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**Evolution of U.S. Regulation and
the Standard-Setting Process for
Financial Reporting: 1930s to the
Present**

Suggested Citation: Stephen A. Zeff (2021), “Evolution of U.S. Regulation and the Standard-Setting Process for Financial Reporting: 1930s to the Present”, Foundations and Trends® in Accounting: Vol. 15, No. 3, pp 263–372. DOI: 10.1561/14000000067.

Stephen A. Zeff
Rice University
Houston, Texas, USA
sazeff@rice.edu

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Evolution of U.S. Regulation and the Standard-Setting Process for Financial Reporting: 1930s to the Present

Stephen A. Zeff

Rice University, Houston, Texas, USA; sazeff@rice.edu

ABSTRACT

Since the 1930s, successive private-sector accounting standard setters in the United States have established, under the oversight of the Securities and Exchange Commission (SEC), “generally accepted accounting principles” for use by public companies. In the early decades, when the standard setter was a committee or board of the American Institute of Certified Public Accountants, and was a part-time body with a slender staff, the SEC intervened actively in its deliberations and in the formulation of its recommended practices. With the coming of the independent, full-time, well-resourced Financial Accounting Standards Board (FASB) in 1973, the SEC’s regard for the standard setter increased, and a climate of mutual respect and consultation prevailed. But beginning in the 1990s, companies and banks strongly opposing the Board’s standards already issued or in prospect increasingly turned to members of Congress for relief, hoping to force the FASB to back down.

This article is a recounting and explanation of the series of episodes from the 1930s to the present on the evolution of the

U.S. regulatory and standard-setting process for financial reporting by companies in the private sector. By gathering together all of these events and developments in a single article, it is hoped that researchers will come to appreciate the historical antecedents that have shaped today's institutional reality for both the SEC and the FASB. An extensive list of references to books, articles, press reports, and other documents has been provided to enable readers to obtain a fuller story of this evolution. An appendix completes the article, containing the first published list of the SEC Chief Accountants from 1935 to the present.

1

Introduction and the Formation of the SEC

The collaborative system for regulating and setting standards for the norms of financial reporting in the United States has evolved in stages since the early 1930s. On various occasions, its sustainability has been threatened by challenges from powerful lobbying groups representing parties aggrieved by a proposed, or already approved, accounting standard. The regulator has been a federal government agency, the Securities and Exchange Commission (SEC), while the standard setter has been a body in the private sector, currently the Financial Accounting Standards Board (FASB). On occasion, members of the federal Congress, which oversees and funds the SEC, have also intervened in the regulatory and standard-setting processes.

The aim of this article is to survey and attempt to explain the evolution of the stream of events and developments in the regulation and standard setting that have set the requirements for companies' financial reporting in the U.S. capital market. Particular attention is given to instances in which the SEC, as regulator, has either been in disagreement with the private-sector accounting standard setter, or where they both have partnered in a solution. Attention is also given to some of the more celebrated attempts by self-interested parties,

particularly the company sector, to interpose themselves forcefully into the standard-setting process. The interventions from members of Congress on behalf of the company sector are also the object of study. Inevitably, the selection of events and developments to review over the span of some 90 years is a personal one, and other researchers would certainly make different choices. In this rendering of the evolution, the author has endeavored to provide extensive references to the published literature to enable readers to study the events and developments in greater depth.

Members of the private-sector standard setter have sometimes chafed at the unequal relationship between it and the federal regulator. Professor Charles T. Horngren (1972, 39), who served for five years as a member of the part-time Accounting Principles Board (APB), the immediate predecessor of the FASB, complained that the relationship between the SEC and the APB was that of top management and lower management. He wrote that lower-level management (the APB) “does an enormous amount of work for no salary and has just enough freedom to want to continue the arrangement. . . . however, the Board has been unjustifiably criticized for timidity or vacillation on several occasions when the basic explanation for the Board’s behavior has been no assurance of support from the SEC.” John C. (Sandy) Burton, then the SEC Chief Accountant, disputed that characterization. In an interview, he said, “I feel that, as Chairman Casey said, we are in partnership and that our best interests are served in an atmosphere of mutual nonsurprise” (Pacter and Nolan, 1973, 26). Subsequently he said, “The relationship is a legitimate partnership, not a superior-subordinate relationship” (Burton, 1974, 273).¹

Leonard M. Savoie, the AICPA’s Executive Vice President who oversaw the APB, had a similar view as Horngren’s. In 1974, he wrote, “we can expect the SEC to continue to use the private sector body, soon to be the FASB, for doing the research and detailed rule-making within the parameters set by the SEC. This is a convenient arrangement for the SEC. It permits the SEC to function with a small accounting staff while

¹For a view on the SEC-FASB relationship during the post-Burton years, see Sprouse (1987). Robert T. Sprouse was Vice Chair of the FASB from 1975 to 1985.

enjoying the extensive expert services of the private sector Board. This arrangement also diverts almost all criticism and some pressures to the Board. The SEC has good reason to want to continue this arrangement” (1974, 324). Miller *et al.* (1998, 158–159) concur with Savoie.

In his replies to Horngren, Sandy Burton may well have been thinking of the SEC’s relationship with the full-time, independent, heavily resourced FASB, which had just come into existence, not with the APB. As will be seen below, the SEC came to regard the FASB as a much more professional standard setter which was worthy of the Commission’s respect.

1.1 Professional Accountancy Body Responds to the New York Stock Exchange, 1932–1934

The story of the evolution of U.S. regulation and the standard-setting process for financial reporting begins in 1932, even before Congressional passage of the Securities Acts of 1933–1934. Prior to then, the New York Stock Exchange (NYSE) had appointed J. M. B. Hoxsey as the full-time executive assistant to the Committee on Stock List in 1926, and the Exchange had been urging its listed companies to secure annual audits and to publish more informative annual and even quarterly financial statements. This was at a time when there was no federal government body that regulated the financial reporting by publicly traded companies, and the states’ corporation laws did not, with rare exceptions, require companies to furnish their shareholders with audited financial statements, or to adopt GAAP (generally accepted accounting principles) when they did (Siegel, 1986). The oversight by the states’ securities commissions was easily circumvented by companies engaging in the interstate trading of shares (Seligman, 2003, 45).

In the mid-1920s, William Z. Ripley, a Harvard University economist, criticized corporations for their deficient financial reporting, first in a widely noticed article, “Stop, Look, Listen! The Shareholder’s Right to Adequate Information,” in the September 1926 issue of *The Atlantic Monthly*, and then in a book, *Main Street and Wall Street* (1927), which caused a public stir (Chatov, 1975, 18–20).² In the article and again in

²For more on Ripley, see Miranti (1990, 136–137).

the book, he called on the Federal Trade Commission to “address itself vigorously to the matter of adequate and intelligent corporate publicity” (Ripley, 1926, 399; 1927, 228). George O. May, the English-bred senior partner of Price, Waterhouse & Co., feared a government takeover of accounting and took steps to head it off (May, 1926, 42; Zeff, 1984, 451). In 1926, his firm offered to be the NYSE’s accounting adviser, with May as its representative, and the Exchange agreed. He then persuaded the American Institute of Accountants, one of the two major national accountancy bodies, to offer to collaborate with the Exchange in order to improve company reporting, but the Exchange declined. Yet May persevered, and, following the Stock Market Crash in October 1929, the Exchange was more receptive. In 1930, spurred by its concern over the multiple accounting methods used for the same kind of transaction by different companies, the Exchange’s Hoxsey said that he welcomed the collaboration with the Institute (Zeff, 1972, 119–122).

In 1930–1931, the Institute formed a blue-ribbon committee, the Special Committee on Co-operation with Stock Exchanges, composed of the senior partners of the six largest audit firms, with May as the chair. It seems that May, who was a dominant figure in the profession, drafted all of the committee’s communications to the Exchange. After an exchange of correspondence in 1931 and early 1932 between the committee and Hoxsey on specific questions, on September 22, 1932 the committee wrote a 15-page letter to the NYSE’s Committee on Stock List in which it proposed that the Exchange “make universal the acceptance by listed corporations of certain broad principles of accounting which have won fairly general acceptance.” The committee then appended five such “broad principles of accounting,” which included some practices that were intended to correct accounting abuses during the 1920s. The committee’s general proposition was that the Exchange should require listed corporations to make available to shareholders “on request and upon payment, if desired,” a list of the accounting methods which the corporation employs in its financial statements, together with an assurance that it will follow those methods consistently from year to year (*Audits of Corporate Accounts*, 1934, 12–14). May himself was opposed to the imposition of uniform accounting methods across corporations, yet the Exchange, or at least Hoxsey, was concerned about

the undisciplined diversity of practice from one listed corporation to the next. May's thinking was expressed in the following sentence in the committee's letter:

Within quite wide limits, it is relatively unimportant to the investor what precise rules or conventions are adopted by a corporation in reporting its earnings if he knows what method is being followed and is assured that it is followed consistently from year to year.

(Audits of Corporate Accounts, 1934, 9)

In the end, the Exchange did not implement the committee's proposition (Carey, 1969, 160–180; Grady, P., ed., 1962, Chap. 6; Seligman, 2003, 46–49; Storey, 1964, 9–15; Zeff, 1972, 121–126; Zeff, 1984, 450–452).

The committee's most important and enduring recommendation was for auditors to affirm in their certificate that companies' balance sheets and statements of income and surplus "fairly present, in accordance with accepted principles of accounting" their position and results of operations. In January 1934, the Stock Exchange approved this new form of certificate (Form of Certificate, 1934; Zeff and Moonitz, 1984, 118).

1.2 Passage of the Securities Acts of 1933–1934 and Formation of the SEC

By the time the committee's series of communications with the Exchange ended in 1934, its efforts were overtaken by Congressional passage of the Securities Act of 1933 and the Securities Exchange Act of 1934, and formation of the Securities and Exchange Commission³ (SEC) (de Bedts, 1964; Doron, 2015; Hawkins, 1986, Chap. 8; Landis, 1959; Parrish,

³The SEC and the Securities Acts have not been without their detractors. Professor George J. Benston was one of the leading critics. He has written that "The accounting information that the SEC requires is, on the whole, not relevant for investors [and] . . . the accounting disclosure requirements of the securities acts are an unwarranted imposition on corporations and investors, despite the good intentions of legislators and honest and conscientious administration by the commission" (1969, 73, 76). Professor Homer Kripke (1979), another critic, has argued that the SEC needs to modernize its approach to regulating corporate disclosure.

1970, Seligman, 2003, Chaps. 2 and 3). The Securities Act, which was approved on May 27, 1933, stipulated that registration statements (in initial public offerings) must include a balance sheet and profit and loss statement, and it charged the Federal Trade Commission with assuring that such information was “fully adequate for the protection of investors” (Section 7) and “not misleading” (Section 8(d)). Schedule A of the Act provided that the balance sheet and profit and loss statement, to be included in the registration statement, shall be prepared “in such detail and in such form as the Commission shall prescribe” (paragraphs 25 and 26).

The Securities Exchange Act, which was approved on June 6, 1934, created the SEC and said in a section entitled “Periodical and Other Reports” as follows:

The Commission may prescribe, in regard to reports made pursuant to this title, the form or forms in which the required information shall be set forth, the items or details to be shown in the balance sheet and the earning statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of separate and/or consolidated balance sheets or income accounts. . . . (Section 13(b)).

The SEC inherited the duties assigned to the Federal Trade Commission in the Securities Act of 1933. The SEC was also charged with overseeing the rules and operations of the New York Stock Exchange and other exchanges.

These Acts for the first time established federal government control over the financial reporting by publicly traded corporations (Pines, 1965, 727–729). The SEC has a Chair and four Commissioners who are chosen

by the President with the advice and consent of the Senate. It has a sizable staff which is organized into divisions and offices.⁴

In December 1935, the SEC established the position of Chief Accountant, and Chair James M. Landis chose Carman G. Blough, a CPA who had been on the Commission's staff for the past year, as the first occupant of that office. The Chief Accountant, who eventually became head of the Office of the Chief Accountant, is the principal adviser to the Commission, and to the various divisions and offices, on matters related to accounting and auditing. He is responsible for these matters in the Commission's administration of the federal securities laws, particularly with respect to the form and content of financial statements to be filed with the Commission.⁵ Thus far, the Commission has had 18 Chief Accountants, all men. The first four and the sixth and seventh (Blough, William W. Werntz, Earle C. King, Andrew Barr, A. Clarence Sampson, and Edmund Coulson) were career civil servants, while the others were typically recruited from the private sector and usually remained in office for two to three years. All were CPAs but Werntz and King; Werntz was a lawyer.⁶ That only one Chair and two Commissioners in the SEC's more than 85 years have been CPAs suggests that the Commission has been heavily dependent on the Chief Accountant for accounting and auditing advice.⁷ A list of the 18 Chief Accountants and their terms of office is shown in the appendix.

