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Ex-Executives Tell How Bristol Burnished Its Financial Results

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Bristol-Myers Squibb Co. is in one of the worst slumps in its 144-year history, facing weak sales and barren new-drug laboratories. The pharmaceutical giant is also preparing to restate two years of its financial reports, owing to its confessed habit of "channel-stuffing" -- jamming products into distribution channels to pump up sales. Both the Justice Department and the Securities and Exchange Commission are investigating that behavior.

But Bristol-Myers's efforts to meet financial targets in recent years went well beyond inventory games, according to more than two dozen of its former and current executives who spoke to The Wall Street Journal.

Among moves the executives describe: dipping into restructuring reserves to bolster operating profits; making repeated asset sales -- small enough to escape disclosure -- that boosted operating profits; and taking an excessive research write-off after an acquisition.

Taken together, the executives portray a leadership so intent on closing a gap between its forecasts and reality that it delved repeatedly into inappropriate financial engineering.

Company's Response

Asked about the allegations, a Bristol-Myers spokesman, John Skule, said: "It's simply untrue that the company used earnings management to obscure the true state of the company." He declined to discuss certain specific financial moves described by

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the executives. The chief executive, Peter Dolan, declined to be interviewed.

The maneuvers the executives cite weren't unique. "Accounting hocus-pocus" infected a growing number of companies amid the frenzy of the bull market, former SEC Chairman Arthur Levitt remarked in a 1998 speech he titled "The Numbers Game." Nor do the tactics described by the executives come anywhere near the level of financial dissembling seen in the past year's worst corporate scandals.

Bristol-Myers, the world's fifth-largest drug maker in terms of revenue, remains a profitable company, with big-selling cholesterol and stroke drugs and a new schizophrenia drug that could prove a huge seller. It says it is on track to overcome its inventory problems. It also still expects to profit from a nearly \$2 billion gamble on an unproven cancer drug from **ImClone Inc.**, now embroiled in the Sam Waksal/Martha Stewart insider-trading probe.

MORE RESOURCES

- See former SEC Chairman Arthur Levitt's 1998 "[Numbers Game](#)" [speech](#)¹¹ on the five illusions of accounting hocus-pocus
- See the full text of SEC bulletins on [materiality](#)¹², [restructuring and impairment charges](#)¹³ and [revenue recognition](#)¹⁴

COMPANIES

Dow Jones, [Reuters](#)

[Bristol-Myers Squibb Co. \(BMY\)](#)

PRICE	27.15
CHANGE	0.05
U.S. dollars	12/11

* At Market Close

ACQUISITION ACCOUNTING

A chart presented in Bristol-Myers' 2001 Annual Report on how the drug maker accounted for its October 2001 acquisition of DuPont Pharmaceuticals, including the large research write-off:

	Dollars in Millions
Current assets	\$520
Property, plant and equipment	321
Intangible assets	1,976
Acquired in-process and development	2,009
Goodwill	3,884
Other assets	280
Total assets acquired	8,990
Current liabilities	353
Restructuring costs	640
Acquisition costs	100
Long-term liabilities	123
Total liabilities assumed	1,216
Purchase price	\$7,774

But Bristol-Myers's stock is off about 50% from a year ago as the company struggles with a loss of credibility after the ImClone fiasco and its inventory gamesmanship.

The interviews with former and current executives help to fill out a picture of the myriad things that have now gone awry at the venerable drug company. The 27 executives asked that their names not be disclosed. Of those no longer at the company, the large majority left voluntarily.

Ambitious Goals

Bristol-Myers's former chief executive, Charles Heimbold Jr., gave investors high targets. He promised Wall Street in 1996 that earnings would grow 12% annually through 2000. But just a couple of years into this forecast, the company faced toughening competition and a threat of low-priced generic competition to one of its top sellers, the cancer drug Taxol.

