, transferred, merged, or otherwise brought together into a single business enterprise, irrespective of the specific form of the combination. Any type of business combination involves a veritable host of tax, legal, economic, accounting, and financial considerations.

Although it is difficult to isolate specific problems, in recent years the primary accounting issue in this conglomeratic area has been that of ascertaining whether a particular business combination is a "purchase" or a "pooling of interests." Accounting Research Bulletin No. 48 specifies that the main distinction between a purchase and a pooling of interests rests on an evaluation of the attendant circumstances surrounding the business combination transaction, rather than on legal or tax considerations. Generally, a purchase involves a substantial change of ownership interests in the acquired corporation or corporations relating to the combination, while in a pooling all or substantially all of the stockholder interests in predecessor companies continue jointly in the surviving corporation.[1]

Applying any simple distinction between a pooling and a purchase is exceedingly difficult. ARB No. 48 states that the following criteria indicate a particular combination is a purchase rather than a pooling of interests:

(1) the elimination of an important part of the ownership interests in the acquired firm;

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[1]Committee on Accounting Procedure, American Institute of Certified Public Accountants, Accounting Research and Terminology Bulletins (final ed.; New York, 1961), p. 21.

(2) the abandonment or sale of a large part of the business of one or more of the constituents;

(3) a material alteration of the relative voting rights between the constituents;

(4) the elimination or reduction of the management of one of the constituents;

(5) the intention to retire a substantial part of the capital stock issued to the owners of one or more of the constituent corporations; and

(6) a situation where one of the constituent corporations is clearly dominant; for example, if the stockholders of the dominant corporation retain at least 90 to 95 per cent of the voting interest in the combined enterprise.

In practice, none of these suggested criteria is necessarily controlling, although the major consideration is that substantially all of the former ownership interests should continue in the combined enterprise.[1] Because most acquisitions and mergers are based on a complex mixture of interacting motivations, it is impractical to say that any one of the above criteria is more important than the others. Furthermore, one authority even contends that these criteria "are artificial guidelines and fail to provide substantive clues to the nature of the combination transaction."[2]

Professor Jaenicke believes that accountants can justify the pooling treatment even in the face of seemingly substantial changes in ownership because "no one of the criteria suggested in ARB No. 48 is in

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[1] Eldon S. Hendriksen, Accounting Theory (Homewood, Ill.: Richard D. Irwin, Inc., 1965), pp. 443-44.

[2] Arthur R. Wyatt, A Critical Study of Accounting for Business Combinations, Accounting Research Study No. 5 (New York: American Institute of Certified Public Accountants, 1963), Conclusion No. 6, p. 104.

itself determinative."[1] Another author states that the "established criteria identifying a pooling are subjective and irrelevant for accounting purposes.[2] After discussing the principal criteria, Arthur Andersen & Company conclude:

> Thus, it can be seen that many of the criteria initially advanced have little practical effect. They were not only unsound and unsupportable from an economic standpoint, but also ill-conceived when related to the intended objectives.[3]

In short, because the criteria set forth in ARB No. 48 fail to clarify the concept of a pooling-of-interests combination, the tests for pooling are now so liberally applied that, for all practical purposes, they have eroded to the point where they are no longer determinative. As a consequence, when accounting for a business combination, management tends to decide on the method which will give the most favorable results. For the moment, the expression "favorable results" will not be explained.[4] From management's point of view, the pooling treatment usually has a favorable effect on financial statements in the sense that it overstates managerial efficiency in operations and tends to maintain earnings per share at their precombination level.

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[1]Henry R. Jaenicke, "Ownership Continuity and ARB No. 48," The Journal of Accountancy, CXIV (December 1962), 63.

[2]Anelise N. Mosich, one of the conclusions in his dissertation entitled "An Evaluation of Purchase and Pooling Concepts of Accounting for Corporate Mergers and Acquisitions," unpublished Ph.D. dissertation, University of California at Los Angeles, 1963.

[3]Arthur Andersen & Co., Accounting and Reporting Problems of the Accounting Profession (2nd ed.; Chicago: Arthur Andersen & Co., October 1962), p. 73.

[4]Later chapters will expound on this point.

This view is held by Martin M. Eigen, a financial analyst associated with Johnson & Johnson. Writing in The Accounting Review, he states,

> At present, accounting for business combinations is so clouded that almost any treatment may be suitable in a given situation. Because of the variety of interpretations under ARB No. 48, the natural tendency of the companies, if supported by their independent accountant, is to choose the method which will create the most favorable financial impression.[1]

In recent years pressure has been exerted upon the accounting profession to accept the pooling-of-interests treatment for a business combination even when an investigation of the attendant circumstances surrounding the combination, as suggested in ARB No. 48, clearly indicates that the event merited purchase accounting treatment. Not only do statistical data show that the pooling-of-interests method is being used in an increasing number of business combination situations, but also some combinations initially accounted for as purchases have been retroactively adjusted to conform to the pooling method.[2]

It is interesting to observe how the pooling-of-interests technique has expanded over the years. At first it was limited to companies of relatively equal size whose stockholders had joined together. Soon

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[1]Martin M. Eigen, "Is Pooling Really Necessary?" The Accounting Review, XL (July 1965), 537. Professor Jaenicke also supports the view that management tends to decide on the method that creates a more favorable impression. See Henry R. Jaenicke, "Management's Choice to Purchase or Pool," The Accounting Review, XXXVII (October 1962), 765, where he writes that analysis indicates "that management usually has a genuine choice of whether to pool or to purchase, and that the choice is made on the basis of that method which will give the most favorable results."

[2]H. A. Finney and Herbert E. Miller, Principles of Accounting, Intermediate (6th ed.; Englewood Cliffs, N. J.: Prentice-Hall, Inc., 1965), p. 504.

the acquired company began to be smaller, but pooling treatment was allowed; at present the relative size criterion is meaningless and can support a pooling even in tenths of one per cent.[1] The size relationship of the constituents involved in a business combination is commonly referred to as the "relative size criterion." This relationship is the number of shares given to the stockholders of the acquired company, expressed as a percentage of the total number of shares outstanding subsequent to the combination.[2] Where one corporate party to a combination is quite small in comparison with another (less than 5 to 10 per cent), ARB No. 48 implies that the transaction should not be regarded as a pooling of interests.

Originally stockholders had to promise to retain the stock resulting from the pooling combination, but now they are permitted to sell off up to 25 per cent.[3] As a practical working limit on the amount of sell-off that could be considered as acceptable and still allow pooling treatment for the business combination, the staff of the SEC has established the informal "25% rule." Although public accounting firms have the basic responsibility for determining whether a particular combination is a pooling or a purchase, the SEC also has a keen interest in the accounting for business combinations involving registered companies.

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[1]Theodore L. Wilkinson, "United States Accounting as Viewed by Accountants of Other Countries," The International Journal of Accounting, I (Fall 1965), 9.

[2]See Wyatt, op. cit., pp. 27-28.

[3]Howard L. Kellogg, "Comments on SEC Practice as to Pooling of Interests," The Quarterly, XI (New York: Touche, Ross, Bailey & Smart, December 1965), 35.

In determining the permissive accounting treatment for a business combination, Certified Public Accountants now seem to be more influenced by the SEC views regarding poolings than by the criteria set forth in ARB No. 48. It appears that SEC practices as to poolings of interest have become the "generally accepted accounting principles" of the accounting profession.

At first the exchange medium had to be entirely in common stock shares; now a significant portion of the payment can be in cash (25 per cent) and the entire payment can be in preference shares, without voiding the pooling treatment. At first the managements had to be merged into joint managements or boards. Now when small firms are being acquired, the services by officers of the smaller companies on divisional committees of the combined enterprise are deemed sufficient to provide continuity of management.[1]

Originally companies had to merge together into one; now the absorbed companies are permitted to survive as subsidiaries. At first only two corporations could pool; later a corporation could pool with a partnership; and now pooling is allowed even for acquiring proprietorships. Possibly pooling soon will be permitted whenever stock is exchanged for stock, with no other requirements.[2] If the present trend of circumventing requirements continues, ultimately even 100 per cent cash acquisitions may be accounted for as poolings of interests.[3]

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[1]Wilkinson, op. cit., pp. 9-10.

[2]Ibid., p. 10.

[3]See discussion in Chapter III on treasury stock poolings.

Two recent pronouncements issued by the Accounting Principles Board of the American Institute of Certified Public Accountants provide additional support for the pooling concept as acceptable accounting practice.

> The Board believes that Accounting Research Bulletin No. 48 should be continued as an expression of the general philosophy for differentiating business combinations that are purchases from those that are poolings of interests, but emphasizes that the criteria set forth in paragraphs 5 and 6 are illustrative guides and not necessarily literal requirements.[1]
>
> Treasury stock delivered to effect a "pooling of interests" should be accounted for as though it were newly issued, and the cost thereof should receive the accounting treatment appropriate for retired stock.[2]

The first statement changes Bulletin No. 48 so that it conforms more closely with the prevailing accounting practice. The second justifies the pooling treatment on the basis of the issuance of equity shares regardless of their source. Both pronouncements support the pooling-of-interests method even though the test of ownership continuity is dubious.

Although still vigorously condemned by some accountants, the pooling-of-interests treatment is presently well accepted and widely used in accounting for business combinations. This is so even when there is every indication that both sound accounting theory and the position of Bulletin No. 48 have been unjustifiably flouted, especially in

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[1] Accounting Principles Board, Opinion No. 6, Status of Accounting Research Bulletins (New York: American Institute of Certified Public Accountants, October 1965), par. 22. concerning the revision of ARB 48--Business Combinations. The Opinion is published as "Statement in Quotes," The Journal of Accountancy, CXX (November 1965), 54-57. Most of the criteria as set forth in paragraphs 5 and 6 are stated earlier in this chapter.

[2] Ibid., par. 12c. concerning the revision of ARB No. 43, Chap. 1B--Treasury Stock.

the case of combinations involving treasury stock and preferred stock, or those involving both cash and shares. Can alternative acquisition and merger accounting practices exist side by side and both be equally acceptable? Do both treatments adequately describe the financial activities of a business enterprise in an understandable manner which is not likely to be the source of misleading inferences?[1]

Obviously the financial statements of a business enterprise with a history of combinations will be affected by the consistent application of either the pooling or the purchase technique. The significance of different methods is important because from them stem changes in reported earnings, changes in rates of return on investment, interpretation of financial reports by investors, and other reactions.[2] While there is little empirical evidence on this point, it is hypothesized that the use of the pooling method in accounting for business acquisitions and mergers has had favorable effects in recent years on most corporate financial statements. Later chapters will show how pooling has favorable effects on financial statements especially in the sense that it overstates managerial efficiency in operations. It is likely that the manner in which business combinations are recorded has distorted many financial relationships, which in turn may have important repercussions on investor decisions.

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[1]This is the goal of acquisition accounting as suggested by R. F. Salmonson, "Reporting Earnings After an Acquisition," The Journal of Accountancy, CXVII (March 1964), 54.

[2]Samuel R. Sapienza, "Pooling Theory and Practice in Business Combinations," The Accounting Review, XXXVII (April 1962), 278.

## The Problem Defined

Even when attendant circumstances surrounding a combination clearly indicate the characteristics of a purchase, the accounting profession--with the sanction of the Securities and Exchange Commission--has increasingly recorded and reported such a transaction in the pooling-of-interests manner. Conflicting conclusions can be drawn from the application of the criteria mentioned in ARB No. 48 to any given business acquisition or merger. Consequently, the decision as to which accounting treatment will be used for the combination transaction is more the result of the subjective attitude of management than the result of the objective application of the criteria. Furthermore, if economic substance, rather than legal form or tax considerations, is the primary determinant of accounting recognition for the business combination exchange transaction, serious doubt exists among many accounting scholars as to whether the pooling-of-interests method satisfies any test of sound accounting practice. The real problem in evaluating the propriety of pooling versus purchase accounting is revealed by Professor Wyatt when he writes:

> The issue here appears to be clearly drawn from a conceptual standpoint. Has an exchange transaction taken place significant enough to warrant an accounting treatment consistent with that accorded other exchange transactions, or is the transaction primarily one of form with so little substance that existing accountabilities should not be disturbed?[1]

In an effort to minimize or eliminate goodwill and other consequences flowing from the application of purchase accounting, businessmen

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[1] Wyatt, op. cit., p. 72.

and accountants alike have developed a liberal interpretation of the guidelines in ARB No. 48 and have favored pooling over purchase whenever possible. As a result, in recent years the pooling criteria have been stretched to the point where many combinations which earlier would have definitely been considered as purchases have been accounted for as poolings. This is especially true for the criteria of relative size, continuity of management, relative voting rights, and sale of securities received in exchange by the selling stockholders. It is also true for recent combinations involving both cash and an exchange of stock which are being accounted for by a method described as "part purchase, part pooling," or simply "partial pooling," representing a distinct change from the previous "all or none" pooling philosophy (full 100 per cent pooling versus purchase).[1]

Considering the varying consequences arising from the application of alternative treatments, is it desirable ethically for the accounting profession to allow companies to choose whichever method (pooling or purchase) is to their own advantage? Can alternative choices in the area of acquisition-merger accounting equally satisfy the American Institute's notion that alternative principles and practices are acceptable if they have "substantial authoritative support?" Are there valid reasons why a business combination effected by the issuance of equity shares (regardless of type or source) should not disturb existing accountabilities? At present there is a wide disparity in financial accounting between the critical conclusions of Accounting Research Study

[1] Kellogg, op. cit., p. 34.

No. 5, the authoritative position of Accounting Research Bulletin No. 48, and actual practices in accounting for business combinations. Surely research efforts should be made to determine appropriate practice and to narrow the areas of difference and inconsistency in practice.

While most combinations of corporate enterprises are so complex as almost to defy classification under a purchase or a pooling heading, still a reasonable position must be reached to guide the accounting profession in this decision. The existence of radically different accounting procedures to record essentially similar economic events (business acquisitions and mergers) is especially questionable from the point of view of the financial analyst. Professionally trained to appraise investment opportunities, the financial analyst is concerned with financial statements, financial relationships, and comparative analyses--all of which are affected by the accounting procedure followed. A review of the literature on the subject of business combinations makes it apparent that no one method has yet received unanimous approval. Research is needed to develop a rational approach to combination accounting procedures that results in continuous improvement in and greater comparability of corporate financial statements.

Obviously, a rational approach to combination accounting procedures should promote sound and informative financial reporting and try to satisfy the primary purpose of accounting. In this study the basic objective of accounting will be that as stressed by Professor Hendriksen: that financial accounting should provide the relevant information necessary for the making of various types of economic decisions by interested parties outside of the reporting enterprise--primarily stockholders,

other investors, and creditors.[1]

Although much has been written on the subject of accounting for business combinations, one major question remains unanswered. What impact do the alternative practices in accounting for business acquisitions and mergers have upon conventional financial statements and investment analysis? An important test of whether any proposed method of acquisition-merger accounting should be adopted by the profession is whether or not the method will improve the end product, i.e., the financial statements. Unless we have a realistic understanding of the impact of any accounting procedure on the underlying financial statements, we are handicapped in determining its merits. Is there perhaps one best method to record the combining of business enterprises? This dissertation will attempt to answer the question.

In the business combination area, many accountants seriously doubt whether alternative practices can exist and can be equally acceptable, i.e., faithfully describe the realities of an enterprise's operations and financial condition in a fair, understandable manner which is not likely to be the source of misleading inferences. Inconsistencies that are permitted over the long run have no place in acquisition-merger accounting. A single reasonable position must be reached on this issue to lessen the degree of misrepresentation of annual corporate statements. Unless accounting guidelines are established so that the permissive quality is reduced in the selection of the pooling approach or the purchase approach, the usefulness and reliability of financial information

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[1] Hendriksen, op. cit., pp. 81-83.

remains questionable.[1]

## Approach to the Problem

An analysis of the various pooling-purchase treatments used in corporate acquisitions and mergers is presented in Chapter II. The variety of treatments which have been held to be in accordance with "generally accepted accounting principles" are carefully examined to determine the rationale behind their existence. Special attention is given to illustrating how alternative pooling-purchase accounting practices produce widely varying differences in a company's financial position and earnings.

In Chapter III, data on the growth of business combinations are evaluated, with particular emphasis on acquisition and merger activity in the industries selected for this dissertation study--chemicals, cosmetics, and drugs. Certain trends in accounting for business combinations and the related issue of goodwill are discussed to gain valuable insight into the nature of the problem.

Chapter IV is devoted to the methodology followed in the study. A review of two published case studies dealing with the income and asset effects of alternative combination accounting treatments provides a convenient introduction. The empirical approach to the study explains how the industries and companies were selected. After describing alternative ways of presenting financial statements, the chapter explains how comparative analysis was made for each of the respective companies.

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[1] Samuel R. Sapienza, "An Examination of AICPA Research Study No. 5--Standards for Pooling," The Accounting Review, XXXIX (July 1964), 590.

The impact of alternative pooling-purchase accounting treatments on conventional financial statements and on investment analysis is appraised in Chapter V. Actual comparisons of operating statistics and significant financial ratios for the selected companies are studied to determine the influence of different acquisition-merger accounting methods on financial statement analysis. Significant financial information is discussed to find out what effect the use of alternative combination methods actually had on the presentation and interpretation of corporate financial statements.

The study concludes in Chapter VI with a summary of the findings, some conclusions, and a statement of a reasonable approach to combination accounting procedures that promotes sound and informative financial reporting, that narrows the areas of difference and inconsistency in practice, and that provides greater comparability in corporate financial statements.

Throughout this study one guiding principle is followed: logical consistency rather than "substantial authoritative support" should dictate the interpretation of exchange transactions and accounting procedures adopted for recording such transactions. Without this goal, accounting information of specific entities would lack even the nominal sense of objectivity and usefulness, for the comparability and significance of a series of successive financial statements over time would be destroyed.

More specifically, the above guiding principle involves consistent application of accounting principles. It is taken to mean comparability in the manner of recording and reporting events relating to

various exchange transactions of a single firm. Such a requirement is necessary for effective communication of dependable and significant information to stockholders, creditors, and other persons having bona fide interests in the reporting enterprise. From year to year it adds greatly to the usefulness and comparability of financial statements for a specific entity.[1]

Although the concept of consistency does not imply comparability among independent entities, uniformity in the application of accounting principles by different firms in one industry and, to the extent practicable, by companies in various industries is also a desirable standard. If financial statements are to possess validity and usefulness, accountants should make every practical effort to adopt accounting principles and reporting standards which facilitate comparisons among enterprises.

For example, if accountants support the principle that asset transactions should be recorded at cost of acquisition, then for a specific business entity arbitrarily to record a transaction involving assets at cost at one time and to record a similar transaction at more or less than cost at another time spells inconsistency. If an accounting practice contradicts logical reasoning, it should be carefully weighed before being accepted. This especially holds true for combination accounting practices.

But on what basis should the inconsistent application of an accounting principle be judged? For purposes of this study, four basic

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[1]Paul Grady, Inventory of Generally Accepted Accounting Principles for Business Enterprises, Accounting Research Study No. 7 (New York: American Institute of Certified Public Accountants, 1965), pp. 31-32.

standards--relevance, verifiability, freedom from bias, and quantifiability--shall be used as criteria in evaluating the acceptability of alternative accounting methods.[1] Thus, the study will attempt to follow the principle of logical consistency in accounting for business combination transactions. But the ultimate adequacy of any acquisition-merger accounting practice that violates this consistency principle will be judged on the basis of these four criteria to improve measurement and communication techniques in accounting for business combinations.

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[1] American Accounting Association Committee to Prepare a Statement on Basic Accounting Theory, A Statement of Basic Accounting Theory (American Accounting Association, July 1966), pp. 7-13. The conclusions of this statement are summarized by Charles T. Zlatkovich in "A New Accounting Theory Statement," The Journal of Accountancy, CXXII (August 1966), 31-36.

# CHAPTER II

# TYPES OF COMBINATION ACCOUNTING TREATMENTS

## Introduction

Before evaluating the effect of alternative pooling-purchase accounting treatments on corporate financial statements, one should understand the existing methods of accounting for business combinations. As indicated in Chapter I, a business combination falls into one of two categories for accounting purposes: a purchase or a pooling of interests. But under each category a variety of accounting practices are accepted and some acquisition-merger practices overlap into both categories.

For the moment no attention shall be given to the reasoning underlying the difference between a purchase and a pooling of interests. Instead the study develops working knowledge of the variety of combination accounting treatments which have been held to be in accordance with "generally accepted accounting principles." This chapter will show that accountants themselves are not certain of the distinction between a purchase and a pooling. Finally, a discussion of these alternative pooling-purchase practices is extremely important in setting the stage for the detailed analysis of later chapters.

## Purchasing and Pooling Fundamentals

If one corporation acquires the net assets or capital stock of another corporation for cash or cash equivalent (which includes debt instruments such as notes and debentures) or a combination of cash and securities (where the stock portion of the acquisition is insignificant), accounting practice generally requires the purchase treatment. Accountants' early views on the subject of business combinations indicate that exchange media such as nonconvertible preferred stock or recently acquired common treasury shares also satisfied the concept of cash equivalent. A quotation from a recent New York Stock Exchange listing application serves to explain important details concerning the purchase method.

> The investment of the Company in Standard will be recorded in the accounts of the Company as a purchase. The total aggregate consideration to be paid by Cenco will be Two Million Dollars ($2,000,000.00), one half of which shall be paid in cash. The balance of One Million Dollars ($1,000,000.00) being paid in Cenco common stock approximates the aggregate value of the 28,684 shares to be delivered determined by reference to the closing price of such stock on the New York Stock Exchange on the date the contract was executed. The capital account will be credited with $26,484.00 (the par value of the Cenco shares); the treasury stock account will be credited with $65,165.00, the cost of the treasury shares, and additional paid-in capital will be credited with the excess of the fair market value of the Cenco shares over (i) the par value of the 26,484 shares to be issued and (ii) the cost of the treasury shares. This accounting treatment has been approved by the Company's auditors, Seidman & Seidman, as being in accordance with generally accepted accounting principles. The amount of the investment in excess of the book value of the net tangible assets of Standard will be treated in consolidation, as an asset termed "cost in excess of book amount of net tangible assets of businesses acquired." The amount charged to "cost in excess of book amount of net tangible assets of businesses acquired" will not be amortized, so long as, in the opinion of management, its value is being maintained.[1]

[1] Cenco Instruments Corporation, NYSE Listing Application

A summarized accounting entry to record Cenco Instruments' acquisition of Standard X-Ray Company is presented below. While this particular acquisition is not a typical purchase, it was selected for illustrative purposes to show how various types of consideration (such as cash, unissued shares, and treasury shares) may be used jointly in acquiring another company.

| | | |
|---|---|---|
| Current assets | $1,036,169 | |
| Property, plant and equipment--net | 69,335 | |
| Other assets | 20,445 | |
| Excess of cost over book value | 1,089,688 | |
| Current liabilities | | $ 215,637 |
| Cash | | 1,000,000 |
| Treasury stock--cost | | 65,165 |
| Common stock--par | | 26,484 |
| Paid-in capital in excess of par value | | 908,351 |

The underlying interpretation for this accounting treatment is:

> When a combination is deemed to be a purchase, the assets acquired should be recorded on the books of the acquiring corporation at cost, measured in money, or, in the event other consideration is given, at the fair value of such other consideration, or at the fair value of the property acquired, whichever is more clearly evident. This is in accordance with the procedure applicable to accounting for purchases of assets.[1]

Under the purchase treatment a new basis of valuation for the net assets is established, and there is no transfer of the acquired corporation's retained earnings to the surviving company's position statement. Typically, the value assigned to the shares given as consideration is based on the average or closing market price of such stock on or

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No. A-22840, November 1, 1965, p. 1; concerning the acquisition of the capital stock of Standard X-Ray Company for $1 million cash, 26,484 shares unissued common stock, and 2,200 common treasury shares.

[1]American Institute of Certified Public Accountants, Accounting Research Bulletin No. 48 (January 1957), par. 8.

near the date of agreement between the constituent corporations. To the extent that the purchase cost is not allocated to tangible assets and intangible assets, such as patents or trademarks, there is goodwill, more commonly termed "excess of cost over value assigned to net tangible assets acquired." This excess of purchase cost over amounts allocable to specific assets is dealt with generally in one of three ways.

1. Written off immediately against either paid-in capital or retained earnings.[1]

2. Amortized by systematic charges in the income statement over a period of years.

3. Carried at cost as an asset on the balance sheet, so long as its value is being maintained.

Three quotations serve as illustrations of these alternative practices.

Purchase--Immediate Write-off of Excess

> On June 12, 1953, the Company entered into an agreement to purchase all of the issued and outstanding shares of capital stock of J. B. Roerig and Company, J. B. Roerig and Company, (Canada) Limited, and J. B. Roerig International Company for an aggregate price of $6,000,000, subject to certain terms and conditions. In accordance with its established practice of stating intangibles at a nominal value the Company has charged to earnings retained and employed in the business an amount of $5,070,400, representing the excess cost of its investment in the aforementioned subsidiaries over the amount of net tangible assets [at book values] of such subsidiaries, at date of acquisition, July 31, 1953.[2]

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[1] It should be emphasized that since ARB No. 43, Chap. 5, issued in 1953, this particular practice has not been considered acceptable accounting.

[2] Chas. Pfizer & Co., Inc., Annual Report 1953, "Notes to Consolidated Financial Statements," Note No. 7 (page not given).

Purchase--Systematic Amortization of Excess

> The transaction will be accounted for as a purchase in the consolidated financial statements of the Company. The excess of the purchase price (determined on the basis of the market value of the shares issued) over net book value of the assets acquired will be allocated to Research and Development and other intangible assets, and will be amortized over various periods not in excess of five years. The Company's independent accountants, Peat, Marwick, Mitchell & Co. have reviewed and approved this accounting treatment as being in accordance with generally accepted accounting principles.[1]

Purchase--Excess Carried as an Unamortized Asset

> Goodwill increased from $755,468 to $4,497,243, representing the goodwill of the new businesses purchased during 1955. Revised accounting rules require that any write-off of purchased goodwill at time of acquisition be made against current earnings and not against surplus. Your management is of the firm opinion that purchased goodwill is not a proper charge against current earnings and, therefore, is electing to carry the item as an asset on the balance sheet.[2]

It should be stressed that each of these ways of handling goodwill in an acquisition has a different effect on the financial statements. The net effect of the immediate write-off treatment is to account for the assets acquired as if the business combination were a pooling of interests. The purchase treatment with systematic amortization by charges to income usually has a material effect on both the income statement and the balance sheet, while the "purchase without amortization" method has its greatest impact on the balance sheet.

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[1] Electronic Specialty Co., NYSE Listing Application No. A-22906, October 21, 1965, p. 1; in connection with the acquisition of the property and assets of Syntorque Corporation for 4,000 shares common stock.

[2] Standard Brands, Inc., Annual Report 1955, p. 4; concerning the cash acquisitions of Animal Foundation, Inc., Old Trusty Dog Food Company, Best Yeast Limited, and Dr. Ballard's Animal Foods Limited during the year of 1955. This quotation was especially chosen to show how one particular company's management feels on the subject of accounting for purchased goodwill.

Furthermore, these alternative ways of handling acquisition goodwill have differing effects on some financial ratios. Chapter V discusses the impact of these alternative methods on corporate financial statements and investment analysis.

In those cases where one corporation acquires the net assets or capital stock of a company in exchange for voting stock, accounting practice allows either the purchase or pooling-of-interests treatment. Various quotations serve to illustrate this point and explain important details concerning the alternative methods.

Acquisition of Net Assets for Common Shares--Purchase Treatment

> Red Owl intends to treat the acquisition of Foodtown's net assets as a purchase for accounting purposes. Accordingly the investment will be recorded at cost measured by the approximate fair value (at date of agreement specifying number of shares to be paid as full consideration) of the 105,592 shares of Red Owl Common Stock to be issued, $20.00 per share or $2,111,840. It is estimated that such fair value will exceed the recorded book value of net assets to be acquired from Foodtown at the closing date by approximately $170,000; this excess will be allocated, if supportable by appraisals or other evidence, first to specific depreciable assets and the balance will be designated as goodwill subject to amortization or charge-off only in the event of evidence of diminution in value. . . . Peat, Marwick, Mitchell & Co., independent certified public accountants, have reviewed and approved the above described treatment as being in accordance with generally accepted accounting principles.[1]

Acquisition of Net Assets for Common Shares--Pooling Treatment

> For accounting purposes, the exchange of shares of the Company's Common Stock for substantially all the net assets of Chesterton is to be treated as a pooling of interests. Accordingly, the assets, liabilities and surplus of Chesterton will be carried forward without change into the consolidated financial

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[1] Red Owl Stores, Inc., NYSE Listing Application No. A-23086, February 4, 1966, p. 1; in connection with the acquisition of Foodtown Super Markets, Inc., for 105,592 shares common stock.

statements of the Company. The excess of the stated value of the shares of Common Stock of the Company to be issued over the stated capital of Chesterton will be charged to capital surplus to the extent thereof, and the balance will be charged to retained earnings. This treatment has been reviewed by the Company's auditors, Peat, Marwick, Mitchell & Co., and approved as being in accordance with generally accepted accounting practice.[1]

Acquisition of Capital Stock for Common Shares--Purchase Treatment

With respect to the Rexall stock to be issued in exchange for the capital stock of Albert, the amount to be credited to the capital stock account will be the number of shares times the par value per share ($2.50). The amount to be credited to the paid in capital account will be the difference between such aggregate par value and the total fair market value of the 11,000 shares of Rexall stock taken at $42.125 per share, the closing price of Rexall shares on the New York Stock Exchange on September 30, 1959, the date of the agreement between Rexall and Albert. The excess, if any, of the fair value of the Rexall shares issued (taken at the aforementioned $42.125 per share) over the fair market value of the underlying net assets of Albert will be treated as an intangible. It is the present policy of Rexall not to amortize such intangibles until such time as it becomes evident that their term of existence has become limited.

Rexall's independent accountants, Price Waterhouse & Co., Los Angeles, California, have reviewed and approved the above described accounting treatment as being in accordance with generally accepted accounting principles.[2]

Acquisition of Capital Stock for Common Shares--Pooling Treatment

For accounting purposes, the Company and F. W. LaFrentz & Co., independent public accountants, who regularly audit the books and accounts of the Company, deem this acquisition to be a "pooling of interests." F. W. LaFrentz & Co., has reviewed and approved this treatment as being in accordance with generally accepted accounting principles.[3]

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[1]Beatrice Foods Co., NYSE Listing Application No. A-22841, October 11, 1965, p. 1; in connection with the acquisition of Chesterton Candy Company, Inc., for 100,838 shares in common stock.

[2]Rexall Drug and Chemical Company, NYSE Listing Application No. A-18474, October 7, 1959, p. 1; in connection with the acquisition of all the outstanding shares of Albert Tool & Gage Co., Inc., for 11,000 shares of capital stock.

[3]Chas. Pfizer & Co., Inc., NYSE Listing Application No. A-20999,

Under the pooling-of-interests method, the acquired company's assets and retained earnings are generally transferred to the records of the acquiring unit at the acquired company's book value. A simple cross-addition of accounts, except for minor adjustments that may be required to bring about uniformity of accounting procedures and proper presentation of legal capital accounts, becomes the basis of accountability for the business combination transaction. An example of this combining procedure is seen in the proxy statement of Bristol-Myers Company which is reproduced in Exhibit 1.

Based on the information in this exhibit, a summarized accounting entry to record Bristol-Myers' acquisition of the Drackett Company is presented thus:

| | | |
|---|---|---|
| Current assets | $17,063,034 | |
| Property, plant and equipment--net | 9,104,740 | |
| Intangible assets | 4,261,228 | |
| Current liabilities | | $ 8,021,102 |
| Other liabilities and minority interest | | 1,114,163 |
| Common stock--par value | | 2,017,391 |
| Capital in excess of par value of stock | | 2,923,286 |
| Retained earnings | | 16,353,060 |

The above intangible assets of approximately $4.3 million do not represent purchased goodwill; they are the cost of patents, trademarks, and other intangible assets on Drackett's books prior to the combination. The fair market value of the shares of stock which Bristol-Myers gave in the exchange approximated $150 million, or about $128.7 million greater than the book value amount at which they were accounted

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March 28, 1963, p. 2; in connection with the acquisition of the outstanding shares of Desitin Chemical Co., Inc., for a maximum of 220,653 shares of common stock.

Exhibit 1

BRISTOL-MYERS COMPANY
THE DRACKETT COMPANY

Unaudited pro forma combined balance sheet
March 31, 1965

## ASSETS

| | Bristol-Myers | Drackett | Pro forma adjustments Dr. (Cr.) (Note 2) | Pro forma balance sheet |
|---|---|---|---|---|
| **CURRENT ASSETS:** | | | | |
| Cash and time deposits | $ 9,299,398 | $ 3,198,863 | | $ 12,498,261 |
| Marketable securities | 26,931,283 | 1,542,553 | | 28,473,836 |
| Accounts receivable, less allowance for discounts and doubtful accounts | 34,555,556 | 4,019,554 | | 38,575,110 |
| Inventories | 23,804,953 | 6,947,018 | | 30,751,971 |
| Prepaid expenses | 2,497,788 | 1,355,046 | | 3,852,834 |
| Total current assets | 97,088,978 | 17,063,034 | | 114,152,012 |
| **OTHER ASSETS:** | | | | |
| Investments in and advances to unconsolidated subsidiaries less reserve of $2,065,000 | 12,127,805 | | | 12,127,805 |
| Miscellaneous investments and sundry assets | 2,741,687 | | | 2,741,687 |
| | 14,869,492 | | | 14,869,492 |
| **PROPERTY, PLANT AND EQUIPMENT,** at cost less depreciation | 33,230,175 | 9,104,740 | | 42,334,915 |
| **GOODWILL, TRADE-MARKS, OTHER INTANGIBLES** | 20,805,224 | 4,261,228 | | 25,066,452 |
| | $165,993,869 | $ 30,429,002 | — | $196,422,871 |

## LIABILITIES

| | | | | |
|---|---|---|---|---|
| **CURRENT LIABILITIES:** | | | | |
| Notes and accounts payable | $ 7,268,263 | $ 4,466,221 | | $ 11,734,484 |
| Accrued liabilities | 23,586,843 | 1,048,452 | | 24,635,295 |
| U. S. and Canadian taxes on income | 15,043,356 | 2,506,429 | | 17,549,785 |
| Total current liabilities | 45,898,462 | 8,021,102 | | 53,919,564 |
| **OTHER LIABILITIES:** | | | | |
| Deferred U. S. and Canadian taxes on income | 2,143,723 | 101,205 | | 2,244,928 |
| Miscellaneous | 1,865,557 | 349,771 | | 2,215,328 |
| | 4,009,280 | 450,976 | | 4,460,256 |
| **LONG-TERM DEBT:** | | | | |
| Long-term loans and instalments | | 500,000 | | 500,000 |
| Twenty year 3% debentures, due April 1, 1968 | 1,068,000 | | | 1,068,000 |
| Twenty-five year 3¼% debentures, due June 1, 1977 | 2,975,000 | | | 2,975,000 |
| | 4,043,000 | 500,000 | | 4,543,000 |
| **MINORITY INTEREST** | | 163,187 | | 163,187 |

## STOCKHOLDERS' EQUITY

| | | | | |
|---|---|---|---|---|
| **CAPITAL STOCK:** | | | | |
| Bristol-Myers Company: | | | | |
| Preferred stock | 4,200,000 | | | 4,200,000 |
| Common stock | 10,537,304 | | (2,017,391) | 12,554,695 |
| The Drackett Company common stock | | 4,385,634 | 4,385,634 | |
| **CAPITAL IN EXCESS OF PAR VALUE OF STOCK** | 14,689,742 | 555,043 | (2,368,243) | 17,613,028 |
| **RETAINED EARNINGS** | 83,985,952 | 16,353,060 | | 100,339,012 |
| Deduct—cost of treasury preferred stock | (1,369,871) | | | (1,369,871) |
| | 112,043,127 | 21,293,737 | — | 133,336,864 |
| | $165,993,869 | $ 30,429,002 | — | $196,422,871 |

NOTES:

1. **PRINCIPLES OF PRO FORMA COMBINED BALANCE SHEET:**

The accompanying pro forma combined balance sheet reflects the combining of the unaudited consolidated balance sheets of Bristol-Myers Company and North American subsidiaries and of The Drackett Company and subsidiaries, both as of March 31, 1965, in a "pooling of interests," giving effect to the transactions described in Note 2 below. Such statement should be read in conjunction with the other financial statements and notes thereto of the constituent companies appearing elsewhere herein.

2. **PRO FORMA ADJUSTMENTS:**

The pro forma adjustment is based on the issuance of 46 shares of Bristol-Myers Common Stock for each 100 shares of Drackett Common Stock outstanding as provided for in the plan for acquisition of The Drackett Company as set forth elsewhere herein. The excess of the Drackett Common Stock account over the par value of the Bristol-Myers shares to be issued is credited to Capital in Excess of Par Value of Stock.

for.[1] If purchase accounting had been accorded this exchange transaction, the $128.7 million excess of market over book value would have been apportioned to tangible and intangible assets. Without expressing any judgment as to the propriety of the pooling treatment accorded this combination, a summarized entry as if purchase techniques had been followed is given.

| | | |
|---|---|---|
| Current assets | $ 17,063,034 | |
| Property, plant and equipment--net | 9,104,740 | |
| Intangible assets | 4,261,228 | |
| Excess of cost over book value | 128,706,263 | |
| Current liabilities | | $ 8,021,102 |
| Other liabilities and minority interest | | 1,114,163 |
| Common stock--par value | | 2,017,391 |
| Capital in excess of par value of stock | | 147,982,609 |

It is interesting to note that this "excess of cost over book value" is greater than the book value of Bristol-Myers stockholders' equity ($112 million) prior to the business combination and more than four times as great as the combined net income of the companies in 1964 ($28 million). This example alone illustrates one important aspect of the purchase treatment, i.e., the problem of accounting for the difference between purchase cost and book values of assets acquired. In short, the pooling concept pretends that the constituent companies were affiliated prior to the combination and carries forward at net book value assets of the disappearing company in the combined enterprise, thus

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[1] In this example the value of the shares given as consideration is based on the closing market price of such stock on or near the date of the agreement between the constituent corporations. A review of many stock listing applications over the span from 1954 to 1965 shows that this particular method of valuing shares under the purchase treatment is a prevalent one. Throughout the study this valuation technique shall be used extensively (see Chapter IV).

eliminating the problem of recording the excess and assigning it to specific tangible and intangible assets or goodwill. The pooling method serves as a convenient means of keeping large amounts of goodwill and other intangibles off the balance sheet in the acquisitions and mergers of going concerns.

If the fair value of the assets acquired in a business combination is greater than book value (which is the usual case), the purchase treatment is especially disadvantageous from management's point of view for a number of reasons.

1. The recording of the acquired assets at higher values often necessitates larger depreciation and amortization charges in the income statement, resulting in lower reported net incomes for several years.

2. If the combination is a "tax-free reorganization" (the usual case where an exchange of stock is involved), then the extra depreciation and amortization charges are not deductible for income tax purposes.

3. Because purchasing eliminates the retained earnings of the acquired corporation, it thereby reduces the amount available for dividends out of accumulated income although the legal amount available may not be altered.[1]

Some business enterprises do use the purchase method even when sizable amounts of goodwill and other intangibles result and the acquisition is effected solely by the issuance of equity shares. An outstanding example of such an enterprise is the Borden Company, which followed the purchase-without-amortization method for the stock acquisitions of Krylon, Inc., Ozon Products, Inc., and Columbus Plastic

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[1]Eldon S. Hendriksen, Accounting Theory (Homewood, Ill.: Richard D. Irwin, Inc., 1965), p. 443.

Products, Inc., in January and February of 1966.[1] Exhibit 2 illustrates the combining procedures for Borden's acquisition of the property and assets of Krylon, Inc., a specific business combination which qualified as "tax free" under the provisions of the Internal Revenue Code.[2] Based on the information in this exhibit, the accounting entry for this purchase transaction is presented.

| | | |
|---|---|---|
| Current assets | $ 3,058,000 | |
| Property and equipment--net | 1,232,000 | |
| Deferred charges and intangibles on Krylon's books | 195,000 | |
| Excess of cost over book value | 8,178,000 | |
| Current liabilities | | $ 1,614,000 |
| Reserves on Krylon's books | | 24,000 |
| Capital stock--par value | | 919,000 |
| Capital surplus | | 10,106,000 |

The excess of the fair value of the capital stock of Borden issued over the net assets of Krylon, according to Exhibit 2, was added to Borden's balance sheet intangibles account. Generally, this excess is retained on the firm's books as an intangible asset not subject to amortization until such time as it becomes clearly evident that its value is diminished. The following schedule of intangible assets on Borden's consolidated balance sheet during the period 1958-65 reveals that the excess of purchase price over value assigned to net tangible assets of businesses acquired (for common shares and/or cash) is being carried on the balance sheet as an unamortized asset.

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[1] The Borden Company, NYSE Listing Applications No. A-23029, No. A-23089, and No. A-23105; respectively dated 1-3-66, 1-10-66, and 2-2-66.

[2] Krylon, Inc., Proxy Statement dated November 1, 1965, "Federal Income Tax Consequences of the Plan," p. 6. For a description of what constitutes a tax free exchange, see Secs. 354 and 368 (a)(1)(C) of the Internal Revenue Code of 1954, as amended.

