Pooling-of-Interests Accounting and High Growth Economy Companies: A Paper Examining the Practical and Theoretical Shortcomings in the Case for Altering Current Accounting Practices

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Executive Summary

Proper accounting is a vitally important component of reliable and useful corporate disclosures.[1] It allows investors, creditors, and other public users to analyze a company's financial information and make appropriate decisions. It also influences strongly how management is measured internally, and how it manages. Pooling accounting, which the Financial Accounting Standards Board (FASB) is proposing to eliminate, allows companies that merge to record their assets in the ongoing entity by simply combining their existing assets and liabilities. If pooling is eliminated, all mergers will be treated as purchases of one company by the other.

The result of this mandatory application of purchase accounting will be that companies will be required to recognize and value at the time of the transaction a variety of intangible assets, including one called goodwill. This intangible asset would have to be amortized over the course of 20 years. As a result, a company's financial statements will be further distorted by an odd hybrid of current value and book value accounting; managers will be provided with artificial incentives to engage in alternative transactions; a company's earnings per share will be depressed over the course of many financial reporting periods; and comparability will suffer.

The FASB's Exposure Draft of the new rules, released on September 7, 1999, and due to be made effective by January 2001, concludes that the time is ripe to eliminate pooling accounting because of the sheer number of transactions that are accounted for using the pooling method; because of concerns that pooling does not provide sufficiently transparent disclosure to the public; and because of the need for international harmonization of accounting rules, among other reasons.

This paper argues that the effort to eliminate pooling is an inappropriate proxy for a more fundamental issue that needs to be addressed. This paper respectfully urges the FASB not to exacerbate accounting problems associated with intangible assets in general and goodwill in particular by simply eliminating pooling accounting and its economic benefits to the knowledge-based High Growth Economy. Instead, the issue of pooling should be addressed in the context of a larger examination of how Generally Accepted Accounting Principles (GAAP) can best handle the financial disclosure of High Growth Economy companies, which present a financial profile profoundly different from traditional "bricks and mortar" enterprises. The FASB recently decided to defer consideration of new rules governing in-process research and development because the issue was too closely intertwined with the treatment of research and development costs generally. Similarly here, the FASB should defer consideration of the pooling issue, because the effort to address only a piece of the puzzle threatens to make matters worse. The proposed change will injure the small entrepreneurial companies fueling the High Growth Economy without the countervailing benefit of enhanced financial disclosure.

Pressing forward with the elimination of pooling accounting could actually have adverse effects on the quality of public disclosure, by:

- Having the perverse effect of eliminating much public disclosure as companies substitute alliances for combinations that require application of purchase accounting;
- Committing all combination transactions to purchase accounting treatment;
- Increasing the cost of capital to small companies;
- Retarding the public availability of innovations and efficiencies sponsored by small companies; and
- Reducing, at least at the margin, the likelihood that some desirable combinations will occur.

This seems an unnecessarily high price to pay for a change in accounting principles that will not significantly advance, and will, in fact in some cases, retard progress towards the goals of fair presentation, neutrality and comparability.

This paper argues that the risk of adverse impacts owing to elimination of pooling are significant enough to require an equally significant showing of benefits to be realized by its elimination. In fact, none of the benefits claimed on behalf of the proposed elimination of pooling meets such a standard, separately, or taken together. For this reason, although we applaud the FASB's willingness to take on a difficult subject, and admire the thought and hard work it has devoted to this project in particular, we respectfully suggest that the FASB should postpone acting on its proposal and should focus instead on the broader issues surrounding the challenges of accounting presentation of the High Growth Economy companies in general, and of intangible assets in particular.

I. The Debate Over Pooling Accounting

An important debate is now occurring in policy circles, the outcome of which will have a significant impact on the future of many High Growth Economy companies and on the future of the overall United States economy. The debate concerns whether, when companies combine, the transaction must always be accounted for as if one company is buying the other company, rather than as if the two companies are merging together to form a new entity. It also concerns whether accounting for business mergers must virtually always generate a new intangible asset, called goodwill, which imposes a cost in every accounting period for many years following the merger and thus lowers reported earnings for the new company.

Under current accounting rules, when one company combines with another, the two companies report the financial results of the new entity in one of two ways. Where a merger takes place with continuing ownership by both groups of shareholders, the companies use the "pooling of interests" method, under which the two companies simply add together their assets and liabilities.[2] The transaction must meet a twelve-point checklist in order to qualify for pooling treatment.[3] Where the transaction does not have the characteristics of a merger, the companies use the "purchase accounting" method, which, as the name suggests, accounts for the transaction as if one company were purchasing the other.

Principles that are part of GAAP do not become mandatory bases of public disclosure unless the Securities and Exchange Commission (SEC) approves them. While US securities laws grant to the SEC the authority to adopt the standards, the SEC historically has looked to the private sector for leadership in establishing and improving accounting principles to be used by public companies. As a result, the SEC normally does not publish or prescribe specific accounting principles that must be used in the preparation of financial statements. Instead, the SEC has formally endorsed the FASB as the private sector body whose standards are considered to have substantial authoritative support.[4]

On September 7, 1999, the FASB released its Exposure Draft of a Proposed Statement of Financial Accounting Standards, entitled "Business Combinations and Intangible Assets." This document and its various appendices set forth at great length the rationale for a radical shift in established accounting practices, by eliminating altogether pooling accounting for mergers and mandating the exclusive use of purchase accounting for all business combinations. Under the new proposed accounting rule, every business combination would have to have a purchaser and a seller; an acquirer and an acquiree. The excess of purchase price over the fair market value of identifiable assets would be automatically denominated "goodwill," designated and treated as a depreciating asset, and generally required to be treated as if its value is diminished until extinction on a straight-line basis over no more than 20 years. While the Board invited comment via written submissions by December 7, 1999, and public hearings are to be held thereafter, the document presents a lengthy defense of the basic premises of the new accounting proposals it proposes.

II. Why Pooling Accounting Matters In The High Growth Economy

The seemingly arcane debate over pooling accounting has important real world consequences. For some transactions, the pooling of interests method is financially sensible and indispensable to the business case for the transaction. This is principally because, under purchase accounting, if the price paid for the identifiable assets is higher than the estimated fair market value of those assets (which is often the case), the resulting "goodwill" represents an acquisition premium. This premium reflects the acquiring company's expectation that the transaction will lead to enhanced profitability of the new combined entity over time.

The required amortization of goodwill and its depressing effect on earnings means that earnings per share, a performance measurement upon which investors and analysts heavily rely, will be affected for many years. The influence of earnings per share announcements on equity prices is well documented.[5] Under the pooling of interest method, in contrast, goodwill is not created or recognized on the new company's books because the new company's books are produced by simply combining the old companies' books. Existing assets are carried at the same values as before, and no new intangible assets, like goodwill, are created. This prospect, under purchase accounting, of paying an acquisition premium, and then having such a payment transformed on the balance sheet into an asset that will generate a two-decade long stream of charges against earnings, may deter some business combinations from occurring.