"The total intangible assets of \$1,976 million will be amortized over their weighted-average useful lives and include core and developed technology of \$1,783 million (15- and 11-years weighted-average useful life, respectively) and patents of \$193 million (11-year weighted-average useful life).

The goodwill of \$3,884 million was assigned to the pharmaceuticals reporting unit. Of that total amount, \$2,418 million is expected to be deductible for tax purposes over a 15 year period.

The preliminary value of \$2,009 million assigned to acquired in-process research and development was charged to earnings in the fourth quarter of 2001. The charge was associated with five research projects in the cardiovascular, central nervous system, oncology, and anti-infective therapeutic areas ranging from the preclinical to the phase II development stage. The amount was determined by identifying research projects for which technological feasibility has not been established and for which there is no alternative future use. The projected FDA approval dates are years 2005 through 2008, at which time the company expects these projects to begin to generate cash flows. The cost to complete these research projects is estimated at \$1.2 billion. All of the research and development projects considered in the valuation are subject to the normal risks and uncertainties associated with demonstrating the safety and efficacy required to obtain FDA approval."

Source: Bristol-Myers 2001 Annual Report. See the [full report at Bristol's Web site](#)¹.

Fourteen former and current executives pinpoint a moment when Bristol-Myers managers realized what was expected of them. Mr. Heimbold met in late 1999 with Donald Haydon Jr., head of the medicines group. Mr. Haydon was a man known for speaking candidly about sales prospects, which clearly were weakening. Soon after the meeting, the chief executive reassigned Mr. Haydon. In his place, the CEO appointed Richard Lane. The medicines group began offering wholesalers incentives to buy more drugs than dictated by prescription demand.

"That meeting," says one former executive, "sent a huge message across the organization that you make your numbers at all costs."

Messrs. Heimbold, Haydon and Lane all declined to comment. Mr. Heimbold, who is 68, left in early 2001 to become the U.S. ambassador to Sweden. This spring, after Bristol-Myers admitted making excessive sales to wholesalers, it dismissed Mr. Lane and gave the 46-year-old Mr. Haydon back part of his old role.

Even with the incentives to wholesalers, Bristol-Myers's sales rose just 6% in total from 1998 through 2001, and much of that was due to the purchase of another drug business. Yet the company managed to report total earnings growth of 67%, or 37% after a charge for breast-implant litigation. How did it do it?

Part of the formula was slashing costs. But according to at least half a dozen former executives, the company also began to bolster earnings by taking slivers of restructuring reserves set up earlier.