## Exhibit 2

## KRYLON, INC. AND SUBSIDIARY COMPANY
## THE BORDEN COMPANY AND CONSOLIDATED SUBSIDIARIES

### UNAUDITED PRO FORMA COMBINED CONDENSED BALANCE SHEET
**July 31, 1965**
**(In Thousands of Dollars)**

### ASSETS

| | Krylon | Borden | Pro Forma Adjustments Note 2 Dr. (Cr.) | Pro Forma Combined |
|---|---|---|---|---|
| CURRENT ASSETS: | | | | |
| Cash | $ 223 | $ 39,085 | $( 75) | $ 39,233 |
| Marketable securities—at cost, which approximates market value: | | | | |
| United States Government | — | 3,963 | — | 3,963 |
| Other | — | 19,886 | — | 19,886 |
| Receivables: | | | | |
| Trade | 1,416 | 129,638 | — | 131,054 |
| Due from unconsolidated foreign subsidiaries | — | 2,371 | — | 2,371 |
| Other | 36 | 3,797 | — | 3,833 |
| Less reserve | (31) | (4,246) | — | (4,277) |
| Inventories: | | | | |
| Finished goods | 882 | 89,240 | — | 90,122 |
| Materials and supplies | 586 | 43,226 | — | 43,812 |
| Other | 21 | — | — | 21 |
| Total current assets | 3,133 | 326,960 | ( 75) | 330,018 |
| INVESTMENTS AND OTHER ASSETS: | | | | |
| Unconsolidated foreign subsidiaries—at cost | — | 14,551 | — | 14,551 |
| Unconsolidated domestic subsidiaries—at cost | — | 1,001 | — | 1,001 |
| Fifty-per cent owned companies—at cost | — | 1,329 | — | 1,329 |
| Securities on deposit (pursuant to workmen's compensation laws, etc.)—at cost | — | 1,804 | — | 1,804 |
| Mortgages, receivables, etc. (less reserve) | — | 12,369 | — | 12,369 |
| PROPERTY AND EQUIPMENT—At cost: | | | | |
| Land and mineral deposits | 39 | 20,842 | — | 20,881 |
| Buildings | 674 | 146,427 | — | 147,101 |
| Machinery, equipment, etc. | 990 | 301,175 | — | 302,165 |
| Less accumulated provision for depreciation | (471) | (201,307) | — | (201,778) |
| DEFERRED CHARGES: | | | | |
| Debt discount and expense | — | 1,446 | — | 1,446 |
| Taxes, rents, insurance, etc. | 71 | 6,625 | — | 6,696 |
| INTANGIBLES—Principally at cost | 124 | 65,057 | 8,178 | 73,359 |
| TOTAL | $ 4,560 | $698,279 | $8,103 | $710,942 |

See Notes to Unaudited Pro Forma Combined Condensed Balance Sheet.

Exhibit 2 (cont.)

## KRYLON, INC. AND SUBSIDIARY COMPANY
## THE BORDEN COMPANY AND CONSOLIDATED SUBSIDIARIES

### UNAUDITED PRO FORMA COMBINED CONDENSED BALANCE SHEET
July 31, 1965
(In Thousands of Dollars)

### LIABILITIES

| | Krylon | Borden | Pro Forma Adjustments Note 2 Dr. (Cr.) | Pro Forma Combined |
|---|---|---|---|---|
| CURRENT LIABILITIES: | | | | |
| Notes payable: | | | | |
| Bank | $ 250 | — | — | $ 250 |
| Unconsolidated foreign subsidiary | — | $ 2,799 | — | 2,799 |
| Accounts payable: | | | | |
| Trade | 786 | 50,939 | — | 51,725 |
| Other | — | 9,446 | — | 9,446 |
| Accrued accounts: | | | | |
| Taxes | 345 | 31,414 | — | 31,759 |
| Payrolls and commissions | 100 | 12,565 | — | 12,665 |
| Interest | — | 1,067 | — | 1,067 |
| Other | 133 | 7,930 | — | 8,063 |
| Total current liabilities | 1,614 | 116,160 | — | 117,774 |
| LONG-TERM DEBT: | | | | |
| 2⅞% debentures, due 1981 | — | 38,745 | — | 38,745 |
| 4⅜% debentures, due 1991 | — | 50,000 | — | 50,000 |
| 5⅛% notes, due 1981 | — | 11,700 | — | 11,700 |
| 3½% note, due 1973 | — | 950 | — | 950 |
| RESERVES: | | | | |
| Deferred Federal taxes on income | 24 | 23,709 | — | 23,733 |
| Insurance, etc. | — | 7,899 | — | 7,899 |
| STOCKHOLDERS' EQUITY: | | | | |
| The Borden Company: | | | | |
| Capital stock—par value $3.75 per share: | | | | |
| Authorized 32,000,000 shares | | | | |
| | Borden | Pro Forma | | |
| Issued | 24,980,506 shs. | 25,225,506 shs. | | |
| Less Treasury Stock | 139,040 shs. | 139,040 shs. | | |
| Outstanding | 24,841,466 shs. | 25,086,466 shs. | — | 93,155 | $ (919) | 94,074 |
| Krylon, Inc.: | | | | |
| Common Stock—without par value | 368 | — | 368 | — |
| Employees' stock purchase instalments | — | 9,627 | | 9,627 |
| Surplus: | | | | |
| Capital | — | 85,585 | (10,106) | 95,691 |
| Earned | 2,554 | 260,749 | 2,554 | 260,749 |
| TOTAL | $ 4,560 | $698,279 | $ (8,103) | $710,942 |

See Notes to Unaudited Pro Forma Combined Condensed Balance Sheet.

| For year ending December 31 | Amount classified as intangibles |
|---|---|
| 1958 | $ 1,370,715 |
| 1959 | 2,753,457 |
| 1960 | 4,809,041 |
| 1961 | 10,970,182 |
| 1962 | 21,335,455 |
| 1963 | 39,081,703 |
| 1964 | 64,109,766 |
| 1965 | 87,698,396 |

## Some Unique Situations

No discussion on existing pooling-purchase accounting methods would be complete without an explanation of three unusual situations which have come to be described as (1) partial-pooling treatment, (2) bargain purchase, and (3) retroactive pooling.

### The Partial-pooling Treatment

In those cases where the acquiring corporation gives up a significant amount of cash or cash equivalent (such as notes and debentures) as well as appropriate equity shares, accounting practice generally questions using the pooling-of-interests treatment for the entire transaction. But the profession does allow either (1) purchase accounting for the entire transaction, or (2) purchase accounting for the cash portion and pooling accounting for the stock portion. This second treatment, commonly referred to as a partial pooling, has come to be accepted in a wide variety of combination situations.

Example A. Diamond Alkali Company acquired 40% of the shares of Harte & Company, Inc., in May 1962 for cash. In September 1965, Diamond acquired the remaining 60% of Harte's outstanding shares in exchange for

95,000 shares of $4.00 convertible Preferred Stock--Series B. Since the 1962 transaction was treated as a purchase and the 1965 transaction was treated as a pooling of interests, the entire combination arrangement was in effect a 40-60% partial pooling.[1]

Example B. Emhart Corporation used the pooling-of-interests method for the 45% minority interest acquired in its January 1966 merger with Plymouth Cordage Company. The 55% interest was represented by Plymouth stock previously acquired and held by Emhart which had been treated for accounting purposes as a purchase. Thus, the combination was essentially a 55-45% partial pooling--that is, 55% purchase, 45% pooling treatment. Furthermore, the 55% portion was a "bargain purchase," since the excess equity in net assets of the 55% purchased over the related cost was $1,312,444. This amount is being amortized by credits to income over a ten-year period commencing with the year 1963.[2]

Example C. Evans Products Company acquired the capital stock of Rand Acceptance Corporation for 34,500 shares of common stock (adjusted for a 3-to-2 stock split). At the same time Evans acquired the assets and businesses of each of three enterprises affiliated with Rand for $8,224,000 cash. The acquisition of Rand was accounted for as a pooling of interests, while the concurrent acquisition of the three affiliates was recorded as a purchase.[3]

---

[1]Diamond Alkali Company, Annual Report 1965, "Notes to 1965 Financial Statements," Note 1, p. 38.

[2]Emhart Corporation, NYSE Listing Application No. A-23040, January 10, 1966, pp. 1-2; in connection with the merger of Plymouth Cordage Company into Emhart Corporation for 327,783 shares common stock.

[3]Evans Products Company, NYSE Listing Application No. A-22902,

Example D. Celanese Corporation of America acquired the ownership equity of two corporations in November 1964, whose principal asset was the outstanding stock of Federal Enameling & Stamping Company, for 241,700 shares of common stock. Celanese Corporation also issued 58,779 shares of common stock for the acquisition of certain fixed assets employed in the business of Federal. The exchange of common shares was treated as a pooling, while the acquisition of the fixed assets was given purchase treatment.[1]

The earliest partial poolings were transactions in which the combination was arranged through different procedures or steps. If there was a time interval between the cash purchase and the exchange of equity shares, accountants supported the theory that the "combination" really occurred at the later date. They concluded that the original cash investment should be accounted for as a conventional purchase; however, the exchange of stock could properly be accounted for as a pooling of interests, assuming other pooling characteristics were present. Because of this time interval factor, the pooling treatment for the last step in the acquisition process was considered an acceptable accounting practice and not a violation of the ownership interests "philosophy" as quoted here.

---

November 29, 1965, p. 1; in connection with the acquisition of Rand Acceptance Corporation for 34,500 shares common stock (after 3-for-2 stock split) and three affiliated enterprises for cash consideration of $8,224,000.

[1]Celanese Corporation of America, Prospectus dated March 11, 1966, "Notes to Financial Statements," Note 1, p. 32.

> For accounting purposes, a purchase may be described as a business combination of two or more corporations in which an important part of the ownership interests in the acquired corporation or corporations is eliminated or in which other factors requisite to a pooling of interests are not present.[1]

Accountants have gradually shifted their position on this point. They now conclude that a time interval between the cash purchase and the exchange of stocks is not a necessary condition of a partial pooling. In effect, both purchase and pooling accounting techniques can be applied in a single cash-stock business combination transaction. There are known cases in which the pooling portion of a single transaction has been as little as 28 per cent.[2] Obviously, this practice is incompatible with the ARB No. 48 position that a purchase is present when an important part of the ownership interest in the acquired corporations is eliminated.

The following quotation from a recent NYSE Listing Application is an excellent illustration of a partial pooling effected in a single transaction that successfully removed a significant amount of intangible assets from the consolidated balance sheet.

> The transaction was accounted for as 78% "pooling of interests" and 22% "purchase" based upon the percentage relationship of the closing price of Mid-Continent's common shares on September 24, 1965, (the last trading day prior to the date of the Agreements) and the cash consideration included in the purchase. . . . In consolidation, 78% of the intangible was charged to capital surplus and 78% of C.T. & N.'s earned surplus was brought forward in consolidated earned surplus. The accounting treatment as outlined

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[1] American Institute of Certified Public Accountants, Accounting Research Bulletin No. 48 (January 1957), par. 3.

[2] Howard L. Kellogg, "Comments on SEC Practice as to Pooling of Interests," The Quarterly, XI (New York: Touche, Ross, Bailey & Smart, December 1965), footnote 5, p. 39.

> has been reviewed by Lybrand, Ross Bros. & Montgomery, Mid-Continent's independent accountants, and meets their approval as being in accordance with generally accepted accounting principles.[1]

Another interesting example of a single transaction partial pooling is Witco Chemical Company's acquisition of Argus Chemical Corporation in February 1966. Exhibit 3 presents the balance sheet pro-forma summary and adjustments for this business combination based on financial information reported to the shareholders of Witco in a proxy statement dated January 25, 1966. Using the proxy statement figures, here is a summarized accounting entry for the 55% purchase-45% pooling treatment as recorded on the acquiring firm's books.

| | | |
|---|---|---|
| Current assets | $ 3,584,900 | |
| Investments and other assets | 1,218,900 | |
| Property, plant and equipment--net | 2,710,200 | |
| Excess of cost over book value | 10,151,700 | |
| Charge against capital surplus | 133,000 | |
| Charge against retained earnings | 88,400 | |
| Current liabilities | | $ 4,672,700 |
| Cash | | 11,714,400 |
| Common stock--par value | | 1,500,000 |

The details of the "accounting treatment" as referred to in the proxy statement are quoted as follows:

> The estimated $11,714,383 ($12,642,000 less excluded assets in the approximate amount of $927,617) of cash to be delivered to Argus represent 55%, and the 300,000 shares of Witco common stock (valued at $32 a share) represent 45% of the aggregate consideration being paid for the Argus business and net assets. The value assigned to the Witco shares was determined for accounting purposes by taking the closing price of the Witco common stock on the New York Stock Exchange on November 29, 1965, the day preceding the announcement to the public of the proposed transaction. Witco intends to account for the transaction as (1) a "pooling of

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[1] Mid-Continent Telephone Corporation, NYSE Listing Application No. A-23016, January 14, 1966, p. 1; in connection with the acquisition of C.T. & N. Telephone Co. for $305,053 cash and 44,800 shares common stock.

## Exhibit 3

### WITCO CHEMICAL COMPANY, INC., AND ARGUS CHEMICAL CORPORATION

### Unaudited Pro Forma Combined Condensed Balance Sheet

| | October 31, 1965 | | | |
|---|---|---|---|---|
| ASSETS | Witco Chemical Company, Inc. | Argus Chemical Corporation | Pro Forma Adjustments Dr (Cr) (Note b) | Pro Forma Combined |
| Current assets: | | | | |
| Cash, certificates of deposit and marketable securities | $12,054,800 | $ 278,200 | $ 10,000,000 (2)<br>(11,714,400) (3)<br>(727,000) (5)<br>(65,000) (6) | $ 9,826,600 |
| Receivables (net) | 20,220,400 | 1,903,000 | | 22,123,400 |
| Inventories | 16,983,400 | 1,250,300 | | 18,233,700 |
| Other current assets | 976,400 | 153,400 | | 1,129,800 |
| Total current assets | 50,235,000 | 3,584,900 | | 51,313,500 |
| Investments in affiliates, associated and other companies (Note c) | 9,582,300 | 915,200 | | 10,497,500 |
| Property, plant and equipment at cost, less accumulated depreciation, depletion and amortization (Note c) | 31,670,000 | 2,710,200 | | 34,380,200 |
| Other assets (Note c) | 1,615,200 | 1,231,300 | (927,600) (1) | 1,918,900 |
| Excess of cost of investment in Argus over underlying book equity as of date of acquisition (Notes c and d) | — | — | 10,151,700 (3)<br>65,000 (6) | 10,216,700 |
| | $93,102,500 | $8,441,600 | | $108,326,800 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | |
| Current liabilities | $18,510,600 | $3,866,900 | $(10,000,000) (2)<br>152,700 (5) | $ 32,224,800 |
| Long-term debt | 18,801,000 | 574,300 | 574,300 (5) | 18,801,000 |
| Other liabilities | 233,800 | — | | 233,800 |
| Deferred credits | 3,510,600 | 231,500 | | 3,742,100 |
| Minority interest in a subsidiary company | 54,200 | — | | 54,200 |
| | 41,110,200 | 4,672,700 | | 55,055,900 |
| Shareholders' equity: | | | | |
| Witco: | | | | |
| Common stock, par value $5; 4,000,000 shares authorized, 2,626,561 shares issued, 2,617,761 shares outstanding (2,926,561 shares issued and 2,917,761 shares outstanding after acquisition) | 13,132,800 | — | (1,500,000) (4) | 14,632,800 |
| Argus: | | | | |
| Common stock, no par value, 200 shares authorized, 25 shares issued and outstanding | — | 117,800 | 64,800 (3)<br>53,000 (4) | — |
| Capital surplus | 133,000 | — | 133,000 (4) | — |
| Retained earnings | 38,984,600 | 3,651,100 | 927,600 (1)<br>1,497,900 (3)<br>1,314,000 (4) | 38,896,200 |
| Treasury stock | (258,100) | — | | (258,100) |
| | 51,992,300 | 3,768,900 | | 53,270,900 |
| | $93,102,500 | $8,441,600 | | $108,326,800 |

## Exhibit 3 (cont.)

### NOTES TO UNAUDITED PRO FORMA COMBINED CONDENSED BALANCE SHEET

**(a) Principles Applied in Preparation of Pro Forma Combined Condensed Balance Sheet:**

The accompanying pro forma combined condensed balance sheet reflects the combining of the unaudited balance sheets of Witco and Argus as of October 31, 1965, giving effect to the proposed acquisition of substantially all of the business and assets and the asumption of substantially all the liabilities of Argus. The cash portion of the proposed transaction is accounted for as a purchase and the stock portion as a pooling of interests.

**(b) Explanation of Pro Forma Adjustments:**

1. To eliminate assets of Argus not being acquired.

2. To give effect to the short-term borrowing by Witco of $10,000,000. See reference to "Financing Arrangements" in this Proxy Statement.

3. To give effect to the disbursement of $11,714,400 for the purchase of 55% of substantially all of the net assets of Argus. The excess ($10,151,700) of the cash consideration over the book amount of such assets is allocated to "Excess of cost of investment in Argus over underlying book equity as of date of acquisition." See Note (c) below.

4. To give effect to the issuance of 300,000 shares of Witco's common stock (par value $5 per share) for 45% of substantially all of the net assets of Argus. The difference between 45% of the stated value ($53,000) of Argus' common stock and the par value ($1,500,000) of Witco's common stock is charged to capital surplus to the extent available ($133,000) and the balance ($1,314,000) is charged to retained earnings.

5. To give effect to the payment of certain of Argus' debt.

6. To give effect to estimated expenses to be incurred in connection with the acquisition.

**(c)** It is contemplated that a portion of the amount assigned to "Excess of cost of investment in Argus over underlying book equity as of date of acquisition" will be allocated to patents, licensing agreements, investments in affiliates, property, plant and equipment on the basis of an independent appraisal, which, it is estimated will not be completed earlier than March 15, 1966. In view of this it is not practicable to estimate the amount to be so allocated.

**(d)** Witco does not intend to amortize the "Excess of cost of investment in Argus over underlying book equity as of date of acquisition" remaining after allocation. It is the opinion of Witco that there is no indication of a limited life for this intangible; hence Witco has no present intention of amortizing this intangible asset.

**(e)** The pro forma combined condensed balance sheet should be read in conjunction with the other financial statements and notes thereto included elsewhere in this Proxy Statement.

### BOOK VALUE PER SHARE

On October 31, 1965 the book value of Witco common stock was $19.86 per share. On such date 25 shares of common stock of Argus were outstanding, all of which were privately held. Per share data on the book value of the common stock of Argus is inappropriate. The pro forma book value per share for the common stock of Witco as of such date, after giving effect to the proposed acquisition, would be $18.26 of which $3.50 per share results from the excess of cash consideration of cost of investment in Argus over underlying book equity as of the date of acquisition. Such amount will be subsequently adjusted after the Argus assets acquired have been appraised. See reference to "Accounting Treatment" in this Proxy Statement.

interests" to the extent of the assigned value of the shares to be issued and (2) a purchase to the extent of the cash payment.

With regard to the purchase, the 55% of the net assets of Argus will be recorded on the books of Witco, by allocation of cost, at fair value to be determined by an independent appraiser. The unallocated excess of the cash payment over the 55% of the net assets acquired by Witco amounting to $10,151,700, will be carried on the books of Witco, as "excess of cost of investment in subsidiary over underlying book equity as at date of acquisition." See Notes to Unaudited Pro Forma Combined Condensed Balance Sheet (b) 3--page 12 [second page of Exhibit 3]. It is the opinion of Witco that there is no indication of a limited life for this intangible; hence Witco has no present intention of amortizing this excess.

S. D. Leidesdorf & Co., Witco's independent public accountants, have reviewed and approved this treatment as being in accordance with generally accepted accounting principles.[1]

Several comments are appropriate. The value of $32 a share assigned to the 300,000 Witco shares issued in the exchange transaction was used for purposes of determining the purchase-pooling ratio for the partial-pooling treatment. But the $32 figure is not the basis of the value assigned to the shares for purposes of recording the transaction, since this would be the conventional purchase accounting. If purchase techniques were applied to the entire transaction, then the appropriate entry would be:

| | | |
|---|---|---|
| Current assets | $ 3,584,900 | |
| Investments and other assets | 1,218,900 | |
| Property, plant and equipment--net | 2,710,200 | |
| Excess of cost over book value | 18,473,100 | |
| Current liabilities | | $ 4,672,700 |
| Cash | | 11,714,400 |
| Common stock--par value | | 1,500,000 |
| Capital in excess of par value | | 8,100,000 |

Computations:

| | |
|---|---|
| Cash | $11,714,400 |
| Stock (300,000 shares @ $32) | 9,600,000 |
| Total purchase price | $21,314,400 |
| less: Book value of net assets acquired | 2,841,300 |
| Excess of cost over book value | $18,473,100 |

[1]Witco Chemical Company, Inc., Proxy Statement dated January 25, 1966, "Accounting Treatment," pp. 5-6.

Thus, the choice of partial-pooling treatment rather than purchase accounting for this exchange transaction had two main effects: (1) assets (excess of cost over book value) were reduced by $8,321,400 and (2) stockholders' equity was reduced by the same amount. This analysis shows that a partial pooling, in comparison with purchasing, can serve as an effective accounting technique in avoiding tangible asset write-ups and in keeping large amounts of goodwill and other intangible assets off the consolidated balance sheet.

But, more importantly, careful examination reveals that the actual basis of accountability for the 300,000 common shares issued by Witco is $1,278,600, or $4.262 per share--less than the par value of these shares, $1,500,000, or $5.00 a share. The following computation illustrates why this is the case.

| | |
|---|---|
| Book value of the net assets acquired . . . | $ 2,841,300 |
| Recorded excess of cost over book value . . | 10,151,700 |
| Subtotal . . . . . | $12,993,000 |
| less: Cash consideration . . . . . | 11,714,400 |
| Recorded increase in equity accounts . . | $ 1,278,600 |

As a result of the partial-pooling treatment, regardless of the par value of the shares issued, the recorded increase in the stockholders' equity for Witco in its cash-stock acquisition of Argus is $1,278,600. Since the total par value of the 300,000 shares issued is greater than this amount, Witco's capital surplus and retained earnings were charged with the difference of $221,400. From outward appearances, one might suggest that the stock was issued at a discount in connection with the Argus acquisition, although it had a fair value far above the recorded amount. At least this is exactly the net effect of recording

this combination as a partial pooling; accountabilities are reflected as if the stock had been issued at a discount--$4.262 per share.

This discussion of partial poolings would suggest that such a technique can be applied in a diversity of combination situations and still allow considerable flexibility for the buying and selling corporations as to the manner in which acquisitions are carried out. Management appears to have a choice in accounting for business combinations where both cash and stock considerations are involved in the exchange transaction. Partial pooling is now a generally accepted accounting practice, even for cash-stock exchanges effected all in a single transaction. But it is difficult to conclude how large the "purchase" element in such a situation can be before a partial pooling does not apply because there are many interesting exceptions to prevailing practices in the business combination area.

By way of hypothesis, the writer illustrates below approximate accounting "standards" that practice follows currently in selecting the appropriate purchase-pooling technique where cash (or cash equivalent) is a portion of the purchase price.

| Cash portion | Technique selected | Comments |
|---|---|---|
| less than 25% | pooling of interest | no need to consider other techniques since pooling is easily available |
| 25% to 75% | partial pooling | a pooling may be questioned |
| more than 75% | purchase | the logic of a partial pooling may be questioned |

The practices listed implicitly assume that the total purchase price is significantly larger than the underlying book values of the acquired net assets or capital stock and that the acquiring firm wishes to avoid the writing up of tangible assets and the recordings of goodwill and other intangible assets.

## The Bargain Purchase

In those cases where one company acquires the net assets or capital stock of another company and the underlying book value of such assets or stock exceeds the acquiring unit's purchase cost, the business combination is commonly referred to as a "bargain purchase." In accounting for this type of a combination, accountants regularly disregard the pooling-of-interests concept, even when an evaluation of the attendant circumstances surrounding the exchange transaction would have suggested that all pooling criteria are satisfied. Instead, accountants prefer the purchase treatment which commonly gives rise to a substantial credit representing an excess of book value over cost. This excess in bargain purchase cases usually has favorable effects on the acquiring firm's financial statements, regardless of the alternative ways it may be handled. These include:

(a) Set up as a deferred credit and amortized to income over an appropriate number of years.

(b) Used to reduce specific tangible assets, such as plant, equipment, and inventories.

(c) Used to reduce goodwill and other intangible assets.

(d) Credited directly to retained earnings (a rarity).

As Professor Jaenicke writes,

> . . . here the excess of book values over cost generally has the result of increasing annual income credits, either by means

> of annual amortization of the excess as such from its position as some sort of deferred credit, or by means of reduced annual depreciation charges because of the allocation of the excess to tangible asset accounts. . . . Whether used to reduce tangible assets or set up as an amortizable deferred credit, the excess will increase annual net income after taxes depending only on the rate of annual depreciation of the tangible assets or the rate of annual amortization of the deferred credit, as the case may be.[1]

Various cases serve as illustrations of the first three alternative ways that accounting practice handles the excess of book value over cost in bargain purchase cases.

(a) Bargain Purchase--Excess Credit Amortized to Income

> The transaction will be treated as a "purchase" and not as a "pooling of interests." . . . Southern contemplates, at this time, transferring to income over five years the excess of the sum of the capital stock and surplus accounts of Farmers, as at July 31, 1965, applicable to the common stock purchased by Southern over the sum of cash paid and common stock issued by Southern in the exchange. Southern's independent accountants, Arthur Andersen & Co., have reviewed and approved the foregoing accounting treatment as being in accordance with generally accepted accounting principles.[2]

> The deferred credit resulting from the acquisition of Mueller, including the amount resulting from the above exchange of shares, is to be amortized to income over seven years.[3]

(b) Bargain Purchase--Excess Credited to Tangible Assets

> In consolidation the excess of the net assets as shown on the books of Western Block Company over the purchase price will be applied as a reduction to the carrying amounts of certain specific

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[1] Henry R. Jaenicke, "Management's Choice to Purchase or Pool," The Accounting Review, XXXVII (October 1962), 763.

[2] Southern Nitrogen Company, Inc., NYSE Listing Application No. A-22743, September 20, 1965, p. 1; in connection with the acquisition of Farmers Cotton Oil Company for 7,213 common shares and $1,027,348 cash.

[3] United States Smelting Refining and Milling Company, proxy statement dated August 27, 1965, under Notes to Pro-Forma Combined Balance Sheet, in connection with the merger with Mueller Brass Co., Note 3, p. 16.

assets (principally property, plant, and equipment and inventories) of Western Block Company based upon present values. This accounting treatment has been approved by Touch, Ross, Bailey & Smart, independent certified public accountants of the Company, as being in accord with generally accepted accounting principles.[1]

Huron's assets and liabilities, as shown on their books as of November 30, 1956, will be recorded on the books of the Company except that the plant account will be reduced so that the aggregate of net assets will be $4,500,000 (maximum). The audited financial statements of Huron at June 30, 1956, indicate net book assets of approximately $6,388,000.[2]

(c) Bargain Purchase--Excess Credited to Intangibles

The acquisition of the said 276 shares will be accounted for as a purchase, wherein upon consolidation the excess of book-value over cost will be credited to the intangible "Excess of cost over net assets of companies acquired."[3]

The established practice of recording assets at the selling company's book values which exceed cost and amortizing the excess of book value over cost to income, as illustrated under alternative (a), is open to serious objection. Such a procedure overstates the buying enterprise's accountability for the economic resources which were purchased. Since excess amounts are recorded in tangible asset accounts, it is likely that future depreciation charges (and cost of goods sold) will be overstated too. The gradual transfer of the excess credit

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[1]American Hoist & Derrick Company, NYSE Listing Application No. A-22992, December 28, 1965, p. 1; in connection with the acquisition of Western Block Company for 14,064 shares capital stock and cash consideration $131,004.

[2]Hercules Powder Company, NYSE Listing Application No. A-16656, November 21, 1956, p. 2; in connection with the acquisition of the Huron Milling Company for 100,000 shares common stock.

[3]United Financial Corp. of California, NYSE Listing Application No. A-22800, October 25, 1965, p. 2; in connection with the acquisition of the stock of United Savings and Loan Association for 79,764 shares of capital stock.

(deferred credit) to income represents an arbitrary and highly dubious method of offsetting inflated depreciation charges in the final determination of periodic income. If such depreciation charges are not excessive, then the practice of amortizing the excess of book value over cost to income is unacceptable because net income may be overstated by the amount of the amortization.

Although accounting practices for the handling of book value over cost in bargain purchases do vary considerably, the basic implications are clear. If the "excess" is on the credit side in combination transactions, accountants willingly write down assets or set up deferred credits to be amortized to income. If the excess is a reverse situation where purchase cost exceeds book value, accountants generally are not willing to write up assets (both tangible and intangible) and to make appropriate depreciation and amortization charges to income. While such practices may be "generally accepted accounting principles," they do not seem logically consistent. Should not the accounting principles applied in usual business combinations be the same as in "bargain" situations? The inherent logic of the situation would argue that if a new basis of accountability arises for bargain purchase combinations, then a new basis of accountability arises for the usual types of business combinations, i.e., where the selling companies are acquired at a premium. From the point of view of responsibility accounting, it makes little difference whether book value exceeds the purchase cost or purchase cost exceeds the book value.

Apparently managements and accountants alike are not willing to accept the usual consequences of purchase accounting except in those

situations where the selling company is acquired on a discount basis. Here the effect of recording under the purchase treatment does present the financial statements in a more favorable light. If the "excess credit" is applied as a reduction of the asset accounts of the selling company, then future income statements are relieved of some of the charges that might have been forthcoming for depreciation or amortization. The alternative practice of using the selling company's book values and amortizing the excess credit gradually through the income account also increases the combined income of the conglomerate enterprise.

The Retroactive Pooling

If a specific business combination is originally accounted for as a purchase and then later is changed to reflect a pooling of interests, this represents a unique accounting phenomenon called a "retroactive pooling." Especially notable in the years 1959-62, these retroactive changes are additional evidence of the confused state of mind in accounting for business combinations. Most writers discussing the retroactive situation emphasize that the revision arises not from a misinterpretation of the original combination transaction but from the changing nature of the pooling-of-interests concept.[1]

The retroactive poolings indicate the unclear standards that delineate a purchase from a pooling of interests. They highlight the

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[1]Arthur R. Wyatt, A Critical Study of Accounting for Business Combinations, Accounting Research Study No. 5 (New York: American Institute for Certified Public Accountants, 1963), p. 49.

intense pressure that some managements have exerted upon the accounting profession to accept business combinations as poolings of interests regardless of the attendant circumstances surrounding the combinations. But, as a consequence, such changes have probably undermined the integrity of financial reporting and impaired the prestige of the accounting profession. Switching from purchase accounting to pooling-of-interests accounting also seems to violate the concept of consistency in accounting, a concept which Moonitz interpreted as one of the basic postulates of accounting.

> Postulate C-3. Consistency. The procedures used in accounting for a given entity should be appropriate for the measurement of its position and its activities and should be followed consistently from period to period.[1]

An evaluation of two particular retroactive pooling cases follows to emphasize management's strong interest in handling business combinations as poolings of interests and to bring out the usual effect of this accounting phenomenon on corporate financial statements.

W. R. Grace & Co.--Acquisition of Hatco Chemical Company

W. R. Grace & Co. acquired the net assets of Hatco Chemical Company in 1959 for 126,000 shares of common stock. These shares represented 2.7 per cent of the shares outstanding after the combination, definitely below the 5-10 per cent presumptive limitation of Accounting Research Bulletin No. 48. Hatco was made an operating division and the exchange transaction was recorded as a purchase. The value placed on

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[1]Maurice Moonitz, The Basic Postulates of Accounting, Accounting Research Study No. 1 (New York: American Institute of Certified Public Accountants, 1961), p. 53.

the stock for accounting purposes was $43.00, based on the approximate average price of the company's stock on the New York Stock Exchange during the period of negotiations.[1] Briefly, the accounting entry was:

| | | |
|---|---|---|
| Net assets of Hatco | | $1,537,679 |
| Excess of cost over book value | | 3,880,321 |
| | Common stock--par value | $ 126,000 |
| | Paid-in surplus | 5,292,000 |

The excess of cost over the book value of the underlying net assets of Hatco was charged to goodwill. Although Grace hinted in the listing application that such goodwill would be amortized on a straight-line basis to income, this was not done. Apparently Grace was undecided on this matter for in the Annual Report 1959 it stated:

> The excess of the market value of the 126,000 shares over the book value of the underlying net assets of Hatco acquired amounted to $3,880,321 and has been recorded as goodwill. . . . the basis for amortizing the Hatco goodwill will be determined after experience indicates the inter-relationship of its business to that of the Company's other chemical operations.[2]

But in 1960 Grace definitely solved their problem of deciding what to do with the purchased goodwill. The purchase accounting treatment was retroactively changed to effect a pooling of interests. The change was explained in the Annual Report 1960 as follows:

> In 1960 the Company reconsidered the circumstances surrounding its 1959 acquisition of the Hatco Chemical Company for 126,000 shares of the Company's common stock and decided that it would be more appropriate to treat the combination as a pooling of interests than as a purchase. Hatco's retained earnings account has

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[1] W. R. Grace & Co., NYSE Listing Application No. A-18322, July 7, 1959, p. 1; in connection with the acquisition of Hatco Chemical Company for 126,000 shares common stock.

[2] W. R. Grace & Co., Annual Report 1959, p. 27.

been retroactively combined with that of the Company, goodwill of $3,880,321 has been eliminated and capital surplus has been reduced by $5,526,531.[1]

In addition to the above-mentioned balance sheet changes, the pooling-of-interests treatment increased Grace's previously reported 1959 net income by approximately $443,000, or 9¢ per share. Although Grace disclosed this change in the notes to the financial statements, the auditors did not mention the change in their short-form report.

If pooling accounting had been used at the time of the acquisition, the net assets of Hatco would have been brought on the books of Grace at book values and Hatco's retained earnings would have been carried forward. Briefly, the accounting entry would have been:

| | | |
|---|---|---|
| Net assets of Hatco | | $1,537,679 |
| Paid-in surplus | | 234,000 |
| Common stock--par value | $ 126,000 | |
| Retained earnings | 1,645,679 | |

The $234,000 charge to paid-in surplus arises under the pooling-of-interests treatment because Grace would have transferred the total balance of retained earnings of Hatco on July 24, 1959; a charge to paid-in surplus, therefore, would have been necessary to account properly for capital elements of the surviving corporation.

Smith Kline & French Laboratories--
Acquisition of Norden Laboratories

Smith Kline & French Laboratories issued 110,194 shares of its common stock in exchange for the business and net assets of Norden Laboratories (Nebraska) in January 1960. These shares represented less

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[1] W. R. Grace & Co., Annual Report 1960, under Notes to Financial Statements, Note 1, p. 28.

than one per cent of the shares outstanding after the combination. This particular acquisition enabled Smith Kline & French to enter the field of veterinary medicine through an established organization. As to the accounting treatment for this exchange transaction, Smith Kline & French reported:

> The fair value of the shares issued has been credited to stated capital and the excess of the fair value of the shares issued over the net tangible assets of Norden (Nebraska) at date of acquisition, $3,659, 820, is being amortized over a ten-year period by equal charges to consolidated earnings.[1]

In December 1961, Smith Kline & French gave notice to the New York Stock Exchange that the accounting method applied in connection with the Norden acquisition was being changed to a pooling of interests in accordance with generally accepted accounting principles. Exhibit 4 illustrates some of the important details concerning the change. The change was also explained in the Annual Report 1961 as follows:

> In 1961 the Company reconsidered its accounting treatment applicable to the 1960 acquisition of Norden Laboratories (Nebraska) for 110,194 shares of the Company common stock and decided that it would be more appropriate to treat the combination as a pooling of interests rather than a purchase. Accordingly, the 1960 financial statements have been restated in that Norden's retained earnings account has been retroactively combined with that of the Company, the excess of the fair value of the shares issued over net tangible assets at date of acquisition, $3,659,820, has been eliminated, and the excess of the stated value assigned to the shares issued over the stated capital of Norden has been charged to earnings retained in the business. The amortization of the excess of investment charged to earnings in 1960, $365,982, has been restored.[2]

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[1] Smith Kline & French Laboratories, Annual Report 1960, under Notes to Financial Statements, Note 4, "Norden Laboratories (Nebraska)," p. 11.

[2] Smith Kline & French Laboratories, Annual Report 1961, under Notes to Financial Statements, Note 1, "Change in Accounting Treatment," p. 13.

Exhibit 4

SUPPLEMENT TO PRIOR
LISTING APPLICATION TO
NEW YORK STOCK EXCHANGE

**A-18692**
**SUPPLEMENT**
December 29, 1961

# SMITH KLINE & FRENCH LABORATORIES

## NOTICE OF CHANGE OF ACCOUNTING METHOD

## IN CONNECTION WITH THE ACQUISITION OF NORDEN LABORATORIES

| Number of shares issued and outstanding | Number of stockholders of record |
|---|---|
| 14,641,504 | 13,086 |
| (as at November 30, 1961) | (as at November 30, 1961) |

CHANGE OF ACCOUNTING METHOD:

Smith Kline & French Laboratories (the "Corporation") hereby gives notice to the New York Stock Exchange that the accounting method applied in connection with the Corporation's acquisition of all of the business and assets of Norden Laboratories ("Norden"), as set forth in the Corporation's Listing Application No. A-18692 dated December 22, 1959, has been changed from a purchase as therein reported to a pooling of interests of Norden with the Corporation. This change was made in accordance with generally accepted accounting principles.

The Listing Application contains the following statement:

> "The Corporation has valued the business and assets (subject to liabilities) to be obtained from Norden at $5,509,700, which is the average fair market value of the shares to be issued to Norden during the period of negotiation prior to the date of the Agreement and this amount will be credited to the common stock account. The excess of such amount over the book value of the net assets of Norden will be shown as goodwill on the books of the subsidiary which will hold the Norden assets and operate the Norden business and will be reflected on the consolidated balance sheet as an intangible which will be amortized over a period in conformity with generally accepted accounting principles."

By reason of the change from purchase treatment to pooling of interests, the quoted statement is hereby deleted. The net book value of the property and assets which were acquired will be shown on the books of the Corporation as the value of its investment in the Norden assets. The asset and liability accounts at the amounts shown on the books of Norden will be carried forward (subject to appropriate reclassifications, if deemed necessary, to place the accounts on a uniform basis) and the earnings retained in the business of Norden will be similarly carried forward. The excess of the stated value assigned to the Corporation's shares issued in the transaction over the stated capital of Norden will be charged to earnings retained in the business. The new treatment will be given effect *nunc pro tunc* and will be shown in the Corporation's consolidated financial statements for its fiscal years ended December 31, 1960 and 1961 to be published in its annual report for 1961.

The Board of Directors of the Corporation on November 16, 1961 authorized the accounting entries necessary to change the accounting treatment of the transaction with Norden after reconsidering the circumstances surrounding the transaction, which included (a) the equity interests in Norden continue as such in the Corporation and (b) there has been a continuity of the business and management of Norden.

Exhibit 4 (cont.)

The Corporation's auditors, who reviewed and approved the accounting treatment as being in accordance with generally accepted principles of accounting, are Peat, Marwick, Mitchell & Co., Philadelphia, Pennsylvania.

The issuance of the 110,194 shares of the Corporation's common stock in exchange for the property and assets of Norden was authorized by the Board of Directors of the Corporation on November 19, 1959; the exchange was consummated on January 12, 1960.

## OPINION OF COUNSEL

In the opinion of Messrs. Ballard, Spahr, Andrews & Ingersoll, Land Title Building, Philadelphia, Pennsylvania, the additional 110,194 shares of common stock of the Corporation covered by this Supplemental Application, as issued and delivered in accordance with the resolution of the Board of Directors of the Corporation referred to above, remain unchanged by the change in accounting treatment from a purchase to a pooling of interests and remain validly issued, fully paid and non-assessable, with no personal liability attached to the ownership thereof under the laws of the Commonwealth of Pennsylvania, the state of incorporation of the Corporation and the state in which the Corporation's principal office is located, other than the statutory liability of all shareholders of Pennsylvania business corporations for wage claims and the like up to the value, as defined in the statute, of the shares owned, such liability being conditioned upon the bringing of suit for such salaries and wages within six months after the same become due. Morris Cheston, a director of the Corporation, is a member of the firm of Ballard, Spahr, Andrews & Ingersoll.

SMITH KLINE & FRENCH LABORATORIES

By: HOWARD E. MORGAN
*Treasurer*

The important effects of this retroactive pooling for Smith Kline & French were to:

(a) remove permanently over $3.6 million of assets from the balance sheet;

(b) reduce reported stockholders' equity about $3.3 million;

(c) increase 1960 reported earnings per share from $1.64 to $1.67.

Other cases in which a retroactive pooling treatment followed the purchase accounting of the original transaction include the following combinations: American Machine & Foundry Company's acquisitions of the W. J. Voit Rubber Corporation and the J. B. Beaird Company, Inc.; Aluminum Company of America's acquisition of Rome Cable; Raytheon Company's acquisition of Sorenson & Co., Inc.; Reichhold Chemicals Company's acquisition of Alsynite Company of America; Universal Match Corporation's acquisition of Sleight & Hellmuth, Inc.; and Riegel Paper Corporation's acquisition of Bartelt Engineering.[1] An earlier case of a retroactive pooling where the size criteria was slightly above Bulletin No. 48's guideline of 5-10 per cent for the acquired company was Food Machinery and Chemical Corporation's acquisition of Buffalo Electro-Chemical Co. in 1952.[2] All of these cases of retroactive change would support the contention that managements were unwilling to accept the usual consequences of purchase accounting. There are probably three main reasons why managements and accountants have increasingly accepted the pooling-of-interests concept in accounting for business combinations.

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[1]Samuel R. Sapienza, "Distinguishing Between Purchase and Pooling," The Journal of Accountancy, CXI (June 1961), 35-40.

[2]Wyatt, op. cit., p. 53.

(a) The reluctance to recognize purchased goodwill and other intangible assets which generally result from using the purchase method and the accompanying amortization of such intangibles in conformity with the policy expressed in Accounting Research Bulletin No. 43, Chapter 5.

(b) The pressure on corporate managements to maintain and increase earnings per share from year to year.

(c) The desire to avoid the discrepancy between reported business earnings and taxable earnings which results from purchase accounting, since the amortization of any excess in stock acquisitions represents a charge against revenues not deductible for income tax purposes.

When managements and accountants realized that the pooling criteria set out in ARB No. 48 were indeterminative and subjective, they did not hesitate to initiate retroactive changes that created more favorable financial results.[1] Thus, the actual effect of both ARB No. 43 (1953), Chapter 5, and ARB No. 48 (1957) was to allow even wider latitude in determining the treatment of a given business combination than had previously existed.[2] The retroactive poolings of the 1959-62 period are convincing evidence that accounting practitioners were not certain of the distinction between a purchase and a pooling of interests. Nevertheless, accountants were willing to deviate significantly from basic accounting standards and recommended criteria and to implant their own notion of desirable practices in this area.

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[1]For example, a pooling will show a better rate of return on assets on a pro-forma basis than a purchase if the selling company is acquired at a premium.

[2]Wyatt, op. cit., p. 38.

Some Variations of Pooling and Purchase Accounting

The main types of combination accounting treatments have been illustrated, but several variations of pooling-purchase methods remain to be explained. Two are:

> Pooling treatment, with retained earnings (earned surplus) of the acquired company capitalized.
>
> Purchase treatment, with the systematic amortization of the excess of cost over book value to retained earnings.