There are several reasons that those outside the immediate circle of debate on accounting policy should care about how the matter is resolved.

First, the impact of a decision that eliminates pooling accounting will be the perpetuation of a set of accounting principles that would provide distorted information – an unfathomable mix of current and book values – to investors. This is at odds with a principal goal of financial accounting, which is to present to investors good and reliable information, which reduces the risk of investing, and, therefore, reduces the cost of capital.

Second, the impact of a decision that eliminates pooling accounting as an option will diminish the likelihood that the innovations and efficiencies that companies generate will be brought forward quickly and broadly to consumers. This is because the elimination of pooling treatment limits exit strategies for investors. Therefore, companies will be limited in their ability to attract capital.

Third, the elimination of pooling will increase the cost of capital for companies in another way as well. A company that is required to record and report depressed earnings because of mandatory purchase accounting faces additional obstacles in raising new equity or achieving favorable terms on newly incurred debt.

Fourth, the elimination of pooling in pursuit of international harmony in accounting standards is pursuit of false progress. International accounting for combinations is complex and varied and so a switch by the US to mandatory purchase accounting will not create harmony in international standards. Moreover, US companies have experienced no marked difficulty in raising capital because of the availability of pooling as a method of accounting for business combinations. To the contrary, the capital markets have robustly supported the growth of US companies in the technology sector and elsewhere.

The difference between the two methods of accounting for business combinations has become a critical issue in the high growth, increasingly knowledge-based, economy of the United States. This is principally because of the difference in the treatment of intangible assets under the two methods. In transactions accounted for by the pooling method, as with other ongoing enterprises, no intangible assets are created. In contrast, purchase accounting mandates the identification, valuation, and amortization of a variety of intangible assets, including the catch-all intangible, goodwill. The increased importance of knowledge means that the net stock of intangible capital (*e.g.* education and research and development) has grown faster than tangible capital (*e.g.* buildings, machinery).[6] The value of companies is increasingly related to intangible assets. In the High Growth Economy, intangible capital has become at least as important as tangible assets, and a greater share of tangible capital is based on intangible inputs.[7] An example of this trend is the fact that the economic output of the US economy, as measured in tons of manufactured output, is roughly the same as it was a century ago, yet its real economic value is twenty times greater.[8] Otherwise stated, the US has added large amounts of intangible attributes to goods and services, the most important of these being knowledge.[9] An elimination of pooling accounting, combined with the current structure of financial reporting, requires arbitrary allocation of value to goodwill, since much of the intangible asset – employee knowledge, management expertise, intellectual ideas and creativity that comprise the value of an enterprise, and the premium to be paid over book value for it – cannot be accounted for as an asset. The result is a disproportionate impact on, and a distortion in financial presentation of High Growth Economy companies.

As a separate matter, a recent analysis of the proposed accounting change emphasizes these points. That report, which Merrill Lynch authored, cites Commerce Department statistics showing that three knowledge-intensive industries – financial services, information technology and pharmaceuticals – accounted for nearly 30% of America's GDP in 1998.[10] The Merrill Lynch report also provides information, set forth below in Table 1, that shows the number of mergers in the United States as compared to Asia and Europe. The report confirms that mergers and acquisitions are a vital part of the US economy and are a key component in the drive for efficiency, innovation and creative partnerships that characterize the High Growth Economy. Those things that facilitate mergers and acquisitions, such as the pooling method, are key to continued positive merger activity.[11] Again, eliminating pooling disproportionately impacts one sector of the economy – and it does so because current accounting fails to recognize the principal assets and drivers of wealth production within that sector.

Table 1: Metrics Of Mergers And Acquisitions In 1998

	Number Of Mergers	Total Value
US	11,400	$1.62 trillion
Europe	5,485	$510 billion
Asia	2,001	$60 billion

Source: Valuing the New Economy, Merrill Lynch, June 1999

The data show that US merger activity has outstripped European merger activity by more than 100 percent, whether measured by number of transactions or total dollar value. The comparison to activity in Asia is even more dramatic. Significantly represented among the US companies that have thrived in the midst of this activity are new and fast growing entrepreneurial companies whose assets are weighted toward knowledge. These new companies, according to The New Economy Index, are responsible for creating 70% of the net new jobs added to the economy between 1993 and 1996.[12] The benefit to the US economy from these mergers is clear; any reduction in these combinations could result in a slowing of the High Growth Economy.

A. The Importance Of Intangible Assets

The manufacturing/service economy is focused on physical and natural resources. Success is premised frequently on geographic efficiencies in moving goods to markets and consumers, and often depends on factors affecting the physical world, such as the weather. In this sector, tangible assets are the drivers of economic growth. Capital equipment is critical to creating and moving products to market. Skills are related to the efficiency of the capital equipment. Job creation is related to expanding markets -- getting more consumers to purchase the product and service. Reducing labor costs or finding cheaper sources of raw materials drive productivity gains.

The High Growth Economy, by contrast, has a knowledge-based foundation. It relies on assets such as patents, brands, and intellectual capital as its base. It is fueled to a great extent by smaller or newer enterprises.

Access to intellectual capital is critical to success, as is rapid product development and market entry. Intellectual innovation, speed, adaptability, and rapid market penetration put a premium on entrepreneurial innovators and the ability to match up and coordinate innovations quickly with a well-executed product-delivery effort. Populated by small and mid-cap firms, the High Growth Economy is characterized by broader risk taking with a smaller asset base to absorb losses. These increased pressures, while bringing benefit to the economy overall, place added impetus to the ability of new firms to merge with other, similarly situated firms to realize gains from product development, delivery, or efficiency that might take too much time to develop internally.

Accounting principles well suited to the bricks and mortar world are often inapposite to High Growth Economy companies. This is principally because the wealth-producing assets of many High Growth Economy companies tend to be weighted heavily towards intangible assets rather than tangible ones. Indeed, tangible assets will often represent only a small fraction of the company's value. Such valuable intangible assets include:

- the knowledge and training of key employees and the rest of the firm's workforce;
- the firm's intellectual property, including trade secrets;
- the firm's long-term strategy and investors' confidence in its soundness;
- the firm's demonstrated comprehension of customer satisfaction and employee morale and loyalty; and
- the firm's standing vis-à-vis competitors in the marketplace.

Such assets are difficult to separate out and assign quantitative values to in the way demanded by traditional accounting principles. Treatment of these forms of assets after their identification is even more problematic. Traditional concepts presume that assets diminish in value over time in some generally predictable and measurable manner (*e.g.*, as the assembly line ages). Knowledge assets, in contrast, do not diminish in value, at least not in the same predictable manner. Companies must struggle to apply existing concepts of amortization to write off the value of these intangible assets – where they are permitted to be recognized at all – over time.