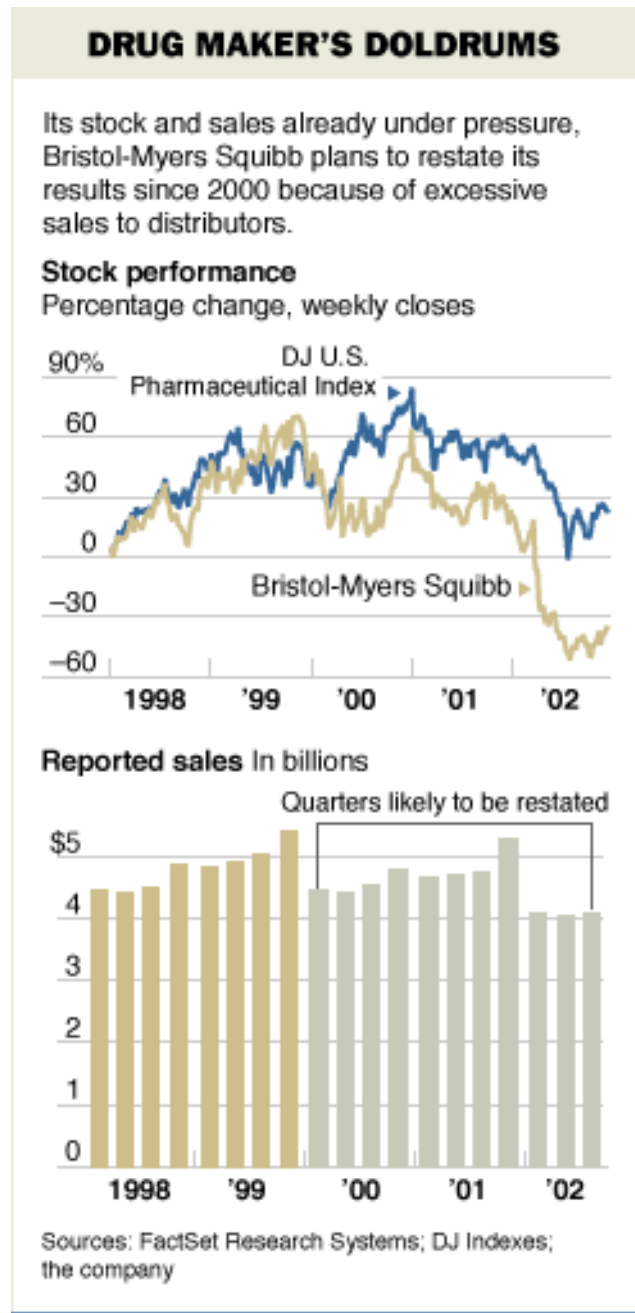
Companies set up such reserves to cover costs such as layoffs and plant closures. They charge the reserve against earnings as a one-time event so analysts will discount the expense as extraordinary. The SEC has specifically barred returning part of a restructuring charge to "earnings over time and in small amounts." In a 1999 bulletin that stated this longstanding policy explicitly, the SEC also said that restructuring reserves must be created to accomplish specific tasks and used solely for those tasks.

At Bristol-Myers, there was something odd about the reserves. Both before and after the SEC bulletin,

the company repeatedly booked restructuring-reserve charges in the same dollar amounts as gains on asset sales. In 1997, for instance, Bristol-Myers sold a unit called Linvatec Corp. for a \$225 million gain and booked a \$225 million restructuring charge. The next year, it sold Ban antiperspirants and two foreign subsidiaries for a \$201 million gain and booked a \$201 million restructuring charge.

In the third quarter of 2000, Bristol-Myers sold Matrix Essentials shampoos for a gain of \$402 million and booked a \$402 million restructuring charge. And then in last year's third quarter, the company sold product lines for gains of \$240 million and booked a \$240 million restructuring charge.

"Asset sales should have nothing to do with restructuring," said Charles Mulford, an accounting professor at Georgia Institute of Technology, when told of these items. "In these cases, they seem to, and one wonders why."



Several former Bristol-Myers executives say the reason was that the restructuring reserves were set up in part to boost operating profits later. The gains were one-time, so they weren't going to impress investors anyway. At the same time, investors wouldn't be bothered by a charge that wiped out the gain, either. Both were one-time events that didn't affect operating earnings. But once the large restructuring reserve was set up, bits of it could be brought back into the income statement later, executives say.

Mr. Skule, the company spokesman, declined to comment on whether Bristol-Myers used its restructuring reserves to bolster operating profits, or to discuss why restructuring reserves often exactly matched gains from asset sales. The auditor of Bristol-Myers's books, PricewaterhouseCoopers LLP, declined to discuss them.

Bristol-Myers also improved the bottom line by repeatedly selling small pieces of itself, many of the executives interviewed say.

'Immaterial'

Some accountants have long used a rule of thumb that a transaction that changes quarterly profits by less than 5% is "immaterial" and needn't be reported. The SEC debunked this notion in a 1999 bulletin, saying the rule "has no basis in the accounting literature or the law." Even if a single small transaction could be ignored, the

SEC added, numerous such transactions that weren't disclosed could "render the financial statements taken as a whole to be materially misleading."

