SEC CONTROL OF THE PUBLISHED FINANCIAL STATEMENTS OF BUSINESS COMBINATIONS THROUGH REGULATION S-X

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TABLE OF CONTENTS

CHAPTER		PAGE
I.	THE PROBLEM AND DEFINITIONS OF TERMS USED	1
	The Problem	2
	Statement of the problem	2
	Importance of the study	2
	Limitations of the study	3
	Definitions of Terms Used	3
	Person	3
	Affiliate	3
	Control	3
	Equity Security	4
	Fifty per cent owned person	4
	Majority owned subsidiary	4
	Parent	4
	Material	4
	Registrant	4
	Significant subsidiary	5
	Subsidiary	5
	Totally-held subsidiary	5
	Listed	5
	SEC	6
	ARB	6
	Commission	6
	Issuer	6

CHAPTER PAGE

Prospectus 6

Procedure. 6

II. POLICIES REGARDING CONSOLIDATION 8

Conditions of Consolidation. 8

The subsidiary must be majority-owned. 9

Fiscal year endings of the parent and its subsidiaries 9

Foreign subsidiaries 9

Group Statements of Subsidiaries Not Consolidated 12

Required Statement as to Principles of Consolidation Followed 14

Reconciliation of Investment of Parent in Subsidiary and Equity of Parent in Net Assets of the Subsidiary 15

Reconciliation of Dividends Received from and earnings of Unconsolidated Subsidiaries. . . 16

Minority Interests 18

Intercompany Transactions. 19

III. REQUIRED FORMS 20

Forms Required by the Securities Act of 1933 . . 20

Form S-1 21

Form S-9 22

Forms Required by the Securities Exchange Act of 1934. 23

CHAPTER PAGE

Form 10. 24

Form 10-K. 25

Form 8-K 26

Form 9-K 27

Application of Regulation S-X. 27

IV. PURCHASE VERSUS POOLING OF INTEREST. 28

Historical Background of the Pooling of Interest Concept 29

Attendant Circumstances of the Pooling of Interest Concept 30

Stock issued in exchange for properties in consolidation 31

Management 33

Relative size of the constituents. 34

Continuity of interests. 36

General Control Exercised by the Securities and Exchange Commission. 41

General Influence of The Securities and Exchange Commission. 44

V. SUMMARY AND CONCLUSIONS. 46

Summary. 46

Conclusions. 50

BIBLIOGRAPHY 54

CHAPTER I

THE PROBLEM AND DEFINITIONS OF TERMS USED

The Securities and Exchange Commission has an impact upon the American business community--especially those companies who have their stocks listed on the various organized exchanges and those who wish to issue securities for the public to purchase.

The Securities and Exchange Commission has been empowered by The Congress of the United States to protect the interests of the investor. While the Commission does not guarantee that a particular security will make a sound investment, it does try to make available, through its rules and regulations, all pertinent information that will enable an investor to analyze the company in which he wished to invest.

Those businesses that wish to issue securities or have their stock traded on the exchange must conform to the rules and regulations set forth by the Securities and Exchange Commission. Upon the conformance to these rules and regulations of the Commission hinges the rights of business to have their stocks listed on the organized exchanges or to sell their securities to the public.

I. THE PROBLEM

Statement of the Problem. It was the purpose of this study to determine the control exercised by the Securities and Exchange Commission over the published financial statements of business combinations through Regulation S-X.

Importance of the Study. In recent years there has been a rapid increase in business combinations. Since many of the companies involved in these combinations were companies who had their stocks listed on the exchange, it was inevitable that government regulations would be a factor in determining the accounting treatment accorded these combinations. This control became necessary, from the point of view of the Government, to protect the uninformed investor.

At the time of this writing, there are two major concepts in the accounting treatment of business combinations. They are the "purchase" concept and the "pooling of interest" concept.

This study tried to develop some understanding of the control that is actually exercised over business combinations relative to their financial statements and the circumstances that differentiate the "purchase" from the "pooling of interest" concept.

__Limitations of the study__. The Securities and Exchange Commission has been granted power by Congress to administer the several laws passed to regulate certain phases of business.

This study is limited to the "business combination aspect" of two of the five major enactments--The Securities Act of 1933 and The Securities Exchange Act of 1934. It is further limited to commercial and industrial companies that are not in the promotional, exploratory, or development stage. It does not consider investment companies of any type, insurance companies, or banks.

II. DEFINITIONS OF TERMS USED

__Person__. The term "person" means an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or a government or political subdivision thereof.

__Affiliate__. A person that directly or indirectly controls, or is controlled by, or is under common control with a specified person.

__Control__. The term "control" means the possession of power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or other methods.

Equity security. The term "equity security" means any stock or similar security. It also includes any security that may be converted into such security and any warrant or right to subscribe to such security.

Fifty per cent owned person. A person who has fifty per cent of the voting securities owned by the registrant and the other fifty per cent is owned by another single interest.

Majority owned subsidiary. A subsidiary in which more than fifty per cent of the outstanding voting securities is owned by the parent and/or one or more of the parent's other majority--owned subsidiaries.

Parent. An affiliate controlling a person through one or more intermediaries.

Material. The term "material" when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which the average prudent investor ought reasonably to be informed before he purchased the security.

Registrant. The issuer of the securities for which an application, a registration statement, or a report is filed.

Significant subsidiary. A subsidiary meeting any one of the following conditions.

1. The assets of the subsidiary, or any investment in and advances made to the subsidiary by the parent which exceeds 15 per cent of the assets of the parent and its subsidiaries on a consolidated basis.

2. The sales and operating revenues of the subsidiary exceeds 15 per cent of the sales and operating revenues of the parent and the subsidiaries on a consolidated basis.

3. The subsidiary itself is a parent of one or more subsidiaries and if aggregated would constitute a significant subsidiary.

Subsidiary. An affiliate controlled by a person through one or more intermediaries.

Totally-held subsidiary. A subsidiary, substantially all of whose outstanding securities are owned by the parent or the parent's other totally-held subsidiaries and which is not indebted to any person other than its parent or the parent's other totally-held subsidiaries. This does not include any indebtedness that would arise through the ordinary course of business.

Listed. The term "listed" means admitted to full trading privileges upon application by the issuer or its fiscal agent.

SEC. A common abbreviation for the Securities and Exchange Commission.

ARB. A common abbreviation for the Accounting Research Board.

Commission. A term commonly used to refer to the Securities and Exchange Commission.

Issuer. Every person who issues or proposes to issue any security.

Prospectus. Any notice, circular, advertisement, letter, or communication written or by radio or television, which offers any security for sale or confirms the sale of any security.

III. PROCEDURE

For the purposes of this study, the historical technique was used. The majority of the information was obtained by correspondence with the Chief Accountant of the Securities and Exchange Commission; the regional office of the SEC in Denver, Colorado; and the purchase of documents, published by the Commission, that were available to the public.