⁴For more about the SEC and its activities related to financial reporting, see Hamlen (2018) and Zeff (1995).

⁵This characterization of the scope of the Chief Accountant's responsibilities has been adapted from the SEC's website. Beginning in the Commission's 1939 annual report to Congress, it included a section entitled "Activities of the Commission in the Field of Accounting and Auditing." These sections from 1939 to 1953 may be found in Zeff and M. Moonitz, eds. (1984). The Commission's full annual reports may be found on the website of the Securities and Exchange Commission Historical Society (<http://www.sechistorical.org/>).

⁶For more on the successive Chief Accountants, see Previts (1978), Sack (1988), and Previts *et al.* (2003).

⁷The Chair was Donald C. Cook (1952–1953), who was also a lawyer, and the Commissioners were Edward T. McCormick (1949–1951) and James J. Needham (1969–1972). Of the three, Needham was the only accounting practitioner; he was a partner in A. M. Pullen & Company. The vast majority of the Chairs and Commissioners have been lawyers.

The SEC's Division of Corporation Finance (CorpFin) regularly reviews the financial statements in filings for compliance with GAAP, and it corresponds with registrants on any questionable accounting and disclosure practices, occasionally leading to conferences at the SEC's offices between the company, the partner in charge of its audit engagement, and the staff of CorpFin. During such meetings, the SEC representatives are sometimes heard to say that the SEC interprets GAAP in a way that was previously not publicly known. In this way, SEC staff creates "silent GAAP," but they also have revealed their interpretations of GAAP in speeches and articles, even though these utterances are always prefaced with the caveat that the views being expressed are not necessarily those of the Commission (Zeff, 1972, 151–152). Hence, not all of GAAP can be found in the pronouncements of the standard setters and in SEC publications.

2

Committee on Accounting Procedure, 1939–1959

2.1 Developments Leading Up to the Institute's Launch in 1939 of Its Committee on Accounting Procedure

After several years of reviewing company filings and regularly seeking advice from leading accounting practitioners on best practice, SEC Chief Accountant Blough became exasperated with the accounting profession's inability or unwillingness to promote uniformity in accounting practice. In a hard-hitting speech to a meeting of the New York State Society of Certified Public Accountants in January 1937, he said,

Almost daily, principles that for years I had thought were definitely accepted among the members of the profession are violated in a registration statement prepared by some accountant in whom I have high confidence. Indeed, an examination of hundreds of statements filed with our Commission almost leads one to the conclusion that aside from the simple rules of double entry bookkeeping, there are very few principles of accounting upon which the accountants of this country are in agreement.

(Blough, 1937, 7)

In his speech, Blough drew attention to a long list of questionable accounting practices that concerned him. John L. Carey (1970, 11), the Institute's longtime administrative head, wrote, "The cumulative effect of this speech was devastating." As if to put teeth into Blough's warning, the Commission on April 1, 1937 issued the first *Accounting Series Release (ASR)*, which was to initiate "a program for the publication, from time to time, of opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions" (SEC, 1937).¹

Blough had persuaded a majority of the five-member Commission that his office lacked sufficient time and staff to formulate "correct" accounting principles, and so, by a 3 to 2 vote, the Commission supported his policy of urging the accounting profession to take the lead instead of having the Commission itself draw up the principles (Chatov, 1975, Chap. 7; Seligman, 2003, 200). Commissioner George C. Mathews (1938, 226), one of the majority, wrote, "One need only recognize that the principles of the science of accounting are in a state of flux and rapid development to be hesitant in wresting guardianship from the hands of the profession."²

In October 1937, Blough took advantage of his participation in the fiftieth anniversary celebration of the founding of the American Institute of Accountants "to make it clear to the [Institute] members that unless the profession took steps to reduce the areas of differences in accounting practices the Commission would" (Blough, 1967, 6). In April 1938, the Commission issued *Accounting Series Release No. 4*, "Administrative Policy on Financial Statements," a policy which continues in effect today. It famously said that "In cases where financial statements . . . are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements

¹In 1982, the Commission terminated the program of issuing *Accounting Series Releases*. Subsequent releases relating to financial reporting have been called *Financial Reporting Releases*.

²For a biographical article about Mathews, who played an important role on accounting at the Commission in the 1930s, see Cooper (1984).

provided the matters involved are material." The Commission has never defined the new term, "substantial authoritative support." One supposes that it was intended to invite the Institute to provide such support by way of creating a sizable committee of accounting experts to pronounce its views on accepted accounting practice.³

One position on which virtually every leader of the accounting profession would readily agree is to keep the determination of accepted accounting principles out of the hands of government. The Institute thereupon began deliberating to find a way to respond to Blough's challenge. In 1938, the leadership agreed to enlarge its Committee on Accounting Procedure, which had been established under that name in 1936 with George O. May as its chair. Its part-time membership of 21 would consist of practitioners drawn from large and small audit firms, and would be joined by three esteemed accounting professors. Carman Blough, who had stepped down as SEC Chief Accountant in May 1938, was named to the committee. It would be authorized to promulgate rules of practice without oversight by either the Institute's Executive Committee or Council. The Institute also set about establishing a research department to service the committee. All of this went into operation early in 1939, and William Werntz, who had succeeded Blough as Chief Accountant in May 1938, attended the launch and offered the Commission's full support in the work of the committee (Carey, 1970, 5–16; Zeff, 1972, 131–135; Zeff, 1984, 453–458). George O. May chaired the committee's meetings for the first two years.⁴

In 1940, the SEC issued *Accounting Series Release No. 12*, announcing its adoption of *Regulation S-X*, which contained "the accounting rules and requirements as to the form and content of financial statements and schedules required in a filing under most of the acts administered by the Commission" (Barr and Koch, 1959, 183). It was the result of a comprehensive study of the Commission's experience since 1935. *Regulation S-X* has been frequently amended in subsequent years. Although

³For a review of the development of the SEC's administrative policies on financial reporting, see Woodside (1965). Byron D. Woodside joined the Commission's staff in 1934 and became a Commissioner in 1960.

⁴For a list of the committee's members and their terms throughout its tenure from 1939 to 1959, see Zeff and Moonitz (1984, Vol. 2, 147–149).

Regulation S-X was intended to be confined to matters of disclosure and display, the SEC made an attempt in 1950, as will be seen below, to take it further afield into measurement methods.

2.2 Congress Ushers LIFO Inventory Accounting into GAAP

In 1939, Congress passed a Revenue Act which approved for taxpayer companies generally the last-in, first-out (LIFO) inventory method for income tax purposes but only when the company also uses LIFO for financial reporting. The precise wording was that LIFO could be used for any and all inventories so long as it was used “to ascertain income, profit, or loss, for credit purposes, or for the purposes of reports to shareholders, partners or other proprietors, or to beneficiaries” (Pincus, 1989, 38). This was called “the LIFO conformity rule.” In 1941–1942, as commodity prices started to rise during the war, companies began adopting LIFO for tax purposes (Butters, 1949, 62–63, Chap. IV) and thus also in their financial reporting; thus, LIFO became *de facto* GAAP. It was not until 1947 that the Institute’s Committee on Accounting Procedure, in *Accounting Research Bulletin No. 29*, finally got round to declaring that LIFO was acceptable under GAAP.

2.3 Committee on Accounting Procedure Jousts with the SEC Chief Accountant, 1939–1953⁵

The Institute’s Committee on Accounting Procedure began its deliberations in earnest in 1939, holding its meetings in private. This was the first U.S. programmatic undertaking to establish accepted accounting principles.⁶ The term, “generally accepted accounting principles,” was first used in an Institute publication in 1936, *Examination of Financial Statements by Independent Public Accountants*, and, by the 1940s and 1950s, GAAP, its acronym, became commonplace in discussions about proper accounting practice.

⁵All of the *Accounting Research Bulletins* from 1939 to 1953, not including the omnibus *ARB No. 43*, as well as the papers issued by the Research Department were reproduced in Zeff and Moonitz (1984). The *ARBs* are digitally available at https://egrove.olemiss.edu/dl_aia/312/.

⁶For more on the work of the committee, see Blough (1954).

Shortly after the committee began issuing *Accounting Research Bulletins* (*ARBs*) to set forth its members' views on proper accounting practice, the issue apparently arose of the bulletins' authority in establishing uniform practice. Imposed uniformity was opposed in some quarters of the profession, notably by George O. May and his audit firm. Beginning in *ARB No. 4*, issued in December 1939, the following cautionary "Notes" were appended:

- (1) Accounting Research Bulletins represent the considered opinion of at least two-thirds of the members of the committee on accounting procedure, reached on a formal vote after examination of the subject matter by the committee and the research department. Except in cases in which formal adoption by the Institute membership has been asked and secured, the authority of the bulletins rests upon the general acceptability of opinions so reached. . . .
- (2) Recommendations of the committee are not intended to be retroactive, nor applicable to immaterial items. . . .
- (3) It is recognized also that any general rules may be subject to exception; it is felt, however, that the burden of justifying departure from accepted procedures must be assumed by those who adopt other treatment. . . .

As far as is known, it was never seriously suggested that any of the committee's bulletins should be put to a vote of the Institute membership. The Notes provided several "loopholes" for Institute members to avail themselves of if they were disinclined to follow the committee's advice. In his remarkably candid memoir-history of the accounting profession, Carey (1970, 87, 88) wrote,

the Accounting Research Bulletins had no teeth in them. . . . Many of the bulletins were phrased in such a way as to leave room for exceptions in special circumstances, and to stress the necessity for professional judgment in their application. As a consequence, except as the SEC or the New York Stock Exchange insisted on compliance, individual companies and auditors were at liberty to deviate if they chose to assume the burden of justifying their departure.

It was understood that the SEC would ordinarily enforce compliance with the committee's views in filings with the Commission except where the Chief Accountant were to take exception, as happened on several occasions (as will be seen).

In 1940, the American Accounting Association (AAA), which was the body led by accounting academics but with a large practitioner membership, published a monograph, *An Introduction to Corporate Accounting Standards*, written by two of the three highly respected academics who were appointed to the Committee on Accounting Procedure in 1939, Professors William A. Paton and A. C. Littleton. As the monograph supported the use of historical cost accounting in the body of the financial statements, which was a view strongly supported by the SEC, the “matching of costs and revenues” phrasing advocated in the monograph came to be widely used in discussions of proper accounting practice, and in university teaching. The monograph became, in effect, an elegant rationalization of accepted practice (Ijiri, 1980).

The AAA's Executive Committee issued concise statements of accounting principles in 1936 and 1941,⁷ also embodying historical cost accounting, and each was favorably cited, as was the monograph, by the Commission and the Chief Accountants. In 1948 and 1957, the AAA issued further revisions of its series of accounting principles statements (Zeff, 1966, 42–54).⁸

In the 1930s, the SEC became an undeviating defender of historical cost accounting (Walker, 1992). The Commissioners believed that many companies' arbitrary writeups of their asset values in the 1920s, coupled with their frothy recording of internally developed goodwill, followed by the massive writedowns during the early years of the Depression, was a nightmare that they did not want to repeat. During the 1920s, companies even charged certain expenses against their revaluation surplus account instead of to income. Robert E. Healy, a strong-willed Vermonter who

⁷See “A Tentative Statement of Accounting Principles Affecting Corporate Reports” (1936) and “Accounting Principles Underlying Corporate Financial Statements” (1941).

⁸For a compilation of the AAA's successive principles statements, from 1936 to 1957, see *Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements* (1957).

was a Commissioner from 1934 to 1946 argued, “I think the purpose of accounting is to account – not to present opinions of value” (Healy, 1938, 6). Healy and like-minded Commissioners did much to instill in the staff this thinking, although Carman Blough and Andrew Barr were already apostles (Zeff, 2007b, 49–51).