Numerous former executives say Bristol-Myers commonly made asset sales for less than \$40 million -- meeting the under-5% test -- and the proceeds beefed up operating profits rather than being flagged as one-time gains. Some former executives say the company used such proceeds to reduce selling, general and administrative expenses, a practice that accounting critics say can give a misleading impression of a company's overhead. The SEC has said proceeds from asset sales should be listed as other income and expenses.

Such moves added a penny or two to per-share earnings quarter after quarter, some executives add, and thus made the business appear healthier than it actually was.

In July 2001, for instance, Bristol-Myers sold a line of chewable calcium supplements called Viactiv to **Johnson & Johnson** for an undisclosed price, which one ex-executive says was \$28 million. Bristol-Myers's financial reports from the period didn't mention the sale of the product line.

One former executive told of joining a group that discussed almost every week which products they would sell. When he expressed surprise, this executive added, another person in the meeting "taps the table and says, 'Even this conference table is for sale. You'll get used to this.' "

Another former Bristol-Myers executive said that "there was this constant garage sale going on. And it wasn't driven by cleaning up the portfolio -- it was driven by the P&L," or the profit-and-loss statement.

Mr. Skule, the spokesman, didn't respond to questions about whether Bristol-Myers used small asset sales to bolster operating profits without disclosing the practice. He had no comment on the Viactiv sale.

A third maneuver that some former executives question involved a big research write-off. In mid-2001, shortly before it began pouring money into ImClone, Bristol-Myers spent \$7.8 billion for **DuPont** Co.'s drug business. This was \$2 billion more than anyone else had bid, say people close to the deal. Bristol-Myers then wrote off \$2.7 billion, mostly from the DuPont purchase, as "acquired in-process research and development."

The SEC has long complained that companies overvalue in-process R&D to minimize how much of an acquisition is recorded as "goodwill" -- the excess of what they paid over the asset's fair value. Calling a big chunk of a purchase price research gives the impression the company got something rather than just overpaid. It also spares the company from a possible future big write-down for goodwill.

The \$2.7 billion in-process-research write-off was excessive, a former research executive at Bristol-Myers says, because the DuPont business didn't have a great many promising drugs well along in the pipeline. Another former executive says Bristol-Myers expanded the in-process R&D charge to have a packet of funds to reach for to manage earnings in the future.

Bristol-Myers's Mr. Skule says that the write-off was appropriate, and "to say otherwise is just not true."

Meanwhile, the company, like many of its rivals, has had a tough time finding new drugs to replace those whose patents expire. Mr. Dolan, taking the top job in February 2001, promised to double both sales and earnings in five years -- his "mega-double" promise, he called it. Two products the now-46-year-old CEO said would help meet this goal were Tequin, an antibiotic, and Vaniqa, to reduce facial hair in women. But Bristol-Myers sold Vaniqa last year, for just \$38.5 million, and prescription demand for Tequin in the latest quarter was off 23%. Mr. Skule says Mr. Dolan no longer stands behind his "mega-double" promise.

Since Bristol-Myers merged with Squibb in 1989, the combined company has spent billions on research but hasn't launched a single major drug discovered in-house. The scarcity of new drugs made planning a tenuous exercise, even as it added to pressure from the top.

Two former executives say strategic planning became a somewhat-empty exercise because whatever plans they presented, top management would essentially tell them what their targets were going to be. Asked about this, Mr. Skule responded: "We do and will continue to have a strategic-planning process, and business heads do and must set targets, and the chairman and everyone else expects you to make those targets."

Strategic Plans

For years, the big new product penciled into strategic plans was Vanlev, once seen as a potential \$3 billion-a-year blockbuster. But shortly before the hypertension drug's expected approval in early 2000, it was found to cause some users' heads and necks to swell. The company spent more than \$100 million trying to fix the problem but so far has failed.

Worse, it also spent half a billion dollars on a plant designed mainly to manufacture the drug. Construction costs for the plant, in Ireland, ran far over budget. Bristol-Myers's Mr. Skule acknowledges the overruns but says the plant "wasn't created just for Vanlev."

