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Petition

FOR RECONSIDERATION AND HEARING ON

ACCOUNTING SERIES RELEASE 146

To

THE SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C.

September 18, 1973

Price
Waterhouse & Co.

PETITION

For Reconsideration and Hearing on Accounting Series Release 146

To: SECURITIES AND EXCHANGE COMMISSION
500 North Capitol Street
Washington, D. C. 20549

I. PETITION

Price Waterhouse & Co. hereby requests the Commission to modify Accounting Series Release 146 of August 24, 1973 for the reasons set forth briefly hereafter, which were discussed by our representatives with the Chief Accountant in his office on September 11, 1973. Based on the discussion with the Chief Accountant, a request is hereby made for a formal reconsideration and, if necessary, a hearing for the purpose of modifying the release.

II. NATURE OF PETITIONER'S INTEREST

Price Waterhouse & Co. acts as independent accountants and accounting advisors for hundreds of registrants with the Securities and Exchange Commission.

III. SUMMARY OF REASONS

1. *Retroactivity.* ASR 146 is inequitable because it applies new and more restrictive rules retroactively.
2. *Accounting Principle.* ASR 146 is also inequitable because it imposes additional limitations on accounting heretofore generally accepted without the customary public examination of the issues.

IV. RELIEF SOUGHT

1. To the extent the provisions of ASR 146 are more restrictive than pre-existing authoritative accounting literature, apply the new restrictions only to acquisitions of treasury stock after the date the Commission revokes the retroactive provisions. Even if the relief requested in the next paragraph is not granted, relief from this retroactive feature of ASR 146 is sought.

2. Because some of the accounting principles established by the Accounting Principles Board in Opinion 16, and dealt with by the ASR, are unsupported or illogical, refer the matter to the Financial Accounting Standards Board for consideration and announce that ASR 146 will be applied only until the FASB takes action with respect to the underlying concepts.

V. RETROACTIVITY

The final sentence of ASR 146 reads as follows, "The interpretation set forth herein should be applied to all subsequent business combinations *even though shares issued in these combinations may have been reacquired prior to the date of this release*" (emphasis supplied). As a result of this retroactive feature, registrants who have acquired their own shares for treasury since August 24, 1971, in good faith reliance on accepted interpretations of generally accepted principles of accounting, would be precluded in the two year period after the shares were acquired from using pooling of interests accounting for business combinations effected by exchanges of common stock which in some cases could extend until as late as August 23, 1975.

In summary, the arguments which were presented to the Chief Accountant on September 11 are:

1. The treasury stock rules are set forth in Accounting Principles Board Opinion 16 as rules with little supporting rationale. Therefore, registrants and their independent accountants had nothing other than a written rule to go by.

2. It was common knowledge, although never officially acknowledged, that the problems in reopening Opinion 16 for any purpose, no matter how justifiable, led the APB to accomplish *de facto* amendment by interpretation.

3. Therefore, it was reasonable to regard Interpretation 20 as an amendment of Opinion 16.

4. We advised our clients according to the rules outstanding as we and many other accountants understood them, and many of our clients have treasury shares that immediately became tainted on August 24, 1973 by the issuance of ASR 146.

In all equity, treasury shares should not be tainted if they were bought before August 24 and if in all respects they were what then was widely considered to be untainted treasury stock.

VI. ACCOUNTING PRINCIPLE

The reasons the concepts underlying Opinion 16 dealt with by ASR 146 are a proper subject for the FASB are as follows:

1. The generally accepted accounting principle that requires pooling of interests accounting is explicitly based on the premise of a combination of existing voting stock interests.
2. The restrictions in par. 47c and par. 47d of Opinion 16 are arbitrary limitations that are neither supported by logical reasoning nor are they related to the underlying concept of pooling of interest accounting enunciated in Opinion 16.
3. In attempts to make the unsupported concepts work, even more artificial time and other limits have subsequently been imposed by AICPA Interpretations.
4. ASR 146, by imposing further limitations, has extended unwarranted and unsupported accounting rules described as interpretations and did so without the customary public examination of the issues.