2.3.1 Research Department

From 1940 to 1953, the Institute’s Research Department published more than 30 studies and other papers in the *Journal of Accountancy*, which included its interpretations of some of the *ARBs*. In 1944, Carman Blough joined the Institute as Director of Research. He attended all of the meetings of the Committee on Accounting Procedure, and he was active in promoting regular communications between the committee and interested parties in the private sector and government, including publicizing exposure drafts of the committee’s pronouncements. But his time soon became precious as his office gradually began servicing as well the growing number of the Institute’s other committees. Blough was an immensely respected member of the profession. From 1947 to 1963 (two years after he retired as Director of Research), he conducted a monthly column in the *Journal of Accountancy*, in which he gave his opinions on the propriety of accounting and auditing practice. Practitioners regarded Blough’s views as the height of respected authority, and he became an almost legendary figure in the field (Moonitz, 1982; Zeff, 1972, 143–148). In 1957, the Institute published a book containing a large selection of his columns (Blough, 1957).⁹

2.3.2 Influence from the NYSE

In 1941, the committee issued *ARB No. 11*, “Corporate Accounting for Ordinary Stock Dividends,” with four dissents, in which it recommended that small stock dividends be recorded at market value, not at par or book value. The New York Stock Exchange had prevailed upon the committee to cite market value in order to discourage companies, chiefly IBM, from declaring regular, small stock dividends, which the Exchange

⁹In 1957, the American Institute of Accountants was renamed the American Institute of Certified Public Accountants.

believed were deceiving shareholders into believing they were receiving something of value. With market value almost always being much higher than par or book value, the requirement to use market value would more rapidly deplete the company's earned surplus (retained earnings) and thus make it difficult to continue declaring stock dividends. At the time, George O. May, the committee chair, said that "the committee came to feel strongly that it had an opportunity, in conjunction with the Stock Exchange, to take a step in the interest of financial morality" so as to lessen the recurrence of such abuses (Zeff, 1972, 148–150; Zeff, 1982a, 46–48). This bulletin illustrated how the Stock Exchange could sway the committee to recommend proper accounting practice with a view toward influencing the decision-making behavior of company directors.

For its part, the New York Stock Exchange incorporated in its regulations the committee's *Accounting Research Bulletins* (Midyear Report of the Committee on Accounting Procedure, 1945, 101).

2.3.3 Influence from the SEC

During the committee's first 14 years, in which it issued 43 *ARBs*, including several revisions and eight terminology reports, the SEC Chief Accountant kept a close and critical eye on the committee's expressed positions (Pines, 1965). Chief Accountants William Werntz and Earle King acted on a number of occasions to caution or disagree with the committee. They clearly made it known that the Commission, not the committee, held the high cards.

The following discussion of SEC interventions in the work of the committee is necessarily based on what appears in the public record. In addition, one supposes that there were countless conversations via telephone and in person, as well as correspondence, which conveyed the SEC's and committee's respective views on issues of importance to both bodies.

The first contretemps between the committee and Chief Accountant Werntz occurred in the early 1940s. The issue was whether the premium on the redemption of preferred stock could be charged to capital surplus however created or only to the extent that the capital surplus was

attributable to the shares being retired. In 1940, the Chief Accountant circulated a draft *Accounting Series Release* supporting the latter view, while the committee and most accountants subscribed to the former view. Because of this festering disagreement, the committee postponed issuing an *ARB*. When, in 1943, the SEC issued its earlier draft as *Accounting Series Release No. 45*, the committee was miffed that the Chief Accountant had marked out its turf in an unsettled area of accounting practice. The committee did take any further action (Zeff, 1972, 153).

The second contested issue was income tax allocation. In 1941, Wertz (1941, 329) said in a speech that differences in timing between taxable and accounting income should be disclosed in a note, not in the body of the financial statements. Yet, in December 1944 the committee issued *ARB No. 23*, stating that “Income taxes are an expense which should be allocated, when necessary and practicable, to income and other accounts, as other expenses are allocated.” Wertz had recently released a draft *Accounting Series Release* disagreeing with tax allocation, but the final *ASR No. 53* issued in November 1945 (SEC, 1945b), while still in opposition, seemed to be concerned more with how the difference between taxable and accounting income was reported. Still, the difference in principle between the committee and the Chief Accountant prevailed (Moonitz, 1974, 42–43; Zeff, 1972, 153–154). The committee arranged for the Research Department to issue advice to practitioners on how to deal with the Commission’s preferred means of reporting.

Also in December 1944, the committee issued *ARB No. 24* on accounting for intangibles. Although the committee said that it “discouraged” the practice of writing off goodwill to capital surplus, it felt obliged to say, “Since the practice has been long established and widely approved, the committee does not feel warranted in recommending, at this time, adoption of a rule prohibiting such disposition” (paragraph 5). This was evidence of the difficulty which the committee faced in uniting its members to oppose an undesirable practice that was still being followed. The SEC had no such compunction. One month after the *ARB* came out, the SEC issued *Accounting Series Release No. 50* (1945a), in which Chief Accountant Wertz was quoted as saying that “in no event

would it be permissible, under sound accounting principles, to charge the [writeoff of goodwill] to capital surplus.” The SEC’s view on this matter could hardly have been a surprise because it had announced the same position in 1942 (Zeff, 1972, 154–155). Committee Chair George D. Bailey, of Ernst & Ernst, forlornly wrote in the committee’s midyear report to the Institute’s Council in April 1945 that *ARB No. 24* “throws light on the rule-making authority of the committee, or the lack of it” (Midyear Report of the Committee on Accounting Procedure, 1945, 101).

The next salient difference between the committee and the Chief Accountant was the first of many until the early 1970s over the upward revaluation of long-lived assets. In 1945, the committee unanimously adopted a resolution which argued that quasi-reorganizations, which had in the past been authorized solely for downward revaluations for companies in dire financial straits, could be upward or downward. It was the committee’s way of opening an avenue for upward asset revaluations. But the committee did not convert the resolution into a bulletin after hearing from Werntz that a quasi-reorganization allowing writeups was unacceptable to the Commission. In 1950, the committee unanimously approved a bulletin calling for upward quasi-reorganizations (following on the high rates of post-war inflation). But the bulletin was never issued, once word was received from Chief Accountant Earle King that it was not acceptable to the Commission (Zeff, 1972, 156–157; Zeff, 2007b, 51–52).

So determined was the SEC to establish the primacy of historical cost in registrants’ financial statements that the Commission, doubtless led by Chief Accountant King, announced in 1950 that it was proposing the insertion of the following provision in *Regulation S-X*: “Except as otherwise specifically provided, accounting for all assets shall be based on cost.” This proposal was met with a chorus of negative reaction both in the accounting profession and among accounting academics. The following year, the SEC withdrew the proposal but nonetheless revised *Regulation S-X* to make the *Accounting Series Releases*, in effect, part of the regulation (Zeff, 1972, 158–159; Zeff, 2007b, 53).

A long-simmering disagreement over the treatment of extraordinary items in the income statement bubbled to the surface in 1947. The

committee favored the “current operating performance” notion of the income statement, by which extraordinary items were charged or credited directly to earned surplus, while the Commission supported the “all-inclusive” (or “clean surplus”) notion, by which such items were taken to income (King, 1948a). After the committee issued *ARB No. 32* in December 1947, King sent a letter to Carman Blough, which King had published in the *Journal of Accountancy*, saying that the Commission would take exception to the “current operating performance” treatment recommended in the bulletin when it is used by companies in their filings. That this crossing of swords was not deadly serious was indicated by the Commission’s not issuing an *Accounting Series Release* instead. The use of a letter was apparently to give both sides the time to resolve their difference, which they achieved in 1950 when the Commission and the committee compromised on a nuanced disclosure of extraordinary items at the bottom of the income statement in *Regulation S-X* (Bernstein, 1967, Chap. 3; Carey, 1970, 65–67; Pines, 1965, 737–738; Zeff, 1972, 157–158).

In 1947, the high rate of postwar inflation led a number of major manufacturing companies, such as Du Pont, Chrysler, and United States Steel, to begin charging “extra” depreciation in their quarterly reports. The SEC rejected such accounting and supported the committee’s issuance of *ARB No. 33* dealing with depreciation and high costs in December 1947, which said, *inter alia*,

It would not increase the usefulness of reported corporate income figures if some companies charged depreciation on appraised values while others adhered to cost. The committee believes, therefore, that consideration of radical changes in accepted accounting procedure should not be undertaken, at least until a stable price level would make it practicable for business as a whole to make the change at the same time.

(paragraph 6)

But there were critics within the Institute, including George O. May, who argued for a more constructive attitude on the part of the committee. This criticism even led to an inquiry into the soundness

of the committee's procedures in approving bulletins. In reaction, the committee issued a letter dated October 14, 1948, with four dissents, reaffirming its view against making a change in accounting for depreciation under present conditions (Zeff, 1972, 162–166; Zeff, 2007b, 52–53). Of course, the SEC would have it no other way, and one wonders if at least some of the committee members voted against change in order to avoid a rupture with the Commission.

In November 1948, the committee, in *ARB No. 37*, said that the value of employee stock options should be measured on the date when the option right becomes the property of the grantee. The SEC agreed with that position. Then, in January 1953, the committee revised the bulletin to say that the measurement should instead be on the grant date, and this view was repeated in the omnibus *ARB No. 43* issued later that year.¹⁰ The SEC did not agree with this change in measurement date, and it began developing an *Accounting Series Release* in opposition. But the Commission found, once it exposed its proposed *ASR* for comment, that the arguments in favor of all the three possible measurement dates were so persuasive that it concluded it would be inappropriate to prescribe the use of any one to be reflected in the income statement. It thereupon issued *Accounting Series Release No 76* (SEC, 1953) to call for disclosure only in the notes, and did not require adherence to any particular treatment in the body of the financial statements (Barr and Koch, 1959, 185–186; Pines, 1965, 738–739; Wernitz, 1954, 143; Zeff, 1972, 159). Once again, the SEC did not endorse a committee recommendation.

In September 1950, the committee issued *ARB No. 40*, “Business Combinations,” in which it exposed for the first time the “pooling of interests” method. Under pooling of interests accounting, companies acquired in business combinations involving the issuance of capital stock would continue to have their net assets shown at book value, not at the fair value of the stock given in exchange. Pooling of interests accounting was much sought after by merger-minded companies. The bulletin set forth the criteria that had to be met for a combination to qualify as a

¹⁰For an explanation of why the committee changed its position, see Wernitz (1954).

pooling. The contents of this bulletin were repeated verbatim in Chapter 7C of *ARB No. 43* (see immediately below) and were expanded upon in *ARB No. 48*, issued in January 1957. In the last of these three, the criterion of “similar or complementary” activities, which in *ARB No. 40* was said to strengthen the presumption of a pooling of interests, was dropped because of the growing trend toward corporate diversification. Rayburn and Powers (1991, 167) have written, “The practical effect of this bulletin [i.e., *ARB No. 48*] was that essentially any business combination could be accounted for as a pooling, regardless of the types of businesses or the relative sizes of the combining firms.” There were no dissenters to any of these three pronouncements. Evidently, *ARB No. 48* imposed no discipline on the choice of accounting for a business combination.

The SEC would have had little reason to limit the spread of pooling of interests. Philip L. Defiesse (1974a, 33), who was to become the last Chair of the Accounting Principles Board (1970–1973), said, “For many years, the SEC was highly in favor of pooling. The SEC felt that the purchase method would create highly inflated balance sheets in many instances by recording intangibles which didn’t exist.”

ARB No 43, issued in 1953, was a 143-page restatement and revision of the previous 37 *ARBs* on accounting, apart from those on terminology. Chapter 9A of *ARB No. 43*, on depreciation and high costs, almost reopened the issue of upward asset valuations which was anathema to the SEC. The chapter consisted of a reprinting of *ARB No. 33* from 1947 and the letter of October 14, 1948, both of which argued against recording replacement cost depreciation at that time of high inflation. Six of the 20 committee members dissented to this reaffirmation of the committee’s 1947–1948 position, which had been taken during a period of economic turmoil. The dissenting members believed that, with the passing of five years and the return to a stable price level, it was time to give serious consideration to contemplating a reform, apparently either replacement cost depreciation or general price-level-adjusted depreciation. The chapter was thus approved by a vote of 14 to 6. Had there been one further dissent, the chapter would have fallen short of the required two-thirds majority, and this reaffirmation of historical cost accounting would have failed (Zeff, 2007b, 53).

2.4 Committee on Accounting Procedure Continues Issuing Bulletins Until 1959, Amid Criticism¹¹

Following issuance of its omnibus *ARB No. 43* in 1953, the committee continued to deliberate on a variety of important issues. Following on from the one-third of committee members who dissented from approving a reaffirmation of the committee's 1947–1948 positions on replacement cost depreciation, a succession of subcommittees, led by Garrett T. Burns of Arthur Andersen & Co., continued the discussion with a view to bringing the issue again to a vote (Zeff, 2001, 173). Actually, the SEC Chair, J. Sinclair Armstrong, encouraged the committee by saying that it would be helpful to have an authoritative statement on the circumstances that would justify upward departures from historical cost. One supposes that Armstrong had not been briefed by Chief Accountant Andrew Barr before uttering these words in a 1956 article, because in 1958, following Armstrong's departure as Chair, Barr advised the committee that there was no need for such a general statement. The committee thereupon removed the project from its agenda (Zeff, 2007b, 54).

In *ARB No. 44*, issued in October 1954, the committee anointed both the declining-balance and sum-of-the-years-digits methods of depreciation as “systematic and rational” and therefore admissible to GAAP. These two accelerated methods of depreciation had just been made available to taxpayers in the Internal Revenue Code of 1954, probably as historical-cost options to replacement cost depreciation, which the latter's advocates pressured Congress to adopt in 1948. These two methods of accelerated historical cost depreciation had been known for years, and were discussed in textbooks, but it required Congressional legislation to make them a part of GAAP. Unlike the case of LIFO, the adoption of either of these accelerated methods for tax purposes does not require their use also for financial reporting purposes.