In mid-2001, Novation LLC, which handles drug purchasing for many hospitals, decided to stop buying Bristol-Myers's Taxol and instead purchase a generic version of the cancer drug. Novation also ended contracts for several other Bristol-Myers cancer drugs. It notified Bristol-Myers in July of 2001 that it would make these changes in about two months, says a former Novation official, David Gaugh.

"But somewhere around the end of July or the first week in August, Bristol-Myers offered incentives to distributors" to buy more, Mr. Gaugh says. The distributors bought huge quantities of drugs, many labeled for Novation, he says. Weeks of confusion followed at hospitals, wholesalers and Novation pharmacists. "It was a huge pain for us," Mr. Gaugh says. "The distributors were stuck with product they couldn't sell to us. They couldn't return it to Bristol-Myers."

The major drug distributors decline to comment. Mr. Skule says he knows nothing about the Novation matter.

As the end of 2001 neared, Bristol-Myers gave some buyers incentives to purchase extra drugs by notifying them that prices would soon rise. It was a strong signal to stock up now.

Jim & Phil's Family Pharmacy in Brooklyn, N.Y., received the price alert because the store sometimes buys direct from the manufacturer. Co-owner Jim Schieffer couldn't believe it. "Some of the prices were going up 11%," he says. "So I ordered six months' supply."

Though such end-of-quarter incentives boosted sales figures, they disrupted manufacturing. "At the end of every quarter, we'd work overtime, 24 hours a day, seven days a week. We'd drain the pipeline of raw material. And then for the next two months we wouldn't have anything to do. It was incredibly inefficient," says one executive.

Another says the last two weeks of a quarter "were berserk -- we had senior people who did nothing but track end-of-quarter shipments ... almost by the minute. What ship is it on, when does it hit Newark ... ?"

Mr. Skule says he can't comment on the effect the sales incentives had on manufacturing.

The growing gap between Bristol-Myers's reported sales and real prescription demand caught the eye of a UBS Warburg analyst, C.J. Sylvester. In September 2001, he warned of an apparent \$550 million in "excess inventory" of Bristol-Myers products in wholesalers' hands.

Bristol-Myers had long had sophisticated systems for tracking inventory, developed after an earlier overstocking flap 10 years ago. Fred Schiff, its longtime controller and later its chief financial officer, said 2½ years ago that Bristol-Myers was unique in the drug industry in how closely it monitored inventory. Yet when the company in April 2002 admitted overloading distribution channels, Mr. Dolan, its CEO, stated that he had only recently gotten the company to build mechanisms to track prescription demand.

Thirteen current or former executives contend Mr. Dolan and Mr. Heimbold, as well as Mr. Schiff, were keenly aware of wholesaler stocking trends. Mr. Skule, the spokesman, says, "The only thing that I can tell you about inventory is that Peter Dolan is dealing with it. He's got the courage to deal with it. It's getting fixed faster than most things." Mr. Schiff, 54, who left in April, didn't respond to phone messages left at his home.

Some former executives speculate that pay incentives such as stock options contributed to the mess the company got into. The pay-performance link was tight. In 2001, about 94% of Mr. Heimbold's \$18.5 million of total compensation came from stock-option grants, a bonus and long-term incentive payments linked to the corporate performance, company data show. And 92% of Mr. Dolan's \$12.9 million of compensation in 2001 was similarly incentive-based. Mr. Skule says that "it's outrageous to insinuate that Charlie Heimbold or Peter Dolan did earnings management to get paid. It's simply

untrue."

The spokesman adds that "companies make mistakes. These are honorable people who have integrity. Peter Dolan inherited some things that he had to fix and he's fixing them." Although "it ain't going to be easy and it's not going to happen this month," he says, "I know this guy can rebuild this company, brick by brick."

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