The following procedures were used in completing this study:

1. An extensive review of published materials was made. This included library research over periodical literature.

No previous studies on this subject could be found.

2. Purchases were made of SEC publications. These included the Securities Act of 1933, the Securities Exchange Act of 1934, General Rules and Regulations of both Acts, the Accounting Series Releases, and the Annual Reports of the Commission.

3. The forms required by the Commission were requested and received from the regional office in Denver, Colorado.

4. Several trips to the University of Kansas Library were made to supplement the materials available at the Kansas State Teachers College Library.

5. The data collected from these sources were summarized, analyzed, and interpreted.

6. Conclusions were reached after the assembled data had been analyzed and interpreted.

CHAPTER II

POLICIES REGARDING CONSOLIDATION

The Securities and Exchange Commission has established under Article 4 of Regulation S-X the conditions under which consolidation may or may not take place. This Article is further divided into "rules" which explain the various situations. Article 5 of Regulation S-X describes the form and content that must appear under the various classifications shown on the balance sheets and income statements of commercial and industrial companies. The requirements set forth in Article 5 apply to any consolidated statement that might be formulated by a commercial or industrial company.

Conditions of Consolidation

In general, the registrant shall follow, in consolidated statements, principles of inclusion or exclusion that will clearly present the financial conditions and results of operations of the registrant and its subsidiaries.[1]

There are three general exceptions in which the consolidation of statements may not take place.

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[1] The United States Securities and Exchange Commission, Regulation S-X (Washington: United States Government Printing Office, 1962), p. 7.

The subsidiary must be majority-owned. A subsidiary in which the parent and/or one or more of the parent's other majority-owned subsidiaries did not own more than fifty per cent of the outstanding securities representing the right to vote for the election of directors would not be included in the consolidation.

Fiscal year endings of the parent and its subsidiaries. The following conditions must all exist with regard to the relationship of dates of the statements of the subsidiaries and the parent company.

1. The difference of the dates of the financial statements of the subsidiary and the date of the financial statements of the parent company cannot exceed 93 days.

2. The closing date of the subsidiary must be expressly stated.

3. The reason for the necessity of using different dates between the subsidiary and the parent company is briefly explained, and

4. Any changes in the fiscal periods of the registrant or its subsidiaries are clearly indicated and the manner of treatment is explained.

Foreign subsidiaries. The registrant shall give due consideration as to the suitability of consolidation of those foreign subsidiaries whose operations are effected in terms of restricted foreign currencies. If consolidated, the effect of such exchange restrictions on financial statements and

operating results, insofar as can be determined upon the registrant and its subsidiaries, must be disclosed.[2]

The last statement on consolidation of foreign subsidiaries gave some concern when the British Government announced in 1949 a very material devaluation of their currency and caused widespread devaluation by many other foreign governments. This devaluation caused many problems as to how the foreign subsidiary accounts should be stated on the books of the domestic corporations. Since many of the companies published quarterly financial statements, a prompt decision was necessary because many inquiries were received by the Commission.

The first problem presented was whether to continue the previous practice of consolidating foreign and domestic corporations. The Commission gave a general conclusion that the problem might be determined upon the degree of integration of foreign operations with domestic operations. The Commission, however, left the final decision to the company and its independent accountants after giving "due regard to all the facts and having in mind the objective of most clearly exhibiting the financial conditions and results of the operations of the parent and its subsidiaries."

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[2] Ibid.

In the Commission's explanation of the term "degree of integration" it stated that if foreign operations are essentially an arm or extension of domestic corporations, and are actively conducted, the view held is that there is a presumption in favor of consolidation, despite the probable impact upon the foreign operations of unfavorable political and economic factors. If, in an instance of this kind, remittances to the parent company are restricted, appropriate disclosure of the facts is necessary and the consolidated profit and loss statements will reflect only earnings of foreign subsidiaries which are available to the parent company in terms of United States dollars. If, on the other hand, the foreign operations constitute a complete and separate business unit, and serious economic problems are presented, non-consolidation would generally appear to be indicated. In the examination of reports filed with the Commission since these developments, it has been observed that in a substantial number of cases, foreign operations previously included in consolidation have been removed. And when these fall within the Commission's test of significance, they have been reported on separately.

A more persistent question was whether there were any new principles to be applied with respect to the conversion of foreign assets into dollar equivalents when there was widespread devaluation.

The Staff felt there were no new principles involved in handling the conversion of foreign assets into dollar equivalents; that well established practices of the past were still adequate and appropriate; and that the general principles applicable in this situation are well expressed in Accounting Research Bulletin Number 4 published by the American Institute of Accountants.

Other questions such as: "To what extent should revaluation losses be recognized?" were asked. The Staff of the Securities and Exchange Commission feels that losses of this nature, even though large in amount, are a risk incident to doing business and are proper charges to income.[3]

Group Statements of Subsidiaries Not Consolidated

If majority-owned subsidiaries are not consolidated for such reasons as dissimilarity of operations or restrictions placed on foreign subsidiaries by foreign governments, the registrant may group these unconsolidated subsidiaries in a manner which will clearly exhibit the financial conditions of the group. If however, it is essential to a properly summarized presentation of facts, then such consolidated or

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[3]Sixteenth Annual Report, The United States Securities and Exchange Commission (Washington: United States Government Printing Office, 1951), pp. 158-159.

combined statements shall be filed.[4] This rule permits the registrant not only to group the statements of unconsolidated majority-owned subsidiaries but is an indication that the Commission may require such groupings.

Suppose, for example, that the fiscal years of the parent and its subsidiaries are more than 93 days apart. Then according to SEC rules, they are not allowed to consolidate. However, if the subsidiaries are significant, their individual statements must be filed. Ordinarily, there would be no objection to combining the statements of the subsidiaries and furnishing a single statement. The only requirement is that the different years of the subsidiaries should be disclosed.[5]

For example, in the 1959 Annual Report of the Elastic Stop Nut Corporation of America, the following footnote appeared.

> Three companies have fiscal years different from that of the parent company. In consolidation for the year ending November 30, 1960, the transactions of these subsidiaries have been restated to report the amounts for the twelve-months period ending November 30, 1960.[6]

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[4]Regulation S-X, Ibid.

[5]Louis H. Rappaport, SEC Accounting Practice and Procedure (New York: The Ronald Press Company, 1963), p. 15·12.

[6]Accounting Trends and Techniques (New York: American Institute of Certified Public Accountants, 1961), p. 219.