The carrying forward of the combined retained earnings of the constituents as the retained earnings of the resultant corporate entity represents one of the basic features of a pooling of interests. ARB No. 48 clearly states that the retained earnings accounts of the constituents should be merged in a pooling combination, except to the extent otherwise required by law or appropriate corporate action. Yet occasionally business combinations are accounted for in a manner, as Wyatt suggests, where "the assets were 'pooled', while the earned surplus was 'purchased'."[1] Two quotations serve as examples of this treatment.

> The assets and liabilities of Formica will be carried forward on the books of the Company at the amounts recorded on the books of Formica. The par value of the Acquisition Common Stock issued as consideration therefore will be credited to capital stock and the excess of the net assets, on the closing date, over such par value will be credited to capital surplus.[2]
>
> The acquisition of the Company's (Speer Carbon Company) business and assets by Airco is to be treated as a pooling of interests for accounting purposes in accordance with generally accepted

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[1] Wyatt, op. cit., p. 29.

[2] American Cyanamid Company, NYSE Listing Application No. A-16202, April 2, 1956; in connection with the acquisition of Formica Company for 573,692 shares of common stock, p. 3.

> accounting principles. . . . The common stock account of Airco will increase by an amount equivalent to the sum of the par value of the Company's common stock, paid-in surplus of the Company, and (as required by certain provisions of the Airco Certificate of Incorporation) the retained earnings of the Company as of the date of acquisition.[1]

While this type of combination accounting treatment may not represent a "true" pooling of interests, for all practical purposes it has similar effects on corporate financial statements. Whether the acquired unit's retained earnings are capitalized or carried forward in a pooling combination, the total assets and stockholders' equity of the surviving company remain the same. Such a distinction between contributed capital and retained earnings on the books and balance sheet of a typical corporate enterprise is generally useless for purposes of financial statement analysis.

Logically, if a combination is deemed to be a pooling of interests, the retained earnings of the acquired company should be permitted to survive, since a new basis of accountability does not arise. The very connotation of the term "pooling" implies a commingling of interests,[2] so that all or substantially all of the equity interests in predecessor companies should continue undisturbed, as such, in the surviving entity.

Capitalization of the acquired company's retained earnings, however, does not consistently reflect the pooling concept as to stockholders' equity accounts. Should the acquiring unit be reluctant to add

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[1]Air Reduction Company, Incorporated, Proxy Statement dated July 18, 1961; concerning the acquisition of Speer Carbon Company, p. 7.

[2]Samuel R. Sapienza, "Pooling Theory and Practice in Business Combinations," The Accounting Review, XXXVII (April 1962), 273.

the acquired entity's retained earnings to its own, then pooling treatment could be questioned. Such capitalization may be suggestive of the applicability of purchase accounting, since in a business combination which is clearly a purchase none of the retained earnings of the acquired company is carried forward. The "pooling treatment, with retained earnings capitalized" is additional evidence that accountants are confused as to the distinction between a purchase and a pooling of interests.

Where a business combination is treated as a purchase of assets, usually there arises the question of what to do with any excess of fair value of assets acquired over their book value. If the purchase price is substantially in excess of the best estimate of the present value of tangible and specific intangible assets being acquired, it is necessary to record "goodwill." Since the write-off of goodwill at date of acquisition is now a questionable practice for purposes of generally accepted accounting principles, this item may be amortized over a period of years against revenues, or carried at cost until such time as it appears to have a limited life. Occasionally, however, such purchased goodwill has been accounted for in a manner different than these customary treatments, i.e., where it is systematically amortized as a special charge <u>after</u> reported net income for the year. Such a treatment avoids reducing reported earnings per share and still gradually eliminates the carrying cost of goodwill on successive balance sheets. Exhibit 5 illustrates this treatment for the Gillette Company on its combined income and retained earnings statement for the years 1956 and 1957.

Exhibit 5

GILLETTE COMPANY

AN ILLUSTRATION WHERE GOODWILL WAS SYSTEMATICALLY AMORTIZED AS A SPECIAL CHARGE, 1956-57

| | Year ended December 31, 1956 | Year ended December 31, 1957 |
|---|---|---|
| Net income before special charges | $31,544,304 | $25,940,570 |
| Special charge to amortize goodwill | 2,817,366 | 2,628,255 |
| Net income after special charge, transferred to U.S. retained earnings | $28,726,938 | $23,312,315 |

Source: Gillette Company, Annual Reports 1956 and 1957, p. 19.

Exhibit 6 shows how Gillette has written off its goodwill and other intangibles from 1949 to 1961 with respect to purchased patents and trademarks and goodwill arising from four business acquisitions.

Exhibit 7 shows the effect of the write-off to retained earnings treatment on the reported earnings per share of common stock for Gillette for six years 1953-58.

If Gillette had not written off any of the purchased goodwill arising from acquisitions (see Exhibit 6) but had followed the "purchase without amortization" treatment instead, then the 1961 balance sheet would have reported "Goodwill, Patents, and Trademarks" of approximately $39,752,000, rather than only $604,000 as it did. Note that over $39 million of purchased goodwill was written off either to paid-in capital or to retained earnings during the 1949-58 period. Gillette followed a policy of "systematic amortization" for the cash acquisitions of the

Exhibit 6

GILLETTE COMPANY

WRITE-OFF OF GOODWILL AND OTHER INTANGIBLES, 1949-61

(in thousands of $)

| Year | Auto Strop Company | Toni Company | Paper Mate Companies | Harris Research Labs. | $1,136 of Purchased Patents & Trademarks |
|---|---|---|---|---|---|
| 1949 | $15,303 | $ 8,000 | -- | -- | -- |
| 1950 | -- | 1,631 | -- | -- | -- |
| 1951 | -- | 1,006 | -- | -- | -- |
| 1952 | -- | 2,156 | -- | -- | -- |
| 1953 | -- | 2,983 | -- | -- | -- |
| 1954 | -- | -- | -- | -- | -- |
| 1955 | -- | -- | $ 653 | -- | -- |
| 1956 | -- | -- | 2,632 | $185 | $ 6 |
| 1957 | -- | -- | 2,628 | -- | 66 |
| 1958 | -- | -- | 1,971 | -- | 66 |
| 1959 | -- | -- | -- | -- | 123 |
| 1960 | -- | -- | -- | -- | 135 |
| 1961 | -- | -- | -- | -- | 136 |
| Total | $15,303 | $15,776 | $7,884 | $185 | $532 |
| Where charge was made | paid-in capital | retained earnings | retained earnings | retained earnings | income statement |
| Balance Dec. 31, 1961 | -- | -- | -- | -- | $604 |

Source: Various prospectuses and annual reports of Gillette Company. The preferred terminology, paid-in capital and retained earnings, has been used in this exhibit although Gillette did use "capital surplus" and "earned surplus" on its balance sheet.

Exhibit 7

GILLETTE COMPANY

EARNINGS PER SHARE OF COMMON STOCK BEFORE AND AFTER SPECIAL CHARGES, 1953-58

| Year | Before Special Charges | After Special Charges | Difference |
|---|---|---|---|
| 1953 | $2.18 | $1.80 | $.38 |
| 1954 | 2.77 | 2.77 | -- |
| 1955 | 3.13 | 3.06 | .07 |
| 1956 | 3.40 | 3.10 | .30 |
| 1957 | 2.80 | 2.51 | .29 |
| 1958 | 2.97 | 2.76 | .21 |

Source: Various prospectuses of Gillette Company.

Toni Company and Paper Mate Companies, but such amortization bypassed the income statement since it was reported as a special charge after annual net income. Practically speaking, the goodwill which arose from these two acquisitions was amortized systematically to Gillette's retained earnings account.

The purchase treatment with systematic amortization of the excess to retained earnings is logically inconsistent and unsupportable for purposes of sound accounting theory. This rare treatment is actually not too far removed from the practice of writing off goodwill at the date of acquisition. If there has been some compelling reason to bring purchased goodwill into the accounts in the first place, then either an immediate write-off or a gradual write-off of this goodwill to paid-in capital or to retained earnings nullifies the fundamental accounting principle requiring substantially all charges to go through the income

account. As one writer maintains,

> . . . when purchased goodwill is being amortized according to a systematic plan, a charge to current operations is the only type of charge which is consistent with the definition and meaning of goodwill and the functions of accounting.[1]

Thus, the "purchase with amortization to retained earnings" technique used by Gillette is a clever piece of conservative balance sheet accounting, which also relieves income of periodic charges for the amortization of goodwill. The recording of purchased goodwill implies that it represents the cost of a valid and consumable asset. Furthermore, any willingness to amortize gradually the recorded goodwill not only suggests that the asset has a limited term of existence (therefore classified as a type (a) intangible according to Bulletin No. 43, Chapter 5), but also represents an orderly and logical disposition of the cost of that asset. Accordingly, such a cost should be amortized against the income expected to be realized from that asset. As Walker suggests,

> Since purchased goodwill is, by definition, the present worth of an anticipated future income stream, logic dictates that the cost be written off against the income over the period for which the excess earnings are expected to be realized.[2]

Finally, the purchase treatment with systematic amortization of the excess to retained earnings can be considered a departure from generally accepted accounting principles, mainly as a result of the first sentence of paragraph 5 of Bulletin No. 43, Chapter 5.

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[1]George T. Walker, "Why Purchased Goodwill Should Be Amortized on a Systematic Basis," The Journal of Accountancy, XCV (February 1953), 215.

[2]Ibid., 213.

The cost of type (a) intangibles should be amortized by systematic charges in the income statement over the period benefited, as in the case of other assets having a limited period of usefulness.[1]

## Summary

From the study of alternative pooling-purchase accounting practices, the following conclusions may be drawn:

1. While there are two basic theories of accounting for business combinations--the purchase doctrine and the pooling-of-interests concept--accountants are not clear as to the underlying distinction between them. Purchasing implies a new basis of accountability for assets, possibly based on the cost or fair market value of what consideration the acquiring company gives up in the exchange, or the appraisal value of what is secured, or some composite of these values. Pooling suggests a commingling of ownership interests, where the surviving economic entity continues to have the same assets, equity interests, and management as did the several entities before combination.

2. The distinction between a "purchase" and a "pooling of interests" is important. Under the latter accounting treatment, the acquiring unit in a business combination is not faced with the problem of accounting for the "excess of purchase cost over book value of assets acquired," because the assets and capital elements of the nonsurviving company are carried forward on the books of the surviving company at book values.

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[1] American Institute of Certified Public Accountants, Accounting Research Bulletin No. 43, Chap. 5, par. 5.

3. Many business combinations are accounted for as poolings-of-interests, although they do not come under the pooling precepts as promulgated in ARB No. 48. By using the pooling approach in accounting for business acquisitions and mergers, corporate managements are not held accountable for the fair value of the assets acquired and the capital stock issued therefore. Pooling-of-interests accounting, in effect, fails to account for all costs of buying a business.[1]

4. There is a very definite relationship between the popular use of the pooling treatment and the present rules for dealing with intangible assets, as promulgated in ARB No. 43, Chapter 5. A closer look at these rules will follow in Chapter III.

5. The established criteria, such as relative size, continuity of ownership and management, alteration of voting rights, and others, are not sufficiently objective as standards in determining whether the pooling treatment ought to be allowed for a particular business combination. Such criteria conceal the real issue: Should corporate management be held accountable for any excess of fair value of assets acquired over their book value at the date of the combination?

6. The failure of accountants to establish determinate pooling criteria has led to an array of combination accounting practices, all embraced in the term "generally accepted accounting principles." These alternative pooling-purchase accounting practices produce widely varying differences in a company's financial position and earnings,

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[1]Leonard Spacek, "The Treatment of Goodwill in the Corporate Balance Sheet," The Journal of Accountancy, CXVII (February 1964), 39.

especially for the asset values recorded and stockholder equity values carried forward into subsequent financial statements.[1]

7. The existing variety of combination accounting practices allows too much inconsistency and diversity in financial reporting. The differences that result from alternative pooling-purchase practices require thorough study and analysis to improve the general understanding and usefulness of corporate financial statements.

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[1] Wyatt, op. cit., p. 103.

# CHAPTER III

# BACKGROUND

## The Growth of Business Combinations

Business combinations have played a dominant role in the economic expansion of the United States. During recent years the number of mergers and acquisitions of business entities has continued at a high level. According to the Federal Trade Commission, a significant spurt in merger activity is apparent during the 1960s. Data on a series of mining and manufacturing acquisitions, kept by the Commission annually since 1940, indicate that the number of mergers and acquisitions in the five years 1960-64 runs about 30 per cent over the total for the 1955-59 period.[1] According to a survey by W. T. Grimm & Co., a Chicago-based financial consulting firm specializing in acquisitions, corporate merger activity set a record in 1965 with a total of 2,125.[2] Private sources expect mergers and acquisitions to reach 2,400 in 1966.[3]

An exact count of all business combinations is practically impossible to compile. Note from Exhibit 8 the increasing trend in merger

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[1] "Merger Tide is Swelling," Business Week (May 29, 1965), p. 27.

[2] "Mergers Set a Record Last Year With 2,125, Consulting Firm Says," The Wall Street Journal, January 28, 1966, p. 12.

[3] "Mergers: Everybody Wants to Get Bigger," Newsweek, April 25, 1966, p. 72.

Exhibit 8

MERGERS AND ACQUISITIONS--MANUFACTURING AND MINING CONCERNS ACQUIRED, 1949-64

| Year | Number | Year | Number |
|---|---|---|---|
| 1949 | 126 | 1957 | 585 |
| 1950 | 219 | 1958 | 589 |
| 1951 | 235 | 1959 | 835 |
| 1952 | 288 | 1960 | 844 |
| 1953 | 295 | 1961 | 954 |
| 1954 | 387 | 1962 | 853 |
| 1955 | 683 | 1963 | 861 |
| 1956 | 673 | 1964 | 854 |

Source: Statistical Abstract of the United States, 1965, p. 503; Federal Trade Commission records. Data limited to actions reported by Moody's Investors Service and Standard & Poor's Corporation, so that many smaller acquisitions are not reported. The data only include partial acquisitions when they comprise whole divisions of other companies.

activity for manufacturing and mining concerns as reported by the Federal Trade Commission during the period 1949 to 1964. This exhibit shows that merger activity for these types of concerns accelerated at a rapid pace starting in 1955. Between 1950 and 1954, for example, an average of 285 mergers and acquisitions occurred each year. Between 1955 and 1959, this average increased to 673 per year. Presently, based on an average of 873 a year between 1960 and 1964, the level of merger activity is higher than at any time during the past thirty years.[1]

In addition to the absolute increase in merger activity, the Commission released merger statistics showing that an increased number of

[1]Federal Trade Commission, Annual Report 1965, p. 39.

acquisitions were made by large companies between 1955 and 1964. For example, in 1955 companies with assets of $100 million or more made 16 per cent of the recorded acquisitions, while in 1964 this size group accounted for almost 25 per cent of the merger activity.[1]

An analysis of merger activity should include more than the mere counting of the number of acquisitions and mergers that take place. The statistics on 720 "large" (defined as acquired firms with assets of $10 million or more) mergers are presented in Exhibit 9 to show both the

Exhibit 9

ACQUISITIONS OF LARGE MINING AND MANUFACTURING CORPORATIONS WITH ASSETS OF $10 MILLION AND OVER, 1948-64

| Year | Number | Value (in millions) |
|---|---|---|
| 1948 | 4 | $ 64.6 |
| 1949 | 5 | 66.8 |
| 1950 | 4 | 154.8 |
| 1951 | 9 | 201.4 |
| 1952 | 13 | 326.5 |
| 1953 | 23 | 678.6 |
| 1954 | 36 | 1,450.2 |
| 1955 | 68 | 2,156.0 |
| 1956 | 59 | 2,069.6 |
| 1957 | 49 | 1,458.9 |
| 1958 | 39 | 1,118.5 |
| 1959 | 63 | 1,949.6 |
| 1960 | 62 | 1,708.3 |
| 1961 | 60 | 2,144.6 |
| 1962 | 71 | 2,179.7 |
| 1963 | 65 | 2,791.0 |
| 1964 | 90 | 2,784.3 |
| Total | 720 | $23,303.4 |

Source: Federal Trade Commission, Annual Report 1965, p. 40. Its information is based on a report on The Scope of the Current Merger Movement, prepared in 1965 for the Senate Subcommittee on Antitrust and Monopoly, which also gives the Bureau of Economics as a source.

[1] Ibid.

number of acquisitions of firms of this size and the value of the acquired assets. Based on the dollar value of the acquired assets involved in these large acquisitions, a significant rise in merger activity is apparent after the year 1953. Takeovers of large firms with assets of more than $10 million definitely are mounting; there were 91 such deals in 1965, as compared with an average of 64 for the years 1959-63.[1]

To gain an insight into merger and acquisition activity by industry class, Exhibit 10 gives the pertinent data for the six leading industry groups of manufacturing concerns for years 1957-64. According to Federal Trade Commission data, the chemical industry in 1964 ranked second among industry groups in level of merger activity, with approximately 14.5 per cent of the acquisitions and mergers for manufacturing concerns.

Exhibit 10

MERGERS AND ACQUISITIONS--MANUFACTURING CONCERNS ACQUIRED FOR SIX LEADING INDUSTRY GROUPS, 1957-64

| Industry Group | 1957 | 1958 | 1959 | 1960 | 1961 | 1962 | 1963 | 1964 |
|---|---|---|---|---|---|---|---|---|
| Electrical machinery | 62 | 59 | 82 | 113 | 122 | 113 | 109 | 116 |
| Chemicals | 46 | 58 | 76 | 68 | 86 | 108 | 78 | 103 |
| Machinery, except elec. | 79 | 71 | 91 | 77 | 87 | 73 | 88 | 72 |
| Food & kindred products | 40 | 51 | 69 | 61 | 73 | 56 | 67 | 69 |
| Transportation equipment | 41 | 49 | 65 | 67 | 47 | 56 | 46 | 56 |
| Textiles & apparel | 26 | 23 | 46 | 53 | 51 | 59 | 62 | 55 |

Source: Statistical Abstract of the United States, 1965, p. 504; Federal Trade Commission records.

[1] "Mergers: Everybody Wants to Get Bigger," op. cit., p. 72.

More reliable and complete data on merger activity in recent years is included in a study by the Select Committee on Small Business of merger actions of the 500 largest industrial and 50 largest merchandising firms for the eleven-year period, 1951-61. Clearly, the most merger-prone industry group during this period was dairy products; but the committee's study found that a substantial number of acquisitions took place in other industries, such as paper and allied products, industrial chemicals, petroleum refining, aerospace, electrical equipment, motor vehicles, and textile-mill products.[1] Exhibit 11 (compiled from

Exhibit 11

NUMBER OF ACQUISITIONS OF 500 LARGEST INDUSTRIALS BY INDUSTRY AND PER FIRM, 1951-61

| SIC Number | Industry | Number of firms among 500 largest | Number of acquisitions | Average number of acquisitions per firm |
|---|---|---|---|---|
| Eight leading industries: | | | | |
| 202 | Dairy products | 7 | 462 | 66.0 |
| 260 | Paper and allied products | 26 | 213 | 8.2 |
| 281 | Industrial chemicals | 25 | 204 | 8.2 |
| 291 | Petroleum refining | 32 | 193 | 6.0 |
| 372 | Aerospace equipment | 23 | 170 | 7.4 |
| 361 | Electrical equipment | 20 | 160 | 8.0 |
| 371 | Motor vehicles and equipment | 20 | 160 | 8.0 |
| 220 | Textile-mill products | 18 | 110 | 6.1 |
| Other selected industries: | | | | |
| 283 | Drugs | 16 | 71 | 4.4 |
| 284 | Soaps, detergents, and cosmetics | 6 | 33 | 5.5 |

[1] Select Committee on Small Business, House of Representatives, 87th Congress. Staff Report: Mergers and Superconcentration, Acquisitions of 500 Largest Industrial and 50 Largest Merchandising Firms (Washington, November 8, 1962), pp. 23-25.

Table 8 of the committee's study) focuses on certain merger patterns for these industries and the selected industries of direct concern to this dissertation (chemicals, cosmetics, and drugs).

Exhibit 11 shows that the third most active industry was industrial chemicals, which recorded some 204 acquisitions by 25 leading companies--or an average of 8.2 per firm. In this exhibit the SIC numbers in the first column represent the Standard Industrial Classification group numbers as developed by the Office of Statistical Standards of the Bureau of the Budget and published in 1957 in its "Standard Industrial Classification Manual." This study will be concerned mainly with companies classified under SIC group numbers 281, 283, and 284.[1] Appendix A lists the company breakdown for the three industries.

As shown in Appendix A, five major chemical companies each acquired 11 or more firms during the eleven-year period, 1950-61, and another 12 firms acquired from 6 to 10 companies each. Especially active leading drug companies would include Chas. Pfizer & Co., Rexall Drug & Chemical Co., Sterling Drug, Inc., and Warner-Lambert Pharmaceutical Co.--all with 6 or more acquisitions. The two leading cosmetics firms, Procter & Gamble Co. and Colgate-Palmolive Co., were also active participants in mergers and acquisitions.

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[1]Exact descriptions for these SIC group numbers are: No. 281--industrial inorganic and organic chemicals; plastic materials and synthetic resins; synthetic rubber and other man-made fibers, except glass. No. 283--drugs. No. 284--soaps, detergents, and cleaning preparations; perfumes, cosmetics, and other toilet preparations. In general, each company is classified on the basis of its major line of activity. In cases where a company has no single line of activity or product which is dominant, the classification must necessarily be somewhat subjective.

As business combinations are maintaining a record-setting pace, the merger movement of the 1950s and 1960s poses problems for the accounting profession. Selected companies in the chemical, cosmetic, and drug industries have a pronounced and interesting history of corporate growth through acquisitions and mergers. Chemical companies, in particular, have joined forces in order to exploit joint interests and garner "captive" sources of raw materials.[1] Typically, the recent merger movement has involved piecemeal acquisitions designed to strengthen a competitive position, to diversity into new markets, and to keep abreast of the rapidly developing technological changes initiated by World War II.[2] Furthermore, the larger and older firms in a wide spectrum of industries have not been idle, themselves making significant, selective, and huge mergers.[3]

Economic evidence suggests that the postwar merger movement cuts across traditional industry lines to reveal a striking trend toward superconcentration. This movement reflects the pervasive rise of the conglomerate corporation--an entity possessing advantages in magnified form over smaller rivals, particularly as to control over product markets, access to capital markets, and accessibility to new government research and development grants.[4] Economic evidence also indicates this

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[1]Select Committee on Small Business, op. cit., p. 43.

[2]Arthur R. Wyatt, A Critical Study of Accounting for Business Combinations, Accounting Research Study No. 5, American Institute of Certified Public Accountants, 1963, p. 2.

[3]Select Committee on Small Business, op. cit., p. 43.

[4]Ibid., p. 44.

accelerating merger movement has had a pronounced impact on corporate financial statements and accounting reporting practices.

## Trends in Accounting for Business Combinations

Although the concepts presented in Accounting Research Bulletin No. 48 were developed over a long period of time, the distinction between a purchase and a pooling of interests is a relatively recent development. It is useful to review briefly relevant pronouncements since 1944 of both the American Institute of Certified Public Accountants (formerly the American Institute of Accountants) and the Securities and Exchange Commission.

Accounting Research Bulletin No. 24, published in December 1944--recognized that it was acceptable practice to write-off goodwill against either paid-in capital or retained earnings, although it discouraged such charges to paid-in capital.

Accounting Series Release No. 50, issued in 1945 by the SEC--held that the write-off of purchased goodwill to paid-in capital was contrary to sound accounting principles, and that it was preferable to make periodic charges to income.

Accounting Research Bulletin No. 40, published in September 1950--gave the accounting profession a guide with respect to business combinations. As the first official pronouncement on the subject, four tests were provided (continuity of equity interests, relative size, continuity of management, and similar or complementary activities) to describe those combinations where a "pooling of interests" was normally involved, otherwise a "purchase" combination was presumed to exist.

Accounting Research Bulletin No. 43, Chapter 5, issued in 1953--held that purchased goodwill should not be written off to retained earnings immediately after acquisition, nor should such intangibles be written off against paid-in capital. Furthermore, it advocated that those intangible assets with a limited term of existence should be amortized by systematic charges in the income statement over the estimated remaining period of usefulness. Intangibles not amortized systematically should be carried at cost until an event has taken place which indicates a loss or a limitation on the useful life of the intangibles.

Accounting Research Bulletin No. 43, Chapter 7, Section C, issued in 1953--was a revision of Bulletin No. 40 and held that any adjustment of asset values or of retained earnings which was in conformity with generally accepted accounting principles in the absence of a combination would be equally so if effected through a pooling of interests.

Accounting Research Bulletin No. 48, issued in January 1957--superceded chapter 7(c) of Bulletin No. 43 and was the third attempt of the committee on accounting procedure to express clearly a concept of a "pooling-of-interests" business combination. Briefly, this revision reiterated the various criteria set forth in earlier bulletins and modified the relative-size criterion. Most importantly, it clearly emphasized that when a combination was deemed to be a pooling of interests, a new basis of accountability did not arise.

Opinion No. 6, Status of Accounting Research Bulletins, issued in October 1965--emphasized that the criteria set forth in Bulletin No. 48 are not necessarily literal requirements and that treasury stock may be used to effect a "pooling of interests."

Prior to 1954 the accounting treatment followed in acquisitions and mergers was uniform in certain respects whether consideration given was cash or stock. Because it was permissible, according to ARB No. 24, to write-off purchased goodwill against retained earnings (earned surplus), future income statements were relieved of any charges for the excess of purchase cost over value assigned to net tangible assets acquired. There was no need to use the pooling-of-interests approach for stock acquisitions or mergers, since the direct write-off of the excess to retained earnings resulted in carrying forward the acquired assets on about the same basis (book value) as if the combination had been recorded as a pooling. Exhibit 12 shows specific examples of this treatment for selected chemical and drug companies during the period 1951-53.

Apparently Accounting Series Release No. 50 was somewhat successful in discouraging the practice of writing off goodwill to capital

Exhibit 12

EXAMPLES OF PURCHASE TREATMENT--EXCESS OF COST OVER BOOK VALUE CHARGED TO RETAINED EARNINGS, 1951-53

| Name of Acquiring Company | Name of Acquired Company | Consideration | Year of Acquisition | Amount Written Off (in thousands) |
|---|---|---|---|---|
| Diamond Alkali Co. | Kolker Chemical Works, Inc. | common shares | 1951 | $1,144 |
| FMC Corp. | Ohio-Apex, Inc. | common shares | 1951 | 2,574 |
| Merck & Company, Inc. | Marine Magnesium Products | common shares | 1951 | 1,346 |
| Pennsalt Chemicals Corp. | Sharples Chemicals, Inc. | common shares | 1951 | 3,000 |
| Rexall Drug & Chem. Co. | V. C. A. Laboratories | cash | 1952 | 150 |
| Warner-Lambert Pharm. Co. | Maltine Company | common shares | 1952 | 3,023 |
| Chas. Pfizer & Co. | J. B. Roerig & Company | cash | 1953 | 5,070 |
| Richardson-Merrell, Inc. | Extruded Plastics, Inc. | treasury shares | 1953 | 471 |

Source: Various annual reports of the acquiring companies. Note that the name of the acquiring company is its current name rather than its former name.

surplus, but it failed to win companies over to the practice of writing down capitalized goodwill through timely charges to operations. In fact, Release No. 50 probably encouraged write-offs to retained earnings, not realizing that retained earnings is basically a "capital" item.

> This practice [write-offs to capital surplus] would permit a corporation to circumvent charges which should be made against income or earned surplus and, in our opinion, it is not consistent with the fundamental principle that a distinction should be maintained between capital and income.[1]

After 1953, however, direct write-offs of intangibles to either capital surplus or earned surplus became a rarity, mainly as a result of the ninth paragraph of Accounting Research Bulletin No. 43, Chapter 5.

> Lump-sum write-offs of intangibles should not be made to earned surplus immediately after acquisition, nor should intangibles be charged against capital surplus. If not amortized systematically, intangibles should be carried at cost until an event has taken place which indicates a loss or a limitation on the useful life of the intangibles.[2]

This explicit change of policy with respect to accounting for goodwill and other intangibles led to a change in combination accounting practices. Now for the first time the accounting concept of a pooling of interests was important. Pressures developed rapidly to employ the pooling technique whenever possible for business acquisitions and mergers to avoid the requirement of capitalizing goodwill and other intangibles. With regard to the prominent characteristics of the pooling type

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[1] As referred to in United States Securities and Exchange Commission, Accounting Series Releases, Release No. 50 (January 20, 1945), Washington, 1956, p. 123.

[2] American Institute of Certified Public Accountants, Accounting Research Bulletin No. 43, Chap. 5, par. 9, as included in Accounting Research and Terminology Bulletins, final ed. (New York: American Institute of Certified Public Accountants, 1961), p. 40.

of business combinations, George D. McCarthy, a partner in the public accounting firm of Price Waterhouse & Co., says:

> Generally, future operations of the combined enterprise will be benefited where the transaction is treated as a pooling of interests. This is so because a pooling transaction ignores the fair value of the capital stock issued, which in the vast majority of cases exceeds the book value of the net assets acquired.[1]

A striking example of this abrupt change in accounting for intangibles and its effect on financial information can be found in the notes to the consolidated financial statements for American Home Products Corporation.

> Intangible assets at December 31, 1965 include the cost, $48,140,444, of goodwill, trade-marks, formulae, etc., acquired since January 1, 1954, and $2,155,303 for patents and patent rights acquired since January 1, 1950, which are stated at cost less amortization. In accordance with generally accepted accounting practice at the time, goodwill, trade-marks, formulae, etc., acquired prior to January 1, 1954, aggregating approximately $40,000,000, were written down to $1 by charges against retained earnings and capital surplus; however, such amount should be recognized in any determination of total invested capital.[2]

From 1954 to 1964 American Home Products followed the "purchase without amortization" treatment in accounting for business acquisitions whether consideration exchanged was cash or stock. In 1965, however, American Home Products had its first pooling of interests when acquiring Ekco Products Company for 2,755,220 shares of a new $2 convertible preferred stock. The market value of the shares of preferred stock which American Home Products gave in the exchange approximated $165 million,

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[1] George D. McCarthy, Acquisitions and Mergers (New York: The Ronald Press Company, 1963), p. 127.

[2] American Home Products Corporation, 1965--40th Annual Report, "Notes to Consolidated Financial Statements," note 4, p. 24.

or $108 million greater than the book value of the net assets at which they were accounted for. The use of the pooling treatment in this combination kept $108 million of goodwill and other intangibles off the consolidated balance sheet. Assuming conversion of the preferred shares into common shares, the relative size criterion was 9.3 per cent. It is interesting to note the effect of alternative combination treatments on the 1965 rate of return on stockholders' equity for American Home Products.

| | |
|---|---|
| Intangibles as reported in 1965 | $ 50,295,748 |
| Write-offs before Jan. 1, 1954 | 40,000,000 |
| Intangibles from Ekco acquisition | 108,000,000 |
| Total intangibles | $198,295,748 |
| 1965 tangible net worth | 245,112,752 |
| Total invested capital | $443,408,500 |
| Reported net income for the year | $ 76,494,743 |

| Alternative combination treatment | 1965 rate of return on stockholders' equity |
|---|---|
| Purchase without amortization (all intangibles included) | $\frac{\$76,494,743}{\$443,408,500} = 17.3\%$ |
| "Mixture" actually used (only reported intangibles included) | $\frac{\$76,494,743}{\$295,408,500} = 25.9\%$ |
| Purchase with immediate write-off | $\frac{\$76,494,743}{\$245,112,752} = 31.2\%$ |

Capitalizing purchased intangibles since 1953 in accordance with generally accepted accounting principles has reduced the rate of return on net worth for American Home Products from 31.2 per cent to 25.9 per cent. But more importantly, if all intangibles prior to January 1, 1954, and the purchased goodwill in connection with the 1965 Ekco acquisition had been capitalized and not amortized, then the rate of

return on net worth would have declined to 17.3 per cent, perhaps a more realistic figure.[1] The rate of return on investment when pooling is used generally is inflated because the pooling treatment does not reflect the capitalization (nor subsequent amortization) of the excess of the purchase price over the book value of the acquired firm's net assets. Note that the current concern is only with the capitalization of assets problem. The allocation and amortization problems will be discussed later.

The American Home Products case illustrates the growing inconsistency that has developed with respect to accounting for goodwill and other intangible assets arising from business acquisitions and mergers. For cash acquisitions intangibles must be capitalized, but in the case of stock acquisitions, capitalization of intangibles can be avoided by using the pooling-of-interests technique, even if the established pooling criteria have to be stretched in the process. Consequently, the form of consideration used for a particular business combination determines the accounting treatment applicable to the exchange transaction. Is there any logical reason for treating a stock acquisition differently than a cash acquisition? Is the "excess of purchase cost over book value" different if a business is purchased for equities rather than cash and notes?

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[1] American Home Products does not amortize the cost of intangibles by systematic charges in the income statement over a period of years. But if the company had followed this alternative practice, the rate of return on stockholders' equity would decline below 17.3 per cent.

Like the American Home Products Corporation, many other business enterprises face this manifested inconsistency with respect to accounting for business combinations. A comparison of Exhibits 13 and 14 should give a clearer understanding of one of the important trends taking place since 1954 in business combination accounting.

Exhibit 13 shows the dollar amount of goodwill and other intangibles reported by six companies on their consolidated balance sheets for the twelve-year period 1954-65. All six companies have an active history of growth through business acquisitions and mergers. Except for Colgate-Palmolive Co., the companies did not amortize the excess of cost over value assigned to net tangible assets acquired. Over the period there has been some amortization taking place for patents, but the amounts involved are relatively insignificant in comparison to the other intangibles which are being carried at cost from year to year. Furthermore, in 1961, the directors of Colgate-Palmolive discontinued the practice of amortizing goodwill by annual charges to earnings.[1] Exact amortization charges to operations made by Colgate-Palmolive for eight years prior to 1961 are:

| | | | |
|---|---|---|---|
| 1953 | $375,000 | 1957 | none |
| 1954 | 375,000 | 1958 | none |
| 1955 | 375,000 | 1959 | $494,000 |
| 1956 | 375,000 | 1960 | 573,000 |

The implications of this exhibit are clear. Since 1954 these companies have been capitalizing purchased goodwill and other

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[1] Colgate-Palmolive Co., Annual Report 1961, "Notes to the Financial Statements," p. 20.

Exhibit 13

REPORTED INTANGIBLE ASSETS HISTORY FOR SIX COMPANIES, 1954-65

| Year | American Home Products | Richardson-Merrell | Colgate-Palmolive | Bristol-Myers | Chas. Pfizer | Procter&Gamble |
|---|---|---|---|---|---|---|
| | Goodwill, trademarks formulae, patents, etc. | Intangible assets | Goodwill, trademarks, etc. | Goodwill, trademarks, other intangibles | Goodwill, trademarks, patents | Goodwill, patents, licenses |
| 1954 | $ 1,713,115 | n | $ 750,000 | n | n | n |
| 1955 | 5,433,313 | $ 1,673,941 | 375,000 | $ 845,340 | n | n |
| 1956 | 5,945,568 | 4,785,604 | n | 845,340 | $ 1,037,506 | $ 2,519,993 |
| 1957 | 6,550,211 | 4,785,604 | n | 845,340 | 2,183,315 | 6,433,758 |
| 1958 | 6,990,078 | 4,785,604 | n | 2,788,936 | 2,424,116 | 24,910,736 |
| 1959 | 9,387,552 | 19,426,614 | 6,919,752 | 13,540,994 | 2,215,466 | 24,910,736 |
| 1960 | 12,889,956 | 28,618,139 | 7,534,304 | 15,083,380 | 2,094,473 | 24,910,736 |
| 1961 | 19,918,740 | 28,621,128 | 10,568,000 | 17,163,842 | 8,043,712 | 24,910,736 |
| 1962 | 24,770,183 | 28,628,555 | 10,204,000 | 19,841,955 | 8,843,740 | 25,620,023 |
| 1963 | 33,028,432 | 30,739,188 | 10,188,000 | 20,762,170 | 26,605,742 | 25,620,023 |
| 1964 | 38,228,397 | 41,157,220 | 10,188,000 | 20,781,710 | 39,018,681 | 25,620,023 |
| 1965 | 50,295,748 | 42,126,807 | 10,188,000 | 24,919,090 | 46,400,816 | 25,620,023 |
| No. of Poolings | 1965, 1 | none | 1960, 1 | 1965, 1 | 1961, 5<br>1962, 2<br>1963, 1<br>1964, 1 | 1964, 1 |

Source: Various annual reports of the six companies. An "n" means that goodwill and other intangible assets were reported at the nominal value of one dollar.

intangibles, thereby following the recommendations of Accounting Research Bulletin No. 43, Chapter 5. As a consequence, sizable amounts of goodwill and other intangible assets have been accumulating on successive balance sheets. Evidence suggests that by 1960-61 the amounts involved became exorbitant. The companies, however, were determined not to amortize the goodwill, trademarks, formulae, licenses, etc., against reserves as suggested in ARB No. 43, Chapter 5.

> When it becomes reasonably evident that the term of existence of a type (b) intangible has become limited and that it has therefore become a type (a) intangible, its cost should be amortized by systematic charges in the income statement over the estimated remaining period of usefulness.[1]

Unwilling to adopt plans of systematic amortization and hesitating to carry forward large amounts of goodwill on the balance sheet, these firms began to use the pooling technique whenever possible to avoid the capitalization of even more intangibles. As Leonard Spacek suggests,

> If the pooling concept had not been invented as a means of keeping large amounts of goodwill off the balance sheets in acquisitions or mergers of going concerns, the amounts that would have been recorded as goodwill would have been staggering (and misleading as reflecting the assets of the continuing corporations) particularly in transactions involving glamour stocks with very high-price earnings ratios.[2]

Exhibit 14 illustrates this point. The thirteen pooling-of-interests combinations during the 1960-65 period for five of the six

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[1] American Institute of Certified Public Accountants, op. cit., Par. 6, p. 38.

[2] Leonard Spacek, "The Treatment of Goodwill in the Corporate Balance Sheet," The Journal of Accountancy, CXVII (February 1964), 38.

Exhibit 14

# INTANGIBLE ASSETS FOR SIX COMPANIES, ALL POOLINGS CONVERTED TO PURCHASES WITHOUT AMORTIZATION, 1954-65

| Year | American Home Products<br>Goodwill, trademarks formulae, patents, etc. | Richardson-Merrell<br>Intangible assets | Colgate-Palmolive*<br>Goodwill, trademarks, etc. | Bristol-Myers<br>Goodwill, trademarks, other intangibles | Chas. Pfizer<br>Goodwill, trademarks, patents | Procter&Gamble<br>Goodwill, patents, licenses |
|---|---|---|---|---|---|---|
| 1954 | $ 1,713,115 | n** | $ 1,125,000 | n | n | n |
| 1955 | 5,433,313 | $ 1,673,941 | 1,125,000 | $ 845,340 | n | n |
| 1956 | 5,945,568 | 4,785,604 | 1,125,000 | 845,340 | $ 1,037,506 | $ 2,519,993 |
| 1957 | 6,550,211 | 4,785,604 | 1,125,000 | 845,340 | 2,183,315 | 6,433,758 |
| 1958 | 6,990,078 | 4,785,604 | 1,125,000 | 2,788,936 | 2,424,116 | 24,910,736 |
| 1959 | 9,387,552 | 19,426,614 | 8,538,752 | 13,540,994 | 2,215,466 | 24,910,736 |
| 1960 | 12,889,956 | 28,618,139 | 22,226,304 | 15,083,380 | 2,094,473 | 24,910,736 |
| 1961 | 19,918,740 | 28,621,128 | 25,260,000 | 17,163,842 | 53,143,712 | 24,910,736 |
| 1962 | 24,770,182 | 28,628,555 | 24,896,000 | 19,841,955 | 70,243,740 | 25,620,023 |
| 1963 | 33,028,432 | 30,739,188 | 24,880,000 | 20,762,170 | 90,705,742 | 25,620,023 |
| 1964 | 38,228,397 | 41,157,220 | 24,880,000 | 20,781,710 | 106,918,681 | 97,220,023 |
| 1965 | 158,295,748 | 42,126,807 | 24,880,000 | 153,619,090 | 114,300,816 | 97,220,023 |

Note: This table assumes that the excess of purchase price over book value is not allocated to any tangible assets.

*Assumes Colgate-Palmolive Co. discontinued amortizing goodwill January 1, 1954.

**An "n" means nominal value of one dollar.

companies have been converted to purchases based on market values of the stock consideration on dates of agreement to combine. Exhibit 15 gives the important details about the respective business combinations. For comparative purposes, Exhibit 14 assumes that Colgate-Palmolive stopped its practice of amortizing purchased goodwill on January 1, 1954, rather than on January 1, 1961, as actually done. A liberal interpretation of ARB No. 43, Chapter 5, would have allowed this since the amortization of type (b) intangibles was regarded as within the discretion of the company and not obligatory.[1]

A study of Exhibits 13, 14, and 15 shows that the pooling-of-interests concept was successful in keeping sizable amounts of goodwill and other intangibles off the corporate balance sheets. Possibly another consequence of pooling accounting in these cases was to prevent the upward adjustment of the inherent value of the tangible assets of the acquired companies. One company, Richardson-Merrell, Inc. (formerly Vick Chemical Company), never used the pooling method although it had several stock acquisitions in 1956 and 1958. The other five companies were definitely late in taking full advantage of the pooling concept. Jaenicke's case study of St. Regis Paper indicates that this company began using the pooling method in December 1956.[2] The Flintkote Company had its first pooling of interests in 1957.[3] Based on his search of

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[1]American Institute of Certified Public Accountants, op. cit., par. 7, p. 39.

[2]Henry R. Jaenicke, "Management's Choice to Purchase or Pool," The Accounting Review, XXXVII (October 1962), 759.

[3]Samuel R. Sapienza, "Business Combinations--A Case Study," The Accounting Review, XXXVIII (January 1963), 93.