By common consent the FASB has the responsibility for promulgating accounting principles and, accordingly, if ASR 146 is to be implemented, even prospectively, this should be done only until such time as that Board has dealt with the issue.

VII. REQUEST FOR HEARING

Since ASR 146 was issued by the Commission, only the Commission can administratively reconsider its provisions. This petition necessarily only summarizes the pertinent arguments. Should the Commission find them not persuasive or require elaboration, we respectfully request an opportunity to appear before the Commission. We think the Commission should act promptly in this matter because of its critical nature for many registrants.

PRICE WATERHOUSE & CO.

1251 Avenue of the Americas
New York, N. Y. 10020
September 18, 1973

**MEMORANDUM SUPPORTING PETITION OF SEPTEMBER 18, 1973
FOR RECONSIDERATION AND HEARING ON
ACCOUNTING SERIES RELEASE 146**

The development of the existing
accounting requirements for
business combinations

The background of these requirements is already well known to the Commission. The basic sources of authoritative information concerning the subject of ASR 146, are, as noted therein, Accounting Principles Board Opinion 16 issued in August 1970 and AICPA Interpretation 20 to Opinion 16 issued in September 1971.

As the Commission is aware, the issuance of Opinion 16 was preceded by years of intense debate. The final approval by the APB was by vote of 12 to 6, which was the minimum required by APB operating procedures. The sister pronouncement, Opinion 17, dealing with accounting for goodwill, was issued simultaneously after a 13-5 vote. The dissenters to the two Opinions were not all the same individuals and, had they combined forces, neither Opinion could have been issued since, in all, eight members dissented to one or both Opinions.

The result of the deep-seated difference of opinion was that certain restrictions tended to be approved because the opponents to pooling of interests accounting supported any and all limitations on its use, and the proponents were willing to concede restrictions in order to get the basic concept approved. All parties recognized that Opinions 16 and 17 did not completely resolve the issues. They also recognized that internal inconsistencies had crept in during the long drafting period during which the successive drafts changed significantly.

When inequities were brought to the Board's attention after issuance of Opinion 16, it was unwilling to reopen the entire debate. Companies and accounting practitioners needed guidance over the inconsistencies, omissions or lapses in logic, however, and the Board encouraged the issuance of Interpretations by the AICPA. At about the same time the imprimatur encouraging members of the AICPA to follow Interpretations was strengthened. In effect, many felt a procedure had been devised to change APB Opinions by a less formal means.

A number of examples of this process can be documented but one simple example will suffice. In November 1971 Interpretation 24 was issued that permitted certain subsidiaries to use pooling of interests accounting for a five-year "grandfather" period, whereas the Opinion specifically prohibited these subsidiaries from using pooling of interests accounting. This establishes without a doubt that the AICPA with the encouragement of the APB used Interpretations to modify APB Opinions. It is against this background that accountants and companies sought to deal with inconsistencies between Opinions and Interpretations relating to accounting for business combinations.

The treasury stock problem

The most arbitrary restrictions on eligibility for pooling of interests accounting and, therefore, those most difficult to interpret, appear in paragraph 47 of Opinion 16. This paragraph is a compendium of seven conditions ostensibly designed to establish that a pooling of interests is a combination of existing voting common stock interests by the exchange of stock. The relevant portions of the two conditions to which ASR 146 relates are:

47c—

"None of the combining companies changes the equity interest of the voting common stock in contemplation of effecting the combination either within two years before the plan of combination is initiated or between the dates the combination is initiated and consummated; changes in contemplation of effecting the combination may include distributions to stockholders and additional issuances, exchanges, and retirements of securities."

47d—

"Each of the combining companies reacquires shares of voting common stock only for purposes other than business combinations, and no company reacquires more than a normal number of shares between the dates the plan of combination is initiated and consummated.