Required Statement as to Principles of Consolidation Followed

The policy of the registrant in determining the inclusion or exclusion of subsidiaries in each consolidated balance sheet and each group balance sheet of unconsolidated subsidiaries shall be stated in a note to the applicable balance sheet. If there has been any deviation of consistent treatment of subsidiaries, with respect to that of the preceding fiscal year, then the names of those subsidiaries shall be given.[7]

In their 1963 Annual Report, the Proctor & Gamble Company disclosed how a "deviation of consistent treatment of subsidiaries with respect to that of the preceding year," would be disclosed. The note to their financial statement states: "Effective as of July 1, 1962, the accounts of the Indonesian Subsidiary were removed from the consolidation due to the continuing restrictions in transmitting earnings to the Company."[8] This action reduced the retained earnings of the business by $841,800 as of that date. The net assets and earnings of the subsidiary represented a relatively insignificant portion of the Company's international operations.

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[7]Regulation S-X, Ibid.

[8]Accounting Trends and Techniques (New York: American Institute of Certified Public Accountants, 1964), p. 230.

This statement of principles of consolidation followed is required because Form 10-K, which is filed in relation to annual reports, does not contain comparable figures and this will then show any changes that have been made.[9]

The following example will show the principles of consolidation followed by one of the 600 companies surveyed by the American Institute of Certified Public Accountants.

AMERICAN OPTICAL COMPANY
Balance Sheet

Investments and advances, at cost:	
Non-consolidated subsidiaries (Note 1)	$6,729,253
Other, less allowances for possible losses	1,227,217
Total Investments and Advances	$7,956,470

Note 1: Principles of Consolidation--The consolidated financial statements include the accounts of the Company and its wholly-owned domestic and Canadian subsidiaries, with the exception of two such subsidiaries which, in the aggregate, are not significant. The accounts of the Canadian subsidiary are converted to United States dollars at appropriate rates of exchange.[10]

<u>Reconciliation of Investments of Parent in Subsidiaries and Equity of Parent in the Net Assets of the Subsidiaries</u>

The difference, if any, between the investment in consolidated subsidiaries as shown on the books of the parent and the equity in the net assets of the subsidiary as shown

[9] Rappaport, *loc. cit.*

[10] Accounting Trends and Techniques, 1964, *op. cit.*, p. 146.

on the books of the subsidiary shall be disclosed as to amounts and the disposition made in the consolidated statements. The balance sheet captions and the amount included under each caption shall be stated in the reconciliation of such differences. The conditions for reconciliation of the investment in unconsolidated subsidiaries and 50 per cent persons are the same for consolidated subsidiaries.[11]

The following example will show how the differences between the investment in consolidated subsidiaries on the books of the parent and the equity in the net assets of the subsidiaries as shown on the books of the subsidiaries are disclosed.

> THE BUDD COMPANY
> Notes to Financial Statements.
>
> Capital Surplus: In 1960 capital surplus was reduced \$353,692, representing the excess of book value of net assets at acquisition of two subsidiaries over the investment therein realized upon liquidation after sale of businesses, less \$5,859 discount on preferred shares repurchased.[12]

Reconciliation of Dividends Received from the Earnings of Unconsolidated Subsidiaries

The proportion of the sum and or difference between current earnings or losses and the dividends declared or paid

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[11] Regulation S-X, op. cit., p. 7.

[12] Accounting Trends and Techniques, 1961, op. cit., p. 216.

by the unconsolidated subsidiaries that is applicable to the parent shall be shown by a note to each consolidated profit and loss statement.

The St. Regis Paper Company and Armco Steel Corporation have shown this required information in the following manner.

ST. REGIS PAPER COMPANY
Investments, at Cost or Less:

Marketable securities (quoted market value, 1963, $36,013,687; 1962, $35,166,457)	$38,512,813
Securities of and advances to subsidiary company	39,213,315
	$77,726,128

Note 2: Subsidiaries Not Consolidated and Associated Companies

Investments in and advances to subsidiaries not consolidated, 50 per cent owned companies and other associated companies (less than 50 per cent owned) aggregated $39,312,315 at December 31, 1963; the related equities in their net assets, based on latest financial statements available, aggregated $44,340,000 including $15,940,000 for companies operating outside the United States and Canada. The equities in net earnings of these companies were $1,996,000 more in 1963 and $455,000 more in 1962, than distributions from such companies included in consolidated earnings for those years.[13]

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[13]Accounting Trends and Techniques, 1964, op. cit., p. 70.

ARMCO STEEL CORPORATION

Investments--At Cost (Note 2)

Foreign subsidiaries not consolidated	$ 9,308,866
Associated companies	34,631,249
Notes receivable and other investments	7,022,731
	$50,962,846

Note 2: Investments: The foreign subsidiaries not consolidated are all wholly-owned except for three in which there are small minority interests. Armco's equity in the net assets of these companies amounted to $35,900,000 at October 31, 1963, based upon translating their audited financial statements from foreign currencies into United States dollars at appropriate rates of exchange. Dividends received from the foreign subsidiaries in 1963 (included in revenues for the year) were $1,800,000 less than Armco's equity in their combined net income.

At December 31, 1963, the cost of Armco's investment in Reserve Mining Company (a 50 per cent owned associated company) was $23,306,939, which was the equity in the company's net assets. Armco's equity in the net assets of associated companies other than Reserve amounted to $24,500,000 at that date based upon unaudited financial statements furnished by the companies.[14]

Minority Interests

Any minority interest in the net assets of consolidated subsidiaries shall be shown in the consolidated balance sheet and separation shall be made between the minority interest in the capital and in the surplus section. The aggregate amount of profit and loss accruing to minority interest shall be stated separately in each consolidated income statement.[15]

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[14] Ibid., p. 73.

[15] Regulation S-X, op. cit., p. 8.

Intercompany Transactions

Generally, any intercompany items and transactions shall be eliminated. If these are not eliminated, reasons and methods of treatment should be set forth.[16]

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[16] *Ibid.*

CHAPTER III

REQUIRED FORMS

The forms that must be submitted in compliance with SEC regulations will be discussed in accordance with the applicable law. The Securities Act of 1933 and the Securities Exchange Act of 1934 each have a specific set of forms that must be submitted. While some of the information required by one law may also be required by the other law, this duplication of information may be handled by the "incorporation by reference," procedure as allowed by the Commission.

The forms are not of the type which requires filling in blanks but are guides as to what information is required and how it should be prepared. The information submitted in compliance with the forms will be considered to be in proper form unless objection to the form is made by the Commission prior to the effective date of the registration statement.[17]

Forms Required by the Securities Act of 1933

There are 17 different forms required by the Securities Act of 1933. The forms are devised so that different types

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[17] General Rules and Regulations Under the Securities Act of 1933 (Washington: The United States Government Printing Office, 1963), p. 32.

of companies will use different forms. The types of companies consist of such organization structures as established commercial and industrial companies; companies in the promotional, developmental and exploratory stage; open and closed end management companies; oil and gas interests; certificate of interest companies; and voting trust certificates.

The most common forms submitted to the Commission are S-1, S-2, S-3, S-9, and S-11. However, only forms S-1 and S-9 will be discussed because they are the only two which require consolidated statements.