The committee revised *ARB No. 44* four years later, and made it clear – as it was not clear in the original *ARB No. 44* – that tax

¹¹*ARB Nos. 43 to 51* were published in *Accounting Research and Terminology Bulletins, Final Edition* (1961). They are digitally available at https://egrove.olemiss.edu/dl_aia/312/.

allocation is a GAAP requirement when there were material differences between using declining-balance depreciation for tax purposes and the straight-line method for accounting purposes. It referred in paragraph 5 to the creation of a “deferred tax account” when recording tax allocation, but nowhere in the bulletin did it say whether the account was a liability or perhaps part of shareholders’ equity. Public utility holding companies look to the SEC to approve bond issues, and it is known that the Commission uses the debt-equity ratio as a gauge of possible over-extension of debt capacity. In that light, three subsidiaries of American Electric Power Company, Inc., the country’s largest electric-power holding company, sued the Institute in federal court to prevent issuance by the committee of a letter saying that the deferred tax account was “a liability or a deferred credit,”¹² implying that it was not to form part of shareholders’ equity. The SEC had asked the committee to make this clarification. The case, which was eventually decided by the U.S. Supreme Court (denying *certiorari*), supported the Institute, which, the courts said, as a private organization had the right to express “its honestly held views.” The committee released its letter following final adjudication of the case (Zeff, 1972, 166–167; *The AICPA Injunction Case*, 1960, 267).

In 1956, Leonard Spacek, the outspoken managing partner of Arthur Andersen & Co., began making a series of hard-hitting speeches, criticizing the committee for approving “equally acceptable alternative principles or procedures for the accounting treatment of identical items,” its failure to articulate the logical reasoning that underpinned its recommended accounting principles, its lack of openness of process, and that it had yielded to outside pressures. In a celebrated speech to the annual meeting of the American Accounting Association in August 1957, he called for creation of an “accounting court” to hear appeals from the committee’s decisions.¹³ Spacek’s firm favored price-level depreciation,

¹²Letter dated April 15, 1959 from William W. Werntz, Chair of the Committee on Accounting Procedure, to the AICPA members, which is included in *Accounting Research and Terminology Bulletins, Final Edition* (1961) immediately following ARB No. 44 (revised).

¹³For a collection of Spacek’s speeches from 1956 to 1969, see *A Search for Fairness in Financial Reporting to the Public* (1969).

and he was not pleased that the committee had backed down from approving a bulletin to support this approach. His speeches were widely covered in the press and greatly embarrassed the leaders of the Institute. Carey (1970, 76) wrote, “While recognizing Mr. Spacek’s right to express his views on specific technical questions, many of his colleagues resented the free-swinging manner in which he attacked the accounting profession as a whole.”

Spacek had not been alone as a critic of the committee’s work, although he was, by far, the most vociferous. SEC Chief Accountant Earle King (1951, 12) complained that “not more than one-third of [*ARB Nos. 4 through 40*] appear to be unequivocal statements of principle or procedure. Most of them contain statements so qualified as to allow for a variety of practices (e.g.,: ‘should ordinarily be included’; ‘is usually combined with’; ‘it is not generally necessary’; ‘it may be desirable’; ‘might well be adopted’; ‘is obviously proper’; ‘is good accounting practice’).” This hedged wording was apparently necessary for the committee to secure a two-thirds approval of the views expressed in its bulletins, and heavily compromised positions on most subjects were unavoidable. Carey (1970, 88) concurred: “Many of the bulletins were phrased in such a way as to leave room for exceptions in special circumstances, and to stress the necessity for professional judgment in their application.”

On the positive side, Carey (1970, 88) wrote, “With the support of the SEC, however, the committee did eradicate many undesirable practices. Most of the questionable practices in evidence in 1938 had completely disappeared by the early 1950’s.” Thus, so much depended on the enforcement of public company compliance by a powerful securities market regulator. But this same regulator exercised tight oversight over the committee’s public pronouncements.

3

Accounting Principles Board, 1959–1973

3.1 Founding of the Accounting Principles Board in 1959

The AICPA's leadership acknowledged the weaknesses of the Committee on Accounting Procedure's ad hoc approach to establishing accounting principles, and it believed that, after almost 20 years, a better approach should be sought (Zeff, 1984, 458–462). It therefore set up a blue-ribbon Special Committee on Research Program, to which it appointed leading thinkers in the profession. The SEC's Andrew Barr was invited to serve, and the Commission gave him permission to do so. The Chief Accountant's acquiescence with whatever the special committee would recommend was critical. Leonard Spacek was invited to be a member, and he agreed. The AICPA's leadership believed that Spacek had to see himself as part of the solution. The special committee, which served in 1957–1958, had some tense meetings, especially with Spacek there, but in the end it agreed to recommend establishment of a more grandly titled Accounting Principles Board, which was to commission studies on the conceptual underpinnings of desired accounting principles (Zeff, 2001). In its report (1958, 63), the special committee said,

The general purpose of the Institute in the field of financial accounting should be to advance the written expression of what constitutes generally accepted accounting principles, for the guidance of its members and of others. This means something more than a survey of existing practice. It means continuing effort to determine appropriate practice and to narrow the areas of difference and inconsistency in practice. In accomplishing this, reliance should be placed on persuasion rather than on compulsion.

Much of the debate within the special committee revolved around whether the Institute should promote improvement in accounting principles by way of persuasion or compulsion, as well as over whether “uniformity of practice” was to be preferred over “flexibility of practice.” Several of the Big 8 audit firms were philosophically split on these interwoven issues (Keller, 1965; Powell, 1965; Zeff, 2001).

It was hoped that an early agreement on “basic postulates” and “broad accounting principles” would lead to more consistent and soundly based recommendations. Proposals had been made in prior years that the Institute, or the Committee on Accounting Procedure, should address the conceptual foundations. SEC Chief Accountant King (1948b, 12) had argued back in 1948 that “the Institute might well consider the publication of a statement of accounting principles as comprehensive and as forthright as that of the [American Accounting] Association.” The Committee on Accounting Procedure decided in January 1949 “to undertake a comprehensive statement of accounting principles, a project the committee had . . . decided at its very inception should not then be undertaken. However, after a great deal of time and effort had been spent on the proposed comprehensive statement the committee decided that the project would take too long to complete, if indeed it could ever be completed” (Blough, 1954, 129).

The AICPA’s 18-member, part-time Accounting Principles Board (APB) succeeded the Committee on Accounting Procedure in September 1959. The Institute’s leaders viewed the new board as more senatorial than technical, and they insisted that, except for the Chair, only the audit firms’ managing partners could serve. Weldon Powell, the highly

respected senior partner of Haskins & Sells who had chaired the Special Committee on Research Program, was designated as the APB's Chair. In the later years of the Committee on Accounting Procedure, it was known that some of its members from audit firms – who were not in the top rung of authority in their firm – would call their firm's executive office to receive instructions on how to vote. The Institute's reaction to this undesirable practice was to secure as APB members each firm's top partner. But, as became evident in the Board's first several years, a number of the managing partners were not versed in, or even comfortable with, technical issues and often did not have the time, what with constant travel and many other pressing duties in running their firm, even to read the pre-meeting documentation. In the middle 1960s, the Institute's leadership gradually brought in the firms' senior technical partners when the original members reached the end of their term.

Also in the middle 1960s, APB Chair Clifford V. Heimbucher, a partner in a medium-sized San Francisco audit firm and the Institute's immediate past President, organized the work of the Board much more effectively. In the past, all of the *Opinions* were drafted from beginning to end in full Board meetings. Instead, he set up drafting subcommittees to handle this chore. He also obtained Executive Committee approval to establish an administrative staff which relieved the heavily burdened accounting research staff of the tasks of circulating exposure drafts, analyzing the letters of comment, and making the arrangements for Board meetings (Heimbucher, 1966). Another reform, suggested by Board member Herman W. Bevis, of Price Waterhouse & Co., was that members be permitted to bring advisers to Board meetings to help with the increasingly technical issues (Zeff, 1972, 193).

Several accounting academics and even financial executives were named to the Board as well, but, as with the Committee on Accounting Procedure, all of the Chairs were partners in audit firms. The Big 8

firms were always represented on the Board.¹ Like the committee it succeeded, the APB required a two-thirds majority to approve *Opinions*, and its meetings were to be held in private.² Exposure drafts, as noted, would be issued. The Institute appointed a full-time Director of Accounting Research, Professor Maurice Moonitz, who would service only the APB, together with a small staff. The only member held over from the Committee on Accounting Procedure was Weldon Powell, but the redoubtable Carman Blough, the Institute's Research Director who attended committee meetings from 1944 to 1959, served on the APB from 1959 to 1964.³

As will be seen, the SEC Chief Accountant, Andrew Barr, who served from 1956 to 1972, scrupulously oversaw the performance of the APB in the light of the Commission's responsibilities under the Securities Acts which it administered. Barr was a highly respected figure with an encyclopedic knowledge of the accounting literature, and it soon became evident to the members of the Board that no majority view within their councils could prevail unless it had secured Barr's backing. The APB's leadership regularly consulted with Barr during the drafting process, and the refrain was often heard at Board meetings that "We need to see what Andy thinks." Looking back, Savoie (1974, 323), the AICPA's Executive Vice President, wrote, "Many of us have known that from the beginning the APB could not take a position without getting SEC approval. On the other hand, the SEC can and often does issue a release without consulting the APB." Barr did not enjoy creating conflict, but he expressed his views firmly and with the ring of authority. In giving speeches, he always read from a prepared

¹There was an exception during the Board's first year, 1959–1960. The national managing partners of Peat, Marwick, Mitchell & Co. (William M. Black) and Arthur Andersen & Co. (Leonard Spacek) refused to join the Board because they argued that their national technical partners were the ones to serve. In 1960, both Black and Spacek were persuaded to become Board members (Zeff, 1972, 173, fn. 164).

²All of the APB's *Opinions* and *Statements* are digitally available at https://en.wikipedia.org/wiki/List_of_Accounting_Principles_Board_Opinions.

³For a list of the APB members and their terms throughout its tenure from 1959 to 1973, see Burns (1974, 106–107) and Zeff (2007a).

text, and he regularly had them published as articles.⁴ Hence, his views were amply known.

3.2 The Research Studies on Postulates and Principles, 1961–1962

Going right to work on the postulates and principles studies, Moonitz himself wrote *The Basic Postulates of Accounting*, which the Institute published in 1961 as Accounting Research Study No. 1 on behalf of the APB. The reaction by readers was muted because the ideas he discussed were rather elevated and abstract for most practitioners. They instead awaited the research study on broad accounting principles, which would be more “down to earth.” In 1962, Moonitz and his colleague at the University of California at Berkeley, Robert T. Sprouse, coauthored Accounting Research Study No. 3, entitled *A Tentative Statement of Broad Accounting Principles for Business Enterprises*. Their study drew almost immediate criticism from the Board and much of the practitioner community. In their study, Sprouse and Moonitz recommended the use of net realizable value or current replacement cost for inventories, current replacement cost for fixed assets, and discounted present value for long-term receivables and payables. These departures from historical cost accounting, which was the “coin of the realm” of conventional accounting practice, were anathema also to the SEC Chief Accountant, Andrew Barr. The elders on the APB – mostly the national managing partners of their audit firms – had apparently hoped to see a research study that rationalized conventional practice, rather than consisting of departures that reminded some members, such as Carman Blough, of the worst excesses of financial reporting in the 1920s. In the end, the Board discarded both of the studies (because the principles study was based on the postulates study) “as too radically different from present generally accepted accounting principles for acceptance at this time.”

⁴For an extensive collection of Barr’s writings, see *Written Contributions of Selected Accounting Practitioners, Volume 3: Andrew Barr* (1980). For a retrospective on Barr, see Previts and Flesher (1996).

This latter utterance appeared in a statement from the Board dated April 13, 1962.⁵

The APB was so anxious that a research study published by the Institute which recommended accounting principles in conflict with GAAP might be viewed by readers as principles endorsed by the Institute, it inserted the following notice on the front cover of Study No. 3: “This research study is published for discussion purposes. It does not represent the official position of the American Institute of Certified Public Accountants.”

As the Special Committee on Research Program had anticipated that the research studies on postulates and principles would form a conceptual basis for the APB’s future *Opinions* on particular accounting issues, the Board had to embark on its work in a manner not all that dissimilar from the ad hoc decision-making by its predecessor, the Committee on Accounting Procedure. Research studies eventually were published on particular issues coming before the Board (e.g., accounting for leases, business combinations, pensions, and goodwill), but few, if any, of them helped shaped the thinking of the members of the Board.