Investors increasingly seem to be taking the position that although the old measures of value have the virtue of being time-tested for reliability, they should be relied on less and less. Investors are increasingly attracted to technology firms with little or no revenues, trading at enormous multiples of price-to-earnings ratios. These investors are showing themselves to be more reliant on what they learn through means other than traditional financial statements about the drivers of the firm's wealth production. Yet, even in this environment, equity price movements are closely linked to announcements concerning earnings per share and how such announcements align with investors' expectations. In this environment, the proposed FASB changes cloud the picture.

In a recent report, Goldman Sachs identified approximately 60 areas of industry and business that have experienced significant merger and acquisition activity in the past decade. It concludes, based on its internal survey of Goldman Sachs analysts, that the elimination of pooling accounting would not adversely affect combinations in most of these areas. But significantly, the same report finds that this accounting change might affect disproportionately certain industry sectors, namely, Computer On-line Services, Data Networking and Semiconductors. These industries are notably ones that rely significantly on knowledge and other intangible assets.[13]

B. The Importance Of The Infusion Of Risk-Taking Capital

Fueling this process of innovation, creativity, and entrepreneurship is financing provided by venture capitalists and other sources of wealth willing to seed such enterprises. Although venture capital amounts to a small share of overall capital markets, its value goes beyond a simple dollar figure. Venture capital has been essential to the ability of thousands of companies to weather and grow beyond the critical early stages of development. The New Economy Index provides useful information in the trends in venture capital investments. Venture capital investments have increased from $6 billion in the mid 1980's to $12 billion in 1997 and from 10% of GDP to 16% of GDP. In 1997, venture capital funds were invested in 2485 companies, five times more than in 1980. United States venture capital activity has grown twice as fast as European venture capital from 1993 to 1996. These venture capital-backed US companies are vitally important to the growth of the economy. Employment in venture capital-backed companies increased 34% annually between 1991 and 1995, while employment in Fortune 500 companies declined 3.6%.[14]

This venture capital funding is fueled by the assumption that many failures or mediocre investments will be offset by a few successes, which provide a large premium. Under this strategy, the venture capitalist must be able to liquidate the investment at an early stage, freeing up the investor's capital for the next ventures.

There are two principal alternative exit strategies. One, of course, is a public offering of stock in the company. But that is only available for a limited range of start-up companies, and it is subject to the broader winds that blow across the public markets. The other way in which these financial seedsowers can realize their investment and move on is through combination with another enterprise.

If the economics of business combination in these High Growth Economy companies is made more problematic, not because of any real-world change in the viability of the companies, but because of the marketplace impact of an accounting change, then venture capital money will become less available to fuel this marketplace of innovation. Investors will become less willing to take risk if their prospects from realizing their successes at an early stage are diminished. Moreover, if they are unable to turn over their investments quickly, then by necessity their money will be unavailable for new investment opportunity, and the liquidity of this part of the capital market will be diminished.

C. The Importance Of Entrepreneurs

Another critical characteristic of the High Growth Economy that impacts consideration of this accounting issue is that this segment of the economy is predominately populated by small, entrepreneurial companies. This type of company is responsible for much of the job growth in the last five years. The explosive growth in the High Growth Economy has been driven by the creation and growth of these companies, *and* their ability to combine with each other to create synergies.

E*Trade, an online broker, is one such fast growing, high tech company. Over the past two years, E*Trade has acquired or agreed to acquire five financial services firms, all using the pooling method.[15] During that time, its stock has doubled, based on investors' view of E*Trade's bright future in a changing industry.[16] E-commerce companies in particular are currently trying to build value by making acquisitions to speed expansion. In discussing the potential elimination of pooling accounting, Ray Berin, a PricewaterhouseCoopers partner, said, "The effectiveness of that merger currency is going to be diminished and that is going to make it difficult for Internet companies to build and grow their businesses."[17]

In June 1999, E*Trade said it would issue stock valued at $1.8 billion to acquire Telebanc whose balance sheet value was listed at $510 million.[18] Under pooling accounting, these details do not significantly impact E*Trade's future earnings. However, under purchase accounting, the Telebanc deal would have required E*Trade to take an annual substantial goodwill charge against earnings.[19]

Any reduction in earnings could create problems with expansion plans. Earnings shortfalls lead to sharp sell-offs and lower share prices, thus reducing their value as acquisition currency. According to Patrick McGurn, director of corporate programs at Institutional Shareholder Services, "If they could not do these [acquisitions] as a pooling, chances are that their currencies would be devalued and a company like E*Trade would be at a disadvantage to someone like Merrill [Lynch], which has strong reserves."[20] In other words, only large entities could easily afford to absorb the financial consequences of merger under mandatory purchase accounting.

For some of these companies, the negative impact on the financial statement of intangible assets, including goodwill, that purchase accounting forces on them in a merger will be enough to prevent them from completing this critical step in the process of innovation and growth. Companies with large capitalization are, in most cases, likely to be able to absorb the impact on their balance sheet of these new assets. In the world of mandated purchase accounting, they will be able to continue to merge with relative ease – although there are likely to be mergers killed by purchase accounting even involving large companies. But this route to synergies, growth, and access to the market will be cut off to the new entrepreneurs who fuel the High Growth Economy.

III. FASB's Proposal On Pooling And Its Impact

A. An Overview Of The Proposal

The FASB's Exposure Draft of its Proposed Statement of Financial Accounting Standards, "Business Combinations and Intangible Assets," sets forth at great length the rationale for a radical shift in established accounting practices, by eliminating altogether pooling-of-interests accounting for mergers and mandating the exclusive use of purchase accounting. The stated reasons for pursuing the elimination of pooling now are several.

First, the FASB and officials of the SEC desire international harmonization of accounting standards.[21]

Second, the FASB believes pooling is being overused.[22]

Third, the FASB believes that purchase accounting gives investors and the public better, more transparent information about transactions.[23]

Under the proposed standard, the excess of purchase price over the fair market value of identifiable assets would be automatically denominated goodwill, and would have to be amortized over a period not to exceed twenty years, generally on a straight-line basis. While the Board invited comment via written submissions by December 7, 1999, and public hearings to be held thereafter, the document presents a lengthy defense of the basic premises of the new accounting.

Indeed, the document seems to leave little room for second thoughts about the basic premise of the proposal, that purchase accounting shall be the only acceptable method of accounting for a merger. The foundation for this approach is the absolute rejection of the idea that two companies can truly merge into a single new entity.