Form S-1. This form is the principal registration statement and is used when no other form is prescribed or authorized. It is divided into two main parts: (1) information required in the prospectus and (2) information not required in the prospectus.

The information required in the prospectus section consists of prime financial statements and organization and structural data. The information not required in the prospectus section consists of securities data such as expense of the issue, sales of any securities, franchises held, indentures, and contracts.[18]

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[18]Form S-1, Registration Statement Under the Securities Act of 1933 (Washington: The United States Securities and Exchange Commission, February 20, 1958), pp. 3-22.

The registration statement must include a consolidated balance sheet of the registrant and its subsidiaries. The consolidated balance sheet must be certified if the registrant's individual balance sheet is certified.

The registration statement must also include a consolidated income statement of the registrant and its subsidiaries for each of the three years prior to the date of the latest consolidated balance sheet filed. A consolidated statement of surplus is required for the same period as the income statement. The surplus statement must be certified up to the date of the last certified consolidated balance sheet that has been filed.[19]

Form S-9. This form is used to register high grade nonconvertible debt securities when the issuer meets certain requirements such as: (1) principal place of operations is the United States or Canada, (2) the business of the issuer has been of the same general character for the last ten years, (3) the issuer has had a net income for the last five years and has not defaulted in payment of principal, interest, or sinking fund on any indebtedness, (4) the securities being registered amount to not less than $1,000,000 are offered for sale in units of not less than $500 each, and the securities are not expressly subordinated to prior outstanding securities.

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[19] Ibid., p. 25.

Form S-9 reduces the information required to: (1) summary of earnings, (2) indication of products or services which constitute the principal source of revenue, (3) use to be made of proceeds resulting from the financing, (4) description of the securities being offered, and (5) offering price information.[20]

The registration statement must contain a consolidated balance sheet of the registrant and its subsidiaries. The balance sheet cannot be dated earlier than 6 months prior to the date of filing of the registration statement.

The consolidated balance sheet need not be certified. If it is not certified, then a certified consolidated balance sheet with a date within one year prior to the filing date must be submitted.[21]

Forms Required by the Securities Exchange Act of 1934.

The forms prescribed by the Securities Exchange Act of 1934 are divided into six major types such as: (1) forms for use by exchanges, (2) forms for use by issuers, (3) forms for reporting ownership of equity securities, (4) forms for use by brokers and dealers, (5) forms for use by securities associations, and (6) other forms.

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[20] Form S-9, Registration Statement Under the Securities Act of 1933 (Washington: The United States Securities and Exchange Commission, June 29, 1962), p. 2.

[21] Ibid., p. 7.

The forms used by issuers are further subdivided into three categories. These are: (a) for registration of securities on a national securities exchange, (b) for annual and other reports, and (c) for amendments to applications or reports.[22]

For the purposes of this paper only those forms required by issuers will be considered. These will be further limited to those requiring consolidated statements.

Form 10. This is the principal form for registration under the Securities Exchange Act of 1934. The information required by this form is primarily financial. It requires among other things, financial statements of the registrant, unconsolidated subsidiaries and affiliates whose securities are pledged as collateral, information regarding reorganization of the registrant, information regarding the succession to or acquisition of other businesses, consolidated financial statements, and information regarding banks and insurance companies, registrants not in the production stage, and historical financial information.

The consolidated statements required by Form 10 must include a consolidated balance sheet as of the close of the

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[22] General Rules and Regulations Under the Securities Exchange Act of 1934 (Washington: The United States Government Printing Office, 1963), pp. 91-92.

latest fiscal year. If the close of the latest fiscal year is within 90 days of the filing date, this balance sheet may be used. If the latest fiscal year ends within 90 days of the filing date but a consolidated balance sheet of the preceding fiscal year was submitted, then within 120 days of the first filing, an amendment to the application must be filed which includes a consolidated balance sheet of the latest fiscal year.

The application must also include a certified income statement and surplus statement for the registrant and its subsidiaries. These statements must be provided for three years preceding the date of the date of the acceptable consolidated balance sheet.[23]

Form 10-K. This is the principal annual report form filed by companies which have securities listed for trading on a national securities exchange and is designed to bring up to date much of the information filed in the application for registration. The report is also filed by companies which do not have securities so listed but which registered under the 1933 Act and are subject to certain regulations of the 1934 Act.

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[23] Form 10, General Form for Registration of Securities (Washington: The United States Securities and Exchange Commission, March 5, 1965), p. 19.

The information required is general. It includes such items as: (1) names of exchanges on which Company's securities are registered, (2) number of stockholders, (3) list of parents and subsidiaries, (4) directors of the registrant and renumeration of the directors and officers, and (5) financial statements of the registrant, affiliates and unconsolidated subsidiaries; financial statements of banks and insurance companies and registrants not in the production stage; and consolidated financial statements.[24]

The annual report on Form 10-K must include for the registrant and its subsidiaries a consolidated balance sheet, income statement, and surplus statement for the fiscal year. All these required financial statements must be certified.[25]

Form 8-K. A so-called current report that must be filed only when certain significant events occur. The significant events are (1) changes in control of registrant, (2) acquisition or disposal of significant amounts of assets that are not in the ordinary course of business, (3) material defaults, (4) revaluation of assets, and (5) material increases or decreases in outstanding securities.[26]

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[24] Form 10-K, Annual Report Form (Washington: The United States Securities and Exchange Commission, March 5, 1965), pp. 3-12.

[25] Ibid., p. 13.

[26] Form 8-K, Current Report Form (Washington: The United States Securities and Exchange Commission, March 5, 1959), pp. 3-10.

If the registrant files consolidated statements, then this report must also be filed on a consolidated basis.[27]

Form 9-K. A semi-annual report required for companies having securities listed for trading on the national exchanges.

This form is entirely financial and requires such items as: (1) net sales, (2) net income before taxes, (3) provisions for income tax, (4) extraordinary items, and (5) earned surplus.[28]

If the registrant files consolidated statements, the information in this form must also be on a consolidated basis.[29]

Application of Regulation S-X

Regulation S-X applies to the form and content of the financial statements required by the forms previously discussed with the exception of Form 9-K.[30]

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[27] Ibid., p. 11.

[28] Form 9-K, Semi-annual Reports (Washington: The United States Securities and Exchange Commission, May 18, 1960), pp. 3-5.

[29] Ibid., p. 1.

[30] Regulation S-X, op. cit., p. 1.