3.3 Controversy Over Accounting for the Investment Credit, 1962–1964

With the economy in the doldrums, the Kennedy Administration persuaded Congress to approve an Investment Credit so as to stimulate capital goods purchases and help the economy recover. A stipulated percentage of the cost of the purchased facilities would be treated as a credit against the purchasing company’s federal income tax for the year. The accounting question that arose within the APB was how to treat the credit: either as a direct increase in net income (“flow-through” method), or as a subtraction from the purchasing company’s fixed assets and be taken as lower depreciation expense over its useful life (“deferral” method). The Board was divided in its view. Finally, in December 1962, by a 14 to 6 vote, barely a two-thirds majority,

⁵For a reproduction of both research studies together with other published writings in the 1960s and 1970s dealing with the studies, see Zeff (1982b). Also see Moonitz (1974, 17–20) and Zeff (1972, 174–178).

the Board approved *Opinion No. 2*, “Accounting for the ‘Investment Credit’,” saying that the deferral method was required. Masked by the 14-6 vote was the equal split between the members from the Big 8 audit firms, 4-4. Industry lobbied to support the flow-through method, as did the Kennedy Administration, which wanted the incentive effect of a purchase to include a boost in companies’ reported earnings. Three of the four dissenting Big 8 audit firms made it known that they would not require their clients to follow the *Opinion* in order to receive a clean audit opinion, which shocked some professional leaders. Suddenly, the authority of the APB came into question.

The matter then moved to the Commission. Seligman (1986, 19) has written, “After being importuned by the Treasury Department, business firms and accountants opposed to the APB Opinion, the SEC reversed the APB in January 1963 with an Accounting Series Release (ASR) [No. 96] that permitted use of either the flow-through or deferral method of accounting for the investment credit.” Both methods, the Commission implied, have “substantial authoritative support.” The following year, 1964, the APB issued *Opinion No. 4*, also titled “Accounting for the ‘Investment Credit’,” by a vote of 15 to 5, including eight assents with qualification, to acknowledge the brute reality of what had since transpired. It stated that the deferral method, which it had said in *Opinion No. 2* was the only acceptable method, was now viewed as preferable, while the flow-through method was also deemed to be acceptable. The Board felt obliged to write, “the authority of Opinions of this Board rests upon their general acceptability. The Board, in the light of events and developments occurring since the issuance of Opinion No. 2, has determined that its conclusions as there expressed have not attained the degree of acceptability which it believes is necessary to make the Opinion effective.” *Opinion No. 4* closed the book on the Investment Credit – until 1967 and 1971, when the Credit twice returned to overmatch the APB yet again (Carey, 1970, 98–108; Moonitz, 1966, 1974, 47–49; Pines, 1965, 735–736; Zeff, 1972, 178–180). Sprouse and Vagts (1965, 716) wrote, “The prestigious image enjoyed by the Accounting Principles

Board was undoubtedly blemished by its joust with the investment credit.” The press reported the controversy with relish.⁶

The developing trend in the number of companies that adhered to the deferral or flow-through method, reflecting *Opinion No. 2*, *Accounting Series Release No. 96*, and *Opinion No. 4*, may be seen in the following year-by-year analysis of the methods disclosed by companies, as reported in the AICPA’s *Accounting Trends & Techniques* (Keller and Zeff, 1969, 418):

	1962	1963	1964	1965	1966
Deferral	158	144	68	61	59
Flow-through	98	122	204	226	222

3.4 Review of the APB’s Authority in 1963–1964

The Investment Credit experience led directly to a searching review by the AICPA of the APB’s authority, held during 1963 and 1964. After the APB and the Institute’s Executive Committee had made conflicting recommendations to resolve the issue, Council held a heated and lengthy debate, and a heavily compromised position on the authority of the APB’s *Opinions* was approved. Council’s decision was made public in a *Special Bulletin* published in October 1964. It said, in essence, that APB *Opinions* and *Accounting Research Bulletins* constitute “substantial authoritative support,” but that such support can exist for accounting principles that differ from those accepted in *Opinions* and *ARBs*. If an auditor believes that a company is using an accounting principle in its financial statements that differs materially in effect from one accepted in an APB *Opinion* or *ARB*, the auditor must decide whether it has “substantial authoritative support.” If, in the auditor’s view, it does, a clean opinion should be given, accompanied by an informative disclosure. If not, the auditor should give a qualified opinion, disclaim an opinion, or give an adverse opinion, as appropriate. On the question of whether the Board’s role in shaping GAAP should be confined to persuasion, as proposed in the report of the Special Committee on Research Program, or be extended to compulsion, this decision moved the needle somewhat

⁶See, for example, “A Matter of Principle Splits CPAs” (1963).

further toward compulsion (Carey, 1970, 110–118; *Establishing Financial Accounting Standards*, 1972, 39–43; Zeff, 1972, 180–183).

Council borrowed the term “substantial authoritative support” from the SEC’s foundational *Accounting Series Release No. 4*, issued in 1938.⁷

Beginning with *Opinion No. 6* issued in October 1965, the “Notes” appended to each *Opinion* were revised in the light of Council’s action. An extract from the revised Notes follows:

Opinions present the considered opinion of at least two-thirds of the members of the Accounting Principles Board, reached on a formal vote after examination of the subject matter. Except as indicated in the succeeding paragraph, the authority of the Opinions rests upon their general acceptability. While it is recognized that general rules may be subject to exception, the burden of justifying departures from Board Opinions must be assumed by those who adopt other practices.

Action of Council of the Institute (Special Bulletin, *Disclosure of Departures from Opinions of Accounting Principles Board*, October 1964) provides that:

- (a) “Generally accepted accounting principles” are those principles which have substantial authoritative support.
- (b) Opinions of the Accounting Principles Board constitute “substantial authoritative support.”
- (c) “Substantial authoritative support” can exist for accounting principles that differ from Opinions of the Accounting Principles Board.

The Council action also requires that departures from Board Opinions be disclosed in footnotes to the financial statements or in independent auditors’ reports when the effect of the departure on the financial statements is material.

⁷For a discussion of “substantial authoritative support” by an APB member who later became the first Chair of the FASB, see Armstrong (1969). Also see Kam (1972).

3.5 APB Was Twice Behind the Curve on Calling for Funds Statements, in 1963 and 1971

After signals of support came from the New York Stock Exchange, a committee of the Financial Analysts Federation, and the SEC Chief Accountant for the view that companies should publish a funds statement, the APB, in *Opinion No. 3*, issued in October 1963, tepidly recommended that companies publish them only “as supplementary information.” The Board made the unprecedented remark that the funds statement need not be covered by the auditor’s report. Yet the leading “intermediate” accounting textbooks had been devoting full chapters since the 1940s on how to prepare a funds statement (Zeff, 2016a, 63–64). The funds statement was hardly a novel form of reporting.

In 1964, the Exchange’s President thereupon wrote to its more than 1,200 listed companies, strongly urging them to publish a funds statement, which more than three-quarters of the 600 companies annually surveyed by the AICPA were doing by 1969. Finally, in 1969, as the SEC was readying releases to require a funds statement, the APB set up a subcommittee to deal with the statement. The APB issued *Opinion No. 19* in March 1971 to mandate a funds statement, but this was five months after (a) the SEC had published its releases which required funds statements in periodic filings and registration statements, and (b) the Exchange had announced that more than 90 percent of its listed companies were including a funds statement in their annual reports. By the time the APB finally acted, such reporting had already become a *fait accompli* (Zeff, 2015a).

3.6 SEC Overrules the APB in 1965 After It Backs Down on Reclassifying the Deferred Tax Credit

In the middle 1960s, large retailers began making more sales on the installment plan. They recognized revenue at the time of delivery in their accounting records, while using the installment method of revenue recognition for tax purposes. When accounting for the differential tax effect, most companies classified their deferred tax liability as noncurrent, but some subtracted it from installment receivables or showed it as a

current liability: there was a clear diversity of practice. In June 1965, the APB voted unanimously for a provision in an exposure draft to require that the deferred tax credit relating to retailers' installment sales should be classified as a current liability to the extent that the corresponding installment receivable was a current asset. The National Retail Merchants Association objected to this reclassification. Several large retailers had balances in their deferred tax credit account that equaled or exceeded 15 percent of their total current liabilities, excluding the credit. The classification of the credit could have a significant effect on the determination of a company's working capital and credit rating. Following pressure from the retail industry and, one supposes, major clients of several of the Board members to reject this proposal, the APB reversed itself, 14 to 2, and voted to delete the provision approved previously from *Opinion No. 6*, issued in October 1965. Hence, the APB left the question of how to classify the deferred tax credit for installment receivables up in the air. Arthur Andersen & Co., which favored the reclassification, quietly petitioned the SEC, because Andrew Barr, its Chief Accountant, was known to favor the reclassification. SEC Chair Manuel F. Cohen, who had been speaking out in favor of narrowing the areas of difference in accounting practice, responded with force. He summoned the APB's leadership to a meeting with the Commission in November, and proceeded to berate them for not solving their problems and for not reducing the diversity in practice. Following this meeting, the Commission issued *Accounting Series Release No. 102* on December 7, 1965 to require the deferred tax credit in such circumstances to be a current liability, thus overruling the APB (Pines, 1965, 739–740; Zeff, 2007c).

3.7 Senate Subcommittee Chair Presses SEC in 1965 to Call for Segment Disclosures, Yet the APB Fails to Issue an *Opinion*

In 1965, the antitrust and monopoly subcommittee of the Senate Committee on the Judiciary, chaired by Philip A. Hart, was looking into the possible anti-competitive effects of conglomerate mergers. Upon learning that the merged companies did not have to break out their

revenues and profits by product lines, he approached SEC Chair Manuel Cohen about the need for diversified companies to make such product line, or segment, disclosures. Cohen (1966, 9), in a speech, said that the Commission “can work with analysts and accountants to determine proper methods of allocation, or establish a defined operating profit and loss statement on a divisional basis.” The SEC looked to the APB for issuance of an *Opinion* on the subject. But the APB, probably owing to resistance by companies, was unable to muster support for anything more than a nonbinding *Statement*, issued in 1967, which called upon companies voluntarily to disclose product line information. Even this softest of recommendations attracted two dissents from APB members. In the absence of firm guidance from the APB but with assistance from a major research study rushed out by the Financial Executives Institute, the SEC itself issued releases in 1969 and 1970 requiring registrants to disclose line-of-business information in registration statements and annual filings, respectively, outside the audited financial statements (Seligman, 2003, 432–438; Skousen, 1970; Sommer, 1968; Zeff, 1972, 202–204; Zeff, 2018a, 258). Hence, the APB, because of its inability to issue an *Opinion*, veritably invited the SEC to take the lead in setting the standard for the required disclosure of segment information. In 1973, the New York Stock Exchange issued a “white paper,” which urged that listed companies disclose line-of-business information in their annual reports which was at least as extensive as that required by the SEC. During its remaining life, even after the SEC issued its releases, the APB did not act again on segment reporting even though pressed to do so by AICPA Executive Vice President Leonard Savoie.

3.8 Return of the Investment Credit, 1967

In March 1967, the Johnson Administration restored the Investment Credit, which had been suspended six months earlier. With SEC encouragement, the APB issued an exposure draft in September which included a provision that would require deferral treatment – which it tried to impose in 1962 – for the Credit. In November, Stanley S. Surrey, the Assistant Secretary of the Treasury (Tax Policy), wrote a letter to the Board, which was published, in which he took strong issue with

mandating the deferral method.⁸ The President's Council of Economic Advisers conveyed a similar view. The SEC then advised the Board that it could no longer assure it of support on a mandatory deferral. Accordingly, the Board decided not to move forward with its proposed accounting for the Credit.

3.9 In 1969–1971, the APB Adds Symposia and Then Public Hearings to Its Due Process

In 1968, the APB came to believe that the formal exposure process for giving publicity to proposed standards was not reaching enough of its intended audience. To complement the regular sending out of exposure drafts, the Board conducted six symposia in 1969 for the purpose of seeking comments on “pre-exposure” drafts of proposed standards. The symposia were run by the Board's subject-area committees that were drafting the standard. The Board invited a select number of interested organizations to send representatives to the symposia. Each organization would submit a memo, and its representative would make a brief oral presentation. The symposia were held in private and were closed to observers. These were not the Board's first experiences with live involvement with interested parties during the course of developing its standards. In the past few years, some of the subject-area committees met privately with other groups, always including the SEC, which possessed special knowledge or interest in the standard being developed.