Exhibit 15

## SELECTED INFORMATION ON THIRTEEN POOLINGS OF INTERESTS, 1960-65

| Year | Name of Acquiring Company | Name of Acquired Company | Relative Size Criterion | Excess of Purchase Cost over Book Value (in millions) | Ratio of Purchase Cost to Book Value |
|---|---|---|---|---|---|
| 1960 | Colgate-Palmolive Co. | Lakeside Laboratories, Inc. | 4.2% | $ 12.5 | 6.5 times |
| 1961 | Chas. Pfizer & Co. | Paul-Lewis Laboratories, Inc. | 0.4 | 1.9 | 4.3 |
| 1961 | Chas. Pfizer & Co. | Globe Laboratories, Inc. | 0.4 | 1.6 | 2.9 |
| 1961 | Chas. Pfizer & Co. | New England Lime Co. | 1.8 | 10.1 | 4.5 |
| 1961 | Chas. Pfizer & Co. | Thomas Leeming & Co. | 3.7 | 23.7 | 6.2 |
| 1961 | Chas. Pfizer & Co. | Pacquins, Inc. | 1.4 | 7.8 | 4.3 |
| 1962 | Chas. Pfizer & Co. | Knickerbocker Biologicals, Inc. | 0.5 | 2.7 | 4.3 |
| 1962 | Chas. Pfizer & Co. | C. K. Williams & Co., Inc. | 2.9 | 7.8 | 1.4 |
| 1963 | Chas. Pfizer & Co. | Desitin Chemical Co., Inc. | 1.0 | 8.5 | 8.2 |
| 1964 | Procter & Gamble Co. | J. A. Folger & Co. | 3.8 | 71.6 | 2.2 |
| 1964 | Chas. Pfizer & Co. | Gibsonburg Lime Products Co. | 0.7 | 3.8 | 2.3 |
| 1965 | Amer. Home Products | Ekco Products Co. | 9.3* | 108.0 | 2.9 |
| 1965 | Bristol-Myers Co. | Drackett Co. | 16.2 | 128.7 | 7.1 |

Source: Various annual reports and NYSE listing applications of acquiring companies.

*Size criterion for this pooling combination assumes preferred stock is converted into common stock at conversion rate. All of the other business combinations were effected solely by the issuance of common shares.

stock listing applications over the span from 1950 to 1960, Sapienza observed "a marked increase in the tempo of poolings after 1957."[1]

Chemical companies have especially been early users of the pooling-of-interests concept. One of the first examples of a pooling is the 1946 merger of Celanese Corporation of American and Tubize Rayon Corporation.[2] This merger transaction probably served as a guide to the committee on accounting procedure in drafting the first pronouncement on business combinations, Accounting Research Bulletin No. 40, issued in September 1950.[3] Below are listed some poolings of leading chemical concerns during the years 1955-57.

| Acquiring Company--Acquired Company | Effective Dates |
|---|---|
| Hooker Electrochemical Co.--Durez Plastics & Chemicals, Inc. | April 1955 |
| Olin-Mathieson Chemical Corp.--Blockson Chemical Co. | June 1955 |
| Monsanto Chemical Co.--Lion Oil Co. | Sept. 1955 |
| American Cyanamid Co.--The Formica Company | April 1956 |
| Stauffer Chemical Co.--West End Chemical Co. | Sept. 1956 |
| Hooker Electrochemical Co.--Oldbury Electro-Chemical Co. | Nov. 1956 |
| Union Carbide Corp.--The Visking Corporation | Dec. 1956 |
| Dow Chemical Co.--The Dobeckmun Company | August 1957 |

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[1] Ibid., 92.

[2] See William M. Black, "Certain Phases of Merger Accounting," The Journal of Accountancy, LXXXIII (March 1947), 214-20, which discusses the merger (pooling) of Celanese Corporation of America and Tubize Rayon Corporation.

[3] See Edward B. Wilcox, "Business Combinations: An Analysis of Mergers, Purchases, and Relating Accounting Procedures," The Journal of Accountancy, LXXXIX (February 1950), 102-107. He discusses the pooling of Celanese Corporation of America and Tubize Rayon Corporation. In sequence, this article was followed by Accounting Research Bulletin No. 40. Wilcox was a member of the Committee on Accounting Procedure which approved Bulletin No. 40.

For the most part, all of these eight poolings were larger transactions and involved the use of voting capital stock of the acquiring company. Typically, the purchase price varied from two to four times the book value of acquired assets. The point to be emphasized here, however, is that after publication of ARB No. 43, Chapter 5, with its untenable methods of handling acquisition goodwill, these leading chemical companies were quick to take full advantage of the "pooling-of-interests" concept to avoid capitalizing goodwill and other intangibles. A review of stock listing applications and annual reports over the span from 1954 to 1965 shows that many chemical companies utilized the pooling concept exceptionally early to prevent upward adjustments of asset values and to keep goodwill off the balance sheet.

One particular drug company to take early advantage of the pooling-of-interests technique was Warner-Lambert Pharmaceutical Company. After its formation in 1955 by the merger of the Lambert Company and Warner-Hudnut, Inc. (which was treated for accounting purposes as a pooling of interests), Warner-Lambert used the pooling concept twice during 1956 under somewhat disputable circumstances.

| Name of acquired company | Consideration | Size criterion (based on common shares) |
|---|---|---|
| Emerson Drug Company of Baltimore City | cash and common shares | 11.1% |
| Nepera Chemical Co., Inc. | preferred and common shares | 7.2% |

Cash represented about 22 per cent of the total purchase price in the Emerson Drug acquisition. Based on fair values of the stock consideration, the $4.50 cumulative (nonconvertible) preferred stock used

in the Nepera acquisition was 47 per cent of the purchase price. During 1959 and 1960, Warner-Lambert purchased and retired all of the shares of preferred stock from the holders for $7,070,200 cash. Using the pooling treatment for these two acquisitions was dubious because an important part of the ownership of the acquired corporations was eliminated either before or after the combination. Nevertheless, pooling treatments were allowed and Warner-Lambert was able to remove from its consolidated balance sheet about $12.6 million of "excess of purchase cost over book value."

If Warner-Lambert had consistently used the purchase-without-amortization method in accounting for business acquisitions since 1955, the amount reported on its 1965 Statement of Financial Position as "goodwill and unamortized cost of patents--resulting from corporate acquisitions" would have been about $162 million, rather than only about $9.3 million as actually reported. In discussing goodwill that results from acquiring going businesses in which the purchase price exceeds the carrying values of the net tangible assets acquired, Warner-Lambert's 1964 Annual Report mentions that "the goodwill so acquired is not amortized since the companies are expected to retain or increase their value."[1]

The statistics given in Exhibit 16 would seem to bear out the general hypothesis that accounting for business combinations has changed in recent years. The exhibit is based on a careful review of 124 business acquisitions and mergers made by the companies possibly to be

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[1] Warner-Lambert Pharmaceutical Company, 1964 Annual Report, "Financial Review," p. 21.

Exhibit 16

BREAKDOWN OF 124 ACQUISITIONS AND MERGERS, 1956-65

| Year | Number of Acquisitions and Mergers | Purchases | | Poolings of Interests | |
|---|---|---|---|---|---|
| | | Number | Per Cent | Number | Per Cent |
| 1956 | 15 | 9 | 60.0 | 6 | 40.0 |
| 1957 | 8 | 7 | 87.5 | 1 | 12.5 |
| 1958 | 5 | 4 | 80.0 | 1 | 20.0 |
| 1959 | 12 | 9* | 75.0 | 3 | 25.0 |
| 1960 | 7 | 4 | 57.1 | 3 | 42.9 |
| 1956-1960 | 47 | 32 | 70.2 | 15 | 29.8 |
| 1961 | 17 | 7 | 41.2 | 10 | 58.8 |
| 1962 | 11 | 4 | 36.4 | 7 | 63.6 |
| 1963 | 12 | 3 | 25.0 | 9 | 75.0 |
| 1964 | 19 | 4 | 21.1 | 15 | 78.9 |
| 1965 | 18 | 2 | 11.1 | 16 | 88.9 |
| 1961-1965 | 77 | 20 | 26.0 | 57 | 74.0 |
| 1956-1965 | 124 | 53 | 42.7 | 71 | 57.3 |

*This exhibit includes W. R. Grace's retroactive pooling as a Purchase treatment in 1959.

selected for this dissertation study (see Appendix B) where stock was used as important consideration for the transaction. The information is compiled from over 100 New York Stock Exchange listing applications filed by the respective chemical, cosmetic, or drug companies during the ten-year period 1956-65. A considerable amount of timely information about business acquisitions and mergers can be obtained from these listing applications.

As Exhibit 16 shows, the selected companies used the purchase doctrine more frequently than the pooling-of-interests concept from 1956 to 1959. But after 1959 these same companies began increasingly to use the pooling technique, until recently substantially all combinations effected solely by the issuance of equity shares (either preferred or common) are considered as poolings of interests. Based on its wide acceptance after 1960, it seems safe to say that the pooling-of-interests accounting treatment has come of age, regardless of the relative size of the constituent companies or the presence of other so-called relevant factors. As extracted from Exhibit 16, the number of poolings whose relative size criterion is below 5 per cent is as follows:

| | | | |
|---|---|---|---|
| 1956 | 1 | 1961 | 7 |
| 1957 | 1 | 1962 | 3 |
| 1958 | 0 | 1963 | 8 |
| 1959 | 1 | 1964 | 10 |
| 1960 | 3 | 1965 | 13 |

This listing, including W. R. Grace's retroactive pooling as a pooling-of-interests treatment in the year of the change, stresses the rapid demise of the relative size criterion that took place after 1959. Perhaps it shows how arbitrary and invalid the 5-10 per cent rule is as a

specific standard for presuming that a purchase, rather than a pooling, exists.

While the discussion centers on trends in combination accounting practices for a sample of chemical, cosmetic, and drug companies, it should be emphasized that most of the conclusions set forth in this study are likely to apply to companies in an array of industries, such as paper, electronics, food, electrical equipment, machinery, textiles, and apparel. An examination of many listing applications, prospectuses, and annual reports over the period 1956 to 1966 suggests that the problem of accounting for business combinations is generic to all companies with an active history of growth through acquisitions and mergers. Examples of practices of disregarding the necessary criteria that set off pooling from purchasing are easily found.[1] As Wyatt writes,

> Our review of the combinations consummated during the 1958-60 period, along with a consideration of the combinations of the earlier periods, leads to the conclusion that the nature of a business combination was lacking in clarity by the end of 1960, both as to the concept itself and as to the practical classification of the various combinations.[2]

## Trends As Published by the AICPA

Each year the American Institute of Certified Public Accountants (hereafter referred to as AICPA) publishes a survey of the accounting aspects of the annual reports of 600 industrial and commercial

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[1] See Samuel R. Sapienza, "Pooling Theory and Practice in Business Combinations," The Accounting Review, XXXVII (April 1962), 268-78. Also see Chapter 16 by the same author in Modern Accounting Theory, Morton Backer, ed. (Englewood Cliffs, N. J.: Prentice-Hall, Inc., 1966), pp. 339-65.

[2] Wyatt, op. cit., pp. 37-38.

corporations under the title Accounting Trends and Techniques. Since 1960 one of the subjects analyzed is the accounting for business combinations. Exhibits 17 through 20 summarize the nature of such information as disclosed in recent report years.

Note from Exhibit 17 that over the four-year period from 1960 to 1963 approximately 55 per cent of the business combinations reported were purchases and 45 per cent were poolings of interests. It is difficult to estimate the extent that cash and stock were used as consideration for these combinations, but generally the vast majority of those involving substantial consideration were effected by exchanges of equities and therefore treated as poolings of interests. In recent years, however, cash deals are gaining popularity, thereby explaining why an increasing percentage of business combinations have received purchase

Exhibit 17

BUSINESS COMBINATIONS REPORTED, 1960-65

| | Purchases | | Poolings of Interests | |
|---|---|---|---|---|
| Year | Number | Per Cent | Number | Per Cent |
| 1965 | -- | -- | 84 | -- |
| 1964 | -- | -- | 67 | -- |
| 1963 | 97 | 68.3 | 45 | 31.7 |
| 1962 | 36 | 53.7 | 31 | 46.3 |
| 1961 | 48 | 48.0 | 52 | 52.0 |
| 1960 | 66 | 49.6 | 67 | 50.4 |
| 1960-63 4-year average | | 54.9 | | 45.1 |

Source: Accounting Trends and Techniques, AICPA, from sections on Business Combinations, 15th-20th eds., 1961-66, an annual cumulative survey of the accounting aspects of the annual reports of 600 industrial and commercial corporations. Statistics were not disclosed before 1960 report year. Number of purchases was not disclosed in the 1964 and 1965 report years.

treatment--68 per cent in the 1963 fiscal year. According to a survey and analysis by W. T. Grimm & Co., 67 per cent of the total acquisitions and mergers in 1965 were for cash. Grimm released the following details on cash and stock acquisitions for the years 1964 and 1965.[1]

| | Cash Deals | | Stock Deals | | Cash-stock Deals | |
|---|---|---|---|---|---|---|
| Year | Total | Per Cent | Total | Per Cent | Total | Per Cent |
| 1964 | 1,248 | 64 | 624 | 32 | 78 | 4 |
| 1965 | 1,424 | 67 | 616 | 29 | 85 | 4 |

One possible explanation for the increase in cash deals is that the growing impact of the depreciation recapture statutes of the Internal Revenue Code seems to have triggered an increase in transactions involving the sale of assets for cash rather than stock.[2] Another possible reason for more cash deals is that there has been an increase in the number of foreign acquisitions. It is likely that foreigners would prefer the use of cash and debt instruments rather than ownership equities in selling corporate interests for several reasons--marketability, effect on country's balance of payments, income tax factors, and such.

From Exhibits 18, 19, and 20 the following trends in pooling accounting can be observed.

1. Since 1962 the number of companies reporting poolings of interests has increased. Furthermore, companies reporting poolings are

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[1] W. T. Grimm & Co., "Merger Review--1964 and 1965," studies on corporate merger activity released by the Grimm organization, a financial consulting firm specializing in corporate acquisitions, Chicago, Illinois, 1964 and 1965.

[2] Ibid., explained by Willard T. Grimm, president of the firm, 1965.

Exhibit 18

BREAKDOWN OF COMPANIES REPORTING POOLINGS OF INTERESTS

| Year | Total Number | Companies Presenting Financial Statements in Comparative Form | | Companies Presenting Financial Statements on Single-year Basis Only | |
|---|---|---|---|---|---|
| | | Number | Per Cent | Number | Per Cent |
| 1965 | 84 | 84 | 100.0 | 0 | 0.0 |
| 1964 | 67 | 62 | 92.5 | 5 | 7.5 |
| 1963 | 45 | 39 | 86.7 | 6 | 13.3 |
| 1962 | 31 | 26 | 83.9 | 5 | 16.1 |

Source: Accounting Trends and Techniques, AICPA, from sections on Business Combinations, 17th-20th eds., 1963-66. Statistics were not disclosed for 1961 and earlier years.

Exhibit 19

BREAKDOWN OF COMPANIES REPORTING POOLINGS OF INTERESTS AND PRESENTING FINANCIAL STATEMENTS IN COMPARATIVE FORM

| Year | Total Number | Companies Restating Previous Years' Figures* | | Companies NOT Restating Previous Years' Figures* | |
|---|---|---|---|---|---|
| | | Number | Per Cent | Number | Per Cent |
| 1965 | 84 | 41 | 48.8 | 43 | 51.2 |
| 1964 | 62 | 33 | 53.2 | 29 | 46.8 |
| 1963 | 39 | 29 | 74.4 | 10 | 25.6 |
| 1962 | 26 | 18 | 69.2 | 8 | 30.8 |

Source: Accounting Trends and Techniques, AICPA, from sections on Business Combinations, 17th-20th eds., 1963-66.

*To give retroactive effect to the pooling.

Exhibit 20

BREAKDOWN OF COMPANIES WITH POOLINGS OF INTERESTS AND PRESENTING TEN-YEAR INCOME SUMMARIES

| Year | Total Number | Summaries Restated for All Prior Years | | Summaries Restated for only 2 Years* | | Summaries NOT Restated | |
|---|---|---|---|---|---|---|---|
| | | Number | Per Cent | Number | Per Cent | Number | Per Cent |
| 1964 | 57 | 6 | 10.5 | 21 | 36.8 | 30 | 52.6 |
| 1963 | 34 | 6 | 17.6 | 17 | 50.0 | 11 | 32.4 |
| 1962 | 28 | 9 | 32.1 | 19 | 67.9 | -- | -- |

Source: Accounting Trends and Techniques, AICPA, from sections on Business Combinations, 17th-19th eds., 1963-65. This breakdown information was not disclosed in the 1965 report year.

*Or since the year the pooling became effective.

increasingly presenting their financial statements in comparative form rather than on a single-year basis.

2. Although increasingly presenting financial statements in comparative form, the percentage of companies reporting a pooling and a restatement of the previous years' figures (to give retroactive effect to the pooling) is decreasing. More companies are not recasting the prior year amounts in annual reports reflecting pooled combinations, even though this practice violates basic recommendations of ARB No. 48, ARB No. 49, and Auditing Standards and Procedures, Chapter 8. The relevant sections of the pronouncements on this point are quoted:

> Accounting Research Bulletin No. 48--Results of operations of the several constituents during periods prior to that in which the combination was effected, when presented for comparative purposes, may be stated on a combined basis, or shown separately where, under the circumstances of the case, that presentation is more useful and informative.[1]
>
> Accounting Research Bulletin No. 49--Where there has been a pooling of interests during the period of years for which data are given, in connection with which the number of shares outstanding or the capital structure in other respects has been changed, the method used in computing earnings per share for those years prior to the pooling of interests should be based on the new capital structure.[2]
>
> Auditing Standards and Procedures, Chapter 8--When companies have been merged or combined in accordance with the accounting concept known as a "pooling of interests," appropriate effect of the pooling should be given in the presentation of results of operations and earnings per share of years prior to the year of pooling as described in Accounting Research Bulletins No. 48 and 49. Comparative financial statements which do not give appropriate recognition to the pooling are not presented on a consistent basis.[3]

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[1]American Institute of Certified Public Accountants, op. cit., ARB No. 48, par. 12, p. 26.

[2]Ibid., ARB No. 49, par. 12, p. 34.

[3]American Institute of Certified Public Accountants, Auditing Standards and Procedures, Chap. 8, Statements on Auditing Procedure

The fact that a company does not restate prior years' statements to give retroactive effect to a pooling combination is convincing evidence that the business combination involved was not a "commingling of interests." This further suggests that it never merited pooling treatment in the first place.

3. Companies reporting poolings are increasingly presenting ten-year income statement summaries, but the practice of recasting such income statement summaries to give effect to pooling combinations is decreasing. Since 1964 the majority (52.6 per cent) of companies with poolings of interests do not restate financial data in presenting ten-year income summaries. Even the percentage of companies with poolings restating summaries for only two years of the ten-year period is rapidly decreasing, from about 68 per cent in 1962 to 37 per cent in 1964.

In studying the annual reports to stockholders of 600 industrial and commercial companies, the American Institute of Certified Public Accountants also has analyzed the subject of intangible assets. Considerable information concerning intangible assets is summarized in Exhibits 21 through 24. From these exhibits, the following trends in accounting for intangibles can be observed.

1. Since 1952 there has been a slight increase in the number of companies not showing intangible assets of any type on the balance sheet, but still the majority of the 600 survey companies are presenting intangibles on the balance sheet--57.7 per cent in the 1965 fiscal year.

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No. 33 (New York: Committee on Auditing Procedure of the American Institute of Certified Public Accountants, 1963), par. 35, p. 52.

Exhibit 21

PRESENTATION OF INTANGIBLE ASSETS OF 600 SURVEY COMPANIES, 1952-65

| Year | Companies Presenting Intangible Assets | | Companies Not Presenting Intangible Assets | |
|---|---|---|---|---|
| | Number | Per Cent | Number | Per Cent |
| 1965 | 346 | 57.7 | 254 | 42.3 |
| 1964 | 333 | 55.5 | 267 | 44.5 |
| 1963 | 339 | 56.5 | 261 | 43.5 |
| 1962 | 342 | 57.0 | 258 | 43.0 |
| 1961 | 343 | 57.2 | 257 | 42.8 |
| 1960 | 345 | 57.5 | 255 | 42.5 |
| 1959 | 342 | 57.0 | 258 | 43.0 |
| 1958 | 335 | 55.8 | 265 | 44.2 |
| 1957 | 348 | 58.0 | 252 | 42.0 |
| 1956 | 358 | 59.7 | 242 | 40.3 |
| 1955 | 376 | 62.7 | 224 | 37.3 |
| 1954 | 375 | 62.5 | 225 | 37.5 |
| 1953 | 375 | 62.5 | 225 | 37.5 |
| 1952 | 383 | 63.8 | 217 | 36.2 |

Source: Accounting Trends and Techniques, AICPA, from sections on Intangible Assets, 7th-20th eds., 1953 through 1966.

Exhibit 22

## TYPES OF INTANGIBLE ASSETS

| Type* | 1956 | 1957 | 1958 | 1959 | 1960 | 1961 | 1962 | 1963 | 1964 | 1965 | Per Cent Increase (Decrease) 1956-65 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Patents, patent rights and applications | 178 | 169 | 165 | 164 | 156 | 148 | 146 | 142 | 138 | 134 | (24.7) |
| Goodwill | 152 | 140 | 140 | 134 | 132 | 126 | 121 | 114 | 107 | 103 | (32.2) |
| Goodwill re: subsidiary | 20 | 24 | 34 | 44 | 51 | 57 | 65 | 61 | 75 | 94 | 370.0 |
| Trademarks, brand names | 111 | 106 | 99 | 99 | 92 | 85 | 82 | 75 | 73 | 68 | (38.7) |
| "Intangible assets" | 18 | 19 | 22 | 26 | 27 | 25 | 28 | 32 | 36 | 34 | 88.9 |
| Licenses, franchises, memberships | 27 | 27 | 27 | 21 | 20 | 20 | 21 | 21 | 20 | 24 | (11.1) |
| Formulae, processes, designs | 23 | 22 | 21 | 19 | 18 | 20 | 22 | 20 | 18 | 17 | (26.1) |
| Research and experimental | 7 | 13 | 8 | 12 | 9 | 10 | 7 | 6 | 6 | 6 | (14.3) |

Source: Accounting Trends and Techniques, AICPA, from sections on Intangible Assets, 11th-20th eds., 1957-66.

*This list reflects the most common types of intangible assets but omits certain types of intangible assets such as leasehold improvements, leases and leaseholds, water rights, and mining and timber rights, which generally were shown on the balance sheet under properties or "fixed assets."

Exhibit 23

INTANGIBLE ASSETS--BALANCE SHEET PRESENTATION, 1964-65

| | Noncurrent Asset Section | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Separately Set Forth | | Under Other Assets | | Under Deferred Charges | | Under Fixed Assets | | Notes to Financial Statements | | Total | |
| Type of Intangible Assets | 1964 | 1965 | 1964 | 1965 | 1964 | 1965 | 1964 | 1965 | 1964 | 1965 | 1964 | 1965 |
| Patents, patent rights, and applications | 101 | 89 | 28 | 33 | 6 | 8 | 2 | 2 | 1 | 2 | 138 | 134 |
| Goodwill | 87 | 82 | 20 | 21 | -- | -- | -- | -- | -- | -- | 107 | 103 |
| Goodwill re: subsidiary | 44 | 50 | 22 | 32 | 4 | 5 | 1 | 2 | 4 | 5 | 75 | 94 |
| Trademarks, brand names | 51 | 46 | 21 | 18 | -- | 3 | -- | -- | 1 | 1 | 73 | 68 |
| "Intangible assets" | 24 | 22 | 8 | 8 | -- | -- | 4 | 4 | -- | -- | 36 | 34 |
| Licenses, franchises, memberships | 11 | 12 | 2 | 5 | 2 | 2 | 5 | 5 | -- | -- | 20 | 24 |
| Formulae, processes, designs | 12 | 10 | 6 | 7 | -- | -- | -- | -- | -- | -- | 18 | 17 |
| Research and experimental | 4 | 4 | 2 | 2 | -- | -- | -- | -- | -- | -- | 6 | 6 |
| Total | 334 | 315 | 109 | 126 | 12 | 18 | 12 | 13 | 6 | 8 | 473 | 480 |
| Per cent of total | 70.6 | 65.6 | 23.1 | 26.4 | 2.5 | 3.7 | 2.5 | 2.7 | 1.3 | 1.6 | 100.0 | 100.0 |

Source: Accounting Trends and Techniques, AICPA, from Table 23, 19th-20th eds., 1965-66, pp. 93, 99.

Exhibit 24

## ACCOUNTING FOR GOODWILL: BALANCE SHEET VALUATION AND AMORTIZATION*

| Year | Amortized Value after Charges to: Income | Retained Earnings | Charge Not Shown | Total | Unamortized Value | Nominal Value | Not Determinable | Year Total |
|---|---|---|---|---|---|---|---|---|
| 1965 | 26 | -- | 24 | 50 | 64 | 46 | 37 | 197 |
| 1964 | 26 | -- | 18 | 44 | 51 | 55 | 32 | 182 |
| 1963 | 42 | -- | 9 | 51 | 46 | 57 | 21 | 175 |
| 1962 | 48 | -- | 11 | 59 | 46 | 64 | 17 | 186 |
| 1961 | 45 | -- | 15 | 60 | 52 | 71 | -- | 183 |
| 1960 | 41 | -- | 14 | 55 | 46 | 82 | -- | 183 |
| 1959 | 26 | -- | 25 | 51 | 43 | 84 | -- | 178 |
| 1958 | 25 | 1 | 22 | 48 | 35 | 91 | -- | 174 |
| 1957 | 19 | 1 | 19 | 39 | 30 | 95 | -- | 164 |
| 1956 | 20 | 2 | 16 | 38 | 27 | 107 | -- | 172 |
| 1955 | 4 | 4 | 16 | 24 | 26 | 111 | -- | 161 |

Source: Accounting Trends and Techniques, AICPA, from sections on Intangible Assets, 10th-20th eds., 1956-66.

*Includes Goodwill and Goodwill re: subsidiary.

2. By far the most common types of intangible assets shown on the balance sheet are patents, goodwill, goodwill re: subsidiary, trademarks, and brand names. From 1956 to 1965, however, only two types of intangibles are increasingly being reported: (1) goodwill re: subsidiary, and (2) a type described as "intangible assets," apparently a sort of catchall account.

3. Most intangible assets are separately set forth on the balance sheet (65.6 per cent in 1965), but a significant per cent of intangibles are presented under other assets (26.4 per cent in 1965).

4. In accounting for goodwill, the practice of carrying it at a nominal value ($1) is decreasing. After 1962 there appears to be less amortization of goodwill as a charge to income. The practice of carrying goodwill at cost (unamortized value) from year to year is increasing.

5. Since 1962 the American Institute's annual survey has reported as "not determinable" certain valuation and amortization practices in accounting for goodwill. There are good reasons for suggesting that these "not determinable" goodwill items are probably being carried at cost from year to year, since amortization against revenues or write-off to retained earnings is generally disclosed and therefore determinable. Should this be the case, the practice of carrying goodwill as an unamortized asset may be increasing more than outwardly suggested by the information in Exhibit 24.

## Recent Observations on Acquisitions and Mergers

While there is little empirical evidence on this point, an examination of many listing applications, prospectuses, and annual reports

over the period 1956 to 1966 suggests a marked increase in the practice of carrying goodwill and other related intangibles as an unamortized asset on the balance sheet. Furthermore, this practice appears acceptable for goodwill arising from cash or stock acquisitions. When Chas. Pfizer & Co. acquired the assets and business of Coty International Corporation by cash payments of $6,262,775 and issuance of 38,378 shares of common stock, the company explained how it planned to handle acquisition goodwill.

> The policy to be followed with respect to any good will resulting on the books of the Company from the transaction will not be to amortize the value thereof systematically but to carry the same at its initial value unless there is a diminution therein.[1]

Another example is Sunbeam Corporation's purchase of Northern Electric Company for $15,000,000 cash and 100,000 shares of common stock.

> Since management of Sunbeam presently foresees no termination in the life of the intangible assets, the portion (excess of investment over net assets of Northern) applicable to intangibles will not at the present time be amortized. Price Waterhouse & Co., independent public accountants for Sunbeam, have reviewed and approved the accounting treatment outlined above as being in accordance with generally accepted accounting principles.[2]

Perhaps the best example of the cash-stock inconsistency referred to earlier and the practice of not amortizing goodwill arising from cash deals can be found in an enterprise such as Pet Milk Company. This company had twelve business combinations during the fiscal year ended March 31, 1965--five poolings and seven purchases.

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[1] Chas. Pfizer & Co., NYSE Listing Application No. A-21422, December 27, 1963, p. 2.

[2] Sunbeam Corporation, NYSE Listing Application No. A-22211, January 11, 1965, p. 2.

> During the year the Company acquired in exchange for 280,021 shares of its common stock, the net assets and business of D. E. Winebrenner, Inc., Stuckey's, Inc., Stuckey's Stores, Inc., Frosted Fruit Products, and Angelus Frozen Foods. These transactions have been accounted for as poolings of interests and, accordingly, the financial statements include the operations of these companies for the entire year. . . . In addition, the Company acquired for 32,707 shares of common stock and $8,500,000 the net assets and business of the following companies: Congeladora y Empacadora Nacional, S.A. (CENSA), of Mexico; Ernest G. Robinson, Ltd., of Canada; the Puerto Rican assets of and operations of Milk Products S.A. and C. A. Toddy Venezolana; Milady Food Products, Inc.; Reese Finer Foods, Inc.; and George H. Dentler & Sons. These acquisitions were accounted for as purchases and, accordingly, the operations of these companies are included in the accompanying financial statements from their respective dates of acquisition. The excess of purchase price of all businesses acquired to date over net assets at dates of acquisition amounted to $10,609,000 at March 31, 1965, and is of such a nature that amortization is not considered necessary.[1]

Since 1960 the following observations are relevant in discussing important trends in combination accounting practices:

1. There seems to be an increasing trend in the number of partial acquisitions. The Grimm organization reports that 15 per cent of the mergers and acquisitions in 1965 represented partial acquisitions or the purchase of a company division.[2] Examples are:

a. September 1962, Monsanto Co. acquired the remaining 50 per cent interest of Plax Corp. from Owens Illinois Glass Co. for stock.

b. November 1963, Kimberly-Clark Corporation acquired 67 per cent interest in Hygienic Products, Inc.

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[1] Pet Milk Company, Annual Report 1965, "Financial Review," p. 16.

[2] W. T. Grimm & Co., op. cit., Merger Review--1965. An exact count of partial acquisitions is practically impossible to compile, but according to Federal Trade Commission data the number of partial acquisitions has probably more than doubled from 1960 to 1965. See "Merger Tide is Swelling," op. cit., p. 27.

c. June 1964, Abbott Laboratories purchased for cash the poultry vaccine division of L & M Laboratories, Inc.

d. May 1965, Celanese Corp. acquired 71 per cent of the assets of SIACE Societa Industriale Agricola per la Produzione di Cellulosa, S.p.A. (Sicily) for cash and subsidiary stock.

e. In 1965, Hooker Chemical Co. acquired the Rubber Corporation of America from a Swiss holding company for cash and treasury shares.

f. May 1965, W. R. Grace & Co. acquired the remaining 17.2 per cent interest of Carolina Nitrogen Corporation for common shares. (PT)[1]

g. September 1965, Food Fair Stores, Inc., acquired the remaining 24 per cent interest of Fox Markets, Inc., for shares of common stock.

h. October 1965, U. S. Rubber Co. acquired the remaining 13 per cent interest of North British Rubber Company Ltd., for common shares.

i. November 1965, Hewlett-Packard Co. acquired the remaining minority interest of hp associates for common shares. (PT)

j. January 1966, W. R. Grace & Co. acquired the remaining 40 per cent interest of Dearborn-Aqua-Serv, Inc., for common shares. (PT)

A careful study of these examples will indicate that the pooling treatment is considered acceptable for some partial acquisitions, i.e., where the buying enterprise acquires the remaining minority interest of

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[1]Note that a PT after any one of the examples means the transaction received a pooling of interests treatment.

the selling company for equity shares. Such practices are closely related to the partial-pooling situation described in Chapter II which involves a diversity of conditions under which pooling accounting has been applied. Like the partial poolings, these practices have no logical basis for support if the minority interest transaction is viewed as a bona fide exchange of assets and/or equities between independent parties.

2. There seems to be an increasing trend in the number of foreign acquisitions. The Grimm Company reported that about 9 per cent of 1965 mergers involved the purchase of foreign corporations.[1] Examples for 1964-65 are:

a. Chas. Pfizer & Co. acquired Bridge Colour Company, England, for cash.

b. Warner-Lambert Pharmaceutical Company acquired Laboratories S.A.M., Belgium, for cash.

c. Procter & Gamble Co. acquired Rei-Werke A. G., West Germany, for cash.

d. W. R. Grace & Co. acquired Rexolin Chemicals Aktiebolag, Sweden, for cash and stock. (PT)

e. Chas. Pfizer & Co. acquired Propas Company, Canada, for cash.

f. Celanese Corp. acquired British Paints, Ltd., England, for cash.

g. W. R. Grace & Co. acquired the Con-Spec Companies, Canada, for cash and stock. (PT)

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[1] W. T. Grimm & Co., op. cit., Merger Review--1965.

h. Pet Milk Company acquired C. V. Gebroeders Pel of Leiden, Holland, for cash.

i. Richardson-Merrell, Inc., acquired Laboratories Picot S.A., Mexico, for cash.

j. Control Data Corporation acquired Waltek Ltd., Hong Kong, for stock. (PT)

These examples affirm the fact that the pooling-of-interests treatment is now acceptable for foreign acquisitions where the consideration for the exchange is substantially in the form of equity shares. Even a small portion of cash in the exchange transaction (perhaps up to 25 per cent) will not void the pooling treatment.

3. There seems to be an increase in the use of treasury stock for business combinations. Furthermore, since about 1962, it has been observed that the accounting profession has permitted the pooling treatment for business combinations effected through the use of treasury stock shares, although the net effect of the completed transaction is to acquire the company for cash. Examples of recent "treasury stock poolings" are:

a. Gillette Co.--Sterilon Corp., 1962
b. Johnson & Johnson--Stim-U-Dent, Inc., 1963
c. Rohm & Haas Co.--Warren-Teed Products Co., 1963
d. Miles Laboratories, Inc.--Lab-Tek Plastics Co., 1964
e. Rohm & Haas Co.--Whitmoyer Laboratories, Inc., 1964
f. Union Carbide Corp.--Neisler Laboratories, Inc., 1965
g. American Cyanamid Co.--Preem Company, 1965
h. Johnson & Johnson--Eastern Magnesia Talc Co., 1965
i. Warner-Lambert Pharm. Co.--Texas Pharmacal Co., 1966
j. Warner-Lambert Pharm. Co.--General Candy Corp., 1966.

The use of treasury stock rather than unissued stock in effecting business combinations is no longer a rarity and its use in whole or in part does not prevent the pooling-of-interests accounting treatment. In his December 1962 article in The Journal of Accountancy, Jaenicke commented on the use of treasury stock as consideration for business acquisitions and speculated that:

> . . . the profession, desirous of permitting the pooling treatment as often as possible, may attempt to justify the pooling treatment on the basis of the issuance of common shares regardless of their source.[1]

He could not have been more correct in his speculation. At present accountants, and the SEC staff, do not question the use of common treasury shares for pooling purposes. Practice now justifies treasury stock poolings, R. C. Lauver explains, "on the theory that this technique has the same net effect as separate transactions to accomplish, first, the acquisition and retirement of treasury stock and, second, the issuance of previously unissued shares to effect the business combination."[2] A treasury stock pooling, in effect, gives the management of the buying company an opportunity to acquire a business for cash and yet cleverly avoid the requirement of accounting for the excess of cost over book value which arises in the usual direct cash acquisition. The excess is written off to retained earnings at the time when the treasury shares are retired. This shall be illustrated by examining the treasury

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[1] Henry R. Jaenicke, "Ownership Continuity and ARB No. 48," The Journal of Accountancy, CXIV (December 1962), 59.

[2] R. C. Lauver, "The Case for Poolings," The Accounting Review, XLI (January 1966), 74.

stock pooling of Warner-Lambert Pharmaceutical Company and Texas Pharmacal Company early in 1966.[1]

| | |
|---|---|
| Consideration for acquisition . . . . | 360,000 treasury shares |
| Market value at date of agreement . . . . . | $14,000,000 |
| Cost basis of treasury shares . . . . . | 10,800,000 |
| Book value of acquired company . . . . . | 2,240,000 |

Entries under pooling concept:

| | | |
|---|---|---|
| Cost of common treasury stock . . . . . | $10,800,000 | |
| Cash . . . . . | | $10,800,000 |
| (purchase of 360,000 treasury shares at $30 per share) | | |
| Common stock--par value $1 . . . . . | $ 360,000 | |
| Retained earnings . . . . . | 10,440,000 | |
| Cost of common treasury stock . . . . . | | $10,800,000 |
| (retirement of 360,000 shares of treasury stock) | | |
| Net assets of acquired company . . . . | $2,240,000 | |
| Common stock--par value $1 . . . . . | | $ 360,000 |
| Paid-in capital in excess of par value . . . . | | 1,140,000 |
| Retained earnings carried forward . . . . . | | 740,000 |
| (acquisition of the net assets of Texas Pharmacal Company for 360,000 shares of treasury stock) | | |

A combined entry for the entire transaction would be:

| | | |
|---|---|---|
| Net assets of acquired company . . . . | $2,240,000 | |
| Retained earnings . . . . . | 9,700,000 | |
| Cash . . . . . | | $10,800,000 |
| Paid-in capital in excess of par value . . . . | | 1,140,000 |

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[1] Warner-Lambert Pharmaceutical Company, 1965 Annual Report, "Financial Review," p. 18. On December 31, 1965, the company held in the treasury 624,833 shares of its common stock at a cost of $29.59 per share. For this illustration we assume the cost basis is $30.00 per share. Net assets of Texas Pharmacal Company were $2,136,875 on September 30, 1965. The amount used for the above illustration, $2,240,000, represents a reasonable estimate of book value of the net assets at December 31, 1965. Any difference between the figures used in this illustration and actual amounts is immaterial and does not change the underlying analysis.

Entries under purchase doctrine:

| | | |
|---|---|---|
| Cost of common treasury stock . . . . . | $10,800,000 | |
| Cash . . . . . | | $10,800,000 |
| (purchase of 360,000 treasury shares at $30 per share) | | |
| Net assets of acquired company . . . . | $ 2,240,000 | |
| Excess of cost over book value . . . . | 11,760,000 | |
| Cost of common treasury stock . . . . . | | $10,800,000 |
| Paid-in capital--from treasury stock transactions . | | 3,200,000 |
| (acquisition of the net assets of Texas Pharmacal Company for 360,000 shares of treasury stock) | | |

For those accountants holding the view that the true "acquisition cost" of the acquired company's assets is the cost basis of the treasury shares used as consideration in the exchange (not the market value of the shares on the date of acquisition), the appropriate accounting entry would be:[1]

| | | |
|---|---|---|
| Net assets of acquired company . . . . | $2,240,000 | |
| Excess of cost over book value . . . . . | 8,560,000 | |
| Cost of common treasury shares . . . . . | | $10,800,000 |

Accountants have every reason to be skeptical of the treasury stock pooling practice. When the combination transaction is viewed in its entirety, the practice generally gives the same results as the "purchase with the immediate write-off of the excess to retained earnings" method, a treatment which most accountants have not sanctioned since 1953. Where treasury stock of the buying enterprise is the consideration

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[1]For example, Colgate-Palmolive Company used this treatment when it purchased the outstanding stock of S. M. Edison Chemical Company, Inc. (Illinois) on January 15, 1960, in exchange for 33,838 shares of common treasury stock. The excess of the cost of the treasury stock over the book value of the net assets of the acquired company amounted to $1,180,000 and was recorded as goodwill. See Colgate-Palmolive Company, 1960 Annual Report, "Notes to the Financial Statements," p. 20.

used in a business combination, the recorded values of the properties on the acquired company's books cannot be assumed to express "acquisition cost" to the buying enterprise.

4. There seems to be a marked increase in the use of convertible preferred stock as a form of consideration for business acquisitions and mergers. As one source suggests, "they are the hot new trend in corporate acquisitions."[1] The issuance of such convertibles in exchange for the common stock of the firm it is buying does offer the acquiring company some advantages. Besides giving the acquiring company more flexibility in making the purchase, these securities generally allow the buyer to pay more, on paper, for a going concern than it could afford if it paid cash.[2]

It is difficult to ascertain just why and how much more a buying firm is willing to pay on paper (by the issuance of equity shares) for a going concern than it would pay if it paid cash. A purchase price is generally arrived at as the result of negotiation, where many factors are considered in reaching an agreement. Some of these factors, such as the form of consideration involved, are not readily susceptible to evaluation. One may have misgivings in using the market price of the stock on the day of the agreement for value purposes, but there is usually little else to go on.

Also on such convertible preferred deals, as one broker says, "the arithmetic is delightful."[3] Usually the acquired company's profits

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[1] "Mergers: Everybody Wants to Get Bigger," op. cit., p. 74.

[2] Ibid.

[3] Ibid.

are greater than the preferred dividend requirements. Therefore, without changing another thing, the acquiring company's profits per share will increase by the profits of the bought-out company that remain after the preferred dividends have been paid. If the buyer's common stock continues to sell at the same price-earnings ratio that existed before the acquisition or merger, price appreciation will likely result subsequent to the combination.[1]

Although the element of ownership continuity is averted to some extent where preferred stock is issued in a business combination, its use will not prevent the pooling treatment. Even in combinations accomplished by the use of nonconvertible preferred stock, a purchase transaction should not be assumed, for the absence of the convertible feature does not prevent the pooling treatment. As Jaenicke writes,

> The general conclusion here can be little other than a statement to the effect that it now appears that neither the issuance of preferred stock in whole or in part, nor any features of the preferred issue, will prevent a pooling-of-interests accounting treatment.[2]

A review of 189 acquisitions and mergers as reported in stock listing applications from August 1965 to March 1966 disclosed 32 (17 per cent) which involved the use of preferred stock.

| | | |
|---|---|---|
| Preferred and common shares: | Purchases | 2 |
| | Poolings | 9 |
| Preferred shares: | Purchases | 4 |
| | Partial pooling | 1 |
| | Poolings | 16 |
| Total | | 32 |

[1] Ibid.

[2] Jaenicke, op. cit., p. 59.

Two of the purchases and the one partial pooling combination involved a significant amount of cash as consideration, so pooling treatment would have been questionable. Of the four remaining purchases, three were bargain purchase situations, where purchase treatment is desirable because of enhancement of subsequently reported earnings. In the one remaining preferred stock acquisition, the purchase price only slightly exceeded the acquired firm's book values, so that handling the transaction as a purchase had no significant effect in the consolidated accounts. Thus, the conclusion is warranted that management's choice to purchase or pool in combinations involving the use of preferred stock is not based on the ownership continuity feature, but is primarily made on the basis of selecting that method which has the most favorable effect on the resultant financial statements.