Rather than first examining the nature of various types of business combinations, the Board began by deciding that having one method of accounting for business combinations was preferable to having two methods, because it would enhance relevance, reliability and comparability of financial statement information.[24] Indeed, the Board argued that accounting for "true mergers" differently from other sorts of business combinations was too difficult operationally and so should not be attempted. The Board was also heavily influenced by a desire to conform to what it sees as the consistent treatment of business combinations outside the United States.[25] At the same time, the Board specifically disclaimed any responsibility to consider what it called the "public policy" impact of its proposal, such as whether its proposal would "impede desirable consolidation in certain industries, reduce the amount of capital flowing into those industries, slow the development of new technology, [or] adversely affect entrepreneurial culture." Instead, the Board insisted that there must be what it called "neutrality in accounting standards."

Having decided one method of accounting should prevail; the Board decided purchase accounting had the most to say for itself, over the pooling and "fresh start" methods.[26] Having decided that purchase accounting should be required over all other methods, the Board acknowledged the difficulty of labeling one company the acquirer and the other the acquiree in all circumstances, but concluded that it will just have to be done. It proposed a variety of criteria to use in making the choice as to which is which.[27]

The Board also had to decide what to do with the excess of purchase price over the valuation of the identifiable assets, the "goodwill." The Board proposed to treat it as an asset with depreciating value, and therefore written off over a period of time, not generally to exceed 20 years, rather than the 40 years previously allowed. In contrast to its discussion of purchase accounting versus pooling, the Board seemed to give more credence to the arguments in favor of alternative treatments of goodwill, including writing it off immediately, allowing more variation in depreciation, or booking it as a non-depreciating asset that would be periodically evaluated for impairment. But it rejected these alternatives for a variety of reasons, generally related to what it saw as greater consistency and clarity of presentation.[28]

B. Critique Of The FASB's Approach

1. The Foundation Of The FASB Proposal Is Wrong

Intangible assets are a difficult problem with which companies, accountants, auditors and the FASB have long struggled. It does not take much understanding of accounting to recognize the difficulty in identifying and segregating out "things" within a company that have ongoing value but have no corporeal identity – you cannot point at it, touch it, see it. Indeed, even deciding that you have something that should be given a name and segregated as having a separate identity can be an immense undertaking. It is a process full of judgment and disagreement, depending as much on the depths of analysis and imagination as on objective criteria, as the non-exhaustive list of potential intangible assets that the FASB provided in its Exposure Draft attests.

Once the items that are going to be denominated "intangible assets" have been identified, the problems multiply. Valuing them at their "fair market value" is no easy task. It is subject to much exercise of judgment, to widespread use and reliance on analogous situations (rather than precisely identical market transactions), and to substantial dispute. Once the assets are valued, the process of evaluating how that value will diminish in future periods (assuming that the presumption of diminishing value is valid) can be a daunting task. This is true whether the task is to calculate appropriate amortization, or to evaluate these assets to determine if the value the company thought they had was "impaired" by intervening external or internal developments.

The accounting for intangible assets was a struggle even in traditional "bricks and mortar" companies, but it was of less critical importance because intangible assets generally accounted for only a small portion of the asset base. However, in the High Growth Economy, these intangibles move front and center. Very often, intangibles are the heart and soul of these companies. And purchase accounting thrusts to the fore the difficulties in accounting for intangibles.

What this means is that the FASB proposal promises to substitute a new set of problems of comparability, reliability, and neutrality for those that it perceives exist as a result of the current use of pooling accounting. The difficulties inherent to identifying and valuing intangible assets mean that the evaluation of and disputes over whether it was done properly will be many. The time consumed by corporate accounting departments, outside auditors, self-regulatory organizations like the FASB and the American Institute of Certified Public Accountants (AICPA), and government regulators like the SEC will be enormous, either trying to answer questions or trying to evaluate what companies have done. The enormous amount of judgment involved in deciding these issues means that users of financial statements will be unable to count on the comparability of financial statements between companies, since investors can expect that the exercise of reasonable judgment can and will regularly produce significant differences across companies and auditors.

To the degree the FASB tries to narrow or eliminate this range of judgment, it will have to substitute arbitrary rules on how the identification, valuation and amortization of intangible assets are to be done. While this may eliminate some of the comparability problems, it will substitute instead enormous neutrality problems. Any arbitrary rules will inevitably undermine the goal of fairly reflecting the reality of a company's financial situation, and will influence directly the behavior of organizations, which will structure their activities to fit the treatment they seek under the arbitrary rules.

Moreover, as long as companies that develop intangible assets internally do not have to recognize them and record their value on the companies' books and records, no rules will eliminate the comparability problems as between companies that have grown internally and companies that have merged. Intangible assets that are developed within a company are not recognized on the company's books – the costs associated with them are expensed and any income they help generate in later periods is recognized without any associated amortized cost. *The FASB does not propose to change that treatment of intangible assets in ongoing companies*. To the degree that the problem of accounting for intangible assets is considered too great to face, the accounting rules will push companies away from merger; thus violating the principle of neutrality that FASB asserts its proposal is designed to serve.

2. Imperfections Of Purchase Accounting

The problems of comparability, relevance, reliability, and neutrality that the FASB says drives the proposed change are recreated in purchase accounting because of the many problems inherent in the treatment of intangible assets in general, and "goodwill" in particular. With so much of the value in High Growth Economy companies resident in these intangibles, the financial presentation under the mandated use of purchase accounting will be significantly more problematic than under pooling.

One of the foundations of financial accounting is comparability across time as well as between companies. Users of financial statements should be able to look across periods and evaluate a company's performance over time, to see and evaluate trends and significant new developments in its financial situation. The strength of accounting for business acquisitions by pooling is that it allows for just such a comparison. The merger of two entities by their owners, the shareholders, is undertaken with the expectation that the new, combined entity will allow for greater value to be generated going forward. By preserving the historical values of assets carried on the books of the predecessor companies, such a comparison over time can be made easily. The assets, income flow, and other financial elements of the two companies are simply combined and not altered, and so any change in the future, good or bad, is readily apparent.

Purchase accounting departs from this model of combination and thus undermines the ability of users of financial statements to compare performance over time easily. Under purchase accounting, the historical valuation of assets of one of the predecessor companies is preserved, while the assets of the other company are revalued according to the fair market at the time of the business combination. Thus, going forward there is an amalgam of differing valuations of assets, some at historical cost and some at this new, fair market valuation. Indeed, the accounting presentation of the new entity will be significantly altered depending on which entity is denominated the "acquirer" and which is the "acquiree." This invitation to manipulation and confusion of presentation does not advance the principles that FASB says it promotes in its proposal.