"Treasury stock acquired for purposes other than business combinations includes shares for stock option and compensation plans and other recurring distributions provided a systematic pattern of reacquisitions is established at least two years before the plan of combination is initiated. A systematic pattern of reacquisitions may be established for less than two years if it coincides with the adoption of a new stock option or compensation plan. The normal number of shares of voting common stock re-

acquired is determined by the pattern of reacquisitions of stock before the plan of combination is initiated."

In the Commission's view enunciated in the ASR, "these provisions have been subject to varying interpretations in practice and [the Commission] has concluded that certain of these interpretations are not compatible with concepts underlying the Opinion." It is the Commission's assertion that Interpretation 20 does not effectively supersede the test of systematic pattern of reacquisition required by the second paragraph under 47d quoted above.

The Commission and its staff may not be the only ones to have reached this conclusion but it is well known that most other accountants have reached the opposite one. When differences of opinion like this arise, the proper approach is to attempt to resolve them by examination of the document and, if such resolution is not possible, to submit the question to the same process of public inquiry used for the original pronouncement.

The principal background passages in Opinion 16 that bear on the problem of "concepts underlying the Opinion" are these:

Par. 47, introduction—

"The combining of existing voting common stock interests by the exchange of stock is the essence of a business combination accounted for by the pooling of interests method. The separate stockholder interests lose their identities and all share mutually in the combined risks and rights. Exchanges of common stock that alter relative voting rights, that result in preferential claims to distributions of profits or assets for some common stockholder groups, or that leave significant minority interests in combining companies are incompatible with the idea of mutual sharing. Similarly, acquisitions of common stock for assets or debt, reacquisitions of outstanding stock for the purpose of exchanging it in a business combination, and other transactions that reduce the common stock interests are contrary to the idea of combining existing stockholder interests."

Par. 45—

"The pooling of interests method of accounting is intended to present as a single interest two or more common stockholder interests which were previously independent and the combined rights and risks represented by those interests. That method shows that stockholder groups neither withdraw nor invest assets but in effect exchange voting common stock in a

ratio that determines their respective interests in the combined corporation. Some business combinations have those features.”

Neither of these descriptions of the underlying nature of pooling of interests accounting supports the idea that all treasury stock transactions, even those with the public on a stock exchange, impinge on the stockholder interests involved in the transaction, result in preferential distributions to some stockholder groups related to the business combination, or otherwise bear on the transaction. The entire two-year requirement is a rule, not a principle.

If one accepts the existence of a relation between business combinations and treasury stock acquisitions from unrelated parties, which we do not, an interpretation difficulty arises with respect to determination of purpose. The establishing of purpose is the substance of the problem that was recognized by the AICPA by the issuance in September 1971 of Interpretation 20, *Treasury Stock Allowed with Pooling*. Interpretation 20 is an approximately 500-word description of purposes for which treasury stock may be reacquired without becoming tainted. It does not once refer to systematic pattern of reacquisition which forms the basis of ASR 146 and it includes purposes other than compensation plans.

While we do not question the authority of the Commission to establish accounting rules, in the face of the unsatisfactory state of the entire subject of restrictions on pooling of interests accounting, we recommend that this entire subject be referred to the body generally conceded to have the responsibility to establish accounting standards, the Financial Accounting Standards Board.

The retroactive feature

ASR 146 was issued on August 24, 1973 two years after Interpretation 20 was issued. During the intervening two years many registrants, with the advice of their independent accountants, acquired treasury stock they believed to be without taint. Since ASR 146 applies to business combinations after its issuance but applies the taint to treasury shares reacquired during the two-year period that do not meet its test, a retroactive disqualification has resulted. This ought to be clearly recognizable as inequitable to registrants who operated within a reasonable and widely accepted construction of Interpretation 20 and paragraphs 47c and 47d of Opinion 16.