## Discussion on Important Trends

An evaluation of trends in the business combination area suggests that the concept of a pooling of interests is still developing. The increase in partial acquisitions, the expansion through foreign acquisitions, and the growing use of cash, treasury stock, and convertible preferred stock are important trends that have definite implications for present and future combination accounting practices. For example, strictly speaking, partial acquisitions are not business combinations; and yet the accounting profession is beginning to treat them as if they were. Today the presence of a significant minority interest outstanding subsequent to the acquisition does not prevent a pooling of interests.[1]

[1] Ibid., p. 62. Also see Samuel R. Sapienza, "Pooling Theory and

Furthermore, pooling has taken on international dimensions, in that American companies now actually "pool" with companies operating all over the world. The use of treasury stock in whole or in part does not forestall the pooling treatment, although the net effect of the completed transaction is to acquire a business for cash. Nor does the presence of cash as a significant portion of the consideration (generally up to 25 per cent of the purchase price) prevent a pooling of interests. Finally, the recipients of stock in a pooling-of-interests combination are allowed to sell off to outside parties a significant portion of their stock interest without destroying the pooling treatment for the business combinations.[1] Although all of these practices seem contrary to the spirit of ARB No. 48, they have become acceptable by the accounting profession and are now embraced in the term "generally accepted accounting principles." Clearly, corporate managements are not willing to face the usual consequences of the cash-equivalent purchase doctrine in accounting for business acquisitions effected by the issuance of shares of stock.

The pooling concept has permitted accountants to record acquired assets without regard to fair value and ignore the problem of accounting for any excess of fair value of assets acquired over their book value, but it has not solved the problem of accounting for business combinations. In fact, as Spacek suggests, it has compounded it.[2] Presently,

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Practice in Business Combinations," The Accounting Review, XXXVII (April 1962), 273-74.

[1]Howard L. Kellogg, "Comments on SEC Practice as to Pooling of Interests," The Quarterly, XI (New York: Touche, Ross, Bailey & Smart, December 1965), 35-36.

[2]Spacek, op. cit., p. 38.

the cash-stock form of the consideration used to effect a given business acquisition seems to determine the alternative purchase-pooling accounting treatment applicable to the combination transaction. If the assets acquired at the time of a particular business combination are the same regardless of the form of consideration involved--cash, other assets, notes, or stock--then it is logically inconsistent to have different accounting practices for cash and stock acquisitions. For purposes of responsibility accounting, the initial amount assigned to all types of properties (tangible and intangible) acquired by a specific enterprise at the time of a business combination should be "acquisition cost." This is in accord with the so-called "generally accepted cost principle," as stated in a leading accounting textbook:

> Subject to generally recognized exceptions, and excluding cash and receivables, cost is the proper basis of accounting for assets and expenses, and accounting records should reflect acquisition costs and the transformation, flow, and expiration of these costs.[1]

Even though the acquisition cost concept has undergone several modifications over the years (for example, the lower of cost or market rule for inventories), it is still fundamental to most accounting theories of value and of income. Considerable support can be found in the accounting literature for such a concept. In the 1957 Revised Statement by the American Accounting Association, much emphasis is placed on the concept of "acquisition cost" in valuing nonmonetary assets, such as inventories, plant, long-term investments, and deferred items.

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[1] H. A. Finney and Herbert E. Miller, Principles of Accounting: Intermediate (6th ed.; Englewood Cliffs, N. J.: Prentice-Hall, Inc., 1965), p. 142.

> Assuming a free market, acquisition cost expressed in the bargained price of an asset is presumed to be a satisfactory quantification of future service expectations at the time of acquisition. Bargained price is the objective and determinable result of a completed transaction, and it tends to reflect the unique relation of the asset to the entity at the time of the transaction.[1]

Accounting Research Study No. 3 states that "the initial basis of measurement for items of plant and equipment is acquisition cost or the equivalent."[2] The study also stresses that intangible items (patents, copyrights, research and development costs, goodwill, and the like) should "probably be carried at acquisition cost in the absence of compelling evidence that their value is markedly different."[3]

Here is the real dilemma in accounting for business combinations. At present, accountants use two different concepts of "acquisition cost" in accounting for the acquisition of a business. If a combination is effected by means of cash, other assets, or notes, accountants record the cost of the properties acquired on the basis of the money value of the cash, other assets, or notes given up as consideration in the exchange. Here cost, in effect, means cash or its equivalent.

But if equity shares are used to effect a merger or acquisition, however, and the transaction is deemed a pooling of interests,

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[1]Committee on Concepts and Standards Underlying Corporate Financial Statements, "Accounting and Reporting Standards for Corporate Financial Statements, 1957 Revision," in Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements (American Accounting Association, 1957), p. 4. Italics mine.

[2]Robert T. Sprouse and Maurice Moonitz, A Tentative Set of Broad Accounting Principles for Business Enterprises, Accounting Research Study No. 3 (New York: American Institute of Certified Public Accountants, 1962), p. 32.

[3]Ibid., p. 36.

accountants record the cost of the properties acquired at the same values as those existing on the acquired company's books. Cost in this case means "amounts as carried on the books of the acquired company," without regard to current values of the acquired properties or the cash equivalent value of the equities given up in the exchange. As Accounting Research Study No. 7 suggests,

> Where two or more previously independent entities merge or otherwise combine in such a manner as to constitute a pooling of interests, the new entity inherits the bases of accountability of the constituent entities.[1]

The above principle is incompatible with another statement on components of cost as expressed in the same study.

> If the consideration employed in acquiring properties is in the form of the capital stock of the buying enterprise, the par or stated value cannot be assumed to express actual cost. A fair measure of actual cost is the amount of money which could have been raised through the issue of the securities for cash.[2]

Both statements expose the two different cost concepts now accepted in accounting for business combinations. The real issue is not one of establishing criteria to differentiate between a purchase and a pooling of interests. The important question is: Should different cost concepts be allowed in accounting for business combinations depending on whether a business is acquired for cash or stock? Unless there are good reasons to support the position that a business combination effected by the issuance of equity shares should not disturb existing

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[1]Paul Grady, Inventory of Generally Accepted Accounting Principles for Business Enterprises, Accounting Research Study No. 7 (New York: American Institute of Certified Public Accountants, 1965), Principle E-4, p. 67.

[2]Ibid., p. 254.

accountabilities, the usefulness and comparability of a series of successive financial statements for a specific reporting enterprise can be questioned. Regardless of the cash-stock form of consideration used to effect the combination, should not all of the costs of acquiring a business be fully accounted for to the corporate stockholders and creditors?

# CHAPTER IV

# METHODOLOGY

## Review of Two Case Studies

In order to evaluate the impact of pooling and purchase accounting on corporate financial statements, it was necessary to select some actual companies for analysis. A logical starting point seemed to be those companies in industries known to have in recent years an active history of growth through business acquisitions and mergers. Such an approach was taken by Jaenicke in his case study of St. Regis Paper Company.[1] Although he suggests that St. Regis was chosen at random, nevertheless there were several good reasons for his selection of this particular firm.

First, the company had a pronounced history of growth through combination and was active in the use of the pooling and purchase concepts. Second, the company used its own common stock as the principal means of achieving these combinations. Finally, the company was listed

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[1] Henry R. Jaenicke, "Management's Choice to Purchase or Pool," The Accounting Review, XXXVII (October 1962), 758-65. Jaenicke's study is concerned with accounting effects of alternative treatments on financial information for St. Regis Paper Co. over the period 1947-60. The company had 29 acquisitions but only 6 received pooling accounting treatments. He converted these 6 to purchase treatments with fifteen-year amortization and made an analysis of the effects on six financial ratios for the period 1957-60.

on a major stock exchange and therefore more complete financial information was available relative to the various business combinations.

Sapienza took a similar approach in his case study of the Flintkote Company.[1] This company had rapid growth during the five-year period 1956-60 mainly as a result of 16 acquisitions, of which 9 received pooling treatments. After converting the poolings to purchase treatments with amortization against revenues based on the company's average rate and making an analysis of the effects on three selected financial ratios, Sapienza concluded:

> Important financial differences of interest to stockholders arise from a consistent application of the pooling method as contrasted with a purchase technique. . . . These results appear likely: (1) Significant undervaluation in assets exists in terms of market appraisal at the time of exchange. (2) Earnings ratios tend to overstate managerial efficiency in operations. (3) The debt to equity ratios tend to worsen with a consistent application of the pooling technique.[2]

Both studies supported the general conclusion that pooling-of-interests accounting reflects an improvement in operating statistics in financial statements which may not be warranted. Neither study, however, measured completely the impact of alternative pooling-purchase accounting techniques on the underlying financial statements and investment analysis. By converting all poolings to purchases (with amortization), both studies compared two alternative ways a company's financial statements can be presented.

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[1] Samuel R. Sapienza, "Business Combinations--A Case Study," The Accounting Review, XXXVIII (January 1963), 91-101.

[2] Ibid., 101. In this article the author does not explain what he means when he amortized by the "company's average rate."

The first way is a mixture of methods--as actually reported--where both the pooling and purchase concepts are followed depending primarily on the form of payment used to effect the business acquisitions.

The other way is to treat all business combinations as purchases and systematically amortize the excess of cost over book value against income on an appropriate basis.

But these two ways simply do not consider the other alternative practices in the area of business combination accounting. Because it is not entirely clear in financial circles that capitalization of purchased goodwill and its subsequent amortization result in more meaningful income data, some accountants propose the direct write-off to retained earnings of the cost of goodwill at the date of the combination, regardless of the form of consideration involved--whether cash, debt, or stock. Remember that a "treasury stock pooling" situation allows management to acquire a business for cash and, for all practical purposes, amounts to the "purchase with immediate write-off" treatment.

Other accountants believe that the purchase treatment is proper for both cash and stock acquisitions, but they insist that no systematic amortization policy should be followed for any excess of fair value of assets acquired over their book values. Chapters II and III have stressed the popularity of this "purchase without amortization" treatment. Clearly, a study of the effects of alternative pooling-purchase accounting treatments on financial statements should consider, within reason, the existing variety of combination accounting practices. The alternative ways of accounting for business combinations and of presenting the

resultant financial statements will be described later in this chapter. The case studies of St. Regis and Flintkote provide only a convenient starting point for purposes of this study.

## Empirical Approach to the Study

The initial task was to select several industries for purposes of the study. It was decided that the industries selected should be popular with investors. Assuming that the corporate return on investment was an important performance standard for investors, ten well-defined industries known to have active histories of business combinations were selected and ranked according to their return on invested capital in 1964.[1]

| Industry | Return on Invested Capital | Industry Rank |
|---|---|---|
| Pharmaceuticals | 16.3% | 1st |
| Soaps, cosmetics | 14.7 | 2nd |
| Chemicals | 12.1 | 6th |
| Appliances, electronics | 11.9 | 7th |
| Office machinery | 11.4 | 10th |
| Apparel | 11.0 | 11th |
| All Industry Median | 10.5 | |
| Food and beverage | 9.8 | 15th |
| Paper and wood products | 9.6 | 17th |
| Petroleum refining | 9.0 | 20th |
| Textiles | 8.6 | 21st |

The next step was to look more closely at those industries performing better than the median. A review of the industry classification system used by Standard & Poor's Corporation showed that the appliances

[1] The Fortune Directory, "The 500 Largest U.S. Industrial Corporations," tables on Return on Invested Capital for the Industry Medians, August 1965, p. 21.

and electronics grouping was not a well-defined industry. It soon became apparent that the leading three industries--pharmaceuticals, cosmetics, and chemicals--have a high degree of homogeneity in operations and have been good quality investments over the years. In the final analysis, there were no good reasons for not choosing these three industries.

The next step was to select for the study a list of companies from within those industries. The following requirements were established.

1. The companies chosen must be listed among the top 500 industrial companies by The Fortune Directory, August 1965.

2. The companies selected must have had their common stock shares traded on the New York Stock Exchange for the ten-year period 1956-65.

3. The companies selected must be classified as Chemicals, Cosmetics, and Drugs as based on the classification system published by Standard & Poor's Corporation, November 1965, in the Security Owner's Stock Guide.

4. The companies selected must be considered as high quality investments. For purposes of the study, an A+, A, or A- stock ranking by Standard & Poor's as of November 1965 satisfied this requirement.

Based on the above requirements, thirty companies were selected. The list is included as Appendix B.

The next step was to review New York Stock Exchange listing applications for the thirty selected companies over the periods 1956-65. Over one hundred pertinent listing applications were examined and selected data of 126 business acquisitions and mergers were compiled.

Excluding two partial poolings, Exhibit 16 in Chapter III gives a breakdown of the purchase and pooling treatments used for 124 acquisitions.

Having reviewed all pertinent listing applications, an examination was made of annual reports, proxy statements, and various prospectuses of the thirty companies. In most instances, the disclosure of information about business combinations accounted for as poolings of interests was reasonably adequate. On the other hand, the disclosure of information about the purchase accounting treatments was generally inadequate. The lack of information about allocation and amortization practices was discouraging and placed definite limitations on the study. In fact, without the information as reported on the listing applications, proxy statements, and the forms 10K filed annually with the Securities and Exchange Commission, important details necessary for certain calculations and adjustments could not have been obtained. Even with these details it was necessary to introduce certain assumptions and estimates.

On the basis of the investigation of the indicated information, eight of the thirty companies studied were selected for detailed case analysis. These eight companies comprise the heart of the empirical section of the study. These firms were chosen because they seemed to satisfy best the central objective of the study, i.e., to determine the effects of pooling and purchase accounting treatments on the presentation and interpretation of corporate financial statements. Appendix C lists the eight companies selected. Appendix D lists the business acquisitions and mergers for these eight over the time period 1951-65.

For purposes of the case analysis a ten-year period from 1956

through 1965 was used, but appropriate adjustments to financial statements under each of the alternative combination accounting treatments also considered mergers and acquisitions occurring during the years 1951-55.

Briefly, the alternative ways of accounting for business combinations and of presenting the resultant financial statements are described here.

1. Pooling Concept. All business combinations were treated as "poolings of interests," regardless of the form of consideration involved. Such a treatment requires the immediate write-off to retained earnings of the cost of goodwill and other intangibles created in the case of a cash acquisition. This practice was acceptable prior to the issuance of ARB No. 43, Chapter 5, in 1953.

2. Mixture, as reported. All business combinations were treated exactly as recorded by the acquiring company at the time of the acquisition or merger. In effect, no adjustments were made to the annual financial statements. Since each company had many purchases and at least one pooling treatment (considering the "purchase with immediate write-off" technique as a pooling treatment), all of the companies actually followed a "mixture" of combination accounting methods throughout their respective histories of acquisitions and mergers. At present,

the typical enterprise follows a mixture of purchase and pooling concepts in accounting for business combinations depending predominantly on the cash-stock forms of consideration used to effect the combinations.

3. Purchase without Amortization. All business combinations were treated as purchases but with no systematic amortization policy followed for any excess of fair value of assets acquired over their book values. The excess of purchase price over the book value (or value assigned to the net tangible assets acquired) is carried at cost as a permanent intangible asset on the balance sheet. For cash deals, this treatment is somewhat similar to the observed practice of recording some foreign acquisitions in an "investments, at cost" account. Of course, under this "investment" treatment all of the acquired assets (including the element of excess of cost over book value) are buried together in the investments account. Celanese Corporation, for example, used this treatment in October 1965 when it purchased for approximately $48,500,000 substantially all of the outstanding shares of British Paints (Holdings), Ltd.[1]

4. Purchase with Amortization. All business combinations were treated as purchases, with the systematic amortization of the cost of acquired intangibles in the income statement over an appropriate number of years. Of the eight firms selected for case analysis, only one (Colgate-Palmolive) actually amortized the cost of goodwill and other general intangibles by annual charges to operations, a practice which the

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[1]Celanese Corporation of America, Annual Report 1965, "Notes to Consolidated Financial Statements of 1965," Note 3, p. 31.

company discontinued in 1961. Nevertheless, it should be stressed that an examination of listing applications for the thirty companies given in Appendix B did reveal several other firms (such as W. R. Grace & Co., American Cyanamid Company, and Air Reduction Corporation) which amortized the excess of cost over value assigned to net tangible assets of businesses acquired over various time periods from five to forty years for certain business combinations.

Expanding upon the approach used by Jaenicke and Sapienza in their respective studies of St. Regis Paper and Flintkote, the study proceeded with detailed case analysis for each of the companies. It was necessary to make adjustments to financial information under each of the alternatives in order to establish what would have resulted had the reporting enterprise treated acquisitions and mergers differently than it actually did. In determining the amount of the difference between cost and book value to be capitalized in the process of converting the poolings to purchases, the value assigned to the shares given as consideration was based on the closing market price of such stock on the date of the agreement between the constituent corporations; from this value was subtracted the net worth of the acquired company as of its last audited balance sheet prior to the combination. In all cases the resulting difference turned out to be a debit figure and was treated as though it were capitalized as an intangible, with a like amount being added to the acquiring firm's capital surplus. Both Exhibit 15 in Chapter III and Appendix E give important particulars about the respective pooling combinations.

Under alternative 4 (the purchase with amortization treatment),

intangibles were amortized over a ten-year period on a straight-line basis. Practically speaking, it is impossible to say that any selected time period is a proper one, for estimating the appropriate amortization rate depends on assumptions and judgments about the nature of goodwill and its useful life. As ARB No. 43 suggests, the pattern for amortization of intangibles should be based on "all the surrounding circumstances, including the basic nature of the intangible and the expenditures currently being made for development, experimentation, and sales promotion."[1] If it is notoriously difficult to evaluate the very nature of goodwill (remembering that all too frequently "goodwill" includes unallocated costs of tangible assets and specific intangibles which do not belong in the account), then it is equally difficult to establish a systematic and rational basis for the allocation of the cost of goodwill.

While it is apparent that any treatment accorded the disposition of goodwill is subjective and arbitrary, some basis had to be selected--if only to show the consequences of such amortization procedures on financial statements. In the previously mentioned study of St. Regis Paper, Jaenicke chose a fifteen-year period mainly to be on the conservative side.[2] Another author contends that "there are sound reasons to amortize the excess debit, if one exists, over the same period of time that expected earnings [of the acquired company in the combination] were capitalized, regardless of whether income is available to absorb the

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[1]Committee on Accounting Procedure, American Institute of Certified Public Accountants, Accounting Research and Terminology Bulletins (final ed.; New York, 1961), Chapter 5, par. 7, p. 39.

[2]Jaenicke, op. cit., p. 760.

charge."[1] Thus, the selection of a ten-year amortization period for purposes of this study implies a ten per cent rate of capitalization at the time of the business combination--which perhaps is realistic in an economic sense. Such an amortization term would appear reasonable if accounting standards as recommended by Paton and Littleton are followed.

> . . . the cost of goodwill or other general intangibles should be absorbed by revenue charges during the period implicit in the computation on which the cost incurred was based; . . . .[2]

The selection of a ten-year amortization plan could be unreasonable when judged in the light of a recommendation by the Committee on Accounting Procedure in accounting for intangible assets.

> Where the intangible is an important income-producing factor and is currently being maintained by advertising or otherwise, the period of amortization should be reasonably long.[3]

In the final analysis, although practices in this area do vary considerably, the study selected a ten-year amortization period primarily because a review of many stock listing applications over the span from 1954 to 1965 showed that this particular term of goodwill amortization is a prevalent one.

## Comparative Analysis

To compare the results of the four alternative pooling-purchase accounting treatments on financial statements and to evaluate the

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[1] Samuel R. Sapienza, "An Examination of AICPA Study No. 5--Standards for Pooling," The Accounting Review XXXIX (July 1964), 584-85.

[2] W. A. Paton and A. C. Littleton, An Introduction to Corporate Accounting Standards, American Accounting Association Monograph No. 3 (American Accounting Association, 1940), p. 66.

[3] Committee on Accounting Procedure, op. cit., p. 39.

changes in investment analysis resulting therefrom, a computer program for financial statement analysis was used. This program was developed at the Graduate School of Business Administration, University of California at Los Angeles.[1] It computes eighteen ratios commonly used by financial analysts and compounds growth rates for selected items. The ratios are grouped into six functional classes: liquidity ratios, efficiency ratios, profitability ratios, price ratios, capital structure ratios, and miscellaneous ratios. In addition, the program calculates and prints out a series of per share data for the analyst which has been adjusted for all stock splits and stock dividends. It also calculates the mean ratio for the entire number of years for each of the eighteen financial ratios.[2] Appendix F reproduces the details concerning the financial ratios and growth rate items.

The computer program for financial statement analysis produces three pages of output for each company. Since the present study considers four alternative pooling-purchase accounting treatments, a given company's financial statements can be presented and analyzed in four different ways. For the eight companies analyzed this actually means there were ninety-six pages of output, considering all of the alternatives. While it is not practical to include all of the pages of output resulting from these case studies, for illustrative purposes Appendix G gives eight pages of output for one of the selected companies,

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[1]David K. Eiteman, "A Computer Program for Financial Statement Analysis," Financial Analysts Journal, XX (November-December 1964), 61-68.

[2]In this dissertation study, for example, the mean ratio for the nine-year period 1957-65 was calculated for each financial ratio. See Appendix G for mean ratios of Chas. Pfizer & Co., Inc.

Chas. Pfizer & Co., Inc. Pfizer was chosen because it not only had a pronounced history of growth through business acquisitions but also because it was active in using both the pooling and purchase concepts.

# CHAPTER V

## THE IMPACT OF ALTERNATIVE COMBINATION ACCOUNTING PRACTICES ON FINANCIAL STATEMENTS AND INVESTMENT ANALYSIS

It is apparent that accounting practices fashioned for business mergers and acquisitions are rather arbitrary, largely ignoring the criteria set forth in Accounting Research Bulletin No. 48 and the underlying nature of the exchange transaction. Accountants themselves are not certain of the distinction between a purchase and a pooling of interests. When faced with the problem of accounting for the "excess of purchase cost over book value of assets acquired," management and accountants alike have favored pooling over purchase accounting whenever possible. The obvious lack of a reliably consistent basis for choosing between methods has led to an array of combination accounting practices, each possessing the stamp of general acceptability.

Earlier chapters have shown briefly how alternative pooling-purchase accounting treatments produce widely varying differences in an enterprise's financial position and earnings. This chapter evaluates the consequences of alternative combination accounting practices on conventional financial statements and investment analysis for selected companies in three industries--chemicals, cosmetics, and drugs. Perhaps a study of the effects of alternative treatments on the presentation and interpretation of corporate financial statements not only will show that

it is logically inconsistent to allow different accounting practices (using different concepts of acquisition cost) for cash and stock acquisitions, but also will disclose the one best method of recording the combining of business enterprises.

## Effect of Alternatives on Financial Data

Exhibits 25 and 26 have been prepared to reflect the effect of alternative combination accounting practices on certain financial data for four drug companies. The information in these exhibits will be referred to many times in the ensuing discussion.

Pooling concept. Under this approach business acquisitions have been treated as if they were poolings of interests. The cost of goodwill and other general intangibles created in the case of cash acquisitions has been written off to retained earnings. Prior to the issuance of ARB No. 43, Chapter V, in 1953, this practice was acceptable accounting (see Exhibit 12). Both Leonard Spacek and Robert C. Holsen favor this method.[1]

Whether called the "purchase with immediate write-off of excess" technique or the "pooling of interests" method, generally both treatments produce the same effect on financial statements. Accountants may object to this inference; they may claim that the term "excess" is being misinterpreted. It is the excess of purchase cost over the fair value

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[1]Leonard Spacek, "The Treatment of Goodwill in the Corporate Balance Sheet," The Journal of Accountancy, CXVII (February 1964), 35-40; Robert C. Holsen, "Another Look at Business Combinations," a section included in Arthur R. Wyatt, A Critical Study of Accounting for Business Combinations, Accounting Research Study No. 5 (New York: AICPA, 1963) pp. 109-114.

of the assets acquired rather than the excess of purchase cost over book value that they believe should be charged to retained earnings at the date of the acquisition or merger. First, any portion of the excess which is attributable to tangible assets and specific intangibles must be assigned; therefore, only the remaining portion (if any) that is truly attributable to goodwill may be accounted for as a reduction of the equity of the acquiring corporation.

While ARB No. 48 states clearly that adjustments of asset values are appropriate for pooling combinations, accountants do not write up assets (either tangible or intangible) in connection with a pooling of interests. In fact, accountants frequently do not write up the book values of the tangible assets acquired when using the purchase approach. Often they merely charge the excess of purchase price over book value of the acquired assets to a catch-all account entitled "cost in excess of book amount of net tangible assets of businesses acquired." Since accountants today do not often record upward adjustments for tangible assets acquired by combination, would they do so in the future if the practice of writing off purchased goodwill to retained earnings became a "generally accepted accounting principle," as it was before 1953?

Possibly here is the greatest weakness of any proposal that purchased goodwill should be charged against retained earnings at the date of the acquisition. Accountants may use the term "goodwill" to describe the entire excess of cost over book value of assets acquired, with little reference to the underlying nature of the excess. Such a goodwill account could easily become a depositary for specific asset items that actually do not belong in the account--a convenient place to hide upward

adjustments of tangible asset values. By writing off to retained earnings the entire excess of purchase cost over book value without regard for the fair value of the absorbed company's specific assets at the time of the combination, accountants will carry forward asset values into the acquiring firm's accounts on the same basis (book value) as if the combination had been treated as a pooling of interests.

Tax aspects of the nontaxable type of business combination only tend to encourage the pooling assumption since any write-up of tangible asset values by the buying firm cannot be depreciated for income tax computations. Accounting for the nontaxable type of combination as a purchase augments continuing differences between reported and taxable business earnings. Practical tax accounting considerations definitely favor the pooling concept.

From Exhibits 25 and 26 it is obvious that material differences in financial data do result from management's choice to purchase or to pool. The use of pooling is appealing as it offers balance sheet conservatism and avoids the difficulties of accounting for the excess debit. The pooling technique gives financial statements a certain sense of form and uniformity since all of the assets of the surviving company are recorded at the book amounts previously carried by the constituent companies. Therefore, the future financial performance of the surviving enterprise will be directly comparable to the combined past records of the merged companies.[1] But using the prior book values as the basis of accounting recognition disregards the valuation and bargaining activity

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[1]A. N. Mosich, "Impact of Merger Accounting on Post-Merger Financial Reports," Management Accounting, XLVII (December 1965), 23.

Exhibit 25

1965 FINANCIAL DATA FOR FOUR DRUG COMPANIES

(in millions of dollars)

| Company and Item | Pooling Concept | Mixture as reported | Purchase without Amortization | Purchase with Amortization |
|---|---|---|---|---|
| Bristol-Myers | | | | |
| Total assets | $168 | $193 | $322 | $295 |
| Common equity | 118 | 143 | 272 | 245 |
| Net income before taxes | 65 | 65 | 65 | 50 |
| Net income to common | 33 | 33 | 33 | 18 |
| Chas. Pfizer | | | | |
| Total assets | 489 | 534 | 607 | 559 |
| Common equity | 293 | 338 | 411 | 363 |
| Net income before taxes | 96 | 96 | 96 | 85 |
| Net income to common | 53 | 53 | 53 | 42 |
| Richardson-Merrell | | | | |
| Total assets | 132 | 174 | 175 | 151 |
| Common equity | 107 | 149 | 150 | 126 |
| Net income before taxes | 42 | 42 | 42 | 38 |
| Net income to common | 20 | 20 | 20 | 16 |
| Warner-Lambert | | | | |
| Total assets | 252 | 262 | 429 | 345 |
| Common equity | 138 | 147 | 314 | 230 |
| Net income before taxes | 72 | 72 | 72 | 56 |
| Net income to common | 37 | 37 | 37 | 21 |

Exhibit 26

1965 FINANCIAL DATA FOR FOUR DRUG COMPANIES

(common equity per share--adjusted data)

| Company and Item | Pooling Concept | Mixture as reported | Purchase without Amortization | Purchase with Amortization |
|---|---|---|---|---|
| Bristol-Myers | | | | |
| Earnings | $ 2.64 | $ 2.64 | $ 2.64 | $ 1.43 |
| Dividends | 1.32 | 1.32 | 1.32 | 1.32 |
| Cash flow | 2.96 | 2.96 | 2.96 | 2.96 |
| Book value | 9.36 | 11.34 | 21.55 | 19.45 |
| Average market price | 83.50 | 83.50 | 83.50 | 45.19* |
| Chas. Pfizer | | | | |
| Earnings | 2.69 | 2.69 | 2.69 | 2.11 |
| Dividends | 1.30 | 1.30 | 1.30 | 1.30 |
| Cash flow | 3.58 | 3.58 | 3.58 | 3.58 |
| Book value | 14.71 | 17.00 | 20.67 | 18.25 |
| Average market price | 62.38 | 62.38 | 62.38 | 48.95* |
| Richardson-Merrell | | | | |
| Earnings | 3.54 | 3.54 | 3.54 | 2.84 |
| Dividends | 1.00 | 1.00 | 1.00 | 1.00 |
| Cash flow | 4.22 | 4.22 | 4.22 | 4.22 |
| Book value | 18.58 | 25.89 | 25.97 | 21.84 |
| Average market price | 70.25 | 70.25 | 70.25 | 56.23* |
| Warner-Lambert | | | | |
| Earnings | 1.60 | 1.60 | 1.60 | .90 |
| Dividends | .90 | .90 | .90 | .90 |
| Cash flow | 1.87 | 1.87 | 1.87 | 1.87 |
| Book value | 5.98 | 6.39 | 13.60 | 9.95 |
| Average market price | 37.94 | 37.94 | 37.94 | 21.33* |

*Assumes that the market price of each company is directly related to earnings and that the 1965 average price-earnings ratios for the companies remains unchanged, i.e., at 31.6, 23.2, 19.8, and 23.7 times earnings, respectively. This assumption is likely invalid because price-earnings ratios are highly unpredictable.

between the constituents and ignores completely the actual exchange transaction without which the combination could not be effected.

Note from Exhibit 25 that the consistent application of the pooling technique for both cash and stock acquisitions causes significant undervaluation in asset and equity values reported in subsequent financial statements. The effect is to omit accountability for the current value of acquired assets existing at the time of the exchange and to retain historical cost figures for post-merger reports of the pooled entities. While historical cost data may be acceptable and significant to the acquired enterprise prior to the business combination, such data should not automatically be recognized as acceptable and relevant to the enterprise which emerges after the combination. Generally book values are relevant to no other enterprise but the one which originally incurred such cost.[1] Keeping in mind that the objective of accounting is always to present meaningful and useful financial statements, the purchase price or fair market value of the consideration given in exchange at the time of the combination is usually a far more significant figure to the purchasing entity than the existing book value of the predecessor company. There is nothing inherent in the pre-merger carrying values on the acquired company's books that guarantees their usefulness as a basis of accountability for the acquiring company.

If a seller's book value figures are virtually insignificant as a basis of accountability for the acquiring company, it appears that the pooling approach to business combination accounting violates the

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[1]Public utility accounting would be a major exception to this statement.

American Accounting Association's primary standard of relevance. This is one of the four basic standards mentioned in Chapter I that this study shall use as criteria in evaluating the acceptability of alternative accounting methods. Past acquisition costs on the books of the selling enterprise generally are inferior to current market prices as a measure of the cost or "sacrifice" involved in acquiring a going concern. Because the pooling technique essentially ignores the new exchange value (purchase price) created by the business combination transaction, it can hardly be said to provide financial information that is relevant for investment decisions.[1]

Mixture, as reported. At present, business combinations effected through the use of assets and debt instruments are accounted for regularly under the purchase concept, but combinations involving an exchange of equity shares generally are treated as poolings of interests. Because the form of consideration used in acquiring a going concern determines the appropriate combination accounting technique, the typical reporting enterprise follows a mixture of methods in accounting for acquisitions and mergers over its history of combination growth.

Most accountants would agree with the proposition that the type of consideration involved in acquiring a business does not cause the book value of the acquired company to become more relevant to the acquiring company in giving information to creditors and stockholders about the financial position of the reporting enterprise. The fact that purchase price for a cash or stock acquisition typically varies from three to

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[1]American Accounting Association Committee to Prepare a Statement on Basic Accounting Theory, A Statement of Basic Accounting Theory (American Accounting Association, 1966), p. 33.

six times the book value of the net assets of the absorbed entity lends considerable support to this proposition. Clearly, if the book value of an acquired company is irrelevant in the case of a cash purchase, then the book value is equally irrelevant if that same company were to be acquired by means of a stock transaction. Except for the difficulties of establishing a suitable value for the shares issued in a stock transaction, the excess of purchase cost over book value in a stock acquisition is fundamentally no different than in a cash acquisition.

Furthermore, once the exchange price has been established in a business combination, the allocation of the total price to various assets is no different when stock is used than when cash is used to acquire the selling company. Thus, for allocation practices under purchase accounting, the standard of verifiability applies just as easily to stock acquisitions as to cash acquisitions.

When consideration for a business combination is in the form of equities, the shares of stock used to effect the exchange are merely substitutes for cash or other assets, notes or bonds. The actual cost of the new properties acquired by the buying entity in a stock acquisition is best measured by the cash equivalent value of the securities transferred in the exchange, i.e., the amount of money which could have been raised through the public issue of the securities.[1] The fact that shares rather than dollars are involved in the exchange does not change the accountant's function of quantifying the business combination activity in

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[1]W. A. Paton and A. C. Littleton, An Introduction to Corporate Accounting Standards, American Accounting Association Monograph No. 3 (American Accounting Association, 1940), p. 28.

terms of money-equivalents. When viewed from the point of view of the buying party, meaningful quantification of data in terms of implied cash costs (bargained prices) for noncash forms of consideration is desirable to improve the measurement process in accounting and to increase the usefulness of financial information.[1] If a series of successive financial statements for a specific entity are to possess comparability and significance, there is no logical basis existing in accounting theory for a continuation of the mixture of methods currently being followed for business combination accounting practices.

Purchase without amortization. Under this approach both cash and stock business combinations have been treated as purchases with no systematic amortization policy adopted for the excess of purchase cost over book value. Previous chapters stressed that the practice of carrying goodwill and other related intangibles as an unamortized asset on the balance sheet is acceptable for cash or stock acquisitions and seems to be increasing in its application.

Note from Exhibit 25 that the consistent application of this method has its greatest impact on successive balance sheets by causing sizable accumulations of goodwill and other general intangibles. Amounts reported on the balance sheet for total assets and stockholders' equity are larger than under any other alternative combination accounting treatment. But now accountabilities are based on the current value of the acquired assets existing at the time of the business acquisition regardless of the cash-stock form of consideration used to effect the exchange.

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[1] American Accounting Association Committee to Prepare a Statement of Basic Accounting Theory, op. cit., p. 12. In this statement the committee suggests that "the accounting function emphasizes meaningful quantification represented by numbers to increase usefulness."

As long as the excess of purchase cost over fair value of net tangible assets of businesses acquired is carried on the balance sheet as an asset, as if its value is being maintained, the amount reported as stockholders' equity does reflect perhaps an amount that should be recognized in the determination of total invested capital. Furthermore, if the intangibles have been acquired at a cost and there is reasonable evidence that their values are being maintained by current expenditures, a continuing policy of nonamortization of such intangibles may be appropriate. As Hendriksen stresses,

> Amortization should occur only when there are indications of limited existence, and a write-off should be made only when there is evidence of loss of value. The same principles should apply to intangibles. A general license to amortize and write them off over arbitrary periods does not lead to responsible accounting. The result is an understatement of net income during the amortization period and a perpetual understatement of assets in subsequent periods.[1]

The practice of continuing to show this excess as an asset on the balance sheet after the circumstances that created it no longer exist may be open to serious objection. This practice could mislead creditors and stockholders who wish to accumulate information about the financial activities of a business enterprise as a basis for the formulation of many business decisions. Carrying goodwill and related intangibles as unamortized assets infers that the present level of corporate earnings are still related to the original cost of the intangibles; but the longer that time elapses, the weaker this connection becomes. Practical difficulties in establishing a sound basis on which the expense for a single period or longer can be calculated, however, indicate that the general

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[1]Eldon S. Hendriksen, Accounting Theory (Homewood, Ill.: Richard D. Irwin, Inc., 1965), p. 344.

practice of expensing the costs of maintaining intangibles with no amortization of capitalized intangibles may be the most appropriate or at least the most expedient method of accounting for purchased goodwill and other unlimited-term intangible assets.[1]

Paton and Littleton advocate that amounts expended for goodwill and other general intangibles are essentially no different from that of any asset subject to depreciation. Such amounts represent committed investments to be recovered in the future just as much as do specific investments in tangible assets. Paton and Littleton believe the practice of not amortizing the cost of goodwill by periodic charges against revenues is fundamentally unsound. They state:

> The cost of goodwill included in the purchase price of a going concern is essentially the discounted value of the estimated excess earning power--the amount of the net income anticipated in excess of income sufficient to clothe the tangible resources involved with a normal rate of return. Thus purchased goodwill represents an advance recognition of a debit for a portion of income that is expected to materialize later. It follows that the amount expended for goodwill should be absorbed by revenue charges--during the period implicit in the computation on which the price paid was based--in order that the income not paid for in advance may be measured.[2]

Purchase with amortization. Under this last approach the excess of purchase cost over book value arising from business acquisitions and mergers has been absorbed by revenue charges over a ten-year period.

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[1] Ibid. Perhaps it should be stressed that this discussion on the amortization of intangible assets is concerned with type (b) intangibles (those without limited life). If an intangible is identified as type (a), this study accepts the generally accepted accounting principle that "the cost of type (a) intangibles should be amortized by systematic charges in the income statement over the period benefited," as prescribed by ARB No. 43, Chapter 5, par. 5.

[2] Op. cit., pp. 92-93.

Although the period is selected arbitrarily, the policy of amortizing goodwill and other intangibles by charges to operations has many proponents in accounting literature. One writer contends that a difference of opinion about the exact period which should bear the charge is an inadequate reason for failing to charge the intangible against any period.[1]

From the information in Exhibits 25 and 26 it is clearly evident that an amortization policy with respect to goodwill arising from business acquisitions does have important consequences on selected financial data. Especially note the probable effect on earnings to common stockholders. When the intangible increment in asset values is amortized, in the case of Bristol-Myers Company the result is a reduction in reported common earnings from $33 million to $18 million, or from $2.64 to $1.43 per share. Such a difference here in reported earnings is obviously a strong inducement to any management to avoid the purchase-with-amortization method in accounting for business acquisitions and mergers.

Under the assumption that the market price of a company's common stock is directly related to earnings, and that the 1965 average price-earnings ratio for Bristol-Myers would remain unchanged at 31.6 times earnings, the purchase-with-amortization treatment would cause the average market value of Bristol-Myers common shares to decline to $45 per share (from an average of $83.50). Although stock prices do not necessarily follow predictable price-earnings patterns, it seems likely that the policy of amortizing the cost of purchased goodwill to

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[1]Gordon M. Hill, "Wanted: Solutions to Three Major Technical Problems," The Journal of Accountancy, C (August 1955), 44.

operations would have a potentially depressing effect on the market value of the buying enterprise's stock. This in turn could have an unfavorable effect on an enterprise's cost of raising additional funds.

If the lower earnings per share is accompanied by a probably lower market price of stock, the cost of raising equity funds may be much higher under purchase-with-amortization accounting than under other combination accounting treatments. The cost of borrowing could also differ as a result of the lower earnings reported when using the purchase-with-amortization method. But since creditors and their financial analysts place great importance on the concept of cash flow in appraising a firm's debt capacity, it is more probable that the cost of raising additional funds through borrowing is not significantly affected by the particular pooling-purchase accounting treatment used. As Exhibit 26 illustrates, an enterprise's cash flow (measured roughly by adding noncash expenses to net income) is the same for each combination accounting method because the amortization charges under purchase-with-amortization accounting are noncash deductions.

Exhibit 27 shows more completely the impact of amortization on earnings per share for two companies over the period 1957-65. By including dividends and dividend payout ratios, this exhibit discloses the enormous fluctuations in dividend-income per share relationships that result from the practice of arbitrarily amortizing the cost of intangibles to operations.

When based on data as reported in the financial statements, for example, the payout ratios for Warner-Lambert are reasonably stable near the mean of 52.4 per cent. With amortization of the intangible

Exhibit 27

SELECTED DATA FOR ALLIED CHEMICAL AND WARNER-LAMBERT, 1957-65

| | Dividends per share | Earnings per share as reported | Dividend Payout Ratio | Earnings per share with Amortization | Dividend Payout Ratio |
|---|---|---|---|---|---|
| Allied Chemical | | | | | |
| 1957 | $1.47 | $2.14 | 68.6% | $2.02 | 72.9% |
| 1958 | 1.47 | 1.67 | 88.1 | 1.54 | 95.2 |
| 1959 | 1.54 | 2.47 | 62.6 | 2.34 | 65.9 |
| 1960 | 1.76 | 2.52 | 70.0 | 2.39 | 73.7 |
| 1961 | 1.76 | 2.31 | 76.4 | 2.18 | 80.8 |
| 1962 | 1.72 | 2.15 | 80.3 | 1.14 | 151.3 |
| 1963 | 1.79 | 2.72 | 66.0 | 1.69 | 105.9 |
| 1964 | 1.77 | 3.02 | 58.4 | 2.06 | 85.5 |
| 1965 | 1.89 | 3.14 | 60.1 | 2.19 | 86.4 |
| 1957-65 Mean | | | 70.0% | | 90.8% |
| Warner-Lambert | | | | | |
| 1957 | $0.39 | $0.91 | 42.8% | $0.74 | 52.6% |
| 1958 | 0.50 | 0.94 | 53.0 | 0.77 | 64.5 |
| 1959 | 0.53 | 1.02 | 51.8 | 0.85 | 61.9 |
| 1960 | 0.55 | 1.03 | 53.2 | 0.87 | 63.3 |
| 1961 | 0.57 | 1.10 | 51.7 | 0.93 | 60.9 |
| 1962 | 0.63 | 1.20 | 52.4 | 0.50 | 124.9 |
| 1963 | 0.71 | 1.24 | 57.0 | 0.53 | 132.3 |
| 1964 | 0.75 | 1.41 | 53.5 | 0.67 | 112.6 |
| 1965 | 0.90 | 1.60 | 56.3 | 0.90 | 100.2 |
| 1957-65 Mean | | | 52.4% | | 85.9% |

Note: Data are based on the actual number of shares of common stock outstanding at the end of each fiscal year and has been adjusted for stock dividends and stock splits. Slight discrepancies between data and payout ratios are likely to exist because computations have been rounded off.

investments, however, these ratios are much higher and vary widely about the mean of 85.9 per cent. In some years the payout percentages exceed 100 per cent which implies that part of the dividend disbursements were a return of stockholders' prior retained earnings rather than a distribution from periodic earnings. This immediately raises the question: Are decisions made by a financial analyst based upon his evaluation of these payout ratios improved as a result of amortization?