3. Perverse Impact On Quality Of Public Disclosure

FASB's self-stated goals include "improv[ing] the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency" and "improv[ing] the common understanding of the nature and purposes of information contained in financial reports."[29] These goals have been among the motivations underlying the reexamination of pooling, and we wholeheartedly support these goals. Ironically, however, the elimination of pooling may have the perverse effect of clouding financial disclosure. For example, corporate combinations other than mergers and acquisitions could grow in popularity as a way of gaining the synergies of combination while avoiding the adverse financial impact of purchase accounting. Instead of combining to capture secure sources of supply or distribution, companies may form joint ventures or strategic alliances. This would provide many of the operational benefits of a merger without the negative financial statement impact of purchase accounting. Shareholders in the participating companies would have to evaluate the performance of the joint venture or strategic alliance based on the disclosures in the statements of the individual participating companies. The shareholders would receive less information about the synergies of the two companies than they would have received had the companies merged.[30]

4. The Real Problem Is Outdated Treatment Of Knowledge Assets As Goodwill

We do not pretend that there are any easy answers to the problem of accounting for intangible assets and their role in the High Growth Economy companies. The rapid changes in the US economy have created new situations where traditional accounting principles no longer can be relied upon to provide accurate, transparent, public disclosure. In discussing the increasing importance of intangible assets in the knowledge economy, the New Economy Index states that, "this change is attributable to the fact that the worth of companies is increasingly related to intangible assets that traditional accounting fails to measure."[31] It is a difficult problem, and FASB's effort is commendable. However, in the face of this recognized difficulty, the elimination of pooling alone will not eliminate problems with accounting reliability, comparability and neutrality; instead, they will be exacerbated.

But the problem does not stop there. For the FASB proposal would pile the construct of goodwill on top of the construct of intangible assets. Not only does the "acquiring" company have to identify, segregate, value and amortize identifiable intangible assets, but it must also recognize the catchall asset called goodwill.

This goodwill grows out of the concept, recognized with "bricks and mortar" companies, that a company over time can develop asset classes, such as strength of brand and relationships with customers, that go beyond simply the value of the delivery trucks and office equipment. Thus, in common parlance "goodwill" can be "the good relationship of a business enterprise with its customers, reckoned as an intangible asset."[32]

But it is important to recognize what "goodwill" has become: "An accounting term used to explain the difference between what a company pays and what it gets in the form of tangible assets…. It comes into existence when a company is purchased or transferred and cannot exist when a company is founded…."[33] Indeed, with the need to account for all identifiable intangible assets, goodwill as used in connection with purchase accounting has become nothing more than the difference between the purchase price and the basket of values placed on both tangible assets and intangible assets, without regard to its actual relationship to anything like traditional goodwill. The rationale is that no one would pay something for nothing, and so if all identifiable assets have been valued at their fair market price, this additional amount must be a payment for another asset – this thing called goodwill.

Having built a construct for labeling things as intangible assets, the FASB builds this additional construct upon it, which requires the residue payment be treated as an asset. Furthermore, this residue asset must be treated as a *depreciating* asset, and written off against earnings over no more than 20 years.[34]

The real world consequence of this amortization requirement is significant, particularly since it halves the period that had previously been allowed for the depreciation of such an intangible asset. Particularly for companies merged in the High Growth Economy, large portions of the value exchanged are not associated with any identifiable asset, tangible or otherwise. So a large asset will necessarily be created. Then, the company is told that it *must*, in most cases, write off at least 1/20 of this asset against earnings for the next 20 years.

Again, what is the basis for imposing this requirement, which is by its nature at least *somewhat* arbitrary, and thus undercuts the principles of neutrality and fair presentation?

Even if one concluded that the price to be paid for having to account for identifiable intangible assets was justified, there is an additional hurdle to overcome to justify the proposed treatment of the acquisition premium. It is hard to see how it serves as an asset in any traditional concept of that term, since it represents value seen in the firm by the acquirer, but a value that cannot really be clearly identified or associated with any particular future benefit. Under those circumstances, there should be an acknowledgement and agreement as to where this path should lead: to the recognition of an additional payment in the transaction that is not associated with any asset, which should just be expensed or otherwise treated in a new manner that does not fit in any of the traditional pigeonholes.

5. The Lessons To Be Learned And Followed From The FASB's Earlier Effort To Address In-Process Research And Development

The FASB recently faced a very similar situation. There, it ultimately recognized the difficulties created by addressing only part of a problem in the financial accounting system brought to the fore by High Growth Economy companies, and it abandoned the partial effort. We respectfully suggest that the FASB should do the same here.

The FASB wanted to address the issues raised by the treatment of "in-process research and development" (IPR&D) in purchase accounting. Under the existing rules, the amount of the purchase price attributable to research and development projects that are in process at the acquired company is immediately written off. In High Growth Economy companies, often a large proportion of the purchase price is attributable to such projects. The SEC and others were concerned that the advantages for future earnings periods of immediately writing off a large portion of the purchased "assets" tempted companies to abuse this accounting principle. Moreover, the large amounts of IPR&D in High Growth Economy companies focused attention on the seeming disparity between the "normal" treatment of intangible assets under purchase accounting (amortization over future earnings periods), and this alternative.[35]

The FASB's initial instinct there, as here, was to extend to IPR&D the fundamental principle of purchase accounting – the valuation of all assets at current, fair market value, and their subsequent amortization. The rationale was very similar to the one proffered here: comparability, the need to treat assets in a similar manner, and the fact that the payment made for the IPR&D demonstrated objectively that the IPR&D was an asset that could be associated with future revenue streams.[36]

Over time, however, the FASB came to recognize that the seeming difficulties with IPR&D were inexorably enmeshed with more fundamental issues relating to the treatment of R&D generally. Under established accounting principles, R&D is expensed, on the theory that research and development cannot be adequately associated with future revenue to justify its treatment as an asset.[37] It thus became hard to see how the principles of comparability and neutrality would be advanced by new rules that required those who purchased that same R&D to capitalize and amortize the cost. Any such rearranging of the rules would skew decisions just as surely as the current system would. The Board came to recognize that the broader issue of how R&D should be accounted for needed to be addressed in order to advance its goals. A partial change would only create different disparities, not better accounting.

The very same dynamics are at play here, and require a similar response. The growth of the High Growth Economy has brought to the fore the problems associated with valuing intangible assets. As a result, the availability of the pooling alternative has become more attractive, and more visible. Concerns about its use beyond its intended limits are similar to the concerns about the stretching of IPR&D principles. Both sets of concerns, however, are symptoms of the more fundamental underlying difficulty, and so remedies aimed at the symptoms only create new symptoms. Thus, eliminating pooling will just focus the issues of fair presentation, comparability and neutrality onto the treatment of intangible assets.