No further symposia were held in 1970, but, in response to a number of criticisms of the symposium approach, including that the Board's invitation went to too limited a range of potentially interested parties, the Board expanded the symposia in 1971 into three fully fledged public hearings. The subjects of the public hearings were all highly controversial: accounting for marketable equity securities, accounting for long-term leases, and accounting practices in the oil and gas industry (Zeff, 1972, 207–209). As it happened, strong pressures from each of the most affected industries effectively quelled any attempt by the Board to move ahead with the three projects (Horngren, 1973; Moonitz,

⁸Surrey's letter is reproduced in Keller and Zeff (1969, 447–449).

1974, 51–52; Zeff, 1978). The Board did not schedule any further public hearings.

3.10 SEC Chief Accountant Demotes an *Opinion* on Price-Level Accounting to a Nonbinding *Statement* in 1969

In 1963, the Institute published an Accounting Research Study written by the APB's staff which explained and illustrated general price-level (GPL) adjusted financial statements, and in 1965 Paul Grady, a retired senior partner in Price Waterhouse & Co. and the Board's Director of Accounting Research, wrote *Accounting Research Study No. 7* in which he advocated supplementary reporting of the financial effects of GPL changes. The Board proceeded to draft an *Opinion* to that effect, but in 1967 the chair of the APB's drafting subcommittee informed the Board that SEC Chief Accountant Barr "was generally not in favor of the positions taken in the draft *Opinion*." As it was evident that the SEC would not enforce compliance with an *Opinion*, the Board decided instead to issue a nonbinding *Statement* [*No. 3*] in 1969 (Moonitz, 1974, 39–41; Zeff, 2018a, 259).

Robert Mednick (1986, 46), a senior partner of Arthur Andersen & Co., wrote as follows about the APB's *Statement No. 3* on GPL accounting:

Because it included only a recommendation, however, it did not require auditors to make any mention in their reports of any departures from or omissions of the recommended [GPL] information. As a result, it had no impact on practice because only one public company, the Indiana Telephone Corporation [an Andersen client], followed its recommendation. Furthermore, that particular company had already been producing price-level adjusted financial statements before APB 3 was issued.

3.11 SEC Chief Accountant Arranges for a Journal Article in 1970 to Establish GAAP for Franchisors

SEC Chief Accountant Andrew Barr, concerned that many franchisors in a burgeoning industry were improperly front-end loading their initial franchise fee revenue, approached the APB in 1969 about the need for an *Opinion*. Because the APB was totally consumed with the controversy over pooling of interests and goodwill accounting and thus had no time to devote to a franchising standard, Barr, with APB encouragement, arranged with a partner in a leading (but not Big 8) audit firm to publish an article in the AICPA’s monthly *Journal Accountancy* to recommend deferring the recognition of initial franchise fee revenue by reference to the progress of the earning process. The article (MacKay, 1970), which was vetted by the Chief Accountant and leading practitioners, quickly appeared and was promptly cited by the Chief Accountant as “substantial authoritative support,” an unprecedented means of establishing GAAP (Zeff, 2012a). At the same time, Barr’s tactic showed the importance to him of having the solution come from the private sector, and not be dictated by the SEC.

3.12 Institute Modifies the “Notes” Appended to the APB’s *Opinions* in 1970, Displacing “General Acceptability”

In 1970, after the Institute received approval from the APB and from its Board of Directors, it modified the “Notes” appended to the Board’s *Opinions* from the 1964 version. The passage affirming that “the authority of the Opinions rests upon their general acceptability” was dropped. And the enumeration of points a, b and c from the *Special Bulletin* of October 1964 no longer appeared. No reason was given for the changes. For the first time since 1939, “general acceptability” was no longer cited as a benchmark of authority. Again, it seems that the needle marking a point between persuasion and compulsion, a weighty issue that was debated in 1957–1958 by the Institute’s Special Committee on Research Program, moved somewhat further toward compulsion.

3.13 **Opinion Nos. 16 and 17 in 1970 Conclude a Fractious Debate Over Pooling of Interests and Goodwill**

The controversy over accounting for pooling of interests had been festering since the 1950s, when factors that identified poolings were first set forth in *ARB No. 40* and then were revised in *ARB No. 48*. Chatov (1975, 215) has written, “The criteria noted in ARB No. 48 were stringent; but they were permitted to erode by the SEC.” By the end of the 1960s, the Board realized it had to address poolings as well as goodwill. Its initial position was to eliminate poolings, but industry, especially the Financial Executives Institute, rose in wrath against this proposal. The issues before the Board, beginning in 1969, attracted the attention of three Congressional committees, the Federal Trade Commission, and the Department of Justice. The SEC wavered in the views it conveyed. The APB held two symposia, and had great difficulty finding a two-thirds majority for any tolerable position. From beginning to end, the deliberations came under intense pressure, which included persistent lobbying by industry of the Board and of its members. Zeff (1972, 216) has written, “Something had to be done, for it was known that the SEC would issue its own rule in the absence of guidance from the Board.” In the end, *Opinion No. 16*, which retained poolings so long as combinations satisfied a considerable number of prescribed conditions, was approved by a vote of 12 to 6, exactly a two-thirds majority, the result of extensive “horse-trading.” *Opinion No. 17* for the first time anywhere set a useful life on goodwill, and required that it be amortized over no more than 40 years. It passed by a vote of 13 to 5. The New York and American Stock Exchanges, which supported both *Opinions*, had so little confidence in their good-faith application that they advised their listed companies to provide letters from their external auditors in connection with listing applications for shares to be issued as a result of poolings (Chatov, 1975, Chap. 14; Defliese, 1974b; Fotenos, 1971; Moonitz, 1974, 44–47; Rayburn and Powers, 1991; Seligman, 1986, 17–22; Seligman, 2003, 418–430; Zeff, 1972, 212–216).

3.14 Pressure Builds on the AICPA in 1970 to Replace the APB and Reinvent Sound Standard Setting

In reaction to their dismay over the intense industry and government pressure brought on the APB, and on its members, during the development of its *Opinion Nos. 16* and *17* on pooling of interests and goodwill accounting, leading to widely criticized compromises in the standards, the managing partners of three of the Big 8 audit firms wrote to the Institute in November 1970 that their firms no longer had confidence in the APB. Moreover, in August 1970 the American Accounting Association (AAA) had empaneled a special committee to recommend whether the Association should establish a commission to propose how accounting principles should be formulated (*The Role of the American Accounting Association in the Development of Accounting Principles, 1971*). The Institute's leadership was furious at the AAA for trespassing on its turf (Edwards, 2010, 188–189), and was alarmed by the letters from the three Big 8 firms' managing partners. In response, Institute President Marshall S. Armstrong convened a special meeting of leading audit firm partners to discuss a way ahead, following which in 1971 the AICPA Board of Directors empaneled two high-level committees: the Wheat Study on Establishment of Accounting Principles, and the Trueblood Study Group on the Objectives of Financial Statements (Van Riper, 1994, 7–8; Zeff, 1972, 224–229; Zeff, 2015b, 147–150). As will be seen below, both study groups issued reports that greatly influenced the standard-setting process and content.

3.15 *Opinion No. 21, in 1971, Brings Present-Valuing into GAAP, One of the APB's Successes*

In August 1971, a unanimous APB issued *Opinion No. 21*, “Interest on Receivables and Payables,” which established the present-valuing of long-term receivables and payables as part of GAAP. Only nine years earlier, in 1962, the APB had labeled as “radical” that same recommendation made by Sprouse and Moonitz in their research study on broad accounting principles. This demonstrated the progress that could be made when, in the middle 1960s, the national managing

partners on the Board were replaced by their firms' senior technical partners. Professor Charles Horngren chaired the Board subcommittee that developed the *Opinion*.

Chief Accountant Barr had been opposed to using present values, but he was persuaded to support the Opinion by the need to discount the mounting long-term receivables on the books of franchisors and retail land sales companies.⁹

3.16 APB is Defeated on the Investment Credit for a Third Time, in 1971

In August 1971, the Nixon Administration advocated a restoration of the Investment Credit, which had been repealed in 1969. In the light of this development, the APB, with support both from a Treasury official and then from the SEC, proposed once again to require that the Credit be given deferred accounting treatment in companies' financial statements. As in 1962, industry objected to this proposal. So did the Treasury Secretary once he learned of his subordinate's advice to the contrary. With Treasury support, Congress inserted a provision in the legislation reinstating the Credit to the effect that companies may use any method of accounting for the Credit they wished, which precluded both the APB and the SEC from acting otherwise. The bill became law in December 1971 (Zeff, 1972, 219–221; Zeff, 1993, 132–135). This was the only time that Congress overruled the APB and SEC on accounting. It lasted 15 years until the Tax Reform Act of 1986 eliminated the Investment Credit.

3.17 SEC Chief Accountant Dictates Present-Value Disclosures for Lessees in 1973, Overruling the APB

In 1972–1973, the APB and SEC Chief Accountant Sandy Burton disagreed over the required disclosure to be made by lessees when not capitalizing long-term leases. The Chief Accountant wanted disclosure of the present value of the future lease payments, while the APB wanted disclosure of only the absolute amounts of the future payments. In the

⁹ Author's interview with Sidney Davidson, July 27, 2001.

end, after the APB published *Opinion No. 31* conveying its view, the Chief Accountant arranged for the Commission to issue *Accounting Series Release No. 147* in October 1973a to mandate the disclosure of the present values (Zeff, 2012b, 2018a, 260–261).

3.18 An Assessment by Arthur Wyatt of Why the APB Failed

Arthur R. Wyatt, a former University of Illinois accounting professor who joined Arthur Andersen & Co. in 1966 and soon became a partner, attended APB meetings during its last five years as assistant to his firm's Board member. Wyatt (1991a, 209), who in the 1980s became a member of the FASB, assessed the weaknesses of the APB as follows:

- (1) It operated without a conceptual focus. This resulted in too many ad hoc decisions and apparent difficulties in anticipating the direction of potential change.
- (2) It operated with too closed a process. Deliberations were behind closed doors without constituent participation.
- (3) It was dominated by the public accounting perspective, whatever that is, which led to an absence of an ability for other significant interests to participate. An overriding concern was the need to recognize that the critical focus of any private sector standard-setting process is the protection of the public interest.

The Wheat Study (see Subsection 4.1) devoted a chapter in its report to a critical review of the APB's record, including especially the disappointing contribution of its research program to the development of its *Opinions* (*Establishing Financial Accounting Standards*, 1972, Chap. 6).

4

Financial Accounting Standards Board, 1973 to the Present

4.1 AICPA Adopts the Wheat Study's Recommendation in 1972 to Replace the APB with the FASB

In March 1972, the Wheat Study, with SEC support, proposed setting up the independent, full-time Financial Accounting Standards Board (FASB) to succeed the APB. It would be overseen by the Financial Accounting Foundation (FAF) trustees, who would raise financing, appoint members of the Board, and oversee its standard-setting process. Even though the AICPA would be losing its standard setter, its Board of Directors and Council promptly endorsed the Wheat Study's recommendations, and the seven-member FASB succeeded the APB on July 1, 1973. The FAF/FASB organization was funded by voluntary donations, mostly from the Big 8 audit firms and large public companies, and from the sale of publications. This was the first full-time accounting standard setter anywhere in the world. Initially, the Institute held considerable sway over appointments to the FAF trustees, and it was stipulated that four of the seven Board members be CPAs with experience in public practice. The Board's standards required at least five affirmative votes for approval (*Establishing Financial Accounting Standards*, 1972; Olson, 1982, 67–69; Van Riper, 1994, 9–11; Zeff, 2015b, 2018b).

The AICPA's initial influence was reflected in the choice of the FASB's Chair, Marshall Armstrong. He was the Institute's immediate past President and the managing partner of a major regional audit firm, Geo. S. Olive & Co., in Indianapolis, Indiana (Adebayo and Coffman, 2007). Armstrong had served for six years on the APB. Another of the FASB members, John W. Queenan, of Haskins & Sells, was also an Institute President and APB member. Both Armstrong and Queenan would have been viewed by the Institute leadership as "safe choices." In addition to the two other audit firm partners who were named to the Board (Donald J. Kirk and Walter Schuetze), Arthur L. Litke came from government service, Robert E. Mays was with Exxon Corporation, and Robert Sprouse was the academic. In 1962, Sprouse had teamed with Maurice Moonitz to write the APB's highly controversial research study on broad accounting principles, which the APB discarded. Moreover, five of the nine FAF trustees were audit firm partners, and all were active in the Institute's leadership.