While there is no easy answer to this question, it does appear likely that an analyst could draw misleading inferences from income data which reflect arbitrary write-off of type (b) intangibles. Current accounting practices are almost exclusively concerned with a monetary or "earning power" concept of income.[1] Advocates of this concept believe that the income statement should show as clearly as possible the monetary flows to the company's production and distribution activities over the fiscal year in order that meaningful comparisons can be made with prior years and with the performance of other companies. Accountants feel that reported "net income" is best measured by the difference between gross revenues from the major operating activities of the enterprise and applicable costs of a regular or recurring nature. Influenced by practical necessities, investors and their financial analysts have become accustomed over the years to reading financial statements based upon this earning power theory of income statement content. Emphasis on the earning power concept has been encouraged further by the increased

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[1]For a discussion of the earning power concept of the income statement, see R. K. Mautz, "Emphasis on Reporting, Not Calculation, Could Settle Income Statement Controversy," The Journal of Accountancy, XCVI (August 1953), 212-16.

use of single-step income statements.[1]

When income calculations are identified primarily with monetary concepts, a company's cash dividends and reported earnings traditionally are bound together by real and definite economic relationships. Consequently, owners often use payout analysis to appraise the dividend-paying capacity of the company and to assess the risk and future prospects of their investments. An accounting procedure which causes unreasonable divergence in dividend payout percentages (from a standard such as the mean) may be of dubious soundness by failing to provide financial measurements that facilitate intelligent decision-making by owners. Thus, the practice of assigning the costs of all intangible assets to time periods for matching with revenues of the time periods could be questioned because it distorts the "normal" relation between dividends and earnings for a going concern and generally impairs the reliability of income data and payout ratios in judging the dividend-paying capacity of that enterprise.

The accounting practice of amortizing intangibles which have no determinable date of expiration of life also may be unwarranted if expenditures are continually being made and charged against revenues to

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[1]The earning power concept of the income statement is comparable to the American Institute's current operating performance concept of net income (see Chapter 8 of ARB No. 43), where the principal emphasis is upon the ordinary, normal, recurring operations of the entity during the current period. Accountants hold a considerable diversity of views on this question of what items should enter into the determination of net income for the period. This study shall not undertake to find a concept of net income which is acceptable to all. Furthermore, past emphasis on the current operating concept of net income is likely to change as a result of the Accounting Principles Board Opinion No. 9 issued December 1966, which supersedes ARB No. 43, Chapter 8.

maintain their value. Here the practice would result in a "double charge" against revenues during the amortization period.[1] Paul Grady also expounds this particular thought when he writes:

> Similarly, the charging off of unlimited term intangibles, such as goodwill, integration costs, etc., which are being fully maintained, would result in an understatement of cost of fixed assets and an overstatement of expenses.[2]

If the primary task of accounting is to present meaningful and useful financial statements, mandatory amortization of intangibles without limited life is not advocated. As long as (1) accounting remains based on the concept of a going concern and (2) outsiders insist on the earning-power concept for measuring periodic business income, the practice of arbitrarily amortizing type (b) intangibles appears unacceptable. Such a practice could mislead a financial analyst in evaluating the past operating performance of a business entity and in forming an opinion about its future potential.

Since many intangible assets have no natural limited life and are closely related to the economic value of the enterprise, usually there is no sound basis on which the expense of such intangibles for a single period or longer can be calculated. Where the intangible is deemed an investment--possessing an important income-producing factor and having no determinate life--and the policy of the enterprise is to maintain fully the value of the investment by high-quality products or services and by continued advertising, research and development, and other maintenance expenditures (which are charged to current operations),

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[1]Hendriksen, op. cit., p. 344.

[2]Paul Grady, "Accounting for Fixed Assets and Their Amortization," The Accounting Review, XXV (January 1950), 12.

the intangible asset "should not be amortized or written off unless and until there is permanent impairment in earning power."[1]

## Effect of Alternatives on Financial Ratios

The information given in a financial statement should be related to its purpose. This purpose was admirably summarized many years ago by the American Institute of Certified Public Accountants:

> Financial statements are prepared for the purpose of presenting a periodical review or report by the management and deal with the status of the investment in the business and the results achieved during the period under review.[2]

As indispensable instruments for the fulfillment of management's fiduciary accountabilities, financial statements are prepared primarily for the benefit of people. These statements should provide stockholders and creditors with comprehensive and dependable information about the conduct of the business. Such information is required in order that these people can form an intelligent opinion about the effectiveness of the management to which they have delegated authority and entrusted their investments.[3]

Closely related to the presentation of financial statements is their analysis and interpretation. In fact, as organized summaries of detailed financial data, statements themselves are a form of analysis.[4]

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[1] Ibid., (italics mine).

[2] Examination of Financial Statements by Independent Public Accountants (New York: American Institute of Certified Public Accountants, 1936), p. 1.

[3] H. A. Finney and Herbert E. Miller, Principles of Accounting, Intermediate (6th ed.; Englewood Cliffs, N. J.: Prentice-Hall, Inc., 1965), p. 49.

[4] Walter B. Meigs, Charles E. Johnson, and Thomas F. Keller, Intermediate Accounting (New York: McGraw-Hill Book Co., Inc., 1963), p. 875.

But many of the items appearing in corporate statements are of limited significance when considered individually. Through the use of percentages, ratios, and trends the art of financial analysis attempts to bring out the full significance and meaning of the data presented in financial statements. These relationships as expressed by financial ratios can be most helpful to people outside of the business enterprise in evaluating the financial condition and operating results of that enterprise.

Now that it is apparent that alternative combination accounting practices do produce striking differences in a firm's financial position and earnings, the consequences of these alternative pooling-purchase treatments on important financial ratios is appraised. A thorough study of the impact of pooling and purchase accounting on financial statement analysis should identify some of the inadequacies in current reporting practices for business combinations. There are two primary purposes of this research:

1. To determine whether any particular combination accounting treatment makes financial statements more meaningful.

2. To determine whether investor decision-making would be improved by the consistent application of one combination accounting method.

## Efficiency and Profitability Ratios

An analysis of the data in Exhibits 28 and 29 makes it apparent that some of the efficiency and profitability ratios are affected substantially. Warner-Lambert and Chas. Pfizer have been selected for this analysis because both companies have an active history of using the pooling and purchasing techniques over the ten-year period 1956-65.

Exhibit 28 shows how the pooling concept tends to overstate

Exhibit 28

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON EFFICIENCY RATIOS OF WARNER-LAMBERT AND CHAS. PFIZER, 1962-65*

| | 1962 | 1963 | 1964 | 1965 |
|---|---|---|---|---|
| **WARNER-LAMBERT** | | | | |
| Earning Power (per cent) | | | | |
| Pooling concept | 34.4 | 28.7 | 29.9 | 29.8 |
| Mixture, as reported | 34.3 | 28.6 | 29.3 | 28.7 |
| Purchase without amortization | 22.1 | 16.2 | 16.9 | 17.2 |
| Purchase with amortization | 17.7 | 13.4 | 14.8 | 16.3 |
| Asset Turnover (times) | | | | |
| Pooling concept | 1.8 | 1.4 | 1.5 | 1.6 |
| Mixture, as reported | 1.8 | 1.4 | 1.5 | 1.5 |
| Purchase without amortization | 1.1 | 0.8 | 0.9 | 0.9 |
| Purchase with amortization | 1.3 | 0.9 | 1.0 | 1.1 |
| Income Margin (per cent) | | | | |
| Pooling concept | 19.5 | 20.6 | 19.9 | 18.7 |
| Mixture, as reported | 19.5 | 20.6 | 19.9 | 18.7 |
| Purchase without amortization | 19.5 | 20.6 | 19.9 | 18.7 |
| Purchase with amortization | 14.2 | 15.1 | 14.8 | 14.4 |
| **CHAS. PFIZER** | | | | |
| Earning Power (per cent) | | | | |
| Pooling concept | 19.6 | 18.7 | 19.0 | 21.0 |
| Mixture, as reported | 19.1 | 17.9 | 17.6 | 19.2 |
| Purchase without amortization | 16.4 | 15.4 | 15.2 | 16.8 |
| Purchase with amortization | 15.2 | 14.1 | 14.0 | 16.0 |
| Asset Turnover (times) | | | | |
| Pooling concept | 1.2 | 1.1 | 1.2 | 1.2 |
| Mixture, as reported | 1.2 | 1.1 | 1.1 | 1.1 |
| Purchase without amortization | 1.0 | 0.9 | 0.9 | 1.0 |
| Purchase with amortization | 1.0 | 1.0 | 1.0 | 1.0 |
| Income Margin (per cent) | | | | |
| Pooling concept | 16.6 | 16.8 | 16.2 | 17.7 |
| Mixture, as reported | 16.6 | 16.8 | 16.2 | 17.7 |
| Purchase without amortization | 16.6 | 16.8 | 16.2 | 17.7 |
| Purchase with amortization | 14.8 | 14.7 | 14.1 | 15.6 |

*Although the ratios are for years 1962-65, the analysis considers all business acquisitions and mergers occurring during the years 1951-65.

Exhibit 29

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON PROFITABILITY RATIOS OF WARNER-LAMBERT AND CHAS. PFIZER, 1962-65

| | 1962 | 1963 | 1964 | 1965 |
|---|---|---|---|---|
| **WARNER-LAMBERT** | | | | |
| Return on Capital (per cent) | | | | |
| Pooling concept | 22.5 | 19.2 | 21.4 | 23.2 |
| Mixture, as reported | 22.4 | 19.1 | 20.8 | 22.0 |
| Purchase without amortization | 12.9 | 9.4 | 10.4 | 11.3 |
| Purchase with amortization | 6.3 | 5.0 | 6.3 | 8.5 |
| Return on CS* Equity (per cent) | | | | |
| Pooling concept | 26.6 | 23.5 | 25.9 | 27.9 |
| Mixture, as reported | 26.5 | 23.4 | 25.0 | 26.2 |
| Purchase without amortization | 13.9 | 10.0 | 11.0 | 12.0 |
| Purchase with amortization | 6.7 | 5.1 | 6.5 | 9.0 |
| Cash Flow to CS Equity (per cent) | | | | |
| Pooling concept | 31.4 | 27.3 | 30.1 | 32.5 |
| Mixture, as reported | 31.2 | 27.1 | 29.2 | 30.5 |
| Purchase without amortization | 16.4 | 11.6 | 12.8 | 14.0 |
| Purchase with amortization | 18.8 | 13.5 | 16.0 | 18.6 |
| **CHAS. PFIZER** | | | | |
| Return on Capital (per cent) | | | | |
| Pooling concept | 15.8 | 15.7 | 16.5 | 17.8 |
| Mixture, as reported | 15.3 | 14.8 | 14.8 | 15.7 |
| Purchase without amortization | 12.5 | 12.0 | 12.1 | 13.0 |
| Purchase with amortization | 10.7 | 10.0 | 10.1 | 11.4 |
| Return on CS Equity (per cent) | | | | |
| Pooling concept | 17.1 | 16.6 | 17.4 | 19.2 |
| Mixture, as reported | 16.5 | 15.5 | 15.5 | 16.7 |
| Purchase without amortization | 13.2 | 12.4 | 12.4 | 13.6 |
| Purchase with amortization | 11.2 | 10.4 | 10.4 | 12.0 |
| Cash Flow to CS Equity (per cent) | | | | |
| Pooling concept | 23.6 | 22.9 | 23.9 | 25.6 |
| Mixture, as reported | 22.7 | 21.4 | 21.4 | 22.3 |
| Purchase without amortization | 18.2 | 17.1 | 17.1 | 18.1 |
| Purchase with amortization | 19.1 | 18.3 | 18.8 | 20.3 |

*CS stands for Common Stock. Capital is defined as the sum of a firm's long-term debt, preferred stock, and common equity.

managerial efficiency in operations. Earning-power ratios are considerably lower under the purchase-with-amortization method than under other combination accounting treatments. Asset turnover ratios also are reduced by using a purchase approach in accounting for business combinations. Operational results unquestionably appear most favorable when reporting practices consistently follow the pooling concept.

But what is the true earning power of Warner-Lambert, for example, in 1965? Is the management actually earning about 30 per cent on the company's total assets, as indicated by the pooling technique? Or is it earning only about 16 or 17 per cent as suggested by purchase treatments (with or without amortization)? Since book values are relevant to no other enterprise but the one which originally incurred such cost, earning-power accountabilities of the buying enterprise are best measured by the consistent application of the purchasing method as contrasted with the pooling technique. This seems to be true regardless of amortization factors in the analysis.

For example, Pfizer's 1965 return on total assets declines slightly from 16.8 per cent to 16.0 per cent when changing from the purchase-without-amortization to the purchase-with-amortization method. This difference is relatively minor when contrasted with a 21 per cent earning power ratio that Pfizer would have reported by using the pooling technique. The conclusion follows that, regardless of amortization policies, the consistent application of purchase accounting offers more realistic operating statistics for an enterprise's earning power. The pooling concept tends to distort earning-power ratios and to make the management's operating results appear more favorable than they really are.

Exhibit 29 demonstrates the consequences of various acquisition-merger accounting techniques on profitability ratios. Return on capital ratios are significantly higher under the pooling concept. Return on common stock equity ratios also are increased by using the pooling approach in business combination accounting. Obviously, from an analysis of the statistics in Exhibit 29, profitability ratios vary widely, depending on the pooling-purchase accounting treatment selected by an enterprise.

What is the relevant return on equity ratio in 1965 applicable to Warner-Lambert common shareholders? Just how successful has the management been in earning a satisfactory return on the owner's investment? If every business combination involves an exchange of assets and/or equities between independent parties, for which the management of the buying enterprise should be held accountable, then the consistent application of the purchasing approach probably provides more intelligible and relevant financial ratios to appraise the profitability of that enterprise. From the point of view of the buying enterprise at the time of the business combination, the purchase treatment (relative to pooling) requires a complete and realistic accounting for the additional capital invested by it to acquire the selling company. Thus, Warner-Lambert's actual return on common stock equity in 1965 is more likely to be about 9 to 12 per cent rather than 26 to 28 per cent. There is no question that information about return on investment may be distorted by extremely conservative combination accounting practices.

Exhibits 30 through 33 emphasize several important points. First of all, they illustrate how efficiency and profitability ratios

Exhibit 30

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON EARNING POWER FOR EIGHT COMPANIES, 1965

| | Pooling Concept | Mixture as reported | Purchase without Amortization | Purchase with Amortization | |
|---|---|---|---|---|---|
| Bristol-Myers | 44.4% | 38.4% | 27.8% | 23.1% | |
| Warner-Lambert | 29.8 | 28.7 | 17.2 | 16.3 | |
| Richardson-Merrell | 33.8 | 25.3 | 25.2 | 26.2 | |
| Chas. Pfizer | 21.0 | 19.2 | 16.8 | 16.0 | |
| Procter & Gamble | 19.7 | 19.1 | 18.1 | 17.9 | |
| Diamond Alkali | 13.1 | 12.6 | 11.8 | 11.1 | |
| Colgate-Palmolive | 12.9 | 12.6 | 12.1 | 12.1 | |
| Allied Chemical | 11.2 | 10.9 | 9.0 | 7.9 | |
| High-Low Spread | 33.2% | 27.5% | 18.8% | 18.3% | |
| Rankings based on above percentages: | | | | | Effect* |
| Bristol-Myers | 1 | 1 | 1 | 2 | F |
| Warner-Lambert | 3 | 2 | 4 | 4 | F |
| Richardson-Merrell | 2 | 3 | 2 | 1 | I |
| Chas. Pfizer | 4 | 4 | 5 | 5 | F |
| Procter & Gamble | 5 | 5 | 3 | 3 | I |
| Diamond Alkali | 6 | 6 | 7 | 7 | F |
| Colgate-Palmolive | 7 | 7 | 6 | 6 | I |
| Allied Chemical | 8 | 8 | 8 | 8 | S |

*F = ranking fell.
I = ranking improved.
S = ranking remained the same.

Exhibit 31

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON RETURN ON CAPITAL FOR EIGHT COMPANIES, 1965

| | Pooling Concept | Mixture as reported | Purchase without Amortization | Purchase with Amortization |
|---|---|---|---|---|
| Bristol-Myers | 32.0% | 26.3% | 17.5% | 10.5% |
| Warner-Lambert | 23.2 | 22.0 | 11.3 | 8.5 |
| Chas. Pfizer | 17.8 | 15.7 | 13.0 | 11.4 |
| Richardson-Merrell | 20.4 | 14.4 | 14.4 | 13.6 |
| Procter & Gamble | 14.3 | 13.8 | 12.9 | 12.3 |
| Diamond Alkali | 10.8 | 10.4 | 9.5 | 8.6 |
| Colgate-Palmolive | 10.7 | 10.3 | 9.7 | 9.5 |
| Allied Chemical | 10.6 | 10.1 | 8.1 | 6.5 |
| High-Low Spread | 21.4% | 16.2% | 9.4% | 7.1% |
| Rankings based on above percentages | | | | Effect* |
| Bristol-Myers | 1 | 1 | 1 | 4 F |
| Warner-Lambert | 2 | 2 | 5 | 7 F |
| Chas. Pfizer | 4 | 3 | 3 | 3 S |
| Richardson-Merrell | 3 | 4 | 2 | 1 I |
| Procter & Gamble | 5 | 5 | 4 | 2 I |
| Diamond Alkali | 6 | 6 | 7 | 6 S |
| Colgate-Palmolive | 7 | 7 | 6 | 5 I |
| Allied Chemical | 8 | 8 | 8 | 8 S |

*F = ranking fell.
I = ranking improved.
S = ranking remained the same.

Exhibit 32

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON RETURN ON COMMON STOCK EQUITY FOR EIGHT COMPANIES, 1965

| | Pooling Concept | Mixture as reported | Purchase without Amortization | Purchase with Amortization |
|---|---|---|---|---|
| Bristol-Myers | 33.0% | 26.9% | 17.7% | 10.6% |
| Warner-Lambert | 27.9 | 26.2 | 12.0 | 9.0 |
| Chas. Pfizer | 19.2 | 16.7 | 13.6 | 12.0 |
| Procter & Gamble | 15.4 | 14.7 | 13.7 | 13.1 |
| Richardson-Merrell | 20.4 | 14.4 | 14.4 | 13.6 |
| Allied Chemical | 13.2 | 12.5 | 9.1 | 7.3 |
| Diamond Alkali | 12.5 | 11.8 | 10.5 | 9.2 |
| Colgate-Palmolive | 11.3 | 10.8 | 10.1 | 9.9 |
| High-Low Spread | 21.7% | 16.1% | 8.6% | 6.3% |

| Rankings based on above percentages | | | | | Effect* |
|---|---|---|---|---|---|
| Bristol-Myers | 1 | 1 | 1 | 4 | F |
| Warner-Lambert | 2 | 2 | 5 | 7 | F |
| Chas. Pfizer | 4 | 3 | 4 | 3 | S |
| Procter & Gamble | 5 | 4 | 3 | 2 | I |
| Richardson-Merrell | 3 | 5 | 2 | 1 | I |
| Allied Chemical | 6 | 6 | 8 | 8 | F |
| Diamond Alkali | 7 | 7 | 6 | 6 | I |
| Colgate-Palmolive | 8 | 8 | 7 | 5 | I |

*F = ranking fell.
I = ranking improved.
S = ranking remained the same.

Exhibit 33

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON CASH FLOW TO COMMON STOCK EQUITY FOR EIGHT COMPANIES, 1965

| | Pooling Concept | Mixture as reported | Purchase without Amortization | Purchase with Amortization |
|---|---|---|---|---|
| Warner-Lambert | 32.5% | 30.5% | 14.0% | 18.6% |
| Bristol-Myers | 36.9 | 30.1 | 19.8 | 22.0 |
| Allied Chemical | 27.7 | 26.3 | 19.2 | 21.9 |
| Diamond Alkali | 24.8 | 23.3 | 20.8 | 22.4 |
| Chas. Pfizer | 25.6 | 22.3 | 18.1 | 20.3 |
| Procter & Gamble | 19.1 | 18.3 | 16.9 | 17.6 |
| Richardson-Merrell | 24.3 | 17.1 | 17.1 | 20.2 |
| Colgate-Palmolive | 17.7 | 16.9 | 15.9 | 16.9 |
| High-Low Spread | 19.2% | 13.6% | 6.8% | 5.5% |
| **Rankings based on above percentages** | | | | **Effect*** |
| Warner-Lambert | 2 | 1 | 8 | 6 F |
| Bristol-Myers | 1 | 2 | 2 | 2 S |
| Allied Chemical | 3 | 3 | 3 | 3 S |
| Diamond Alkali | 5 | 4 | 1 | 1 I |
| Chas. Pfizer | 4 | 5 | 4 | 4 I |
| Procter & Gamble | 7 | 6 | 6 | 7 F |
| Richardson-Merrell | 6 | 7 | 5 | 5 I |
| Colgate-Palmolive | 8 | 8 | 7 | 8 S |

*F = ranking fell.
I = ranking improved.
S = ranking remained the same.

change enough to have a significant effect on financial analysis. Decisions made by a financial analyst are likely to be different depending on the combination accounting method adopted. In these exhibits the effects on a company's ranking is based on a comparison between the "mixture, as reported" and "purchase-with-amortization" treatments. Clearly, the number of firms given a different ranking as a result of using the purchase-with-amortization approach is of significance. Of the eight companies, the following number were given a different ranking from that which they had before:

| | Ranking Fell | Ranking Improved | Total |
|---|---|---|---|
| Earning power | 4 | 3 | 7 |
| Return on capital | 2 | 3 | 5 |
| Return on common stock equity | 3 | 4 | 7 |
| Cash flow to common stock equity | 2 | 3 | 5 |

Furthermore, when based on a comparison between the mixture as reported and the purchase-without-amortization treatments, there is a similar significant change in rankings for the eight companies:

| | Ranking Fell | Ranking Improved | Total |
|---|---|---|---|
| Earning power | 3 | 3 | 6 |
| Return on capital | 2 | 3 | 5 |
| Return on common stock equity | 3 | 4 | 7 |
| Cash flow to common stock equity | 1 | 4 | 5 |

In many cases there was a spread of two or more places between the companies' positions depending on alternative combination accounting practices. With respect to return on capital, for example,

Warner-Lambert ranked seventh under the purchase-with-amortization technique, but it actually ranked second based on information as reported in the financial statements. It is interesting to note the companies whose rankings fell or improved by two or more places:

Warner-Lambert . . . . . ranking fell 4 times.
Bristol-Myers . . . . . ranking fell twice.
Allied Chemical . . . . ranking fell once.
Richardson-Merrell . . . ranking improved 4 times.
Procter & Gamble . . . . ranking improved 3 times.
Colgate-Palmolive . . . ranking improved twice.
Diamond Alkali . . . . . ranking improved once.

As might be expected, Exhibits 30 through 33 illustrate further that the companies which have an active history of large poolings are the ones which would be hurt most as to ranking by using the purchase-with-amortization method of accounting for business combinations. For example, Warner-Lambert ranked first in regard to the ratio of cash flow to common stock equity, but it ranked sixth after all poolings were converted to purchases with amortization. At the other extreme, Richardson-Merrell, a firm which used the pooling concept to the smallest degree, improved from fifth to first place in the ranking for rate of return on common stock equity.

For all ratios, Exhibits 30 through 33 also illustrate that the high-low spread (difference) between the best and the worst ranking company is the <u>largest</u> under the pooling concept. This high-low spread becomes correspondingly smaller as one moves from the pooling concept to the mixture approach, the purchase-without-amortization method, and finally, the purchase-with-amortization method. Such exorbitant

differences between these financial ratios that result from applying the pooling technique could indicate that such ratios are essentially invalid for analytical purposes. Although the evidence is inconclusive, this may suggest that the consistent application of purchase accounting (with or without amortization) gives more reliable financial ratios and hence makes financial statements more meaningful. The ratios appear unreliable under the pooling concept (or mixture method) in the sense that they may not be accurately measuring what they are intended to measure (evaluate managerial performance) and therefore could be invalid for purposes of making intercompany comparisons.

The operations of the dominant company--the one continuing enterprise of paramount importance--do not need to be restated at the time of a business combination because the past costs incurred by it are as significant as before. But the historical cost transactions of acquired companies are unrelated to the operations of the buying enterprise. These costs are essentially meaningless for future analytical purposes and generally have no inherent reporting value to the acquiring company. Such costs may not be representative of the service potential of assets acquired by the buying entity at the time of the combination if market value of shares given is substantially greater than book value of assets purchased. The "normal" significance of future reports of the dominant company can be distorted when historical cost data of acquired companies are injected into its record-keeping process. Furthermore, the significance of current value information at the time of a business combination does not depend in any way whatsoever upon the usual

criteria which are proposed as guidelines for distinguishing between a purchase and a pooling of interests.[1]

It should be stressed that useful analysis and interpretation of published financial data as a basis for decision-making by creditors and stockholders depend on the validity of financial statements. The results obtained from accounting records are no more reliable than the validity of the information that is put into them.[2] Since ratios are normally computed directly from a company's financial statements, if inaccurate information is put into the accounting records, then the financial ratios calculated from resultant reports cannot themselves be accurate.

Other Ratios

Exhibits 34 through 36 are designed to illustrate important points on three financial relationships:

1. Funded debt to capital
2. Interest coverage (or times interest earned)
3. Price to book value

From an analysis of Exhibit 34, it is apparent that using a pooling approach in accounting for business combinations tends to increase debt as a per cent of total capital. Debt-to-capital relationships are more favorable (lower) under purchasing treatments. This

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[1]William M. Parker, "Business Combinations and Accounting Valuation," Journal of Accounting Research, IV (Autumn 1966), 153.

[2]Louis Goldberg, An Inquiry Into the Nature of Accounting, American Accounting Association Monograph No. 7 (American Accounting Association, 1965), p. 220.

result arises from the fact that pooling, relative to purchasing, simultaneously understates the asset side and net worth section of the balance sheet. If the reported values for stockholders' equity are lower by reason of pooling accounting, then debt-to-capital ratios will worsen (be higher) with the consistent application of the pooling technique.

Exhibit 34, for example, shows how debt-to-capital ratios are higher for Allied Chemical under the pooling concept than for other combination accounting practices. From 23.8 per cent in 1965 using the purchase-without-amortization method, the debt-to-capital ratio

Exhibit 34

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON DEBT-TO-CAPITAL RATIOS FOR THREE COMPANIES, 1962-65

| | 1962 | 1963 | 1964 | 1965 |
|---|---|---|---|---|
| ALLIED CHEMICAL | | | | |
| Pooling concept | 28.2% | 27.0% | 26.7% | 30.9% |
| Mixture, as reported | 27.3 | 26.1 | 25.6 | 29.8 |
| Purchase without amortization | 21.2 | 20.2 | 20.1 | 23.8 |
| Purchase with amortization | 22.1 | 21.7 | 22.0 | 26.6 |
| COLGATE-PALMOLIVE | | | | |
| Pooling concept | 15.1 | 14.3 | 12.8 | 12.7 |
| Mixture, as reported | 14.5 | 13.8 | 12.3 | 12.3 |
| Purchase without amortization | 13.7 | 13.0 | 11.6 | 11.6 |
| Purchase with amortization | 14.2 | 13.6 | 12.3 | 12.3 |
| DIAMOND ALKALI | | | | |
| Pooling concept | 21.9 | 21.8 | 27.3 | 25.0 |
| Mixture, as reported | 20.9 | 20.9 | 26.3 | 23.7 |
| Purchase without amortization | 19.3 | 19.3 | 24.5 | 21.6 |
| Purchase with amortization | 19.9 | 20.1 | 25.7 | 22.9 |

increases to 30.9 per cent using the pooling concept. As a result of this worsening ratio of debt to capital resulting from pooling, the capital market could require Allied Chemical to pay a higher rate of interest on future debt securities.

While debt-to-capital ratios are relatively greater when combinations are accounted for on a pooling basis than under purchasing methods, accounting for such combinations under the purchase-with-amortization technique leads to unfavorable interest coverage ratios. Note from Exhibit 35 how "times interest earned" computations for Allied Chemical, Colgate-Palmolive, and Diamond Alkali are lower when amortization enters into the analysis.

The differences in Exhibit 35 between interest coverage ratios with or without amortization may not be considered too significant for

Exhibit 35

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON INTEREST COVERAGE RATIOS FOR THREE COMPANIES, 1962-65
(times interest earned)

| | 1962 | 1963 | 1964 | 1965 | 1962-65 Mean |
|---|---|---|---|---|---|
| ALLIED CHEMICAL | | | | | |
| Purchase without amortization* | 12.3 | 15.1 | 16.3 | 12.9 | 14.2 |
| Purchase with amortization | 9.2 | 12.1 | 13.3 | 10.5 | 11.3 |
| COLGATE-PALMOLIVE | | | | | |
| Purchase without amortization* | 15.7 | 16.3 | 16.8 | 17.8 | 16.7 |
| Purchase with amortization | 15.0 | 15.5 | 16.1 | 17.1 | 15.9 |
| DIAMOND ALKALI | | | | | |
| Purchase without amortization* | 15.6 | 13.6 | 13.1 | 14.4 | 14.2 |
| Purchase with amortization | 14.2 | 12.3 | 12.1 | 13.0 | 12.9 |

*It should be noted that interest coverage ratios are the same using the pooling or mixture approach as they are under the purchase-without-amortization treatment. Colgate-Palmolive discontinued the practice of amortizing goodwill in 1961.

purposes of financial analysis. All of these companies have large amounts of earnings available to meet interest requirements even when these earnings are reduced by amortization charges. Furthermore, as mentioned earlier, most creditors, when appraising an enterprise's debt capacity, place greater importance on cash flow statistics rather than on reported earnings. Thus, it is likely that the creditor decision-making process in evaluating a firm's interest-paying ability is not affected unduly by management's choice of alternative combination accounting practices.

An analysis of the data in Exhibit 36 makes it apparent that price-to-book-value ratios are affected substantially depending on which combination accounting practice is followed. Price-to-book-value relationships unquestionably are highest when reporting practices consistently follow the pooling concept.

Although book value is a statistic of questionable value, financial analysts do measure a company's price-to-book-value ratio in order to evaluate whether the current market price is in line with price-to-book-value relationships traditionally experienced by that company. Such a measure may be of some significance in appraising the degree of valuation risk associated with common stock investments.[1]

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[1] "Valuation" risk may be defined as the inherent price volatility underlying common stocks as an investment media. Even though specific adverse developments do not occur within a company, an effective loss of principal can result because the company may fail to live up to the very favorable expectations implied by the market price and incorporated into the optimistic valuation estimate. This dimension of valuation risk appears quite frequently in connection with growth companies. See Douglas A. Hayes, Investments: Analysis and Management (New York: The Macmillan Company, 1961), pp. 548-50.

Exhibit 36

EFFECTS OF ALTERNATIVE POOLING-PURCHASE ACCOUNTING TREATMENTS ON PRICE-TO-BOOK-VALUE RATIOS FOR EIGHT COMPANIES, 1965
(times)

| | Pooling Concept | Mixture as reported | Purchase without Amortization | Purchase with Amortization | |
|---|---|---|---|---|---|
| Bristol-Myers | 8.92 | 7.36 | 3.87 | 4.29 | |
| Warner-Lambert | 6.34 | 5.94 | 2.79 | 3.81 | |
| Chas. Pfizer | 4.24 | 3.67 | 3.02 | 3.42 | |
| Procter & Gamble | 3.72 | 3.57 | 3.31 | 3.47 | |
| Richardson-Merrell | 3.78 | 2.71 | 2.70 | 3.22 | |
| Allied Chemical | 2.07 | 1.96 | 1.45 | 1.67 | |
| Colgate-Palmolive | 1.94 | 1.86 | 1.75 | 1.87 | |
| Diamond Alkali | 1.49 | 1.38 | 1.22 | 1.31 | |
| High-Low Spread | 7.43 | 5.98 | 2.65 | 2.98 | |
| Rankings based on above ratios | | | | | Effect* |
| Bristols-Myers | 1 | 1 | 1 | 1 | S |
| Warner-Lambert | 2 | 2 | 4 | 2 | F |
| Chas. Pfizer | 3 | 3 | 3 | 4 | S |
| Procter & Gamble | 5 | 4 | 2 | 3 | I |
| Richardson-Merrell | 4 | 5 | 5 | 5 | S |
| Allied Chemical | 6 | 6 | 7 | 7 | F |
| Colgate-Palmolive | 7 | 7 | 6 | 6 | I |
| Diamond Alkali | 8 | 8 | 8 | 8 | S |

*In this exhibit the effect on ranking is based on a comparison between the "mixture, as reported" and "purchase without amortization" treatments. F, I, and S have same meanings as in Exhibits 30 through 33.

A study of Chas. Pfizer, for example, during 1957-58 before the company began its active history of growth through acquisitions and mergers reveals that the firm's price-to-book-value ratio traditionally deviated slightly about 2.8. But observe what has happened to this price-book value relationship in recent years depending on the pooling-purchase accounting technique followed:

| Year | Pooling Concept | Mixture as reported | Purchase without Amortization | Purchase with Amortization |
|---|---|---|---|---|
| 1961 | 3.98 | 3.83 | 3.06 | 3.20 |
| 1962 | 3.68 | 3.55 | 2.85 | 3.02 |
| 1963 | 3.92 | 3.57 | 2.85 | 3.09 |
| 1964 | 3.59 | 3.15 | 2.53 | 2.81 |
| 1965 | 4.24 | 3.67 | 3.02 | 3.42 |
| 1961-65 Mean | 3.88 | 3.56 | 2.86 | 3.11 |

Note how following the purchase-without-amortization treatment for Chas. Pfizer gives the lowest price-to-book-value ratios that are very much in line with ratios previously experienced by that company. Clearly, the consistent application of purchase-without-amortization accounting results in price-to-book-value ratios that correlate best with historical price-book value relationships normally maintained by the enterprise. The analytical significance of price-to-book-value relationships appears to be misconstrued when the pooling concept is used.

Exhibit 36 also discloses that the high-low spread between the ratios of the eight companies is largest under the pooling approach to business combination accounting. Such extreme differences between these price-to-book-value ratios that result from applying the pooling

technique could suggest that such ratios are essentially unreliable for sound analytical purposes. Although the evidence is not conclusive, the study finds price-to-book-value ratios most valid as an analytical tool for investor decision-making in appraising valuation risk when business combination accounting practices consistently apply the purchase-without-amortization method.

Effect of Alternatives on Growth Rate Analysis

Growth rate analysis is regarded as a practical aid to stock valuation and investor decision-making. By studying the historical growth rates of earnings per share, dividends per share, and other financial data a shareholder may be able to determine the future prospects of his investment and value his stock investment in relation to its apparent future prospects. Growth rate statistics also assist stockholders and creditors in measuring the past effectiveness of the management to which they have entrusted their investments. An investigation of the effects of pooling and purchase accounting on growth rate analysis should help determine whether any particular combination accounting treatment renders financial statements more meaningful.

Exhibit 37 gives growth rates per annum for selected companies for three financial items: (1) net income to common, (2) net sales, and (3) book value per common share. From the exhibit it is apparent that growth rates for book value per share vary widely depending on which combination accounting treatment is adopted. The book-value growth rates that result by reason of pooling accounting are lower and definitely out of line in comparison to the other growth rates. In fact, comparisons between the growth rates for net income to common, net sales,

Exhibit 37

COMPARISON OF GROWTH RATES FOR SELECTED COMPANIES, 1956-65
(growth rates per annum)

| | Net Income to Common | Net Sales | Book Value Per Share: Purchase without Amortization | Book Value Per Share: Purchase with Amortization | Book Value Per Share: Pooling Concept |
|---|---|---|---|---|---|
| Bristol-Myers | 21.8% | 16.0% | 16.7% | 15.1% | 10.1% |
| Chas. Pfizer | 12.0 | 13.2 | 14.0 | 12.7 | 9.3 |
| Warner-Lambert | 14.3 | 11.9 | 13.8 | 11.3 | 6.4 |
| Richardson-Merrell | 12.4 | 10.5 | 12.1 | 10.0 | 8.8 |
| Allied Chemical | 8.7 | 6.4 | 6.5 | 5.1 | 1.5 |
| Colgate-Palmolive | 4.6 | 6.3 | 4.7 | 4.0 | 3.4 |

and book value per share under the purchase-without-amortization method seem to possess the best correlative characteristics. If there is any significant connection between a firm's growth in earnings, sales, and book value per share, this relationship is severely distorted when that firm consistently follows the pooling concept in accounting for business acquisitions and mergers.

From Exhibit 38 it also is apparent that growth rates for earnings per share are affected quite substantially as a result of the policy of amortizing goodwill and other intangibles by charges against revenues. This exhibit shows the fundamental underlying relationships of three principal items of financial data. Although they may fluctuate slightly, the cash flows, dividends, and reported earnings of a typical going concern generally are bound together by a real and definite

Exhibit 38

GROWTH RATE ANALYSIS FOR FOUR SELECTED COMPANIES, 1956-65

| | Growth Rate per annum as per cent | Correlation Coefficient with Time |
|---|---|---|
| **Bristol-Myers** | | |
| Cash flow per share | 16.3 | 0.9929 |
| Dividends per share | 18.4 | 0.9945 |
| Earnings per share | 18.6 | 0.9953 |
| Earnings per share (A)* | 14.2 | 0.9479 |
| **Richardson-Merrell** | | |
| Cash flow per share | 11.3 | 0.9786 |
| Dividends per share | 11.4 | 0.9417 |
| Earnings per share | 11.5 | 0.9653 |
| Earnings per share (A) | 9.2 | 0.9493 |
| **Chas. Pfizer** | | |
| Cash flow per share | 9.5 | 0.9917 |
| Dividends per share | 8.2 | 0.9787 |
| Earnings per share | 8.6 | 0.9794 |
| Earnings per share (A) | 5.1 | 0.8896 |
| **Colgate-Palmolive** | | |
| Cash flow per share | 4.2 | 0.8646 |
| Dividends per share | 4.9 | 0.9435 |
| Earnings per share** | 3.6 | 0.7499 |
| Earnings per share (A) | 2.1 | 0.4778 |

*(A) means that the analysis reflects amortization charges over a ten-year period.

**These data for Colgate-Palmolive reflect minor amortization charges to operations in the years 1956, 1959, and 1960.

relationship.[1] Each respective correlation coefficient should be used to measure the validity of the indicated growth rate per annum.

Note from Exhibit 38 that each company's growth rate for earnings per share is comparable to cash flow and dividend growth rates as long as the income figures do not reflect amortization charges. But when goodwill and related intangible assets are amortized by periodic charges, growth rates for earnings per share are lower and at variance with cash flow and dividend growth rates. Note also how each company's correlation coefficient is lowered as a result of amortization, suggesting that the indicated earnings per share growth rate is less reliable in measuring past management effectiveness and in predicting the future prospects of the company. The accounting practice of arbitrarily amortizing the costs of type (b) intangible assets may be questioned because it fails to provide meaningful growth rate statistics for earnings per share (in comparison to other growth rates) that facilitate intelligent decision-making by investors. The lower earnings that result from such amortization may produce a statistical bias in income information contained in external general purpose reports. If there is a choice between biased and unbiased information, presuming that other standards have been met, the unbiased information is preferable.[2]

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[1]Support for such a statement is felt unnecessary because this is an economic pattern generally accepted by professional financial analysts. Professors Weston and Brigham suggest further that cash flows have a slightly better relationship to dividends than do earnings, but that discovering the exact nature of the relation requires more exhaustive studies than have been made to date. See J. Fred Weston and Eugene F. Brigham, Managerial Finance (2nd ed.; New York: Holt, Rinehart and Winston, 1966), pp. 445-49. Analysis of the eight selected companies in this study supports the views of the financial analysts.

[2]American Accounting Association Committee to Prepare a Statement on Basic Accounting Theory, op. cit., p. 11.

# CHAPTER VI

## SUMMARY AND CONCLUSIONS

The accounting treatment of business combinations must fall into one of two categories, either as "purchases" or as "poolings of interest." Under each category a variety of recording practices have been held to be in accordance with generally accepted accounting principles. Some business combination accounting practices, such as "partial poolings," actually overlap into both categories. The existing variety of pooling-purchase accounting treatments permits so much inconsistency in financial reports that they often become confusing and misleading.

The established criteria--such as relative size, continuity of ownership interests, alteration of voting rights, and others--are gradually being reduced to a minor role in deciding between a purchase or pooling application. These criteria are not sufficiently objective as standards in determining whether the pooling treatment ought to be allowed for a particular business acquisition or merger. Many accountants are not certain of the distinction between a purchase and a pooling of interests; nevertheless, they have deviated intentionally from basic accounting standards and implanted their own notion of desirable practices in this area.

At present, the decision to purchase or to pool is influenced more by the subjective attitudes of management than by the criteria of Accounting Research Bulletin No. 48 or sound accounting theory. Where a significant portion of the consideration used to effect an acquisition is in the form of equity shares, there now are no insurmountable barriers preventing management from adopting the pooling treatment if such a treatment is desirable and likely to give the most favorable financial impression. But when companies are allowed to choose whichever method is to their own advantage, confidence in the independence of the public accounting profession is weakened.

The financial statements of a business enterprise with an active history of acquisitions and mergers are affected substantially by the consistent application of different business combination accounting treatments. The manner in which business combinations are recorded has important consequences on selected financial data, on many financial ratios, and on investment analysis. Alternative pooling-purchase accounting procedures may, for example, affect (1) asset and equity values carried forward into subsequent financial statements, (2) the level of reported earnings, (3) efficiency ratios, (4) profitability ratios, (5) dividend payout ratios, (6) interest coverage ratios, and (7) growth rate analysis.

Much of the business combination controversy is centered in legal and tax considerations, neither of which is a proper criterion for evaluating the true merits of the issue. Economic substance, rather than legal form or tax considerations, should be the primary determinant of the accounting recognition for the business combination exchange

transaction.[1] SEC practice as to pooling of interests should be rejected because it appears to be adhering more to the legal aspects of the transaction than to the economic realities. At the time of a business combination, a careful process of investigation, evaluation, and reporting of results should be required to reflect as accurately as possible the fair value and true nature of the assets acquired.