SEC Chairman Arthur Levitt spoke to this very dilemma publicly in October 1999. In a speech to the Economic Club of New York, he highlighted the problem of quantifying values in the new, knowledge-based economy. And he warned that, "As intangible assets continue to grow both in size and scope, more and more people are questioning whether true value—and the drivers of that value—is being reflected in a timely manner in publicly available disclosure."[38] Indeed, he announced the formation of a new group of distinguished leaders, to be headed by the Dean of the Yale School of Management, "to examine expeditiously whether our current business reporting framework can more effectively capture these momentous changes in our economy."[39] While he encouraged "initiatives" like the FASB's to continue forward, he said that such "projects must be evaluated on their own merits."[40] We agree, but although we sympathize with the FASB's concerns, and applaud its willingness to tackle difficult issues, we believe that evaluation in this instance leaves the FASB's proposal wanting.

The FASB argues that eliminating pooling will take the thumb off of the scales that currently favor companies that can use pooling accounting.[41] It says those companies are in a position to pay a premium to the shareholders of companies with which they want to merge, and there seems to be an implication that there is something wrong with that. But purchase accounting can force an inappropriate cost onto the merged company that takes fair value away from the shareholders. Thus, the FASB's "correction" may simply make a bad situation worse, by eliminating one safety valve that allows some shareholders in some situations to realize fair value.

The problem ties back to the fact that the process of identifying and valuing intangible assets is so imprecise. Thus, purchase accounting imposes a cost on a company going forward, by creating a whole new set of assets that need to be depreciated against future earnings. In contrast, companies that are not involved in a merger have no obligation even to recognize intangible assets, let alone estimate their fair market value and depreciate them against earnings.

The financial accounting system is not neutral, therefore, in the sense that the FASB means.[42] It is biased in favor of creating and maintaining intangible assets in a manner that avoids having to value them and depreciate them against earnings. In High Growth Economy companies, this bias can be particularly compelling, since the proportionate value of intangible assets is so great. Pooling accounting is at least one methodology for neutralizing that bias. Eliminating pooling, of course, eliminates that possibility.

Thus, at bottom, the proposal to eliminate pooling accounting suffers from the same crippling flaw that the FASB recognized in its initial approach to IPR&D accounting. By addressing only a piece of the issue, the proposed solution at best substitutes one set of issues of fair presentation, comparability, and neutrality for another. At worst, it exacerbates the existing problems. Without addressing the dilemmas posed by the accounting for intangible assets, particularly as exacerbated by the impact of historical-cost-based accounting and its application to knowledge-based companies, the proposed change does not advance financial accounting toward its goals.

Acceptance of these problems might be persuasive if the result more faithfully represented results in accordance with a coherent principle. The existing distinction between pooling and purchase accounting is at least true to such a principle (putting aside the question of whether the criteria for pooling need to be adjusted to carry out the principle more faithfully). That principle distinguishes between the purchase of assets, which may include the purchase of all the assets of a company, and the merger of two existing entities into something new. If there is really a purchase of assets occurring, then the new assets are booked into the existing, ongoing entity in the same manner as the purchase of any other new assets, like factory equipment, office furniture, or customer lists.

However, if there is a merging of separate entities into a combined ongoing entity, there is no principled reason for treating the event as if a purchase of assets has taken place. Something different is occurring, and current accounting principles recognize that difference by carrying forward the existing book values of assets. Thus, the fundamental principle of valuation of assets of ongoing enterprises (carried at acquisition cost minus depreciation) is consistently applied.

The current FASB proposal does violence to this principle by insisting on the fiction that every business combination is nothing more than, in effect, the purchase of the assets of one company by another company. Thus, the conclusion follows logically that the assets so purchased should be valued at fair market. But it accomplishes this "consistency" only by forcing adoption of that fiction. Thus, in reality it simply exacerbates the lack of fair presentation, comparability, and neutrality as between the ongoing enterprise that does not engage in a transaction – with its appreciating but unbooked assets and unrecognized intangible assets, including goodwill – and these newly-combined entities.

Furthermore, eliminating pooling requires one company to be considered the purchaser. This results in a significantly different financial presentation depending simply on which company is considered the purchaser. If company A is presumed to have purchased company B, the financial presentation of the new entity is completely different than if company B is presumed to have purchased company A. Companies will work hard to structure their transactions to be able to have the companies assigned the labels that produce the most appealing financial statements. How will the neutrality principle be advanced there?

At bottom, then, the FASB's effort to address only a slice of the financial accounting issues presented by the growth in importance of intangible assets simply papers over the underlying issues with new fictions and thus will worsen the problems. As with IPR&D, the FASB should acknowledge the broader issues and undertake to address them systematically, in light of the profound changes wrought by the fundamentally different profiles of High Growth Economy companies.

The American Institute of Certified Public Accountants (AICPA) actually began the process of reviewing broader issues related to the High Growth Economy in 1994 when it issued a comprehensive report entitled, "Improving Business Reporting – A Customer Focus – Meeting the Information Needs of Investors and Creditors."[43] The 202-page report was based on in-depth research into the financial reporting needs of investors and creditors. The report made recommendations on how to make financial statements more useful as well as identifying lower priority areas that investors and creditors do not believe are worth changing. The report stated that:

> Standard setters should defer considering issues that have lower priority according to the current evidence of users' needs. One advantage of focusing on the information needs of users is that it helps identify high-priority areas for improving business reporting. A less apparent, but still important, benefit is that it provides insight about what areas are less important. This is particularly useful because it channels debate and resources away from highly contentious but less important areas and into more important issues, where improvements are likely to be of greater value.[44]

The report identified five areas in which standard setters should defer. One of the five areas was "Accounting for Business Combinations." The report found that while some consumers of financial information prefer the purchase method and some prefer the pooling method, most also agree that the existence of the two methods is not a significant impediment to users' analysis of financial statements.[45] It further concluded that, "A project to do away with either method would be controversial, require a significant amount of FASB time and resources, and in the end is not likely to improve significantly the usefulness of financial statements."[46] The report recounted that the investors and creditors would prefer a project to strengthen disclosures about business combinations. In particular, and telling with regard to the issue here, many investors and creditors were concerned that under purchase accounting, there is inadequate disclosure about how assets are written up or down at acquisition, and about the liabilities created at acquisition and how they are settled in later periods.[47]

In sum, then, the FASB has not addressed, let alone answered, the fundamental question of how to make accounting for business combinations better. Eliminating pooling accounting simply introduces other biases into business combination transactions. Why then is the FASB moving ahead? It would make more sense for FASB to focus on the more sweeping, needed improvements in financial reporting based on the changes in the US economy as well as investors' and creditors' needs. On this rationale, FASB recently postponed consideration of changes to the rules governing IPR&D. It should do the same here.

C. Adverse Consequences Of The FASB Proposal

1. The Impact On Small Companies' Access To Capital

Some analysts have focused on whether the elimination of pooling will adversely affect merger and acquisition activity. That focus suggests that the adverse effect, if there is one, is upon those who benefit when transaction volume is high. Some have focused on the issue from the perspective of the impact that the unavailability of pooling would have on earnings per share for particular companies because of the required amortization of goodwill.