It is noteworthy that the Institute had named Francis M. Wheat, a former SEC Commissioner, to chair the Study on establishing accounting principles. In 1958, the Institute had invited SEC Chief Accountant Andrew Barr to serve on its Special Committee on Research Program. In 1991–1994, the Institute's Special Committee on Financial Reporting, chaired by Edmund L. Jenkins, of Arthur Andersen, included the immediate past SEC Chief Accountant among its 15 members, and the SEC's Associate Chief Accountant was one of three observers (Special Committee on Financial Reporting, 1994). It was regarded as essential that these bodies' policy and program recommendations be viewed as credible by the SEC. The same SEC ubiquity has been evident in major auditing inquiries. Former SEC Chairs or Commissioners played leadership roles on three major auditing panels in the 1970s and 1980s: Commission on Auditors' Responsibilities (Manuel Cohen, Chair), Public Oversight Board (Ray Garrett, Jr., the initial Vice Chair, and A. A. Sommer, Jr., a later Chair), and the National Commission on Fraudulent Financial Reporting (James C. Treadway, Chair).

The FASB was to meet several times a year with its Financial Accounting Standards Advisory Council (FASAC). The Council's some 30 members were composed of audit firm partners, financial executives,

academics, and user representatives. Among the first members appointed to FASAC were Andrew Barr, the recently retired SEC Chief Accountant, and Frank Wheat. Barr served until 1976, while Wheat remained until 1977. Former Chief Accountant Sandy Burton was on FASAC from 1977 to 1981.

In its early years, encouraged by a recommendation in the Wheat Study report, the Board began issuing hefty Discussion Memoranda which surveyed the academic and professional literature on the subject at hand. Soon the Board began publishing monograph-length Research Reports mostly conducted by academics. But by the early 1990s, the Board abandoned both of these research enterprises. The Board has, however, embarked on multiple programs of bringing accounting academics into its research and standard-setting operation (Zeff, 2021).

4.2 Trueblood Study Group Calls in 1973 for the Objective of Financial Statements to Focus on Potential Cash Flows

In October 1973, the AICPA's Trueblood Study Group on the Objectives of Financial Statements rendered its long-awaited report – long-awaited, because the APB had been unable in its 14-year life to provide an authoritative conceptual framework in support of its *Opinions*. The Study Group's chief recommendation was the following:

An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing, evaluating potential cash flows to them in terms of amount, timing, and related uncertainty.

This emphasis on “potential cash flows” was a breakthrough in the authoritative accounting literature, and is traceable mainly to the influence of C. Reed Parker, the lone financial analyst and non-CPA on the Study Group. In 1978 and again in 2010, the FASB incorporated this cash-flow emphasis in its own statement of objective, as have all of the other major world standard setters, including the International Accounting Standards Committee and International Accounting Standards Board (Most and Winters, 1977; *Objectives of Financial Statements*, 1973; Zeff, 2013, 2016b, 150–152).

4.3 In 1973, the SEC, for the First Time, Officially Expresses Support for the Accounting Standard Setter

In October 1973, the SEC issued *Accounting Series Release No. 150* (SEC, 1973b) in which it announced its support of the FASB as the new standard setter for financial reporting. This was the SEC's first-ever official public statement avowing its support for an accounting standard setter. *ASR No. 150* said, "The Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors."¹ Arthur Andersen & Co. unsuccessfully sued the SEC, arguing that the FASB, as a private-sector body, did not require "legal validation" to issue standards (Olson, 1982, 70–72). In fact, during his four-year term as SEC Chief Accountant, from 1972 to 1976, Sandy Burton, a former accounting and finance professor at Columbia University, was an activist figure who was not loath to challenge the Board, as will be seen below. But no subsequent Chief Accountant intervened in the work of the standard setter as much as Andrew Barr had during the years of the APB.

4.4 AICPA Membership Implements Rule 203 in 1973 to Ratify the *Special Bulletin* of October 1964

By February 1973, the Institute had secured membership approval of Rule 203 in its Code of Professional Ethics to ratify the contents of the Institute's *Special Bulletin*, issued in October 1964, which required members to disclose departures from the standard setter's recommendations. The Institute attempted to gain membership approval of such a rule in 1969, but it narrowly failed to win approval by two-thirds of those voting (Carey, 1970, 453–455). Rule 203, which became effective on March 1, 1973, stated as follows:

Rule 203—Accounting Principles. A member shall not express an opinion that financial statements are presented in

¹For a brief history of the interactions between the SEC and the FASB, see Palmon *et al.* (2011).

conformity with generally accepted accounting principles if such statements contain any departure from an accounting principle promulgated by the body designated by [the AICPA] Council to establish such principles which has a material effect on the statements taken as a whole, unless the member can demonstrate that due to unusual circumstances the financial statements would otherwise have been misleading. In such cases his report must describe the departure, the approximate effects thereof, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

In May 1973, AICPA Council implemented Rule 203 by recognizing FASB *Statements*, APB *Opinions*, and *Accounting Research Bulletins* which were outstanding and effective as being covered by the rule (Strother, 1975, 219–220).

This adoption of Rule 203 elevated the auditor's reporting obligation on departures from the FASB's standards to the highest level in the AICPA's hierarchy.

4.5 AICPA Creates Accounting Standards Executive Committee in 1973, Which Becomes an Authoritative Source of GAAP Until the Early 2000s

In 1973, following the dissolution of the APB, the AICPA set up a senior technical committee known as the Accounting Standards Executive Committee (AcSEC). Initially composed of 15 audit firm partners, its role was to speak on behalf of the Institute on accounting proposals before the FASB. As with the APB, all of the Big 8 audit firms were represented. In 1974, AcSEC began issuing *Statements of Position (SOPs)* on fairly narrow technical issues, and also began focusing on emerging problems. It worked closely with the FASB, but its *SOPs* were, in the early years, informational and not part of the authoritative literature under the Institute's Rule 203 of its Code of Professional Ethics (Beresford, 1976). AcSEC also began issuing industry *Audit and Accounting Guides*. The FASB apparently began to have concerns that AcSEC was evolving into a competing standard-setting body. In *SFAS*

No. 32, issued in September 1979, the Board said that it would “exercise responsibility for the specialized accounting and reporting principles and practices” in the *SOPs* and *Guides* by issuing some of them as FASB *Statements*, after the usual due process, which it did in 1981 and 1982 (Zell, 1981, 54). Some observers were apprehensive that the recommendations contained in future *SOPs* and *Guides* may not be followed unless and until the FASB were to issue them as a *Statement*.

In January 1992, when the Institute’s Auditing Standards Board issued *Statement on Auditing Standards (SAS) No. 69*, “The Meaning of *Present Fairly in Conformity with Generally Accepted Accounting Principles* in the Independent Auditor’s Report,” the *SOPs* and industry *Guides* were included in category (b) in the GAAP hierarchy, behind the FASB’s *Statements* in category (a). Even before the issuance of *SAS 69*, the SEC had occasionally alerted registrants to adhere to *SOPs* and *Guides* (Craig, 1993).

In 2002–2003, FASB Chair Robert H. Herz, concerned over the fact that authoritative GAAP emanated from as many as three sources – the FASB, the SEC, and the AICPA – at a time when the Board had a strong desire to converge U.S. GAAP with IFRS, asked the AICPA to consider discontinuing the issuance of *SOPs* and *Guides* by AcSEC (Herz, 2016, 64–65). While the AICPA was reluctant to give up this standard-setting role, it agreed to have AcSEC finish the *SOP* projects in process and not commence new ones intended to provide authoritative guidance on accounting matters (“Changes to U.S. Standard Setting”, 2002). The AICPA pushed to keep the industry *Guides* as authoritative but soon accepted that it should focus instead on providing non-authoritative implementation guidance.

In 2009, as will be seen below, the FASB announced its *Accounting Standards Codification* of FASB and SEC pronouncements, which supplanted the need for a GAAP hierarchy. In 2010, AcSEC was renamed the Financial Reporting Executive Committee (FinREC) in an attempt to avoid any confusion about the AICPA’s break from AcSEC’s previous role.

4.6 AICPA Launches an Annual Conference on SEC Developments in 1974

On January 8–9, 1974, the AICPA held its first National Conference on Current SEC Developments, in Washington DC, which provided a platform for members of the Commission and its staff to speak on important topics (Institute Sponsoring National Parley, 1973). This annual conference continues in existence today and is very well attended. Over the years at the conference, the Chief Accountant and members of his staff have made known their views on emerging accounting and auditing issues, thus informing the FASB and practitioners generally of the evolving positions at the Commission. Speeches by the Chief Accountant and his staff, ever since the 1930s, have often established GAAP for purposes of SEC registrants.

4.7 In 1974, the SEC Invites the FASB to Issue a Standard on Capitalizing Interest Cost, Which It Does in 1979

In a weakening economy with rising interest rates driven by mounting inflation, some SEC registrants began in 1974 to capitalize their interest cost in order not to depress their reporting earnings. While the practice of capitalizing the interest cost on self-constructed assets had long prevailed in the public utility field, the capitalization of interest was not acceptable under GAAP for nonutility registrants. The SEC objected to the practice and then placed a moratorium on further companies adopting it. In *Accounting Series Release No. 163*, issued in November 1974, the Commission said, “it does not seem desirable to have an alternative practice grow up through selective adoption by individual companies without careful consideration of such a change by the Financial Accounting Standards Board.” The FASB took up the matter, and in 1979, by a 4 to 3 vote, the Board issued *Statement of Financial Accounting Standards (SFAS) No. 34*, which supported a limited capitalization of interest cost, chiefly for self-constructed assets.

4.8 FASB Faces a Possible Challenge in 1975 to Its Supremacy as the U.S. Standard Setter

In June 1975, less than two years after the SEC had said it looked to the FASB for leadership “in establishing and improving accounting principles and standards” (above), Chief Accountant Sandy Burton threw a scare into the FASB that it might not be the only accounting standard setter in the SEC’s eyes. Burton referred to an exposure draft recently issued by the relatively young, part-time International Accounting Standards Committee (IASC), based in London, that called for the inclusion in consolidated financial statements of dissimilar subsidiaries, such as those in banking, insurance and finance, in relation to an industrial parent. U.S. GAAP at that time allowed such dissimilar subsidiaries to be excluded from consolidation. Burton evidently liked the IASC’s proposal, and he advised the FASB Chair that, if the IASC were to issue a final standard to this effect and if the FASB were not to issue a contrary recommendation, he would propose an amendment to *Regulation S-X* in conformity with the IASC standard. FASB Chair Marshall Armstrong was taken aback that the Board was not the *only* standard setter to which the SEC looked for improving accounting standards. He protested to SEC Chair Ray Garrett, Jr., but Garrett counseled, “we believe that there is enough work for everybody,” especially as the FASB had not yet decided to deal with the issue. The Financial Executives Institute also expressed concern about Burton’s surprise initiative, but to no avail. In the event, the IASC decided in June 1976 to issue its final standard in line with U.S. practice, and the threat to the FASB’s supremacy faded away (Camfferman and Zeff, 2007, 157–160).

In October 1987, the Board issued *SFAS No. 94*, “Consolidation of All Majority-Owned Subsidiaries,” which ended the exclusion of dissimilar subsidiaries from consolidation.

4.9 SEC Begins Publishing *Staff Accounting Bulletins* in 1975

Further reflecting Chief Accountant Burton’s activism, the SEC’s Office of the Chief Accountant and Division of Corporation Finance in 1975 began publishing *Staff Accounting Bulletins*, setting forth their views

on accounting-related disclosure practices. More than 100 *SABs* have since been issued. While they do not carry the SEC's official imprimatur as do *Accounting Series Releases*, they are nonetheless authoritative statements of the views of the senior staff who deal with accounting matters. The SEC says that "They represent interpretations and policies followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the federal securities laws."

4.10 SEC Requires Replacement Cost Disclosures in 1976, Overtaking the FASB's Proposal for General Price-Level Disclosures

In December 1974, with the arrival of double-digit inflation, the FASB issued an exposure draft to require companies to provide supplementary disclosure of certain financial information in units of general purchasing power. But SEC Chief Accountant Sandy Burton ridiculed this recommendation, because, he said, inflation affects different companies differently. Instead, he favored replacement cost information. In March 1976, under Burton's watch, the SEC issued *Accounting Series Release No. 190*, supplanting the FASB's proposal and requiring some 1,300 public companies to provide supplementary disclosure of replacement cost information about inventories, cost of sales, productive capacity, and depreciation (Tweedie and Whittington, 1984, 156–163; Van Riper, 1994, 48–50 Zeff, 2007b, 57). In only the third year of the FASB's life, this action by the SEC to overtake its proposal to deal with inflationary times was an embarrassment and a setback. The Board then proceeded to develop a pronouncement of its own to retake the initiative, which became *SFAS No. 33*, discussed below.

The SEC stated in its *ASR* that "it did not and does not view its proposal [issued in 1975] as competitive with that of the FASB." But Leonard Savoie (1979, 231) said, "I do not know of anyone who agrees with the Commission on that."

