SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

July 17, 1975

Honorable Charles A. Cooper
Acting Chairman
Committee on Foreign Investment
in the United States
Department of the Treasury
Washington, D.C. 20220

Dear Mr. Cooper:

In your letter of June 30, 1975, you requested our comments on the points raised by Charls E. Walker in his letter of June 23 to Mr. Jack Bennett dealing with the problems arising for American companies from Accounting Principles Board Opinion No. 17 and the competitive disadvantage which they might suffer as a result.

As a general principle, we agree that American public companies are subject to more rigorous accounting and disclosure requirements than are their foreign counterparts. While such requirements are occasionally annoying to companies which would prefer to be able to manage earnings through the judicious selection of accounting principles or the use of secret reserves and unaccounted for assets, we believe that American companies as a whole receive great benefits from the high standards which exist in this country and the excellent capital markets which result at least in significant part from the confidence of investors in the completeness of disclosure and the appropriateness of accounting principles used by public companies. The Commission's mandate from Congress to protect investors has led us to devote substantial and continuing efforts to the improvement of the disclosure framework which underlies our markers.

A major part of our efforts in this regard have been focused on the improvement of corporate accounting practices. In this respect, our policy has been to encourage the accounting profession in the private sector to develop improved standards of accounting which can be consistently applied by all public companies. We have endorsed the Financial Accounting Standards Board and its predecessor, the Accounting Principles Board, as the sources of accounting principles with authoritative support, and we have required registrants to use such principles in filings with the Commission and in annual reports to stockholders. In this fashion, we have been able to achieve increasing comparability in financial reporting which has enabled investors to make more informed comparisons among available investment opportunities.

One of the most controversial areas of accounting for many years has been the problem of accounting for business combinations. The misuse of "pooling of interests" accounting under which corporations were permitted not to account for the purchase price paid in acquisitions was probably the most conspicuous accounting abuse of the 1960s. Under this accounting method, corporations made large acquisitions at highly inflated prices, but by making payment in stock and accounting on a pooling-of-interests basis, they were able to take over the low book values of the acquired company and make no charge against earnings for the premium paid. A similar effect could be obtained by recording this excess purchase price on the books but not amortizing it as a cost of obtaining the subsequent earnings of the entity acquired. Investors, therefore, were substantially misled by a pattern of substantially increasing earnings per share when no operating improvements were in fact taking place.

Very belatedly, in 1970, the Accounting Principles Board issued two opinions on this subject reducing some of the most conspicuous abuses in the area. The second of these opinions, APB Opinion No. 17, required the amortization of purchased goodwill against the earnings generated in the acquisition over a period not to exceed 40 years. The Commission has supported this Opinion and required registrants to follow its terms in their accounting.

In 1973 the Financial Accounting Standards Board was established by the accounting and business communities as the organization in the private sector to develop accounting standards. The Commission, which has the statutory authority to prescribe accounting methods, endorsed its establishment and indicated that its pronouncements would be accepted as the source of authoritative support for accounting principles (see Accounting Series Release No. 150 which is enclosed). Soon after the Board's establishment the Commission and others requested that it place the subject of accounting for business combinations on its technical agenda for action since we believed that Opinions 16 and 17 did not represent a sound long run solution to the problem. In 1974 the Board placed this subject on its agenda and established a task force to develop a discussion memorandum covering the issues in the area. The staff of the Board is now undertaking research in this area and we anticipate that the discussion memorandum will be issued before the end of the year and that the Board will hold public hearings on the subject in early 1976. A final statement on the subject could be issued late in that year.

We believe tha the issues surrounding business combination accounting are highly complex and that they should be considered in the systematic fashion provided for under the rules of procedure of the Financial Accounting Standards Board. These procedures provide all parties with the opportunity to be heard. We suggest that the Committee on Foreign Investment refer Mr. Walker's letter to the Board for its consideration.

In the meantime, the Commission believes that it would not be appropriate for it to suspend the applicability of Opinion No. 17 with respect to its registrants. Such an action would remove a major element of accounting comparability which does now exist and thus would make it more difficult for investors to make informed investment decisions. In addition, it would prejudice the considerations of the Board, raise questions about our support of its efforts, and create a major problem for public accounting firms who would face a conflict between our standards and those set forth in the authoritative statements of the profession which they are committed to follow.

In summary, therefore, we believe the accounting problem raised by Mr. Walker is currently under study and that precipitous action either on our part or in a legislative forum could have a very adverse effect on the structure which has been carefully developed to improve accounting standards for the benefit of investors. In addition, we are not convinced that the magnitude of the problem raised by Mr. Walker is such that dramatic and immediate action is required in the national interest.

Because of our substantial concern about this matter, I have asked our Chief Accountant, John C. Burton, and our Director of Economic and Policy Research, Andrew P. Steffan, to attend the meeting of the Committee on Friday as my representatives.

Sincerely,

Ray Garrett, Jr.
Chairman

Enclosure
Accounting Series Release No. 150