The most important issue is the impact on the cost of capital, particularly for small companies, and what that means, in turn, for investors. Banks rely on future earning predictions in making lending decisions. These companies will now show depressed earnings as a result of the accounting rule change and thus will not be able to obtain capital or will have to pay a premium to obtain it.

2. Elimination Of Mergers Of Companies With Continued Ongoing Operations

Recently, many larger companies have combined using the pooling method. These companies, once considered too large to combine, are coming together to form large organizations designed to serve the global market. In these mergers, the operations of both companies continue and the resulting new entity has the capacity to reach the global economy. Requiring one company to be identified as the purchaser may not be an accurate reflection of the transaction. The chart below shows recent merger activity and the implied goodwill that would have been required to be shown under the purchase method.

TABLE 2

Merger	Date Announced	Implied Goodwill*
Citicorp/Travelers Group	4/6/98	$60 billion
Bank America/Nations Bank	4/13/98	$42 billion
Bank One/First Chicago NBD	4/13/98	$20 billion
Daimler-Benz/Chrysler	5/7/98	$39 billion
SBC/Ameritech	5/11/98	$47 billion
United Health Care/Humana	5/28/98	$3 billion
Wells Fargo/Norwest	6/8/98	$29 billion

****Implied goodwill assumes the merger is accounted for as a purchase under APB No. 16. The amount is estimated by multiplying the assumed acquisitor's stock price at the announcement date times the exchange ratio and subtract the assumed acquired company's book value as of its March 31, 1998 Form 10-Q. Some of the premium could be allocated to identifiable assets in a purchase, but information is not available to estimate those allocations.***

Source: The CPA Journal, January 1998

3. Some Desirable And Beneficial Transactions Will Not Occur, Which Will Have An Adverse Effect On The Delivery Of Innovation To The Public.

Pooling accounting has been used in recent years in a number of high-profile transactions that accelerated delivery of valuable innovations to the public. It is difficult to evaluate objectively whether these transactions would have occurred without the availability of pooling treatment. But it is possible to identify the innovation that emanates from the transaction, and to identify that a large goodwill asset would have been created and would have had to have been amortized if pooling treatment had not been available. The following chart sets forth several such examples.

Table 3

Acquirer	**Acquiree**	**Innovation**	**Purchase Price**	**Pooling?**	**Evidence of a Large Acquisition Premium**
Microsoft	**WebTV**	**Easy access to the Internet via television**	**$425mm (stock and cash)**	**Yes**	**Value of WebTV estimated at $85 million**
Cisco	**Cerent**	**Next-generation optical transport products enabling accelerated migration from traditional circuit-based networks to New World cell and packet-based networks.**	**$6.9B (stock)**	**Yes**	**Purchase price was 700 times Cerent's previous six months earnings**
Cisco	**Geotel**	**Software enabling delivery of integrated data and voice to call centers over the Internet and telephone system to customer service representatives in distributed locations**	**$2B (stock)**	**Yes**	**Geotel valued at $650 million shortly before merger**
Yahoo	**Broadcast.com**	**Streaming broadcast on the Web; live and on-demand audio and video programs over the Internet**	**$5.7B**	**Yes**	**Broadcast.com lost $16 million the year before the merger**

Source: Company press releases and news articles

IV. Alternative Approaches

Even if the FASB feels compelled to move forward with its piecemeal approach, there are alternatives that (1) are consistent with traditional accounting principles, (2) would not exacerbate as badly the intangible assets issues, and (3) would be less threatening to continued economic growth in the High Growth Economy.

The accounting standards could acknowledge the difficulty of evaluating the continuing value of goodwill by having this "asset" written off immediately upon the consummation of the business combination. Generally, under established accounting principles, where a company cannot reasonably evaluate the continuing value of an asset to the future of the company, that asset should be written off. Here, whatever difficulties there may be in evaluating the continuing value of identifiable intangible assets, the process of evaluating the continuing value of this goodwill is a black hole of amorphous judgments and evaluations of subjective intentions. It may be inevitable that any judgment made will lack sufficient certainty to justify the continuing recognition of such an inchoate asset. Under those circumstances, it should be immediately written off.

The Association for Investment Management and Research (AIMR) reached a similar conclusion in a report entitled "Financial Reporting in the 1990's and Beyond":

> Goodwill should not be recognized except briefly as it is determined by the exchange price for an entire enterprise because (a) its determination (except at the rarely-encountered moment of an exchange) is the stuff of financial analysis, not accounting, and (b) its value at that moment is fleeting and has no necessary or casual relationship to its value in the future.[48]

Even if goodwill is to be conceptualized as an asset *and* carried on the company's books into future periods, the FASB still selected an arbitrary approach that is inconsistent with the reality of the economics of the transaction. To the extent there is any reality behind the idea that this "asset" is a valuation premium paid over the value of identifiable assets, and is not just a reflection of the limitations inherent in the process of accounting for assets, especially in High Growth Economy companies, it reflects a valuation of future prospects for generating cash flow and establishing and maintaining profitability. For example, under these circumstances, it is possible that FASB should be treating goodwill as a non-depreciating asset. It may need to be carried on the books of the company, but is it clear that a portion of its value is necessarily lost year-by-year? Rather, if it represents this inchoate value of the intellectual and organizational capital continuing to produce new ideas and efficiencies, that continuing value could be evaluated periodically.

But the FASB is prepared to say that none of those alternatives are suitable. It seems prepared to say that, somehow, the alternative it has suggested so definitively serves the goals of financial accounting that all others should be discarded. The case for that position has not been made.

V. Conclusion

This paper has sought to convey various ways in which the FASB, while very well-intentioned and motivated by laudatory goals, and after a great deal of hard work, has headed down a path that fails to serve its purposes and threatens to disrupt the vibrancy of a critical portion of the Nation's economic growth. One does not have to accept all of the arguments made in this paper to agree that the case has not been made that (1) accounting theory supports the FASB's approach, (2) the FASB's construct will better serve the goals of financial accounting than today's rules, or that (3) the benefits of the current FASB approach outweigh its costs. The proposal will exacerbate many of the problems that the FASB seeks to mitigate, because it does not address the fundamental issues raised by the different financial picture presented by High Growth Economy companies. Until the FASB takes on that challenge, as daunting as it may be, any effort to tinker with the accounting likely will suffer from similar flaws.

[1]This paper was prepared on behalf of the NETT Coalition, which is comprised of leading companies and associations in the fields of information technology, biotechnology, venture capital, and investment banking. Its member associations include the American Electronics Association, Information Technology Association of America, National Venture Capital Association, Semiconductor Equipment and Materials International, and Technology Network.