CHAPTER IV

PURCHASE VERSUS POOLING OF INTEREST

The pooling of interest concept implies the combining of surplus and deficits. Under this doctrine, the only change that may be made in the stated amounts are those necessary to present the accounts in accordance with generally accepted accounting principles or to bring inventory valuation and depreciation methods into conformity with those of the acquiring corporation.[31]

The Accounting Research Committee of the AICPA states specifically that under the pooling of interest concept, it is inappropriate and misleading to eliminate the deficit of one of the constituent corporations against its capital surplus and to carry forward the earned surplus of another constituent. Under these conditions, there would be no new basis of accountability. The amount of the assets of all corporations are carried forward and the combined earned surplus and deficits of the combining corporations should also be carried forward.[32]

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[31] Samuel R. Sapienza, "Distinguishing Between Purchase and Pooling," *Journal of Accountancy*, 111:37, June, 1961.

[32] *Accounting Research and Terminology Bulletins* (New York: American Institute of Certified Public Accountants, 1961), p. 25.

The Accounting Research Committee further states that when an acquisition has been determined to be a purchase, the assets should be recorded by the acquiring corporation in terms of cost measured in money or the fair market value of the assets acquired, whichever is more clearly evident.[33]

Historical Background of the Pooling of Interest Concept

In 1944, the American Institute of Certified Public Accountants issued Bulletin Number 24 which recognized that it is acceptable practice to eliminate goodwill by a write-off to any capital surplus account. This was so prevalent in practice that the AICPA Committee on Accounting Procedure did not prohibit it, but merely urged that these charges to capital surplus be discouraged.[34]

In 1945, Accounting Series Release Number 50 expressed the view of Mr. William W. Wertz, then Chief Accountant of the Securities and Exchange Commission, that charges to capital surplus are contrary to sound accounting principles. Mr. Wertz felt the write-off of goodwill should be made through timely charges to income.[35]

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[33] Ibid., p. 24.

[34] Andrew Barr, "Accounting Aspects of Business Combinations," The Accounting Review, 30:175, April, 1959.

[35] Accounting Series Release Number 50, United States Securities and Exchange Commission (Washington: United States Government Printing Office, 1956), p. 123.

Bulletin Number 24 and Accounting Series Release Number 50 then gave a historical background for the issuance of Bulletin Number 40, dated September 1950, which differentiated between the concepts of a purchase and a pooling of interest. Bulletin Number 40 contains the earliest reference to the terminology "pooling of interest" in any official publication.

With the issuance of Bulletin Number 43 (which included a restatement of Bulletin Number 40) by the Committee on Accounting Procedure, charges to capital surplus and lump-sum write-offs after acquisition were prohibited. Their stated position was that intangibles such as goodwill should be systematically charged to income over the period of usefullness. This position was again restated in the Committee's Opinion on Business Combinations published in Bulletin Number 48.[36]

The Securities and Exchange Commission and the Committee on Accounting Procedure of the AICPA are now in agreement as to how intangibles should be written off.

Attendant Circumstances of the Pooling of Interest Concept

The accounting treatment of a purchase or a pooling of interest depends upon the attendant circumstances of the

[36] Restatement and Revision of Accounting Research Bulletins, Intangible Assets (New York: American Institute of Accountants, 1953), p. 38.

combination rather than the legal designation as a merger or a consolidation or the legal implications with respect to the availability of new assets for dividends. The income tax considerations set forth by the provisions of the Internal Revenue Code are not considered.[37]

The attendant circumstances to distinguish a pooling of interest from a purchase as set forth by Bulletin Number 48 are

<u>Stock issued in exchange for properties in consolidation</u>. When the shares of stock issued by the acquiring company to the stockholders of one of the acquired companies are not in substantially the same proportion as the stockholder's original holdings in the acquired company, then a purchase is presumed to result. If the relative voting rights are altered through the issuance of senior equity or debt securities which have limited or no voting rights, a purchase is indicated. Furthermore, any plan to retire the shares issued by the acquiring company to the stockholders of the acquired company will be viewed as a purchase. The retiring or converting of a senior class of stock need not preclude considering the combination as a pooling of interest.[38]

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[37] "New Accounting Research Bulletin Issued: Number 40, Business Combinations," <u>Journal of Accountancy</u>, 9:490, December, 1950.

[38] Accounting Research and Terminology Bulletins, <u>op</u>. <u>cit</u>., p. 23.

It is evident then, from the foregoing criteria, the stockholders of the new entity must have approximately the same general relationship they had with their original company before acquisition. This same general relationship would include approximately the same percentage of ownership, approximately the same relative voting rights, and would include their desire to retain the stock issued by the new entity.

In one case, the Commission concluded that a business combination represented a purchase of assets. In this case, a company having total assets of $95,000,000 submitted preliminary proxy-soliciting material containing a pro forma balance sheet giving effect to the acquisition of the net assets of a company with total assets of approximately $15,000,000. The registrant issued 115,000 shares of its common stock, $25 par value, for substantially all of the net assets of the company to be acquired. This represented the issuance of approximately 20 per cent additional stock. This sum of $2,296,000, representing the excess of the common stock equity of the company to be acquired over the aggregate par value of the registrant's common stock issued, was reflected in the registrant's earned surplus account. The Staff of the SEC took the position that the accumulated earnings of the acquired company that were in excess of the credit made to the registrant's common stock account would

be credited to capital surplus instead of the earned surplus account of the registrant. The amount, $2,875,000, was credited to capital surplus because the transaction was represented as a purchase of net assets.[39]

Furthermore, the SEC will not ordinarily object to pooling accounting where the owners of the acquired company do not dispose of more than 25 per cent of the shares received in the combination.[40]

Management. If the management of the constituents is eliminated or its influence is very small upon the management of the combination, then a purchase is probably indicated.[41]

In a paper presented at Syracuse University, Mr. Andrew Barr stated that the Securities and Exchange Commission was interested in the fact that some of the top management of the acquired companies would be given a place in the top management structure of the combined entity. This, as far as the Commission was concerned, was evidence that the plan was a pooling of interest and not a purchase.[42]

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[39] Eighteenth Annual Report, The United States Securities and Exchange Commission (Washington: United States Government Printing Office, 1952), p. 60.

[40] Rappaport, op. cit., p. 19·12.

[41] Barr, op. cit., p. 180.

[42] Ibid.

<u>Relative size of the constituents</u>. Relative size of each constituent to the combination may not be a determining factor, especially when the smaller corporation contributes something else besides assets, such as management personnel. However, where one of the corporations is definitely dominant, 90 per cent to 95 per cent or more of the combined voting interest, then a purchase is indicated.[43]

The Securities and Exchange Commission, as a general proposition, has objected to the pooling of interest when the smaller company had less than 5 per cent. In some cases when the interest of the acquiring company exceeded 95 per cent, pooling of interest has been accepted, when it was evident that other factors such as size and position of the companies would have excluded certain industry leaders from the pooling of interest doctrine entirely.[44]

The following illustrative actual cases of combinations will show that the Securities and Exchange Commission does deviate from its established 5 per cent rule as shown on the following page.

In the case of American Machine and Foundry Company, the acquisitions of Voit and Beaird were actually recorded as

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[43]Accounting Research and Terminology Bulletin, <u>op</u>. <u>cit</u>., p. 23.