## Conclusions

Based on the findings yielded by this study, the following conclusions are deemed warranted. With these conclusions a rational approach to business combination accounting procedures is suggested to improve the general usefulness of conventional financial statements. In developing a logical body of accounting principles and procedures applicable to mergers and acquisitions, the study has tried to adhere to the four basic standards (relevance, verifiability, freedom from bias, and quantifiability) for the best communication of financial information to interested parties outside the reporting enterprise--primarily stockholders, other investors, and creditors.

1. One of the minimum requirements of accounting is that its procedures are carried out consistently from a particular point of view.[2] In substance, most business combinations are acquisitions of one or more

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[1]Donald E. Kieso, one of the conclusions in his dissertation entitled "The Development of an Accounting Concept of Business Combinations," unpublished Ph.D. dissertation, University of Illinois, Urbana, 1963.

[2]Louis Goldberg, An Inquiry into the Nature of Accounting, American Accounting Association Monograph No. 7 (American Accounting Association, 1965), p. 47.

going concerns by a dominant enterprise. Accountability for such acquisitions should reflect the point of view of the continuing enterprise--"the entity which produces the activity."[1]

2. For the dominant enterprise, fundamentally, business mergers and acquisitions are simply one of several alternative methods of attaining the objective of business expansion. Often management finds it more economical to acquire an established business than to attempt to develop one by its own efforts and expenditures over a period of years. In effect, assets of acquired companies should be regarded as additions to the facilities of that dominant enterprise.

3. The purchase price of a going concern represents a capital investment from the point of view of the acquiring enterprise. To promote sound and informative financial reporting, most business combinations should be accounted for as purchases in the context of an investment decision, for in this way financial statements present fairly the enterprise's financial position and results of operations. From the point of view of the dominant "buying" enterprise at the time of a business combination, the purchase treatment (relative to pooling) requires a complete and realistic accounting for the additional capital invested by it to acquire the selling company. The general reliability of a reporting enterprise's financial information for interpretive purposes is not improved by the consistent application of the pooling concept in accounting for business combinations.

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[1]Arthur R. Wyatt, A Critical Study of Accounting for Business Combinations, Accounting Research Study No. 5 (New York: American Institute of Certified Public Accountants, 1963), p. 72.

4. The pooling-of-interests technique is incompatible with the investment concept of a business combination. In general, pooling-of-interests accounting should be discontinued because it fails to account for all costs of buying a business. It is common knowledge in business that going concerns are bought and sold at amounts widely divergent from book values. Recorded values of properties on the books of the acquired company are generally irrelevant to the investment decision and should not be assumed to express the total cost of the acquisition to the buying organization. Furthermore, when vendors' book values exceed acquisition cost as in a bargain purchase, the accounting practice of setting up the excess of book value over cost as a deferred credit and amortizing it to income is unacceptable. The excess credit in this type of business combination generally should be applied as a reduction to the carrying amounts of specific assets (principally property, plant, equipment, inventories, and intangibles) of the selling company based upon current values of the assets acquired.

5. The significance and meaning of information presented in the financial statements of a dominant enterprise are distorted when meaningless historical cost data of acquired companies are injected into its record-keeping process. Empirical evidence in this study demonstrates that many financial ratios are made invalid and lack significance by reason of applying the pooling technique. Useful analysis and interpretation of accounting reports as a basis for intelligent decision-making by outsiders was found more reliable when business combination accounting practices consistently followed the purchase-without-amortization method.

6. Accounting Research Bulletin No. 48 should be revised or withdrawn. In practice it does not provide any equitable means of distinguishing purchases from poolings. New criteria should be established that make the distinction between a purchase and a pooling of interests rest on differences of economic substance. Any revision of ARB No. 48 must justify from an economic viewpoint why a new basis of accountability should not arise at the time of the business combination. The position taken here is that only those mergers which have the characteristics of a "genuine corporate marriage" should be allowed to be treated as poolings of interests.[1]

7. There is no logical basis existing in accounting theory for a continuation of two different concepts of "acquisition cost" in accounting for business combinations depending mainly on the cash-stock forms of consideration used to effect the combinations. The type of consideration used in acquiring a going concern should not determine the purchase or pooling treatment applicable to the business combination transaction.

8. When consideration for a business combination is in the form of ownership equities, the shares of stock used by the acquiring corporation to effect the exchange are merely substitutes for cash, other assets, notes, or bonds. The acquisition cost of properties acquired by the buying enterprise in a stock transaction is best measured by the implied cash cost of the securities issued by the purchaser in the

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[1]This study also accepts the pooling treatment for a business combination between two legally separate but formerly related entities. See Wyatt, op. cit., recommendation No. 2, pp. 105-106. This study defines a genuine corporate marriage as that type of business combination situation in which Wyatt recommends the application of the "fair-value pooling" concept, pp. 81-86.

exchange, i.e., the amount of money which could have been raised through the public issue of the securities.[1] The cost of treasury stock given for a business acquisition is not a proper basis for determining the purchase price unless this cost happens to represent the fair value of the stock given up in the exchange.

9. It usually takes from six to eight months to consummate a merger or acquisition. Generally, the value assigned to any shares given as consideration should be based on the average market price of the stock for a period of 60 to 90 days prior to the date of the agreement between the bargaining constituents, rather than the closing market price of the stock on the date of the agreement. In this way combination transactions in which exact quantification is not apparent may be recorded at purchase prices that are reasonable approximations of exchange prices. The results of this study suggest that such a manner of valuation for ownership equities adequately meets the standard of quantifiability that the American Accounting Association Committee recommends as one of the criteria to be used in evaluating the acceptability of potential accounting information.[2]

10. After establishing the purchase price of a business combination, part of the acquisition cost should be assigned or allocated to current assets, prepaid items, tangible fixed assets, and sundry assets on a reasonable basis--at amounts representing the fair value of such assets

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[1]W. A. Paton and A. C. Littleton, An Introduction to Corporate Accounting Standards, American Accounting Association Monograph No. 3 (American Accounting Association, 1940), p. 28.

[2]American Accounting Association Committee to Prepare a Statement of Basic Accounting Theory, A Statement of Basic Accounting Theory (American Accounting Association, 1966), p. 8.

at the time of purchase. Any amount remaining may be considered to represent the investment in intangibles. Tax aspects of the exchange transaction should not dictate allocation procedures for purposes of financial reporting. The main objective in allocating the purchase price of a business combination is "to spread the cost realistically over the assets purchased so that financial position will be fairly stated and, upon realization of the assets purchased, income will be reflected in a reasonable manner" (italics mine).[1]

11. The investment in intangible assets should not be charged against retained earnings at the date of the acquisition. The amount of capital devoted to the enterprise is materially understated because of the arbitrary write-off of intangibles. Generally, such a practice distorts the value of assets (as bundles of service-potentials) relating to future periods and overstates an enterprise's efficiency and profitability ratios.

12. Although most intangible assets are unique and difficult to evaluate, the cash (or its equivalent) which is invested in patents, goodwill, formulas, trademarks, and similar intangibles is just as real as the cash which is invested in visible implements of production and distribution such as land, buildings, and equipment. Intangibles are valid capital assets of economic significance to the usual business enterprise. Where intangibles are acquired by the issuance of securities, or purchased for cash and other consideration, they should be accorded the same accounting recognition as tangible assets.

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[1]William L. Gladstone, "Tax Aspects of the Allocation of Purchase Price of a Business," The Journal of Accountancy, CXXII (October 1966), 37.

13. Present accounting procedures for intangible resources are confusing. Many of the intangible costs incurred in the normal operations of an enterprise (e.g., research and development costs, advertising expenditures, engineering and promotional costs) are recorded as expenses in the year they are incurred. Other intangible costs are either (1) written off immediately against retained earnings, (2) deferred and amortized by systematic charges in the income statement over a period of years, (3) carried at cost as a permanent asset on the balance sheet, or (4) never accounted for at all by reason of the pooling treatment. In accounting for intangibles the profession has instituted, as Dwight R. Ladd suggests, "truly a procedure for every taste."[1]

14. From an accounting standpoint, there is little difference between the costs of internally developed intangibles and the costs of intangibles acquired from another company. Both represent investment expenditures from the point of view of the acquiring enterprise to maintain or improve its competitive position in business affairs. Both types of intangible expenditures are likely to benefit the enterprise beyond the normal operating cycle of the business. Ideally, all intangible costs incurred by a specific business enterprise should be capitalized (recognized as assets), and then, as Accounting Research Study No. 3 recommends:

> "Intangibles" of limited term should be amortized as production cost or expense over their estimated service lives. Unlimited-term items should continue to be carried as assets, without amortization.[2]

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[1] Contemporary Corporate Accounting and the Public (Homewood, Ill.: Richard D. Irwin, Inc., 1963), p. 148.

[2] Robert T. Sprouse and Maurice Moonitz, A Tentative Set of Broad Accounting Principles for Business Enterprises, Accounting Research Study No. 3 (New York: American Institute of Certified Public Accountants, 1962), p. 36.

15. In accounting for intangibles, conservatism should not be the only governing factor. The desirable objective is clear--that there should be a proper matching of these costs with the future revenues to which they relate. Present accounting practices (with some noteworthy exceptions) of expensing immediately self-developed intangibles, capitalizing permanently the costs of externally acquired intangibles when purchased for cash, and omitting entirely such intangible assets when acquired by the issuance of equity securities are obviously inconsistent. This study suggests that such accounting does not properly match costs and revenues. When costs and the related benefits are improperly matched between fiscal periods, management performance and accountability for results of operations are obscured.[1]

16. One important characteristic of most intangible assets is the high degree of uncertainty regarding the value of the future benefits to be received.[2] Accounting for research and development costs presents a difficult problem because most of such expenditures cannot be identified with specific products or projects on any practicable basis. Many intangibles which do not have a natural limited life are a component part of the economic value of the enterprise. Often the rights, conditions, claims, or privileges received in an intangible investment can be associated with specific tangible assets, but unlike the tangibles they cannot be transferred to alternative uses. The costs of some intangibles,

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[1]Arthur Andersen and Co., Accounting and Reporting Problems of the Accounting Profession (2nd ed.; Chicago: Arthur Andersen and Co., October 1962), p. 93.

[2]Eldon S. Hendriksen, Accounting Theory (Homewood, Ill.: Richard D. Irwin, Inc., 1965), p. 337.

such as patents, trademarks, and trade names, are joint costs.[1]

17. Even though there are difficult problems in the valuation of intangibles, this is not sufficient reason for failing to account properly for such assets. The costs of internally developed intangibles should not be deferred to future operations unless there is a reasonable expectation that they will be recovered.[2] But where the cost of organization, secret processes, integration, trademarks, going concern, goodwill, and other unlimited-term intangibles are encountered in a lump-sum purchase of an operating company, generally there is no sound basis on which the expense for a single period or longer can be calculated. In such cases, the intangibles may be properly carried in the accounts at unamortized cost until it becomes reasonably evident that their value has been permanently impaired or that their term of existence has become limited.[3]

18. At the time of a business combination, a careful process of evaluation is required to determine as closely as possible the exact nature of the intangible assets acquired. Any portion of the purchase price that can be reasonably identified with limited-term intangible fixed assets (such as patents, copyrights, and fixed-term franchises) should be amortized over their estimated period of usefulness. Only unlimited-term intangibles may be carried as assets without amortization. The

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[1]Ibid., p. 338.

[2]Arthur Andersen and Co., op. cit., p. 93.

[3]American Institute of Certified Public Accountants, Accounting Research Bulletin No. 43, Chapter 5, pars. 6 and 8. With reference to type (b) intangibles: "those having no such limited term of existence."

practice of arbitrarily amortizing the costs of type (b) intangible assets is not advocated. For many profitable and highly successful companies, such a practice results in a double charge against revenues during the amortization period. Empirical evidence in this study shows that many financial ratios become meaningless as a result of arbitrary amortization of intangibles. General license to amortize unlimited-term intangibles as production cost or expense over arbitrary periods makes financial statements less reliable to outsiders using them for analytical purposes.

19. If the task of accounting is to present meaningful and useful financial statements, mandatory amortization of unlimited-term intangible assets is unacceptable. Where the intangible is deemed an investment, possessing an important income-producing factor and having no determinate life, and the policy of the enterprise is to maintain fully the value of the investment by high-quality products or services and by continued advertising, research and development, and other maintenance expenditures (which are charged to current operations), the cost of the intangible investment should not be amortized against revenues or written off to retained earnings "unless and until there is permanent impairment in earning power" (italics mine).[1] Recurring appraisal of the intangible asset would then be the primary requirement for proper accountability. If conditions develop after the investment which indicate that the unamortized intangible has become valueless, or that its value is unrelated to the present level of corporate earnings, or that

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[1]Paul Grady, "Accounting for Fixed Assets and Their Amortization," The Accounting Review, XXV (January 1950), 12.

its life will terminate, it should be written off by charges in the income statement in accordance with the recommendations of Accounting Principles Board Opinion No. 9 (issued December 1966). Pertinent sentences from this opinion are quoted:

> Extraordinary items should, however, be segregated from the results of ordinary operations and shown separately in the income statement, with disclosure of the nature and amounts thereof.[1]
>
> Examples of extraordinary items, . . . include material gains or losses (or provisions for losses) from . . . (c) the write-off of goodwill due to unusual events or developments within the period, . . .[2]
>
> It is the Board's opinion that the reporting of per share data should disclose amounts for (a) income before extraordinary items, (b) extraordinary items, if any, (less applicable income tax) and (c) net income--the total of (a) and (b).[3]

20. The practice of understating intangible assets, particularly for well-established businesses, should not be tolerated. Many intangible assets belong on the balance sheet where their true nature can be disclosed. Tangible and intangible fixed assets should be classified separately. The costs of both limited- and unlimited-term intangibles should be reported as separate items on the corporate balance sheet. For illustrative purposes, the following balance sheet presentation for intangible assets by Diamond Alkali Company on December 31, 1965, represents an acceptable manner of disclosure.

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[1]Accounting Principles Board, Opinion No. 9, Reporting the Results of Operations (New York: American Institute of Certified Public Accountants, December 1966), par. 17.

[2]Ibid., par. 21.

[3]Ibid., par. 32.

Intangible Assets

| | |
|---|---|
| Patents, trademarks, formulae, processes, etc., at cost, less amortization . . . . . | $1,582,884 |
| Excess of cost over value of net assets of companies acquired since 1960 . . . . . | 7,616,040 |
| | $9,198,924 |

The amounts as reported, however, are of dubious soundness because Diamond Alkali had several poolings since 1960 (see Appendix D). Naturally, details about the acquired companies, amortization rates, and other matters which may require disclosure could be given in notes accompanying the statements.

## Final Comments on the Pooling-of-Interests Concept

As stressed in paragraphs 3 and 4 of the conclusions, most business combinations are investments by a dominant enterprise and the pooling technique is incompatible with this "investment" concept. But are there any instances in which the pooling-of-interests concept and its related accounting treatment are sound and should be applied in practice?

Wyatt recognizes that pooling-of-interests accounting is acceptable when no substantive changes occur because of the combination of "formerly related entities."[1] Such a view is sound because a business combination between related enterprises is not an actual exchange transaction between genuinely independent parties which establishes a new basis of accountability (acquisition cost). Nor should such a combination be viewed in the context of an investment decision, if no exchange

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[1]Wyatt, op. cit., pp. 105-106.

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The position taken in this study (see paragraph 6) is that those mergers which have the characteristics of a genuine corporate marriage should be allowed to be treated as poolings of interests. The firms combining need not be formerly related before a combination merits consideration as a pooling of interests.

If a business combination is effected through the use of residual ownership equities and the constituents are relatively the same size, a problem arises in determining which company is the dominant enterprise. Any evaluation of the attendant circumstances surrounding the combination may reveal that there is no one continuing enterprise of paramount importance through which economic activity takes place. In this case, conceptually, the dominant entity of accountability and center of interest for accounting analysis and reports cannot be identified. Wyatt was aware of this problem when he wrote:

> . . . identification of the entity of accountability in a combination transaction is a crucial problem.[1]

When the resources of two separate and "equal" business enterprises are merged, Wyatt concluded that the resultant entity was essentially a "new" enterprise--one materially different from either preexisting business. Under such conditions, he recommended that the business combination be accounted for by a method to be known as the "fair-value pooling" concept.[2]

The underlying reasoning for his recommendation is:

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[1] Ibid., p. 69.

[2] Ibid., pp. 81-86.

> In combinations which result in an essentially new enterprise there may be nothing inherent in prior carrying values to warrant their continued usage subsequent to the combination. Rather, it is possible that the assets of the resultant entity should be accounted for based on their "cost" to the new entity. Since the accounting unit is, in effect, a new entity, cost to the entity would involve a determination of the fair value of the assets contributed to the future use of the entity.[1]

Yet it must be stressed that the fair-value pooling concept definitely entails a departure from the established cost basis of accounting. Accounting deals primarily with the effect on a specific enterprise of its completed exchange transactions with other enterprises or individuals. Postulate B-3 of Accounting Research Study No. 1 supports the assumption that a given enterprise constitutes the basis unit of accountability.

> Postulate B-3. Entities. The results of the accounting process are expressed in terms of specific units or entities.[2]

In a purchase type of business combination, the properties of the acquiring company do not need to be restated at the time of the acquisition or merger; only the assets of the acquired company are restated to recognize current values so that an adequate measure of new capital is obtained. But the significance of current value information at the time of a combination exchange transaction does not depend in any way whatsoever upon the ability to identify the dominant entity of accountability. Although there may be nothing inherent in prior carrying values on the buying company's books to warrant their continued

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[1] Ibid., p. 82.

[2] Maurice Moonitz, "The Basic Postulates of Accounting, Accounting Research Study No. 1 (New York: American Institute of Certified Public Accountants, 1961), p. 52.

usage after the combination, generally accepted accounting principles require that the buying company's existing accountabilities should not be disturbed. As long as historical cost information constitutes the basis of prevailing theory and practice, accounting procedures must be carried out consistently from a particular point of view. When accountabilities are reflected from the point of view of the acquiring enterprise, the fact that the buying firm has been identified dictates that a new basis of accountability arises only for the acquired company.

As stressed throughout this study, the initial amount assigned to all types of properties (tangible and intangible) acquired by a specific enterprise should be "acquisition cost." "Costs" (bargained prices) are the fundamental data of accounting; their recognition, measurement, and classification are indispensable requisites in the process of compiling relevant and dependable accounting data.[1] Apparently, to an important degree, the acquisition cost concept is influenced by the concept of an enterprise. Because cost in accountancy implies a sacrifice made by a buyer to secure something of economic value, the generally accepted cost principle in accounting requires that a specific buying unit or entity be identified.

It is difficult to say that a new cost basis, and therefore a new basis of accountability, must result from a business combination situation where no dominant "investing" enterprise can be identified.

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[1]Paton and Littleton, op. cit., p. 25. It should be stressed that the term "costs" is being used in its broadest sense. Broadly defined, cost is "the amount of bargained-price of goods or services received or of securities issued in transactions between independent parties." Ibid., p. 24.

For purposes of responsibility accounting, there is no relevant basis of acquisition cost at the time of a business combination when the given unit or entity of accountability cannot be determined. Meaningful standards of cost recognition in accounting require that an exchange transaction be viewed from the standpoint of a buying party. Cost, as a valid accounting concept, is the product of a buying transaction; so unless a buying company is identified there can be no proper cost determination at the time of a business combination. In an exchange transaction in which the dominant entity is indeterminate, there can be no new basis of accountability because there is no buying organization with which to establish the initial recognition of acquisition cost.

Where there is a reorganization merger of two "equals," implying a corporate marriage, it is difficult to establish which business enterprise constitutes the most relevant center of interest for future accounting analysis and reports. Since there is no one "investing" organization, both business enterprises continue on in the surviving entity in form and in spirit. When an evaluation of the attendant circumstances surrounding the combination clearly indicates that there is no one investing business entity, as in a genuine corporate marriage, accountabilities for the resultant entity may properly be reflected from the point of view of <u>both</u> enterprises prior to the business combination.[1]

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[1]It is difficult to enunciate the essential attributes of a genuine corporate marriage, but the intent of the parties involved in a merger is probably the most significant factor. The "criterion of effective control" over the assets, management, and ownership of the merged entity, as advanced by Phillips, appears to be the best test for judging the underlying intentions of the parties to a business combination. See Lawrence C. Phillips, "Accounting for Business Combinations," <u>The Accounting Review</u>, XL (April 1965), 377-81.

Such a corporate marriage should not be recorded as a purchase, for if there is no investing enterprise, the business combination cannot be viewed realistically in the context of an investment decision.

The pooling-of-interests treatment should be allowed for a business combination between separate and equal entities when a review of all circumstances surrounding the exchange transaction verifies that the dominant reporting enterprise is unidentifiable. When business combinations are considered in mass, this particular type of combination situation will be rare and have limited application in accounting practice; thus, allowing pooling treatment for such a corporate merger should not impair the general usefulness and reliability of financial information.

If the conditions of a genuine corporate marriage exist (similar to Wyatt's conditions for a fair-value pooling), it may be appropriate to ignore the market value of stock issued to effect the business combination exchange transaction and assume that the assets of the surviving enterprise are equal to the sum of the assets of the two formerly separate enterprises. With respect to accounting recognition in the financial statements, such a business combination would be viewed as involving no change of economic substance. If nothing of economic substance has occurred in the exchange transaction, the conclusion follows that accounting for assets on the same basis as they were carried by the predecessor entities is an appropriate basis of accountability for the resultant entity.

# APPENDICES

APPENDIX A

LIST OF COMPANIES CLASSIFIED
UNDER SIC GROUP NUMBERS 281, 283, AND 284

Acquisitions by Leading Industrial Chemical Firms, 1951-61
SIC No. 281

| 1961 sales rank among 500 largest | Company | Number |
|---|---|---|
| 13 | E. I. Du Pont de Nemours & Co. | 1 |
| 24 | Union Carbide Corp. | 6 |
| 49 | Monsanto Chemical Co. | 10 |
| 54 | Dow Chemical Co. | 9 |
| 56 | Allied Chemical Corp. | 9 |
| 66 | Olin Mathieson Chemical Corp. | 25 |
| 74 | American Cyanamid Co. | 8 |
| 80 | W. R. Grace & Co. | 13 |
| 129 | Food Machinery & Chemical Corp. | 23 |
| 155 | Koppers Co., Inc. | 17 |
| 179 | Celanese Corp. of America | 7 |
| 215 | Stauffer Chemical Co. | 10 |
| 217 | Rohm & Haas Co. | -- |
| 231 | American Viscose Corp. | -- |
| 233 | Air Reduction Co., Inc. | 4 |
| 282 | Hooker Chemical Co. | 9 |
| 302 | Diamond Alkali Co. | 8 |
| 310 | Chemetron Corp. | 14 |
| 341 | Eagle-Picher Co. | 7 |
| 394 | Reichhold Chemicals, Inc. | 6 |
| 402 | Wyandotte Chemicals Corp. | 1 |
| 405 | Witco Chemical Co., Inc. | 5 |
| 408 | American Enka Corp. | 3 |
| 421 | Pennsalt Chemical Corp. | 6 |
| 496 | Harshaw Chemical Co. | 3 |
| | Total | 204 |

APPENDIX A (cont.)

Acquisitions by Leading Drug Firms, 1951-61
SIC No. 283

| 1961 sales rank among 500 largest | Company | Number |
|---|---|---|
| 103 | American Home Products | 4 |
| 177 | Chas. Pfizer & Co., Inc. | 8 |
| 199 | Rexall Drug & Chemical Co. | 18 |
| 216 | Sterling Drug, Inc. | 8 |
| 219 | Merck & Co., Inc. | 2 |
| 234 | Parke, Davis & Co. | 1 |
| 247 | Warner-Lambert Pharmaceutical Co. | 6 |
| 256 | Eli Lilly & Co. | 2 |
| 275 | Upjohn Co. | -- |
| 288 | Bristol-Myers Co. | 5 |
| 290 | Smith, Kline & French Laboratories | 2 |
| 311 | Richardson-Merrell, Inc. | 8 |
| 325 | Abbott Laboratories | -- |
| 367 | Mead Johnson & Co. | 1 |
| 462 | Schering Corp. | 2 |
| 463 | Miles Laboratories, Inc. | 3 |
| | Total | 71 |

Acquisitions by Leading Cosmetic Firms, 1951-61
SIC No. 284

| 1961 sales rank among 500 largest | Company | Number |
|---|---|---|
| 26 | Procter & Gamble Co. | 6 |
| 75 | Colgate-Palmolive Co. | 6 |
| 122 | Lever Bros. Co. | 3 |
| 266 | Avon Products, Inc. | -- |
| 308 | Revlon, Inc. | 9 |
| 474 | Purex Corp., Ltd. | 9 |
| | Total | 33 |

Source: Select Committee on Small Business, House of Representatives, 87th Congress. Staff Report: Mergers and Superconcentration, Acquisitions of 500 Largest Industrial and 50 Largest Merchandising Firms, Nov. 8, 1962, pp. 46-52.

APPENDIX B

LIST OF COMPANIES POSSIBLY TO BE SELECTED FOR THE STUDY

| Company | 1964 Rank Fortune 500 | 1965 S & P Stock Ranking | S & P Major Industry Classification | 1963 SIC Group No. |
|---|---|---|---|---|
| E. I. Du Pont de Nemours & Co. | 12 | A+ | Chemicals | 281 |
| Procter & Gamble Co. | 24 | A+ | Cosmetics | 284 |
| Union Carbide Corp. | 26 | A | Chemicals | 281 |
| Monsanto Co. | 33 | A | Chemicals | 281 |
| Dow Chemical Co. | 50 | A | Chemicals | 281 |
| Allied Chemical Corp. | 52 | A- | Chemicals | 281 |
| FMC Corp. | 69 | A | Chemicals | 281 |
| W. R. Grace & Co. | 73 | A- | Chemicals | 281 |
| Colgate-Palmolive Co. | 74 | A- | Cosmetics | 284 |
| American Cyanamid Co. | 75 | A | Chemicals | 281 |
| Celanese Corp. of America | 82 | A- | Chemicals | 281 |
| American Home Products | 109 | A+ | Drugs | 283 |
| Hercules Powder Co. | 118 | A | Chemicals | 289 |
| Chas. Pfizer & Co. | 130 | A+ | Drugs | 283 |
| Johnson & Johnson | 159 | A | Drugs-Misc. | 384 |
| Air Reduction Corp. | 175 | A- | Chemicals | 281 |
| Warner-Lambert Pharm. Co. | 177 | A | Drugs | 283 |
| Rohm & Haas Co. | 189 | A+ | Chemicals | 281 |
| Gillette Co. | 204 | A- | Cosmetics | 342 |
| Merck & Co., Inc. | 214 | A+ | Drugs | 283 |
| Rexall Drug & Chemical Co. | 215 | A- | Drugs | 283 |
| Stauffer Chemical Co. | 219 | A- | Chemicals | 281 |
| Sterling Drug, Inc. | 226 | A+ | Drugs | 283 |
| Bristol-Myers Co. | 229 | A+ | Drugs | 283 |
| Abbott Laboratories | 280 | A | Drugs | 283 |
| Hooker Chemical Co. | 283 | A- | Chemicals | 281 |
| Parke, Davis & Co. | 290 | A | Drugs | 283 |
| Richardson-Merrell, Inc. | 316 | A | Drugs | 283 |
| Diamond Alkali Co. | 319 | A- | Chemicals | 281 |
| Pennsalt Chemicals Corp. | 368 | A | Chemicals | 281 |

Note: All of the companies on this list have had their common shares traded on the NYSE over the ten-year period 1956-65.

# APPENDIX C

## LIST OF EIGHT COMPANIES SELECTED FOR CASE ANALYSIS

Allied Chemical Corporation, 61 Broadway, New York 6, New York

Bristol-Myers Company, 630 Fifth Ave., New York 20, New York

Colgate-Palmolive Company, 300 Park Ave., New York 22, New York

Diamond Alkali Company, 925 Euclid Ave., Cleveland 4, Ohio

Pfizer (Chas.) & Co., Inc., 235 East 42nd St., New York 17, New York

Procter & Gamble Company, 301 East 6th St., Cincinnati 2, Ohio

Richardson-Merrell, Inc., 122 East 42nd St., New York 17, New York

Warner-Lambert Pharmaceutical Co., 201 Tabor Rd., Morris Plains, New Jersey

# APPENDIX D

## LIST OF ACQUISITIONS AND MERGERS FOR EIGHT SELECTED COMPANIES[1] 1951-65

### Allied Chemical Corporation

Maizewood Insulation Co. (1953)
Plaskon Division of Libbey-Owens-Ford Glass Co. (1954, p.a.[2])
Artex Roofing Co. (1954)
Williams Roofing Co. (1954)
Mutual Chemical Co. of America (1954)
Valley Asphalt Co., Inc. (1954)
Newark Plaster Co. (1956)
Harmon Color Works from B. F. Goodrich Co. (1959, p.a.)
Specialty Resins Co., Inc. (1960)
Union Texas Natural Gas Corp. (1962, pooling of interests)
Mesa Plastics Co. (1964)
Southern Propane Co. (1964)
Harrison Gas Service, Inc. (1964)

### Bristol-Myers Company

Angier Chemical Co., Ltd. (1952)
Tubos de Estano, S.A. (1952, p.a.)
Luzier's, Inc. (1955)
Kimball Manufacturing Corp. (1955)
Grove Laboratories, Inc. (1958)
Khasana G.m.b.H. Dr. Albersheim (1958)
Clairol, Inc. (1959)
Drackett Co. (1965, pooling of interests)

### Colgate-Palmolive Company

Wildroot Company, Inc. (1958)
Sterno Corp. (1959)
S. M. Edison Chemical Co., Inc. (1960)
Lakeside Laboratories, Inc. (1960, pooling of interests)
Consumer Products Division of Unexcelled Chemical Corp. (1961, p.a.)
Keefer-Galler, Inc. (1961)
Barbier & Dauphin, S.A. (1963)
Lombardi Companies, S.p.A. (1964, p.a.)

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[1]The list is gathered from Moody's Investor Service, Standard & Poor's Corporation records, and various annual reports. Some foreign and partial acquisitions may have been omitted because source information was lacking. All known "purchase with immediate write-off" and "pooling of interests" treatments have been indicated.

[2]p.a. represents a partial acquisition.

APPENDIX D (cont.)

Diamond Alkali Company

Kolker Chemical Works, Inc. (1951, purchase with write-off)
Belle Alkali Co. (1953)
Black Leaf Division of Virginia-Carolina Chemical Corp. (1955, p.a.)
Black Leaf Division of Virginia-Carolina Chemical Corp. (1957, remaining interest)
Bessemer Limestone and Cement Co. (1961, pooling of interests)
Chemical Process Co. (1961)
Fiber Chemical Corp. (1961)
Central New Jersey Chemical Corp. (1961)
Harte & Co., Inc. (1962, p.a.)
Heritage House Products, Inc. (1964)
Harte & Co., Inc. (1965, remaining interest, pooling of interests)

Chas. Pfizer & Company, Inc.

J. B. Roerig & Company (1953, purchase with write-off)
Morton-Withers Chemical Co. (1957)
Dupont y Cia (1957)
Fiber Division of Virginia-Carolina Chemical Co. (1958, p.a.)
Dumex Companies (1958, p.a.)
Kemball, Bishop & Co., Ltd. (1958)
New England Lime Co. (1961, pooling of interests)
Paul-Lewis Laboratories, Inc. (1961, pooling of interests)
Globe Laboratories, Inc. (1961, pooling of interests)
Thomas Leeming & Co. (1961, pooling of interests)
Pacquins, Inc. (1961, pooling of interests)
Barbasol Co. (1962)
C. K. Williams & Co., Inc. (1962, pooling of interests)
Knickerbocker Biologicals, Inc. (1962, pooling of interests)
Desitin Chemical Co., Inc. (1963, pooling of interests)
Metals for Electronics, Inc. (1963)
Coty, Inc. (1963)
Coty International Corp. (1963)
Gibsonburg Lime Products Co. (1964, pooling of interests)
Dolite Co. (1964)
British Alkaloids, Ltd. (1964)
Societe Chimique Agricole du Centre, S.A. (1964)
Baker Laboratories, Inc., from U.S. Vitamin & Pharmaceutical Corp. (1965, p.a.)
Bridge Colour Co. (1965)
Hull and Liverpool Red Oxide Co. (1965)
Seger Co. (1965)
Institut Serotherapique de Gembloux (1965)
Propas Co. (1965)
G. P. Proprietary, Ltd. (1965)

APPENDIX D (cont.)

Procter & Gamble Company

W. T. Young Foods, Inc. (1955)
Nebraska Consolidated Mills Co. of Omaha (1956, p.a.)
Hines-Park Foods, Inc. (1956)
Duncan Hines Institute, Inc. (1956)
Charmin Paper Mills, Inc. (1957)
Clorox Chemical Co. (1957)
Superior Foods, Inc. (1960, p.a.)
J. A. Folger & Co. (1963, pooling of interests)
Rei-Werke A. G. (1965)

Richardson-Merrell, Inc. (formerly Vick Chemical Company)

Extruded Plastics, Inc. (1953, purchase with write-off)
Dr. Hess & Clark, Inc. (1955)
National Drug Co. (1956)
Walker Laboratories, Inc. (1958)
Lavoris Co. (1958)
Milton Antiseptic, Ltd. (1958)
Clearasil, Inc. (1959)
Laboratorios Moura Brasil-Orlando Rangel, S.A. (1959)
Mila, S.A. (1962)
Lumalite Corp. (1963)
Diger-Selz (1963)
Gascoigna-Crowther, Ltd. (1964)
Laboratorios Picot, S.A. (1964)
Farmochimica Autolo-Calosi (1964)
Sterol Derivatives, Inc. (1964)
Istituto Sieroterpico Italiano, S.p.A. (1964)
Productos Quinicos Berkman, S.A. (1965)
Nomisol Products (1965)
Bradley Industries, Inc. (1965)

Warner-Lambert Pharmaceutical Company (formerly Warner-Hudnut, Inc.)

Maltine Co. (1951, purchase with write-off)
Lambert Co. (1955, pooling of interests)
Emerson Drug Co. of Baltimore City (1956, pooling of interests)
Nepera Chemical Co., Inc. (1956, pooling of interests)
Oculine Co. (1959)
Lactona, Inc. (1961)
DuBarry Perfumery Co., Ltd. (1962)
American Chicle Co. (1962, pooling of interests)
West Indies Bay Co. (1964)
Smith Brothers, Inc. (1964)
Research Specialties Co. (1964)
Laboratories S.A.M. (1964)
Hall Bros. (Whitefield), Ltd. (1964)

## APPENDIX E

### SELECTED INFORMATION ON SEVEN POOLINGS OF INTERESTS

| Year | Name of Acquiring Company | Name of Acquired Company | Relative Size Criterion | Excess of Purchase Cost over Book Value (in millions) | Ratio of Purchase Cost to Book Value |
|---|---|---|---|---|---|
| 1955 | Warner-Hudnut, Inc. | Lambert Co. | 37.9 | 10.5 | 1.7 times |
| 1956 | Warner-Lambert Pharm. Co. | Emerson Drug Co. | 11.1 | 7.0 | 2.1 |
| 1956 | Warner-Lambert Pharm. Co. | Nepera Chemical Co. | 7.2 | 5.6 | 1.6 |
| 1961 | Diamond Alkali Co. | Bessemer Limestone & Cement Co. | 10.4* | 11.1 | 1.9 |
| 1962 | Allied Chemical Corp. | Union Texas Natural Gas | 24.1 | 246.2 | 3.7 |
| 1962 | Warner-Lambert Pharm. Co. | American Chicle Co. | 35.6* | 140.3 | 3.6 |
| 1965 | Diamond Alkali Co. | Harte & Co., Inc. | 3.9* | 9.4 | 3.2 |

Source: Various annual reports and NYSE listing applications.

*Size criterion for these business combinations assumes that the preferred stock is converted into common stock at conversion rate.

# APPENDIX F

## FINANCIAL RATIOS AND GROWTH RATE FACTORS[1]

Liquidity Ratios:

1. Current Ratio $= \dfrac{\text{Cash + Receivables + Inventory}}{\text{Current Liabilities}}$

2. Receivable Turnover $= \dfrac{\text{Sales (n)}}{\dfrac{\text{Receivables (n) + Receivables (n - 1)}}{2}}$

3. Inventory Turnover $= \dfrac{\text{Cost of Goods Sold (n)}}{\dfrac{\text{Inventory (n) + Inventory (n - 1)}}{2}}$

Efficiency Ratios:

4. Earning Power $= \dfrac{\text{Net Income before Income Taxes (n)}}{\dfrac{\text{Total Assets (n) + Total Assets (n - 1)}}{2}}$

5. Asset Turnover $= \dfrac{\text{Sales (n)}}{\dfrac{\text{Total Assets (n) + Total Assets (n - 1)}}{2}}$

6. Income Margin $= \dfrac{\text{Net Income before Incomes Taxes}}{\text{Sales}}$

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[1]The current year and the previous year are indicated by (n) and (n-1), respectively.

Information about the computer program for financial statement analysis used may be obtained from Western Data Processing Center, Graduate School of Business Administration, The University of California, Los Angeles, California. Also see David K. Eiteman, "A Computer Program for Financial Statement Analysis," Financial Analysts Journal, XX (November-December 1964), 61-68. Two changes should be noted as variations from the published program: Operating Income is Net Income Before Income Taxes; and Operating Assets are Total Assets.

APPENDIX F (cont.)

Profitability Ratios:

7. Return on Capital $= \dfrac{\text{Net Income + Fixed Charges}}{\dfrac{\text{Total Capital (n) + Total Capital (n - 1)}}{2}}$

8. Return on Common Stock Equity $= \dfrac{\text{Net to Common}}{\dfrac{\text{Com. Stk. Eq. (n) + Com. Stk. Eq. (n - 1)}}{2}}$

9. Cash Flow to Common Stock Equity $= \dfrac{\text{Net to Common + Depreciation}}{\dfrac{\text{Com. Stk. Eq. (n) + Com. Stk. Eq. (n - 1)}}{2}}$

Price Ratios:

10. Price Earnings Ratio $= \dfrac{\text{Adjusted Average Price}}{\text{Adjusted Earnings per Share}}$

11. Dividend Yield $= \dfrac{\text{Adjusted Dividend per Share}}{\text{Adjusted Average Price}}$

12. Price to Book Value $= \dfrac{\text{Adjusted Average Price}}{\text{Adjusted Book Value per Share}}$

13. Price to Cash Flow $= \dfrac{\text{Adjusted Average Price}}{\text{Adjusted Cash Flow per Share}}$

Capital Structure Ratios:

14. Long-Term Debt as a Per Cent of Total Capital $= \dfrac{\text{Long-Term Debt}}{\text{Total Capital}}$

15. Common Stock as a Per Cent of Total Capital $= \dfrac{\text{Common Equity}}{\text{Total Capital}}$

APPENDIX F (cont.)