[2] Federal Accounting Standards Board, *Accounting Principles Board Opinion No. 16, Business Combinations* ¶12 (Aug. 1970) ("*APB Opinion 16"*).

[3] The conditions for using pooling of interests accounting are:

(1) Each of the combining companies is autonomous and has not been a subsidiary or division of another corporation within two years before the plan of combination is initiated;
(2) Each of the combining companies is independent of the other combining companies;
(3) The combination is effected in a single transaction or is completed in accordance with a specific plan within one year after the plan is initiated;
(4) A corporation offers and issues only common stock with rights identical to those of the majority of its outstanding voting common stock in exchange for substantially all of the voting common stock interest of another company at the date the plan of combination is consummated;
(5) 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;
(6) Each of the combining companies reacquires shares of voting 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; dividends must be no greater than normal for two years before the initiation date through the consummation date;
(7) The ratio of an interest of an individual common stockholder to those of other stockholders in a combining company remains the same as a result of the exchange of stock to effect the combination;
(8) The voting rights to which the common stock ownership interests in the combined corporation are entitled are exercisable by the stockholders; the stock holders are neither deprived of nor restricted in exercising those rights for a period;
(9) The combination is resolved at the date the plan is consummated and no provisions of the plan relating to the issue of securities or other consideration are pending;
(10) The combined corporation does not agree directly or indirectly to retire or reacquire all or part of the common stock issued to effect the combination;
(11) The combined corporation does not enter into other financial arrangements for the benefit of the former stockholders of a combining company, such as a guarantee of loans secured by stock issued in the combination, which in effect negates the exchange of equity securities;
(12) The combined corporation does not intend or plan to dispose of a significant part of the assets of the combining companies within two years after the combination other than disposals in the ordinary course of business of the formerly separate companies and to eliminate duplicate facilities or excess capacity.

APB Opinion 16 at ¶45-48.

[4] Securities and Exchange Commission, *SEC 1998 Annual Report* (1998) <http://www.sec.gov/asec>.

[5] J. Fred Weston, Brian A., Johnson, and Juan A. Sui, "Mergers and Acquisitions," *Business Economics*, Oct. 1, 1999, p. 23, 30.

[6] Robert D. Atkinson and Randolph Court, *The New Economy Index, Understanding America's Economic Transformation* at p. 13 (Progressive Policy Institute 1990) ("*The New Economy Index*").

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] The Merrill Lynch Forum, *Valuing the New Economy, How New Accounting Standards Will Inhibit Economically Sound Mergers and Hinder the Efficiency and Innovation of U.S. Business*, p. 5 (June 1999).

[11] *Id.*

[12] Atkinson and Court, *The New Economy Index* at p. 13.
[13] Although Goldman Sachs' and other investment company studies of the elimination of pooling in future mergers do not predict a significant decrease in merger activity, these studies were not conducted through any empirical method. Rather, company analysts, whose jobs and compensation depend on continued merger activity, were simply asked their opinion on the matter.
[14] Atkinson and Court*, The New Economy Index,* at page 13.
[15]Caroline Humer, "How Pooling Accounting could leave E*Trade all Wet," *TheStreet.com*, (October 20, 1999) at <http://www.TheStreet.com>.
[16] *Id.*
[17] *Id.*
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] Financial Accounting Standards Board, *Exposure Draft Proposed Statement of Financial Accounting Standards,(FASB Exposure Draft) Business Combinations and Intangible Assets* in *Financial Accounting Series*, ¶81-84 (Sept. 1999).
[22] *Id.*at ¶3.
[23] *Id.* at , ¶81-84.
[24] *Id* at ¶ 111-115.
[25] *Id* at ¶ 85-90.
[26] Under pooling, assets continue to be carried at book value. Under the "fresh start" method, all assets contributed by both companies would be carried at current market value.
[27] *FASB Exposure Draft* at ¶ 160-168.
[28] *Id* at ¶ 169-246.
[29] Financial Accounting Standards Board, *FASB Home Page* <http://www.fasb.org>.
[30] The performance of alliances is often difficult to gauge. Some 61% of corporate partnerships "are either outright failures or seen as 'limping along,'" *See* Debra Sparks, "Special Report: Partners," *Business Week*, Oct. 25, 1999, at p.110 quoting Anderson Consulting Managing Partner Charles Kalmbach. Contributing to this poor performance is the fact that "only 51% of alliances use formal performance yardsticks. And only 20% of executives consider such yardsticks reliable barometers of success…." *Id.* Measuring results is difficult because of the structure of the partnership:

> In a traditional joint venture, where each partner contributes equity and together creates a stand-along entity, success or failure is easy for the world to see. But in a loosely formed partnership, results can be tougher to gauge. It can be hard to discern if a marketing alliance really enhance a company's bottom line or even how to track the costs of partnership. For instance, it's tricky to know how much management time is spent working on the alliance, or whether a joint sales force is selling a partnership product or a proprietary product.

Id.
[31] Atkinson and Court, *The New Economy Index* at p. 13
[32] Anne H. Soukhanov, ed., *American Heritage Dictionary of the English Language*, p. 781 (Houghton Mifflin Co. 3d edition 1996).
[33] Douglas Greenwald, ed., *McGraw Hill Dictionary of Modern Economics*, pp. 259-260 (McGraw Hill Inc. 2d ed. 1973).
[34] *FASB Exposure Draft* at ¶243.
[35] *See, e.g.* Abraham J. Briloff, "Big Blue Haze: How Accounting for the Lotus Takeover Allowed IBM to Inflate Profits," *Barron's*, Dec. 23, 1996, p. 42.
[36] Financial Accounting Standards Board, *Exposure Draft Proposed Statement of Financial Accounting Standards, Business Combinations and Intangible Assets* in *Financial Accounting Series*, Project Summary, (Sept. 1999).
[37] Financial Accounting Standards Board, *Accounting Principles Board Opinion 2*.

[38] *See* “Quality Information: The Lifehood of Our Markets,” remarks of Chairman Arthur Levitt, Securities and Exchange Commission, to the Economic Club of New York, New York City, October 18, 1999, available at <http://www.sec.gov/news/speeches/spch304.htm>.

[39] *Id.*

[40] *Id.*

[41] *FASB Exposure Draft* at ¶84.

[42] *FASB Exposure Draft* at ¶81-84.

[43] American Institute of Certified Public Accountants, A Comprehensive Report of the Special Committee on Financial Reporting, *Improving Business Reporting—A Customer Focus* (1994).

[44] *Id.* at 93.

[45] *Id.*

[46] *Id.*

[47] *Id.*

[48] Peter H. Knutson, *Financial Reporting in the 1990s and Beyond* at p. 13 (Association for Investment Management and Research 1993).