[44]Barr, <u>op</u>. <u>cit</u>., p. 179.

	Net Assets Contributed	Per Cent	Equity Shares	Per Cent
American Machinery & Foundry Company	65,422,203	95.7	2,747,378	95.8
Voit	2,997,262	4.3	121,680	4.2
Beaird	2,903,639	4.2	153,492	5.3
Aluminum Company of America	687,140,610	97.8	20,644,966	98.4
Rome Cable	16,266,610	2.2	355,226	1.6
Raytheon Company	59,982,440	98.3	3,409,821	98.8
Sorensen & Co., Inc.	1,098,535	1.7	44,132	1.2
Reigel Paper Company	39,224,000	97.9	1,329,979	95.9
Bartell Engineering Company	824,358	2.1	56,592	4.1
Universal Match Corp.	25,218,469	96.7	4,222,843	98.3
Sleight & Hellmuth, Inc.	865,443	3.3	73,100	1.7

a purchase and were consolidated as wholly-owned subsidiaries for the years 1957, 1958, and nine months of 1959. On September 23, 1959, the original handling of the acquisition of the two subsidiaries was changed to a pooling of interest classification on a retroactive basis. And the books of the acquiring corporation were adjusted to reflect this.[45]

Dr. Samuel Sapienza observed that apparent size is becoming less and less important while continuity of equity and management are becoming the more dominant factors when a pooling of interest is made.[46]

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[45] Sapenzia, op. cit., pp. 37-40.

[46] Ibid., p. 39.

This view is also held by Mr. Rappaport when he states that experience has shown that many of the criteria of a pooling of interest and a purchase, from an accounting point of view, have eroded in some respects and broken down in others.[47]

Dr. Sapenzia, after studying the pooling of interest and purchase methods used by combining companies, devised and presented, in the April 1962 Accounting Review, two charts which present the criteria for differentiating between a pooling of interest and a purchase. These charts present the situation from a theoretical viewpoint and from a practical viewpoint of how this is actually done by the joining constituents. The charts of Dr. Sapenzia are shown on the following page.

Continuity of interests. The Securities and Exchange Commission is also concerned with the evidence of the constituent parties as to the disposition of the shares they obtained in the transaction. In order to sell the shares, it is sometimes necessary to register them under the Securities Act of 1933 and this is the evidence which will indicate intent to dispose of them.[48] Registration under the Securities

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[47]Rappaport, op. cit., p. 19·13.

[48]Barr, op. cit., p. 180.

COMPARISON OF CRITERIA FOR PURCHASING A

Factor	CRIT Purchasing	 Pooli
Consideration Exchanged	Stock or cash for all or part of the stock of the acquired company. Stock or cash for all or part of the net assets.	Stock, impliedly co or virtually all th pooled company. St common, for all or of the net assets o company.
Assets Contributed by the Constituent Companies	Possible abandonment or sale of a large part of the assets of the acquired corporation.	Substantially all t the joined company forward to the join
Size of Constituent Company's Net Assets	Not determinative, although if one company is minor, relatively, a purchase may be indicated.	Not determinative, although the larger relatively, the str for a pooling.
Stock Ownership	Possible elimination of an important part of the stock ownership of the acquired corporation.	Continuance of subs of the ownership in pooled company in t pooling company. a limit of at least per cent of the vot in the combined ent given to the pooled
Management of the Combined Enterprise	No requisite to bring forward any of the management of the acquired company, although this may be done.	Continuance of mana maintenance of desi
Post-combination Corporate Form	Any corporate structure dictated by the circumstances.	Any corporate form the circumstances.

COMPARISON OF CRITERIA FOR PURCHASING AND POOLING TYPES OF BUSIN

CRITERIA

Purchasing	Pooling	Po
tock or cash for all or part of he stock of the acquired company. tock or cash for all or part of he net assets.	Stock, impliedly common, for all or virtually all the stock of the pooled company. Stock, impliedly common, for all or virtually all of the net assets of the pooled company.	Stock i all or v stock of Stock, i all or v net asse company.
ossible abandonment or sale of large part of the assets of he acquired corporation.	Substantially all the assets of the joined company are brought forward to the joining companies.	Substant assets o are brou joining
ot determinative, although if ne company is minor, relatively, purchase may be indicated.	Not determinative, in itself, although the larger the companies, relatively, the stronger the case for a pooling.	Not dete although panies, stronger
ossible elimination of an impor- ant part of the stock ownership f the acquired corporation.	Continuance of substantially all of the ownership interest of the pooled company in the stock of the pooling company. Bulletin 48 set a limit of at least five to ten per cent of the voting interest in the combined enterprise to be given to the pooled company.	Continua all of t of the p stock of Bulletin at least of the v combined given to
o requisite to bring forward ny of the management of the cquired company, although this ay be done.	Continuance of management, and maintenance of desired personnel.	Continua and main personne
ny corporate structure dictated y the circumstances.	Any corporate form dictated by the circumstances.	Any corp dictated stances.

FOR PURCHASING AND POOLING TYPES OF BUSINESS COMBINATIONS

CRITERIA

Pooling	Pooling Criteria	Pooling Practice
ck, impliedly common, for all virtually all the stock of the led company. Stock, impliedly mon, for all or virtually all the net assets of the pooled pany.	Stock impliedly common, for all or virtually all of the stock of the pooled company. Stock, impliedly common, for all or virtually all of the net assets of the pooled company.	Poolings occur with practically any combinations of different classes of stock, for stock or net assets.
tantially all the assets of joined company are brought ward to the joining companies.	Substantially all the net assets of the joined company are brought forward to the joining company	Generally, all assets are contributed although cases can be shown where disinvestment in the pooled company appeared significant.
determinative, in itself, ough the larger the companies, atively, the stronger the case a pooling.	Not determinative, in itself, although the larger the companies, relatively, the stronger the case for pooling.	Illustrations have been offered where the company pooled is absolutely and relatively small. As a test, this is fading in importance.
tinuance of substantially all the ownership interest of the led company in the stock of the ling company. Bulletin 48 set imit of at least five to ten cent of the voting interest the combined enterprise to be en to the pooled company.	Continuance of substantially all of the ownership interest of the pooled company in the stock of the pooling company Bulletin 48 sets a limit of at least five to ten per cent of the voting interest in the combined enterprise to be given to the pooled company.	Continuity of ownership interest cannot be proved in fact, except for major stockholders who agree not to sell. The force of the tax law militates against transfer so as to under cut this as a test. This test of five to ten per cent of the stock, as a minimum, to go to the pooled company has been breached to the point that as a test it is unimportant.
tinuance of management, and ntenance of desired personnel.	Continuance of management, and maintenance of desired personnel.	As defined in this paper, this test seems to have been adhered to, generally, and management continued in force.
corporate form dictated by circumstances.	Any corporate structure dictated by the circumstances.	The post-combination corporate form has varied from division to subsidiary.