Miscellaneous Ratios:

16. Interest Coverage = $\frac{\text{Net Income + Income Taxes + Fixed Charges}}{\text{Fixed Charges}}$

17. Dividend Payout = $\frac{\text{Common Stock Dividends}}{\text{Net to Common}}$

18. Ratio designed to reveal abnormal tax status = $\frac{\text{Income Taxes}}{\text{Net Income + Income Taxes}}$

Growth Rate Factors:

1. Earnings per share
2. Net profit to common stock
3. Net sales
4. Dividends per share
5. Average market price
6. Book value per share
7. Cash flow per share

# APPENDIX G

## COMPUTER PRINT-OUT FOR CHAS. PFIZER & COMPANY, INC., UNDER FOUR ALTERNATIVE WAYS OF ACCOUNTING FOR BUSINESS COMBINATIONS

### Alternative 1. Pooling Concept

FINANCIAL STATEMENT DATA IN MILLIONS OF DOLLAR

| YEAR | CASH ITEMS | RECEIV- ABLES | INVEN- TORY | CURRENT ASSETS | OPERATING ASSETS | CURRENT LIABS | LONG TERM DEBT | PREF'D STOCK | COMMON EQUITY | TOTAL CAPITAL | STK DIVS -SPLITS |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 21.974 | 33.345 | 52.468 | 107.987 | 152.583 | 35.396 | 0.000 | 8.744 | 106.307 | 115.051 | 1.000 |
| 1957 | 25.673 | 37.678 | 61.741 | 125.092 | 178.360 | 50.196 | 0.000 | 8.169 | 117.660 | 125.829 | 1.000 |
| 1958 | 17.311 | 43.619 | 66.842 | 127.772 | 210.338 | 58.407 | 11.905 | 7.594 | 129.478 | 148.977 | 1.000 |
| 1959 | 15.554 | 43.887 | 73.049 | 133.390 | 240.245 | 53.985 | 29.671 | 7.019 | 146.553 | 183.243 | 3.000 |
| 1960 | 24.282 | 45.738 | 71.199 | 141.211 | 262.287 | 62.748 | 27.600 | 6.444 | 162.741 | 196.785 | 1.000 |
| 1961 | 26.159 | 56.847 | 82.824 | 165.830 | 301.062 | 78.529 | 25.792 | 0.000 | 192.301 | 218.093 | 1.000 |
| 1962 | 18.229 | 68.985 | 98.707 | 185.921 | 348.815 | 87.454 | 20.479 | 0.000 | 235.871 | 256.350 | 1.000 |
| 1963 | 17.925 | 83.259 | 123.097 | 224.281 | 394.900 | 123.236 | 14.529 | 0.000 | 250.078 | 264.607 | 1.000 |
| 1964 | 22.627 | 84.722 | 128.973 | 236.322 | 428.310 | 125.441 | 28.773 | 0.000 | 264.003 | 292.776 | 1.000 |
| 1965 | 36.891 | 101.474 | 140.318 | 278.683 | 488.610 | 152.283 | 30.349 | 0.000 | 292.569 | 322.918 | 1.000 |

| YEAR | NET SALES | COST OF GOODS SOLD | DEPREC- IATION | OPERATING INCOME | FIXED CHARGES | INCOME TAXES | NET INCOME | PREF'D DIVS | NET TO COMMON | COMMON DIVS |
|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 178.362 | 91.448 | 5.748 | 32.428 | 0.000 | 14.174 | 18.254 | 0.497 | 17.757 | 9.018 |
| 1957 | 207.152 | 101.142 | 6.201 | 42.953 | 0.000 | 20.044 | 22.909 | 0.192 | 22.717 | 11.274 |
| 1958 | 222.726 | 116.964 | 6.939 | 36.865 | 0.536 | 12.900 | 23.965 | 0.165 | 23.800 | 12.087 |
| 1959 | 253.673 | 125.119 | 7.213 | 35.213 | 1.335 | 10.350 | 24.863 | 0.150 | 24.713 | 13.021 |
| 1960 | 269.376 | 126.854 | 8.344 | 38.853 | 1.242 | 12.670 | 26.183 | 0.128 | 26.055 | 13.186 |
| 1961 | 312.433 | 137.280 | 11.524 | 53.443 | 1.161 | 22.200 | 31.443 | 0.024 | 31.419 | 15.349 |
| 1962 | 383.573 | 173.914 | 13.934 | 63.494 | 0.922 | 27.200 | 36.494 | 0.000 | 36.494 | 17.678 |
| 1963 | 414.290 | 189.396 | 15.235 | 69.807 | 0.654 | 29.300 | 40.307 | 0.000 | 40.307 | 20.322 |
| 1964 | 480.144 | 224.811 | 16.846 | 77.996 | 1.295 | 33.300 | 44.696 | 0.000 | 44.696 | 22.468 |
| 1965 | 542.620 | 253.024 | 17.850 | 96.414 | 1.366 | 42.700 | 53.414 | 0.000 | 53.414 | 25.733 |

PER SHARE ADJUSTED DATA

| YEAR | STK HI PRICE | STK LO PRICE | AVERAGE PRICE | EARN- INGS | DIVI- DENDS | BOOK VALUE | CASH FLOW | ACTUAL HIGH STOCK PRICE | ACTUAL LOW STOCK PRICE | NUMBER OF SHARES ACTUAL | NUMBER OF SHARES ADJUSTED |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 17.167 | 12.417 | 14.792 | 1.120 | 0.569 | 6.705 | 1.482 | 51.500 | 37.250 | 5.285 | 15.855 |
| 1957 | 21.833 | 14.250 | 18.042 | 1.410 | 0.700 | 7.301 | 1.794 | 65.500 | 42.750 | 5.372 | 16.116 |
| 1958 | 37.000 | 16.583 | 26.792 | 1.477 | 0.750 | 8.034 | 1.852 | 111.000 | 49.750 | 5.372 | 16.116 |
| 1959 | 45.250 | 30.500 | 37.875 | 1.510 | 0.796 | 8.954 | 1.951 | 45.250 | 30.500 | 16.368 | 16.368 |
| 1960 | 38.250 | 26.375 | 32.313 | 1.575 | 0.797 | 9.834 | 2.079 | 38.250 | 26.375 | 16.548 | 16.548 |
| 1961 | 53.875 | 30.625 | 42.250 | 1.734 | 0.847 | 10.615 | 2.371 | 53.875 | 30.625 | 18.116 | 18.116 |
| 1962 | 57.875 | 33.250 | 45.563 | 1.917 | 0.929 | 12.393 | 2.650 | 57.875 | 33.250 | 19.033 | 19.033 |
| 1963 | 55.500 | 44.750 | 50.125 | 2.058 | 1.038 | 12.771 | 2.837 | 55.500 | 44.750 | 19.581 | 19.581 |
| 1964 | 52.125 | 44.250 | 48.188 | 2.270 | 1.141 | 13.407 | 3.125 | 52.125 | 44.250 | 19.692 | 19.692 |
| 1965 | 75.500 | 49.250 | 62.375 | 2.685 | 1.294 | 14.709 | 3.583 | 75.500 | 49.250 | 19.891 | 19.891 |

## APPENDIX G (cont.)

## Alternative 1. Pooling Concept

| YEAR | LIQUIDITY RATIOS | | | EFFICIENCY RATIOS | | | PROFITABILITY RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| | CURRENT RATIO (TIMES) | RECEIVABLE TURNOVER (TIMES) | INVENTORY TURNOVER (TIMES) | EARNING POWER (PCT) | OPER ASSET TURNOVER (TIMES) | OPER INCOME MARGIN (PCT) | RETURN ON CAPITAL (PCT) | RETURN ON CS EQUITY (PCT) | CASH FLOW TO CS EQUITY (PCT) |
| 1957 | 2.49 | 5.93 | 1.77 | 25.96 | 1.25 | 20.74 | 19.02 | 20.29 | 25.82 |
| 1958 | 2.19 | 5.48 | 1.92 | 18.97 | 1.15 | 16.55 | 17.83 | 19.26 | 24.15 |
| 1959 | 2.47 | 5.30 | 1.78 | 15.63 | 1.13 | 13.88 | 15.77 | 17.91 | 23.13 |
| 1960 | 2.25 | 6.11 | 1.75 | 15.46 | 1.07 | 14.42 | 14.43 | 16.85 | 22.24 |
| 1961 | 2.10 | 6.09 | 1.79 | 19.04 | 1.11 | 17.17 | 15.72 | 17.70 | 24.19 |
| 1962 | 2.13 | 6.10 | 1.92 | 19.60 | 1.18 | 16.61 | 15.77 | 17.05 | 23.56 |
| 1963 | 1.82 | 5.44 | 1.71 | 18.72 | 1.11 | 16.80 | 15.73 | 16.59 | 22.86 |
| 1964 | 1.88 | 5.72 | 1.78 | 18.95 | 1.17 | 16.24 | 16.50 | 17.39 | 23.94 |
| 1965 | 1.83 | 5.93 | 1.88 | 20.96 | 1.18 | 17.71 | 17.79 | 19.19 | 25.61 |
| MEAN | 2.13 | 5.91 | 1.80 | 19.26 | 1.15 | 16.68 | 16.51 | 18.02 | 23.94 |

| YEAR | PRICE RATIOS | | | | CAPITAL STRUCTURE | | MISCELLANEOUS RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| | PRICE/EARN RATIO (TIMES) | DIVIDEND YIELD (PCT) | PRICE TO BOOK VALUE (TIMES) | PRICE TO CASH FLOW (TIMES) | FUNDED DEBT TO CAPITAL (PCT) | COMMON STK TO CAPITAL (PCT) | INTEREST COVERAGE (TIMES) | DIVIDEND PAYOUT (PCT) | EFFECTIVE TAX RATE (PCT) |
| 1957 | 12.80 | 3.88 | 2.47 | 10.05 | 0.00 | 93.51 | 0.00 | 49.63 | 46.66 |
| 1958 | 18.14 | 2.30 | 3.33 | 14.47 | 7.99 | 86.91 | 69.78 | 50.79 | 34.99 |
| 1959 | 25.09 | 2.10 | 4.23 | 19.42 | 16.19 | 79.98 | 27.38 | 52.69 | 29.39 |
| 1960 | 20.52 | 2.47 | 3.29 | 15.54 | 14.03 | 82.70 | 32.28 | 50.61 | 32.61 |
| 1961 | 24.36 | 2.01 | 3.98 | 17.82 | 11.83 | 88.17 | 47.20 | 48.85 | 41.38 |
| 1962 | 23.76 | 2.14 | 3.68 | 17.20 | 7.99 | 92.01 | 70.08 | 48.44 | 42.70 |
| 1963 | 24.35 | 2.07 | 3.92 | 17.67 | 5.49 | 94.51 | 107.43 | 50.42 | 42.09 |
| 1964 | 21.23 | 2.37 | 3.59 | 15.42 | 9.83 | 90.17 | 61.23 | 50.27 | 42.69 |
| 1965 | 23.23 | 2.07 | 4.24 | 17.41 | 9.40 | 90.60 | 71.36 | 48.18 | 44.43 |
| MEAN | 21.50 | 2.42 | 3.64 | 16.11 | 9.19 | 88.73 | 54.08 | 49.99 | 39.66 |

## APPENDIX G (cont.)

## Alternative 2. Mixture, As Reported

FINANCIAL STATEMENT DATA IN MILLIONS OF DOLLAR

| YEAR | CASH ITEMS | RECEIV-ABLES | INVEN-TORY | CURRENT ASSETS | OPERATING ASSETS | CURRENT LIABS | LONG TERM DEBT | PREF≠D STOCK | COMMON EQUITY | TOTAL CAPITAL | STK DIVS -SPLITS |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 21.974 | 33.345 | 52.668 | 107.987 | 152.583 | 35.396 | 0.000 | 8.744 | 106.307 | 115.051 | 1.000 |
| 1957 | 25.673 | 37.678 | 61.741 | 125.092 | 179.612 | 50.196 | 0.000 | 8.169 | 118.912 | 127.081 | 1.000 |
| 1958 | 17.311 | 43.619 | 66.842 | 127.772 | 211.700 | 58.407 | 11.905 | 7.594 | 130.840 | 150.339 | 1.000 |
| 1959 | 15.554 | 43.887 | 73.049 | 133.390 | 241.522 | 53.985 | 29.671 | 7.019 | 147.830 | 184.520 | 3.000 |
| 1960 | 24.282 | 45.736 | 71.199 | 141.214 | 263.564 | 62.748 | 27.600 | 6.444 | 164.018 | 198.062 | 1.000 |
| 1961 | 26.159 | 56.847 | 82.024 | 165.030 | 308.408 | 78.529 | 25.792 | 0.000 | 199.647 | 225.439 | 1.000 |
| 1962 | 18.229 | 68.985 | 98.707 | 185.921 | 357.081 | 87.454 | 20.479 | 0.000 | 244.137 | 264.616 | 1.000 |
| 1963 | 17.925 | 83.259 | 123.097 | 224.281 | 419.042 | 123.236 | 14.529 | 0.000 | 275.120 | 289.649 | 1.000 |
| 1964 | 22.627 | 84.722 | 128.073 | 236.322 | 465.755 | 125.441 | 28.773 | 0.000 | 301.448 | 330.221 | 1.000 |
| 1965 | 36.891 | 101.474 | 140.318 | 278.683 | 534.206 | 152.283 | 30.349 | 0.000 | 338.165 | 368.514 | 1.000 |

| YEAR | NET SALES | COST OF GOODS SOLD | DEPREC-IATION | OPERATING INCOME | FIXED CHARGES | INCOME TAXES | NET INCOME | PREF≠D DIVS | NET TO COMMON | COMMON DIVS |
|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 178.362 | 91.446 | 5.748 | 32.428 | 0.000 | 14.174 | 18.254 | 0.497 | 17.757 | 9.018 |
| 1957 | 207.152 | 101.142 | 6.201 | 42.953 | 0.000 | 20.044 | 22.909 | 0.192 | 22.717 | 11.274 |
| 1958 | 222.726 | 116.964 | 6.639 | 36.865 | 0.536 | 12.900 | 23.965 | 0.165 | 23.800 | 12.087 |
| 1959 | 253.673 | 125.119 | 7.213 | 55.213 | 1.335 | 10.350 | 24.863 | 0.150 | 24.713 | 13.021 |
| 1960 | 269.374 | 126.854 | 8.344 | 38.853 | 1.242 | 12.670 | 26.183 | 0.128 | 26.055 | 13.186 |
| 1961 | 312.433 | 137.280 | 11.526 | 53.643 | 1.161 | 22.200 | 31.443 | 0.024 | 31.419 | 15.349 |
| 1962 | 383.573 | 173.914 | 13.934 | 63.694 | 0.922 | 27.200 | 36.494 | 0.000 | 36.494 | 17.678 |
| 1963 | 414.290 | 189.394 | 15.235 | 69.407 | 0.654 | 29.300 | 40.307 | 0.000 | 40.307 | 20.322 |
| 1964 | 480.144 | 224.811 | 16.846 | 77.996 | 1.295 | 33.300 | 44.696 | 0.000 | 44.696 | 22.468 |
| 1965 | 542.620 | 253.024 | 17.850 | 96.414 | 1.366 | 42.700 | 53.414 | 0.000 | 53.414 | 25.733 |

| | PER SHARE ADJUSTED DATA | | | | | | | ACTUAL HIGH | ACTUAL LOW | NUMBER OF SHARES | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| YEAR | STK HI PRICE | STK LO PRICE | AVERAGE PRICE | EARN-INGS | DIVI-DENDS | BOOK VALUE | CASH FLOW | STOCK PRICE | STOCK PRICE | ACTUAL | ADJUSTED |
| 1956 | 17.167 | 12.417 | 14.792 | 1.120 | 0.569 | 6.705 | 1.482 | 51.500 | 37.250 | 5.285 | 15.855 |
| 1957 | 21.833 | 14.250 | 18.042 | 1.410 | 0.700 | 7.379 | 1.794 | 65.500 | 42.750 | 5.372 | 16.116 |
| 1958 | 37.000 | 16.583 | 26.792 | 1.477 | 0.750 | 8.119 | 1.852 | 111.000 | 49.750 | 5.372 | 16.116 |
| 1959 | 45.250 | 30.500 | 37.875 | 1.510 | 0.796 | 9.032 | 1.951 | 45.250 | 30.500 | 16.368 | 16.368 |
| 1960 | 38.250 | 26.375 | 32.313 | 1.575 | 0.797 | 9.912 | 2.079 | 38.250 | 26.375 | 16.548 | 16.548 |
| 1961 | 53.875 | 30.625 | 42.250 | 1.734 | 0.847 | 11.020 | 2.371 | 53.875 | 30.625 | 18.116 | 18.116 |
| 1962 | 57.875 | 33.250 | 45.563 | 1.917 | 0.929 | 12.827 | 2.650 | 57.875 | 33.250 | 19.033 | 19.033 |
| 1963 | 55.500 | 44.750 | 50.125 | 2.058 | 1.038 | 14.050 | 2.837 | 55.500 | 44.750 | 19.581 | 19.581 |
| 1964 | 52.125 | 44.250 | 48.188 | 2.270 | 1.141 | 15.308 | 3.125 | 52.125 | 44.250 | 19.692 | 19.692 |
| 1965 | 75.500 | 49.250 | 62.375 | 2.685 | 1.294 | 17.001 | 3.583 | 75.500 | 49.250 | 19.891 | 19.891 |

APPENDIX G (cont.)

Alternative 2. Mixture, As Reported

| | LIQUIDITY RATIOS | | | EFFICIENCY RATIOS | | | PROFITABILITY RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| YEAR | CURRENT RATIO (TIMES) | RECEIVABLE TURNOVER (TIMES) | INVENTORY TURNOVER (TIMES) | EARNING POWER (PCT) | OPER ASSET TURNOVER (TIMES) | OPER INCOME MARGIN (PCT) | RETURN ON CAPITAL (PCT) | RETURN ON CS EQUITY (PCT) | CASH FLOW TO CS EQUITY (PCT) |
| 1957 | 2.49 | 5.93 | 1.77 | 25.86 | 1.25 | 20.74 | 18.92 | 20.17 | 25.68 |
| 1958 | 2.19 | 5.48 | 1.82 | 18.84 | 1.14 | 16.55 | 17.66 | 19.06 | 23.89 |
| 1959 | 2.47 | 5.80 | 1.78 | 15.54 | 1.12 | 13.88 | 15.65 | 17.74 | 22.91 |
| 1960 | 2.25 | 6.01 | 1.75 | 15.38 | 1.07 | 14.42 | 14.34 | 16.71 | 22.06 |
| 1961 | 2.10 | 6.09 | 1.79 | 18.76 | 1.09 | 17.17 | 15.40 | 17.28 | 23.62 |
| 1962 | 2.13 | 6.10 | 1.82 | 19.14 | 1.15 | 16.61 | 15.27 | 16.45 | 22.73 |
| 1963 | 1.82 | 5.44 | 1.71 | 17.92 | 1.07 | 16.80 | 14.78 | 15.52 | 21.39 |
| 1964 | 1.88 | 5.72 | 1.78 | 17.41 | 1.08 | 15.24 | 14.84 | 15.50 | 21.35 |
| 1965 | 1.83 | 5.83 | 1.88 | 19.22 | 1.09 | 17.71 | 15.68 | 16.70 | 22.28 |
| MEAN | 2.13 | 5.81 | 1.80 | 18.70 | 1.12 | 16.68 | 15.84 | 17.24 | 22.88 |

| | PRICE RATIOS | | | | CAPITAL STRUCTURE | | MISCELLANEOUS RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| | PRICE/EARN RATIO (TIMES) | DIVIDEND YIELD (PCT) | PRICE TO BOOK VALUE (TIMES) | PRICE TO CASH FLOW (TIMES) | FUNDED DEBT TO CAPITAL (PCT) | COMMON STK TO CAPITAL (PCT) | INTEREST COVERAGE (TIMES) | DIVIDEND PAYOUT (PCT) | EFFECTIVE TAX RATE (PCT) |
| 1957 | 12.80 | 3.88 | 2.45 | 10.05 | 0.00 | 93.57 | 0.00 | 49.63 | 46.66 |
| 1958 | 18.14 | 2.80 | 3.30 | 14.47 | 7.92 | 87.03 | 69.78 | 50.79 | 34.99 |
| 1959 | 25.09 | 2.10 | 4.19 | 19.42 | 16.08 | 80.12 | 27.38 | 52.69 | 29.39 |
| 1960 | 20.52 | 2.47 | 3.26 | 15.54 | 13.94 | 82.81 | 32.28 | 50.61 | 32.61 |
| 1961 | 24.36 | 2.21 | 3.83 | 17.82 | 11.44 | 88.56 | 47.20 | 48.85 | 41.38 |
| 1962 | 23.76 | 2.14 | 3.55 | 17.20 | 7.74 | 92.26 | 70.08 | 48.44 | 42.70 |
| 1963 | 24.35 | 2.07 | 3.67 | 18.67 | 5.02 | 94.98 | 107.43 | 50.42 | 42.09 |
| 1964 | 21.23 | 2.37 | 3.15 | 15.42 | 8.71 | 91.29 | 61.23 | 50.27 | 42.69 |
| 1965 | 23.23 | 2.07 | 3.47 | 17.41 | 8.24 | 91.76 | 71.36 | 48.18 | 44.43 |
| MEAN | 21.50 | 2.42 | 3.44 | 16.11 | 8.79 | 89.15 | 54.08 | 49.99 | 39.66 |

## APPENDIX G (cont.)

## Alternative 3. Purchase Without Amortization

FINANCIAL STATEMENT DATA IN MILLIONS OF DOLLAR

| YEAR | CASH ITEMS | RECEIV-ABLES | INVEN-TORY | CURRENT ASSETS | OPERATING ASSETS | CURRENT LIABS | LONG TERM DEBT | PREF'D STOCK | COMMON EQUITY | TOTAL CAPITAL | STK DIVS -SPLITS |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 21.974 | 33.345 | 52.468 | 107.987 | 157.653 | 35.396 | 0.000 | 8.744 | 111.377 | 120.121 | 1.000 |
| 1957 | 25.673 | 37.678 | 61.741 | 125.092 | 184.682 | 50.196 | 0.000 | 8.169 | 123.982 | 132.151 | 1.000 |
| 1958 | 17.311 | 43.619 | 66.842 | 127.772 | 216.770 | 58.407 | 11.905 | 7.594 | 135.910 | 155.409 | 1.000 |
| 1959 | 15.554 | 43.887 | 73.949 | 133.390 | 246.592 | 53.985 | 29.671 | 7.019 | 152.900 | 189.590 | 3.000 |
| 1960 | 24.282 | 45.738 | 71.199 | 141.211 | 268.634 | 62.748 | 27.600 | 6.444 | 169.088 | 203.132 | 1.000 |
| 1961 | 24.159 | 56.847 | 82.024 | 165.030 | 358.578 | 78.529 | 25.792 | 0.000 | 249.817 | 275.609 | 1.000 |
| 1962 | 18.229 | 68.985 | 98.707 | 185.921 | 417.751 | 87.454 | 20.479 | 0.000 | 304.807 | 325.286 | 1.000 |
| 1963 | 17.925 | 83.259 | 123.897 | 224.281 | 489.112 | 123.236 | 14.529 | 0.000 | 344.290 | 358.819 | 1.000 |
| 1964 | 22.627 | 84.729 | 128.973 | 236.329 | 538.725 | 125.441 | 28.773 | 0.000 | 374.418 | 403.191 | 1.000 |
| 1965 | 34.891 | 101.474 | 140.318 | 276.683 | 607.176 | 152.283 | 30.349 | 0.000 | 411.135 | 441.484 | 1.000 |

| YEAR | NET SALES | COST OF GOODS SOLD | DEPREC-IATION | OPERATING INCOME | FIXED CHARGES | INCOME TAXES | NET INCOME | PREF'D DIVS | NET TO COMMON | COMMON DIVS |
|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 178.362 | 91.440 | 5.748 | 32.428 | 0.600 | 14.174 | 18.254 | 0.497 | 17.757 | 9.018 |
| 1957 | 207.152 | 101.142 | 6.201 | 42.953 | 0.000 | 20.044 | 22.909 | 0.192 | 22.717 | 11.274 |
| 1958 | 222.726 | 116.964 | 6.039 | 34.865 | 0.536 | 12.900 | 23.965 | 0.165 | 23.800 | 12.087 |
| 1959 | 253.473 | 125.119 | 7.213 | 35.213 | 1.335 | 10.350 | 24.863 | 0.150 | 24.713 | 13.021 |
| 1960 | 269.376 | 126.854 | 8.344 | 38.853 | 1.242 | 12.670 | 26.183 | 0.128 | 26.055 | 13.186 |
| 1961 | 312.433 | 137.280 | 11.526 | 53.443 | 1.161 | 22.200 | 31.443 | 0.024 | 31.419 | 15.349 |
| 1962 | 383.573 | 173.914 | 13.934 | 63.494 | 0.922 | 27.200 | 36.494 | 0.000 | 36.494 | 17.678 |
| 1963 | 414.290 | 189.396 | 15.235 | 69.607 | 0.654 | 29.300 | 40.307 | 0.000 | 40.307 | 20.322 |
| 1964 | 480.144 | 224.811 | 16.846 | 77.996 | 1.295 | 33.300 | 44.696 | 0.000 | 44.696 | 22.468 |
| 1965 | 542.620 | 253.024 | 17.850 | 96.114 | 1.366 | 42.700 | 53.414 | 0.000 | 53.414 | 25.733 |

PER SHARE ADJUSTED DATA

| YEAR | STK HI PRICE | STK LO PRICE | AVERAGE PRICE | EARN-INGS | DIVI-DENDS | BOOK VALUE | CASH FLOW | ACTUAL HIGH STOCK PRICE | ACTUAL LOW STOCK PRICE | NUMBER OF SHARES ACTUAL | NUMBER OF SHARES ADJUSTED |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 17.167 | 12.417 | 14.792 | 1.120 | 0.569 | 7.025 | 1.482 | 51.500 | 37.250 | 5.285 | 15.855 |
| 1957 | 21.833 | 14.250 | 18.042 | 1.410 | 0.700 | 7.693 | 1.794 | 65.500 | 42.750 | 5.372 | 16.116 |
| 1958 | 37.000 | 16.583 | 26.792 | 1.477 | 0.750 | 8.433 | 1.852 | 111.000 | 49.750 | 5.372 | 16.116 |
| 1959 | 45.250 | 30.500 | 37.875 | 1.510 | 0.796 | 9.341 | 1.951 | 45.250 | 30.500 | 16.368 | 16.368 |
| 1960 | 38.250 | 26.375 | 32.313 | 1.575 | 0.797 | 10.218 | 2.079 | 38.250 | 26.375 | 16.548 | 16.548 |
| 1961 | 53.875 | 30.625 | 42.250 | 1.734 | 0.847 | 13.790 | 2.371 | 53.875 | 30.625 | 18.116 | 18.116 |
| 1962 | 57.875 | 33.250 | 45.563 | 1.917 | 0.929 | 16.015 | 2.650 | 57.875 | 33.250 | 19.033 | 19.033 |
| 1963 | 55.500 | 44.750 | 50.125 | 2.058 | 1.038 | 17.583 | 2.837 | 55.500 | 44.750 | 19.581 | 19.581 |
| 1964 | 52.125 | 44.250 | 48.188 | 2.270 | 1.141 | 19.014 | 3.125 | 52.125 | 44.250 | 19.692 | 19.692 |
| 1965 | 75.500 | 49.250 | 62.375 | 2.685 | 1.294 | 20.669 | 3.583 | 75.500 | 49.250 | 19.891 | 19.891 |

Alternative 3. Purchase Without Amortization

| | LIQUIDITY RATIOS | | | EFFICIENCY RATIOS | | | PROFITABILITY RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| YEAR | CURRENT RATIO (TIMES) | RECEIVABLE TURNOVER (TIMES) | INVENTORY TURNOVER (TIMES) | EARNING POWER (PCT) | OPER ASSET TURNOVER (TIMES) | OPER INCOME MARGIN (PCT) | RETURN ON CAPITAL (PCT) | RETURN ON CS EQUITY (PCT) | CASH FLOW TO CS EQUITY (PCT) |
| 1957 | 2.49 | 5.83 | 1.77 | 25.09 | 1.21 | 20.74 | 18.16 | 19.30 | 24.57 |
| 1958 | 2.19 | 5.48 | 1.82 | 18.37 | 1.11 | 16.55 | 17.04 | 18.32 | 22.96 |
| 1959 | 2.47 | 5.80 | 1.78 | 15.20 | 1.09 | 13.88 | 15.19 | 17.11 | 22.11 |
| 1960 | 2.25 | 6.11 | 1.75 | 15.08 | 1.05 | 14.42 | 13.97 | 16.18 | 21.37 |
| 1961 | 2.10 | 6.09 | 1.79 | 17.11 | 1.00 | 17.17 | 13.62 | 15.00 | 20.50 |
| 1962 | 2.13 | 6.10 | 1.82 | 16.41 | 0.99 | 16.61 | 12.45 | 13.16 | 18.18 |
| 1963 | 1.82 | 5.44 | 1.71 | 15.35 | 0.91 | 16.80 | 11.98 | 12.42 | 17.11 |
| 1964 | 1.88 | 5.72 | 1.78 | 15.18 | 0.93 | 16.24 | 12.07 | 12.44 | 17.13 |
| 1965 | 1.83 | 5.83 | 1.88 | 16.78 | 0.95 | 17.71 | 12.97 | 13.60 | 18.14 |
| MEAN | 2.13 | 5.81 | 1.80 | 17.17 | 1.03 | 16.68 | 14.16 | 15.28 | 20.23 |

| | PRICE RATIOS | | | | CAPITAL STRUCTURE | | MISCELLANEOUS RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| | PRICE/EARN RATIO (TIMES) | DIVIDEND YIELD (PCT) | PRICE TO BOOK VALUE (TIMES) | PRICE TO CASH FLOW (TIMES) | FUNDED DEBT TO CAPITAL (PCT) | COMMON STK TO CAPITAL (PCT) | INTEREST COVERAGE (TIMES) | DIVIDEND PAYOUT (PCT) | EFFECTIVE TAX RATE (PCT) |
| 1957 | 12.80 | 3.88 | 2.35 | 10.05 | 0.00 | 93.82 | 0.00 | 49.63 | 46.66 |
| 1958 | 18.14 | 2.80 | 3.18 | 14.47 | 7.66 | 87.45 | 69.78 | 50.79 | 34.99 |
| 1959 | 25.09 | 2.40 | 4.05 | 19.42 | 15.45 | 80.65 | 27.38 | 52.69 | 29.39 |
| 1960 | 20.52 | 2.47 | 3.16 | 15.54 | 13.59 | 83.24 | 32.28 | 50.61 | 32.61 |
| 1961 | 24.36 | 2.31 | 3.76 | 17.82 | 9.36 | 90.64 | 47.20 | 48.85 | 41.38 |
| 1962 | 23.76 | 2.74 | 2.85 | 17.20 | 6.30 | 93.70 | 70.08 | 48.44 | 42.70 |
| 1963 | 24.35 | 2.77 | 2.85 | 17.47 | 4.05 | 95.95 | 107.43 | 50.42 | 42.09 |
| 1964 | 21.23 | 2.77 | 2.53 | 15.42 | 7.14 | 92.86 | 61.23 | 50.27 | 42.69 |
| 1965 | 23.23 | 2.77 | 3.02 | 17.41 | 6.87 | 93.13 | 71.36 | 48.18 | 44.43 |
| MEAN | 21.50 | 2.42 | 3.01 | 16.11 | 7.85 | 90.16 | 54.08 | 49.99 | 39.66 |

## APPENDIX G (cont.)

## Alternative 4. Purchase With Amortization (ten-year period)

FINANCIAL STATEMENT DATA IN MILLIONS OF DOLLAR

| YEAR | CASH ITEMS | RECEIV-ABLES | INVEN-TORY | CURRENT ASSETS | OPERATING ASSETS | CURRENT LIABS | LONG TERM DEBT | PREF'D STOCK | COMMON EQUITY | TOTAL CAPITAL | STK DIVS -SPLITS |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 21.974 | 33.345 | 52.468 | 107.987 | 155.625 | 35.396 | 0.000 | 8.744 | 109.349 | 118.093 | 1.000 |
| 1957 | 25.673 | 37.678 | 61.741 | 125.092 | 182.022 | 50.196 | 0.000 | 8.169 | 121.322 | 129.491 | 1.000 |
| 1958 | 17.311 | 43.610 | 66.842 | 127.772 | 213.467 | 58.407 | 11.905 | 7.594 | 132.607 | 152.106 | 1.000 |
| 1959 | 15.554 | 43.887 | 73.949 | 133.390 | 242.446 | 53.985 | 29.671 | 7.019 | 148.954 | 185.644 | 3.000 |
| 1960 | 24.282 | 45.730 | 71.199 | 141.211 | 264.045 | 62.748 | 27.600 | 6.444 | 164.499 | 198.543 | 1.000 |
| 1961 | 24.159 | 56.847 | 82.524 | 165.530 | 348.229 | 78.529 | 25.792 | 0.000 | 239.468 | 265.260 | 1.000 |
| 1962 | 18.229 | 68.988 | 98.707 | 185.924 | 400.500 | 87.454 | 20.479 | 0.000 | 287.556 | 308.035 | 1.000 |
| 1963 | 17.925 | 83.259 | 123.897 | 224.281 | 462.938 | 123.236 | 14.529 | 0.000 | 318.116 | 332.645 | 1.000 |
| 1964 | 22.427 | 84.722 | 128.973 | 236.322 | 502.008 | 125.441 | 28.773 | 0.000 | 337.701 | 366.474 | 1.000 |
| 1965 | 36.891 | 101.474 | 140.918 | 279.483 | 559.101 | 152.283 | 30.349 | 0.000 | 363.060 | 393.409 | 1.000 |

| YEAR | NET SALES | COST OF GOODS SOLD | DEPREC-IATION | OPERATING INCOME | FIXED CHARGES | INCOME TAXES | NET INCOME | PREF'D DIVS | NET TO COMMON | COMMON DIVS |
|---|---|---|---|---|---|---|---|---|---|---|
| 1956 | 178.362 | 91.448 | 6.255 | 31.927 | 0.000 | 14.174 | 17.747 | 0.497 | 17.250 | 9.018 |
| 1957 | 207.152 | 101.142 | 6.833 | 42.321 | 0.000 | 20.044 | 22.277 | 0.192 | 22.085 | 11.274 |
| 1958 | 222.726 | 114.964 | 6.482 | 34.222 | 0.536 | 12.900 | 23.322 | 0.165 | 23.157 | 12.087 |
| 1959 | 253.673 | 125.119 | 7.856 | 34.570 | 1.335 | 10.350 | 24.220 | 0.150 | 24.070 | 13.021 |
| 1960 | 269.376 | 126.854 | 8.987 | 38.210 | 1.242 | 12.670 | 25.540 | 0.128 | 25.412 | 13.186 |
| 1961 | 312.433 | 137.280 | 17.286 | 47.883 | 1.161 | 22.200 | 25.683 | 0.024 | 25.659 | 15.349 |
| 1962 | 383.573 | 173.914 | 20.836 | 56.792 | 0.922 | 27.200 | 29.592 | 0.000 | 29.592 | 17.678 |
| 1963 | 414.290 | 189.396 | 24.158 | 60.484 | 0.654 | 29.300 | 31.384 | 0.000 | 31.384 | 20.322 |
| 1964 | 480.144 | 224.811 | 27.389 | 67.453 | 1.295 | 33.300 | 34.153 | 0.000 | 34.153 | 22.468 |
| 1965 | 542.620 | 253.024 | 29.208 | 84.756 | 1.366 | 42.700 | 42.056 | 0.000 | 42.056 | 25.733 |

| | PER SHARE ADJUSTED DATA | | | | | | | ACTUAL HIGH | ACTUAL LOW | NUMBER OF SHARES | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| YEAR | STK HI PRICE | STK LO PRICE | AVERAGE PRICE | EARN-INGS | DIVI-DENDS | BOOK VALUE | CASH FLOW | STOCK PRICE | STOCK PRICE | ACTUAL | ADJUSTED |
| 1956 | 17.167 | 12.417 | 14.792 | 1.088 | 0.569 | 6.897 | 1.482 | 51.500 | 37.250 | 5.285 | 15.855 |
| 1957 | 21.833 | 14.250 | 18.042 | 1.370 | 0.700 | 7.528 | 1.794 | 65.500 | 42.750 | 5.372 | 16.116 |
| 1958 | 37.000 | 16.583 | 26.792 | 1.437 | 0.750 | 8.228 | 1.852 | 111.000 | 49.750 | 5.372 | 16.116 |
| 1959 | 45.250 | 30.500 | 37.875 | 1.471 | 0.794 | 9.100 | 1.951 | 45.250 | 30.500 | 16.368 | 16.368 |
| 1960 | 38.250 | 26.375 | 32.313 | 1.534 | 0.797 | 9.941 | 2.079 | 38.250 | 26.375 | 16.548 | 16.548 |
| 1961 | 53.875 | 30.625 | 42.250 | 1.414 | 0.847 | 13.219 | 2.371 | 53.875 | 30.625 | 18.116 | 18.116 |
| 1962 | 57.875 | 33.250 | 45.563 | 1.555 | 0.929 | 15.108 | 2.650 | 57.875 | 33.250 | 19.033 | 19.033 |
| 1963 | 55.500 | 44.750 | 50.125 | 1.403 | 1.038 | 16.246 | 2.837 | 55.500 | 44.750 | 19.581 | 19.581 |
| 1964 | 52.125 | 44.250 | 48.188 | 1.734 | 1.141 | 17.149 | 3.125 | 52.125 | 44.250 | 19.692 | 19.692 |
| 1965 | 75.500 | 49.250 | 62.375 | 2.114 | 1.294 | 18.252 | 3.583 | 75.500 | 49.250 | 19.891 | 19.891 |

APPENDIX G (cont.)

Alternative 4. Purchase With Amortization (ten-year period)

| YEAR | LIQUIDITY RATIOS | | | EFFICIENCY RATIOS | | | PROFITABILITY RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| | CURRENT RATIO (TIMES) | RECEIVABLE TURNOVER (TIMES) | INVENTORY TURNOVER (TIMES) | EARNING POWER (PCT) | OPER ASSET TURNOVER (TIMES) | OPER INCOME MARGIN (PCT) | RETURN ON CAPITAL (PCT) | RETURN ON CS EQUITY (PCT) | CASH FLOW TO CS EQUITY (PCT) |
| 1957 | 2.49 | 5.83 | 1.77 | 25.07 | 1.23 | 20.43 | 18.00 | 19.15 | 25.07 |
| 1958 | 2.19 | 5.48 | 1.82 | 18.32 | 1.13 | 16.26 | 16.94 | 18.24 | 23.50 |
| 1959 | 2.47 | 5.80 | 1.78 | 15.16 | 1.11 | 13.63 | 15.13 | 17.10 | 22.68 |
| 1960 | 2.25 | 6.11 | 1.75 | 15.08 | 1.06 | 14.18 | 13.94 | 16.21 | 21.95 |
| 1961 | 2.10 | 6.09 | 1.79 | 15.64 | 1.02 | 15.33 | 11.58 | 12.70 | 21.26 |
| 1962 | 2.13 | 6.10 | 1.92 | 15.17 | 1.02 | 14.81 | 10.65 | 11.23 | 19.14 |
| 1963 | 1.82 | 5.44 | 1.71 | 14.06 | 0.96 | 14.65 | 10.00 | 10.36 | 18.34 |
| 1964 | 1.88 | 5.72 | 1.78 | 13.98 | 1.00 | 14.05 | 10.14 | 10.42 | 18.77 |
| 1965 | 1.83 | 5.83 | 1.88 | 15.97 | 1.02 | 15.62 | 11.43 | 12.00 | 20.34 |
| MEAN | 2.13 | 5.81 | 1.80 | 16.49 | 1.06 | 15.44 | 13.09 | 14.16 | 21.23 |

| YEAR | PRICE RATIOS | | | | CAPITAL STRUCTURE | | MISCELLANEOUS RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| | PRICE/EARN RATIO (TIMES) | DIVIDEND YIELD (PCT) | PRICE TO BOOK VALUE (TIMES) | PRICE TO CASH FLOW (TIMES) | FUNDED DEBT TO CAPITAL (PCT) | COMMON STK TO CAPITAL (PCT) | INTEREST COVERAGE (TIMES) | DIVIDEND PAYOUT (PCT) | EFFECTIVE TAX RATE (PCT) |
| 1957 | 13.17 | 3.88 | 2.40 | 10.05 | 0.00 | 93.69 | 0.00 | 51.05 | 47.36 |
| 1958 | 18.65 | 2.90 | 3.26 | 14.47 | 7.83 | 87.18 | 68.58 | 52.20 | 35.61 |
| 1959 | 25.76 | 2.10 | 4.16 | 19.42 | 15.98 | 80.24 | 26.90 | 54.10 | 29.94 |
| 1960 | 21.04 | 2.47 | 3.25 | 15.54 | 13.90 | 82.85 | 31.76 | 51.89 | 33.16 |
| 1961 | 29.83 | 2.11 | 3.20 | 17.82 | 9.72 | 90.28 | 42.24 | 59.82 | 46.36 |
| 1962 | 29.30 | 2.04 | 3.02 | 17.20 | 6.65 | 93.35 | 62.60 | 59.74 | 47.89 |
| 1963 | 31.27 | 2.07 | 3.09 | 17.67 | 4.37 | 95.63 | 93.79 | 64.75 | 48.28 |
| 1964 | 27.78 | 2.37 | 2.81 | 15.42 | 7.85 | 92.15 | 53.09 | 65.79 | 49.37 |
| 1965 | 29.50 | 2.07 | 3.42 | 18.41 | 7.71 | 92.29 | 63.05 | 61.19 | 50.38 |
| MEAN | 25.14 | 2.42 | 3.18 | 16.11 | 8.22 | 89.74 | 49.11 | 57.83 | 43.15 |

APPENDIX G (cont.)

Alternative 4. Purchase With Amortization (ten-year period)

| YEAR | LIQUIDITY RATIOS | | | EFFICIENCY RATIOS | | | PROFITABILITY RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| | CURRENT RATIO (TIMES) | RECEIVABLE TURNOVER (TIMES) | INVENTORY TURNOVER (TIMES) | EARNING POWER (PCT) | OPER ASSET TURNOVER (TIMES) | OPER INCOME MARGIN (PCT) | RETURN ON CAPITAL (PCT) | RETURN ON CS EQUITY (PCT) | CASH FLOW TO CS EQUITY (PCT) |
| 1957 | 2.49 | 5.93 | 1.77 | 25.07 | 1.23 | 20.43 | 18.00 | 19.15 | 25.07 |
| 1958 | 2.19 | 5.48 | 1.82 | 18.32 | 1.13 | 16.26 | 16.94 | 18.24 | 23.50 |
| 1959 | 2.47 | 5.80 | 1.78 | 15.16 | 1.11 | 13.63 | 15.13 | 17.10 | 22.68 |
| 1960 | 2.25 | 6.91 | 1.75 | 15.08 | 1.06 | 14.18 | 13.94 | 16.21 | 21.95 |
| 1961 | 2.10 | 6.89 | 1.79 | 15.64 | 1.02 | 15.33 | 11.58 | 12.70 | 21.26 |
| 1962 | 2.13 | 6.10 | 1.92 | 15.17 | 1.02 | 14.81 | 10.65 | 11.23 | 19.14 |
| 1963 | 1.82 | 5.44 | 1.71 | 14.06 | 0.96 | 14.65 | 10.00 | 10.36 | 18.34 |
| 1964 | 1.88 | 5.72 | 1.78 | 13.98 | 1.00 | 14.05 | 10.14 | 10.42 | 18.77 |
| 1965 | 1.83 | 5.93 | 1.88 | 15.97 | 1.02 | 15.62 | 11.43 | 12.00 | 20.34 |
| MEAN | 2.13 | 5.91 | 1.80 | 16.49 | 1.06 | 15.44 | 13.09 | 14.16 | 21.23 |

| YEAR | PRICE RATIOS | | | | CAPITAL STRUCTURE | | MISCELLANEOUS RATIOS | | |
|---|---|---|---|---|---|---|---|---|---|
| | PRICE/EARN RATIO (TIMES) | DIVIDEND YIELD (PCT) | PRICE TO BOOK VALUE (TIMES) | PRICE TO CASH FLOW (TIMES) | FUNDED DEBT TO CAPITAL (PCT) | COMMON STK TO CAPITAL (PCT) | INTEREST COVERAGE (TIMES) | DIVIDEND PAYOUT (PCT) | EFFECTIVE TAX RATE (PCT) |
| 1957 | 13.17 | 3.98 | 2.40 | 10.85 | 0.00 | 93.69 | 0.00 | 51.05 | 47.36 |
| 1958 | 18.65 | 2.90 | 3.26 | 14.47 | 7.83 | 87.18 | 68.58 | 52.20 | 35.61 |
| 1959 | 25.76 | 2.40 | 4.16 | 19.42 | 15.98 | 80.24 | 26.90 | 54.10 | 29.94 |
| 1960 | 21.04 | 2.47 | 3.25 | 15.54 | 13.90 | 82.85 | 31.76 | 51.89 | 33.16 |
| 1961 | 29.83 | 2.91 | 3.20 | 17.82 | 9.72 | 90.28 | 42.24 | 59.82 | 46.36 |
| 1962 | 29.30 | 2.84 | 3.02 | 17.20 | 6.65 | 93.35 | 62.60 | 59.74 | 47.89 |
| 1963 | 31.27 | 2.97 | 3.09 | 17.47 | 4.37 | 95.63 | 93.79 | 64.75 | 48.28 |
| 1964 | 27.78 | 2.37 | 2.81 | 15.42 | 7.85 | 92.15 | 53.09 | 65.79 | 49.37 |
| 1965 | 29.50 | 2.07 | 3.42 | 18.41 | 7.71 | 92.29 | 63.05 | 61.19 | 50.38 |
| MEAN | 25.14 | 2.42 | 3.18 | 16.71 | 8.22 | 89.74 | 49.11 | 57.83 | 43.15 |

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