Act of 1933 of shares received in the transaction or other evidence to dispose of them will usually cause the disallowance of a pooling of interest treatment.[49]

The principles of pooling of interest accounting permit the combining of the earned surplus accounts of the combining companies and thus avoid the recording of any goodwill or any revaluation of the assets that would be required in purchase accounting.

In one case the purchase method of accounting treatment was used. The registration statement reported $14,500,000 in assets and in excess of $10,000,000 capital surplus. The Commission concluded this case was a pooling of interest. As a result, the amended statement reported $8,400,000 in total assets and a capital surplus of $4,100,000.

In this case the Commission had given consideration to the nature and effect of the transactions resulting in the formation of the registrant and its absorption of the businesses of its predecessor and subsidiary companies and concluded that the pooling of interest was the method that should be followed in setting up the balance sheet of the new company. The Commission did not elaborate on the nature and effect of the transactions which led to the conclusion that the combination was a pooling of interest.[50]

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[49] Ibid.

[50] Eighteenth Annual Report, op. cit., p. 14.

The SEC also considered the accounting implications in a merger resulting in the acquisition of the assets of Company A by the issuance of preferred stock of Company B in exchange for all of the common stock of Company A, which was to be dissolved and its plant operated as a division of Company B. The net assets to be obtained after assumption of liabilities amounted to $1,667,000 less than the aggregate par value of the preferred stock to be issued, and Company B, the registrant, indicated it would charge off this difference of $1,667,000 to earned surplus. The SEC advised the registrant that the proposed accounting treatment appeared to be inappropriate since it appeared that the merger plan was developed primarily for the purpose of acquiring an additional plant. The registrant stated that the other company was acquired in order to obtain urgently needed building space and that the past earnings of the acquired company did not justify capitalization of any part of the consideration as having been paid for goodwill or for any other intangible. Accordingly, the registration statement was amended in which it was stated that the difference would be added to the cost of the building.[51]

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[51]Nineteenth Annual Report, The United States Securities and Exchange Commission (Washington: United States Government Printing Office, 1953), p. 20.

In another case, one registrant filed a registration statement in which an exchange offer was described and acquisition accounting was proposed for the combination of two companies. The proposed parent was one-fifth the size of the company being acquired in this instance.

The smaller company had 400,000 shares of stock outstanding and was to issue 1,600,000 of its $25 par value common stock for the entire common stock of the larger company. The smaller company assigned a $2 value to its own shares and the prospectus carried an offering of 250,000 shares at a net price to the company of $2.10 per share.

In the original proposal, $2,600,000 of the excess of the value of the new shares to be assigned to certain undeveloped real estate was owned by the larger company. The Staff of the Securities and Exchange Commission objected to acquisition accounting and write-up of the land.

The previously outstanding stock of the registrant was redesignated as Class A convertible stock and was convertible up to a certain date and then it automatically became common stock. Both the Class A stock and the debentures carried voting rights for the election of five directors and the new common stock had a right to elect five directors.

After negotiation, an amended registration statement was filed showing the pooling of interest method. The

investment was recorded at cost and no revaluation was necessary.[52]

It must be remembered that no one factor of the ones discussed previously would necessarily determine whether a combination is a purchase or a pooling of interests. These factors may have varying degrees of significance in different cases. However, the presence or absence of these factors would be cumulative in effect.[53]

General Control Exercised by the Securities and Exchange Commission

In the area of general control exercised by the Securities and Exchange Commission, the case of the Atlantic Research Corporation points out the extent to which the SEC may investigate.

The Atlantic Research Corporation was found guilty of false and misleading statements with respect to, among other things, the description of the business of the registrant; the subsidiaries of the registrant; extensive purchase of stock of the registrant on the open market through undisclosed subsidiaries with funds provided by the registrant

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[52] Twenty-fourth Annual Report, The United States Securities and Exchange Commission (Washington: United States Government Printing Office, 1958), p. 14.

[53] Accounting and Research Terminology Bulletin, op. cit., p. 24.

and the effect on the market price; transactions with and loans to related companies and officers; possibilities of substantial disallowances under government cost contracts of rental payments made to related companies; and overstatement of assets and earnings.

The Atlantic Research Corporation failed to disclose business transactions with satellite companies and sham transactions where the registrant directly and completely dominated the management policies and business activities of other companies. These satellite companies had no business activities of their own that were not related to the registrant but were operated together with the registrant as one economic unit.

The failure to disclose the business transactions that actually took place with the satellite companies was held to be misleading because consolidation would cause the elimination of the effect of intercompany and sham transactions even though these satellite companies were subsidiaries.

The specific deficiencies of the company were

1. The registration statement was materially deficient with respect to the failure to disclose that the registrant was engaged in a practice of making loans as a part of its business activities and failed to disclose its policies with respect to such practices.

2. The registration statement was materially deficient and misleading in failing to disclose the relationships and transactions between the registrant and Eastern Pine Ridge Corporation

and Edsall, both subsidiaries of Atlantic Research Corporation, and the nature and extent of the interests of the officials and employees of the registrant in these companies.

3. The registration statement was materially false and misleading in failing to disclose the required information with respect to loans to and transactions with officers and by denying the existence of material transactions with officers.

4. The registration statement does not disclose the fact that the Navy Audit Office had given notice of disallowances, the surrounding circumstances, and the extent of potential disallowances of rental expenses under registrant's cost type contracts with the Department of the Navy and is materially deficient in these respects.

5. The registration statement was materially inaccurate and misleading with respect to provisions for estimated corporate income taxes.

6. Current assets in the consolidated balance sheet as of December 31, 1962, are materially overstated by the inclusion of notes and interest receivable due from Texas Capital Investment, Inc., a satellite company of Atlantic Research Corporation, and other companies of approximately $1,300,000 and $2,400,000 respectively. These amounts would have been eliminated in a consolidation of Texas Capital Investment, Inc., and the other companies.[54]

The information used as a basis to rule the registration statement deficient and misleading was taken from the annual reports and not from the information filed in the registration statement.

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[54] Securities Act Release No. 4657, The Securities and Exchange Commission (Washington, D. C., December 6, 1963), pp. 3-35.

A footnote used in the summary made by the Securities and Exchange Commission reads as follows:

> The financial statements contained in this annual report were not of course contained in the registration statement, but the underlying transactions to which this recorded provision applies occured prior to the filing of the registration statement. Had the historical facts now known been revealed in connection with the prospectus in the registration statement, it may be fairly assumed that material changes in the financial statements in the registration statements would have been necessary.[55]

This case is significant in that this is the first time that a suspension order was based, not on what was in the office files of the Commission, but on information which is available to the public such as the annual reports of the Atlantic Research Corporation.

General Influence of the Securities and Exchange Commission

In recent years, many mergers and acquisitions were in progress and the Staff of the Securities and Exchange Commission is cooperating with the accounting profession to bring about uniform accounting procedures in that area.

To accomplish this, the Chief Accountant or his representative is in constant contact with the various accounting organizations such as: (1) the American Accounting Association, (2) The American Institute of Certified Public Accountants, (3) The National Association of Railroad and Utility

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[55] *Ibid.*, p. 32.

Commissioners, and (4) The Financial Executives Institute. In turn, these professional accounting organizations appoint specific committees to cooperate with the Commission on accounting and financial matters.[56]

The Chief Accountant personally acts as a consultant to the American Accounting Association; as a "conferee" to the Committee on Accounts and Statistics of the National Association of Railroad and Utility Commissioners; and the Securities and Exchange Commission has authorized its Chief Accountant to serve as a member of the Committee on Research of the American Institute of Certified Public Accountants.[57]

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[56]"Official Decisions and Releases, SEC Annual Report Discusses Accounting Principles and Procedures," Journal of Accountancy, 95:602-603, May, 1953.

[57]Twenty-fifth Annual Report, The United States Securities and Exchange Commission (Washington: United States Government Printing Office, 1958), p. 186.

CHAPTER V

SUMMARY AND CONCLUSIONS

It was the purpose of this study to determine the control exercised by the Securities and Exchange Commission over the published financial statements of business combinations. The basis of this study was the Securities Act of 1933, the Securities Exchange Act of 1934, Regulation S-X, the forms required by the Commission, the Accounting Series Releases, the Annual Reports of the Securities and Exchange Commission, releases made by the Commission, and Cases and Decisions made by the Commission.

Article 4 of Regulation S-X governs the preparation of consolidated and combined statements. This article defines the procedures the registrant must follow in determining the principles of inclusion or exclusion of subsidiaries which will clearly represent the financial condition and the results of operations of the registrant and its subsidiaries.

The requirements set forth by Regulation S-X relative to consolidated statements may be summarized as follows:

1. When consolidated statements should be prepared.
2. Treatment of subsidiaries not consolidated.
3. Required statements regarding the inclusion or exclusion of subsidiaries in the consolidated statements.
4. Reconciliation of:
   a. Investment of parent in subsidiaries and

fifty-per cent owned persons and equity of parent in the net assets of the subsidiary and fifty-per cent owned persons.

b. Dividends received from and earnings of unconsolidated subsidiaries.

The Commission does not specify which forms will be required. The responsibility of determining which forms are the proper ones to use is one of management and their legal counsel. These forms are very complex and need special study to determine which is the correct form to submit.

The forms are not of the type in which blanks are filled in but are merely guides as to the required information. If duplicate information is required due to filing under more than one Act, this information may be incorporated by reference if it is not needed for the prospectus.

The purchase and pooling of interest concepts have caused confusion as to the accounting treatment to be used. The Accounting Research Bulletin Number 48 has tried to define the circumstances necessary to determine whether an acquisition of another business should be treated as a purchase or a pooling of interest.

There are four attendant circumstances set forth by Bulletin Number 48 as necessary to distinguish between the two concepts. These are (1) stock issued in exchange for properties in consolidation, (2) management, (3) relative size of the constituents, and (4) continuity of interest.

If shares are not issued in proportion to the respective interests of the predecessor companies, if relative voting rights are altered, and if there are plans to retire substantial amounts of the capital stock issued to the owners of the predecessor companies, a purchase is indicated.

The Securities and Exchange Commission states that if the management of the constituent companies is eliminated, then a purchase is indicated. In order to satisfy their requirements, part of the management of the constituent companies must become part of the management of the new entity.

On the factor of relative size of the constituents, the SEC at first objected to a pooling of interest treatment when the smaller company had less than a five per cent interest in the new entity. However, this has not been strictly adhered to because to do so would exclude certain industry leaders from the pooling of interest doctrine entirely.

The SEC is interested in the disposition that constituent parties make with the shares they received in the combination. As it is sometimes necessary to register these shares before they can be sold, this registering would not indicate a continuity of interest and hence the transaction could not be treated as a pooling of interest.

The Commission assumed a new area of control in the Atlantic Research Corporation case. The information used as

a basis to rule the registration statement deficient and misleading was taken from annual reports issued by the Corporation and not what was in the file of the Securities and Exchange Commission.

The Commission is continuing its efforts to cooperate with the various professional accounting organizations by permitting its Chief Accountant to act as a consultant, as a conferee, and to serve as a member of the Committee on Research. In turn, the various professional organizations have appointed specific committees to cooperate with the Securities and Exchange Commission. Their mutual aim is to bring about a system of uniform accounting procedures.

II. CONCLUSIONS

The conclusions from this study are as follows:

1. The control of the Securities and Exchange Commission is extensive with regard to the published financial statements of business combinations.

2. The laws and forms are complex and require special study to be able to meet the requirements of the Commission.

3. The Securities and Exchange Commission has tried to follow the criteria of Accounting Research Bulletin Number 48, but has not been able to hold to these factors because the concepts of the Bulletin have not proved to be practicable or sound.

4. There are no logical guidelines to determine what constitutes a purchase or a pooling of interest. Accounting Research Bulletin Number 48 attempts to define the criteria, but the definitions are broad, vague, and difficult to apply.

5. The application of either the purchase concept or the pooling of interest concept is not mandatory. The treatment of business combinations seems to be a management decision rather than one which conforms to generally accepted accounting principles.

6. There is more of a possibility of misleading results if the pooling of interest concept is applied.

7. The Securities and Exchange Commission has given freely of the time of its Chief Accountant, and its Staff has cooperated with the various accounting organizations to establish some definite guidelines in developing the pooling of interest and the purchase concepts.

8. There will be no long-run solution to the problem until the accounting profession makes an authoritative determination of the purposes of the concepts of purchase and pooling of interest and sound accounting principles are developed on this basis.

It may also be shown that the attendant circumstances used as a criteria in distinguishing between the purchase and pooling of interest concepts may be questioned.

<u>In the area of management</u>. The pooling of interest concept requires a continuance of the management. One of the objectives of a combination is to eliminate inefficient management and any duplication that exists.

<u>In the area of relative size of the constituents</u>. There seems to be no logic connected with the requirement that the constituent company be 5 to 10 per cent of the combined unit. No arbitrary rule such as this can be sustained and accounting theory should not change because of such an arbitrary rule.

<u>In the area of continuity of interest.</u> No substantial change in ownership can occur shortly before or after the combination. Stockholders may choose to sell or retain their shares and it would be difficult to rule out the pooling of interest concept on this basis.

<u>In the area of stock issued in exchange for properties in consolidation.</u> The pooling of interest requires that no significant portion of the property of the constituent companies be abandoned or sold. This may be a questionable requirement because one of the objectives of a combination would be to eliminate inefficient operations and combine the efficient operations.

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