4.11 Congressional Staff Study in 1976, Critical of the FASB, Prompts Reforms in the FAF and FASB in 1978, Leading to Structural Changes at the FASB

In its first five years, from 1973 to 1977, the FAF's and FASB's membership selection was, as noted above, much influenced by the AICPA and by the need to have four of the Board members being CPAs. Mainly because a Senate subcommittee, chaired by Lee Metcalf (Democrat, Montana), whose staff issued a 1,760-page attack on the FASB, the AICPA, and the Big 8 audit firms, published in December 1976, the FAF trustees appointed a special committee to increase the independence and probity of the FASB. As a result of the special committee's report, the FAF largely expunged the heavy AICPA influence over the selection of FAF trustees. It also relaxed the CPA requirement for Board members and instructed the Board to hold its meetings "in the sunshine," that is, be open to the public. At the same time, the FAF lowered the required majority to approve standards from 5 to 2 to 4 to 3, apparently to eliminate the roadblock for approval and issuance of the urgently needed oil and gas standard, *SFAS No. 19*, which had only four votes in favor (see below). These changes took effect in 1978 (Pacter, 1983, 10–12; Zeff, 2018b).

The Metcalf subcommittee's staff study, entitled *The Accounting Establishment* (1976), said, "This study finds that the 'Big Eight' accounting firms, the AICPA, and, to a lesser extent, the other sponsoring groups have control over the operation of the FASB. Such control is exercised in terms of money, personnel, and organizational support" (page 15). It recommended that "The Federal Government should directly establish financial accounting standards for publicly-owned corporations. Accounting standards involve social and economic issues which can only be resolved effectively through the processes of government responsible solely to the public" (page 21). The recommendation was not carried forward into proposed legislation, perhaps in part because Lee Metcalf, the subcommittee Chair, died of a heart attack in January 1978. In April 1977, the FAF and the FASB coauthored "a relatively bland demurrer to the [Metcalf] report's conclusions" (Van Riper, 1994, 46).

At the same time, a House subcommittee chaired by John E. Moss (Democrat, California), was investigating “Federal Regulation and Regulatory Reform,” including the SEC. The Moss subcommittee, in its report published in October 1976, was very critical of the FASB. It said:

The FASB has accomplished virtually nothing toward resolving fundamental accounting problems plaguing the profession. These include the plethora of optional “generally accepted” accounting principles (GAAPs), the ambiguities inherent in many of those principles, and the manifestations of private accountants’ lack of independence with respect to their corporate clients. Considering the FASB’s record, the SEC’s continued reliance on the private accounting profession is questionable. (page 33)

The subcommittee recommended that, “to the maximum extent practicable, the SEC should prescribe by rule a framework of uniform accounting principles” (page 51). As it happens, Rep. Moss retired from Congress at the end of 1978. This recommendation also was not implemented (Olson, 1982, 42–57; Savoie, 1978, 224–225; Van Riper, 1994, 43–47).

It is noteworthy that Professor Abraham J. Briloff, of the Baruch College of the City University of New York, who had long been a critic of the accounting profession, was consulted by both subcommittees.

Savoie (1979, 229) wrote, “Throughout the congressional hearings and investigations, the SEC remained strongly supportive of professional accounting standard-setting in the private sector, even when the SEC itself was severely criticized for doing so.”

4.12 Perverse Effect of *SFAS No. 15*, Issued in 1977, on Troubled-Debt Restructurings

With the impending bankruptcy of New York City in 1974, banks that held the city’s paper sought to restructure its “troubled debt” by lengthening the maturities of the principal payments. The FASB began to consider whether banks, following such a move, should show such troubled debt at market value in their own financial statements, instead of still at its carrying value. In an FASB public hearing held

in 1975, bankers vigorously protested any required use of the lower market value, because it would depress their reported earnings. The Board, apparently feeling intense pressure from the banking industry, compromised in *SFAS No. 15*, issued in June 1977. It allowed the banks, following a modification of terms of the debt, to retain on their books the much higher carrying value than the market value (or discounted present value) so long as the sum of the future *undiscounted* debt service receipts from a troubled debtor were not less than the carrying value – illustrating how lobbying by a powerful industry can distort a standard (Zeff, 1982a, 44–46; Zeff, 1993, 135–137). Under *SFAS No. 15*, accounting recognition of the *economic* loss from restructuring the debt was postponed until future years, a view that was contested by many.

Kieso *et al.* (2001, 747) wrote, “The position taken by the FASB under *Statement No. 15* was the position lobbied for by the financial institutions. They argued that the economic consequences of loss recognition would be devastating to their industry.” Walter Schuetze, a former member of the FASB, was quoted as saying, “An entire generation of accountants has been retarded by Statement No. 15” (Van Riper, 1994, 43). This standard, which some believe was the worst ever issued by the Board, came back to haunt the accounting profession and the country in the 1980s, when the Federal Home Loan Bank Board instructed savings and loan associations (S&Ls) to use Regulatory Accounting Principles, conveniently based on *SFAS No. 15* and on a misapplication of GAAP on goodwill accounting, in order to keep afloat those S&Ls that were barely solvent or actually insolvent, at a great cost to U.S. taxpayers (Breedon, 1991, S77–S85; Pushkin and Pariser, 1991; Van Riper, 1994, 39–43, 179–182). And, of course, *SFAS No. 15* itself was still GAAP in the 1980s.

4.13 SEC Rebuffs the FASB Yet Again, This Time in 1978 on the Accounting treatment of Exploration Costs by Oil and Gas Companies

In 1975, Congress approved the Energy Policy and Conservation Act, which required the SEC to prescribe accounting practices for producers of crude oil or natural gas in order to develop “a reliable energy data

base.” The Act allowed the SEC to rely on the FASB to provide a standard, and the SEC asked the Board for its opinion with respect to the choice between the two historical cost methods of accounting for oil and gas exploration: “successful efforts costing” and “full costing.” Under successful efforts costing, companies are to expense the cost of dry holes. Under full costing, the cost of dry holes is capitalized, and it was the method most widely used by mid-sized and small oil companies in order to avoid volatility of earnings and depressed earnings. The big, international oil giants used “successful efforts costing.” In December 1977, the FASB, by a 4 to 3 vote, favored successful efforts costing in *SFAS No. 19*. Small oil and gas producers thereupon mounted a massive lobbying campaign, arguing that the required use of successful efforts costing would increase the volatility of their reported earnings and thus discourage bankers and investors from providing needed finance to sustain their operations. No less than the Justice Department, the Federal Trade Commission, and the Energy Department all signified agreement with the small producers and advised the SEC that the required use by them of successful efforts costing would lead to a lessening of competition in the industry. After holding ten days of public hearings in Washington and Houston, the SEC rejected both of the historical cost methods in 1978 and instead called for “reserve recognition accounting,” involving the use of current values of companies’ proven reserves in the body of the financial statements, with the unrealized gains and losses taken to earnings. Savoie (1979, 231) wrote that the SEC’s rejection of the Board’s standard “was a cruel and crushing blow to the FASB.”

This decision by the SEC represented a startling departure from its historic aversion to including unrealized gains on inventories in the income statement. This was a ruling apparently dictated by the Chair and the Commissioners, based on what they heard during their extensive public hearings, rather than one drafted by the accounting staff (Evans, 1979, 7–8). The members of the Commission, unlike most of the accounting staff, were not wedded intellectually and emotionally to historical cost. They were evidently seeking to provide useful financial information that those whom they heard during the hearings were

requesting – current values, not historical costs, of the reserves (Interview with A. Clarence Sampson, 2005, 8).

Following pressure by Big Oil, which did not want to record unrealized gains and thus higher earnings as OPEC was raising the price of crude, the SEC relented, and in February 1981 it asked the FASB “to develop a comprehensive package of disclosures for those engaged in oil and gas producing activities.” The Commission claimed in *Accounting Series Release No. 289* that the reason for its decision to call instead for disclosures in a note was the difficulty in estimating the proved oil and gas reserves, but the pressure brought by the big, vertically integrated oil and gas companies can hardly be discounted as a factor. The result was that small oil and gas producers could continue to use full costing, while Big Oil could continue using successful efforts costing, in the body of their financial statements (Adkerson, 1979; Cortese, 2011; Gorton, 1991; Kirk, 1984, 568–569; Larcker and Revsine, 1983; Tweedie and Whittington, 1984, 179–182; Van Riper 1974, 28–29, Chap. 4; Zeff, 1982a, 39–44; Zeff, 1993, 137–140; Zeff, 2007b, 58).

In November 1982, after fast-tracking the project, the FASB issued *SFAS No. 69*, “Disclosures about Oil and Gas Producing Activities,” which established the comprehensive disclosures to be provided.

4.14 FASB Issues a Standard in 1979 to Regain Its Position on Disclosing the Effects of Inflation

In September 1979, the FASB issued *SFAS No. 33*, “Financial Reporting and Changing Prices,” in order to establish its primacy vis-à-vis the SEC in dealing with the effects of the 1970s inflation on financial reporting. In an exposure draft issued in 1974, the Board had favored supplementary general price-level (GPL) disclosures, but this proposal was overtaken in 1976, when the SEC required large companies to display replacement cost information in supplementary disclosures. Then the Board went to work, and issued a standard that would secure the SEC’s respect and still call for a reporting of GPL-restated information, all supplementary. Thus, *SFAS No. 33* required a similar set of large companies to disclose both supplementary current cost and GPL information (Tweedie and Whittington, 1984, 170–179). In October 1979,

the SEC duly deleted the disclosure requirements set forth in its *ASR No. 190* issued in 1976, once *SFAS No. 33* were to go into effect. In the 1980s, when the U.S. inflation rate subsided to a level of normalcy, the Board, in two stages, made the dual disclosures of the information on changing prices voluntary instead of required (Mednick, 1986, 48–50; Van Riper, 1994, 50–52).

Former FASB Chair Kirk (1988, 16) has said that *SFAS No. 33* was a “laboratory” for the Board’s conceptual framework project (see below). “It was the testing ground,” he said, “for the application of the current cost system to the most difficult of valuation problems – fixed assets – and the testing ground for the validity and utility of the concept of physical, rather than financial, capital.”

4.15 In 1979, the SEC Chief Accountant Pinpoints Standard Setters’ Principal Weakness

At a conference in 1979, just as the FASB was beginning to roll out its *Statements of Financial Accounting Concepts*, SEC Chief Accountant Clarence Sampson said that, in his view, “the inability of the [Committee on Accounting Procedure] and the APB to survive, as well as the current questions regarding the effectiveness of the FASB, is largely attributable to the lack of a comprehensive and meaningful conceptual framework” (Sampson, 1980, 17).

4.16 FASB Forms the EITF in 1984 to Propose Timely Guidance on Breaking Issues

In 1984, the FASB formed the Emerging Issues Task Force (EITF) to identify, discuss, and propose resolutions to the Board on breaking issues in financial reporting, and to propose timely guidance to the FASB for its approval. The Big 8 audit firms had been competing for clients over GAAP application issues, leading to a very low common denominator of application on their part and to a reputation for unsavory professional behavior. The EITF has been composed of some 15 members, drawn from the auditors, preparers, and users of financial statements. Depending on its workload, the EITF meets as frequently as every six to eight

weeks. A senior FASB staff person serves as chair. The SEC Chief Accountant or his deputy attend as an observer with the privilege of the floor, and their views are important in the development of its consensus positions. Soon after its formation, the EITF played an important role in recommending accounting treatment for the great variety of financial instruments, including derivatives, that were fashioned by Wall Street firms beginning in the middle 1980s (Miller and Redding, 1986, 131–133; Upton and Scott, 1988; Van Riper, 1994, 105–107).

4.17 In 1985, the FASB Concludes an Incomplete Conceptual Framework, Which is Partially Revised in 2010

From 1973 to 1985, the FASB labored to compose its conceptual framework. As mentioned above, it incorporated the Trueblood Study Group's recommended objective, enabling investors and creditors to estimate the amount, timing and related uncertainty of potential cash flows, into its framework. It also proposed a tradeoff between relevance and reliability, broached the novel idea of "comprehensive income," installed the asset-liability rationale, and defined assets and liabilities in terms of probable future economic benefits. The Board failed, however, to make meaningful or helpful recommendations for the attributes of the all-important issues of recognition and measurement (Miller, 1990). Whether, and to what degree, the Board has subsequently relied on its completed framework to make decisions about standards has been much discussed (Kirk, 1986, 8). But it was important to *have* one and to be able to cite it as authority.

In 2010, the FASB joined with the IASB to issue revised sections of the conceptual framework on the objective of financial reporting and the qualitative characteristics of useful financial information. As to the latter, it replaced reliability with faithful representation, perhaps to provide more scope for the use of fair value (Gore, 1992; Horngren, 1981; Solomons, 1986; Storey and Storey, 1998; Van Riper, 1994, 19–22, 74–81; Zeff, 1999, 2013).

4.18 SEC Chief Accountant Fails in 1986 to Move Toward a Requirement That All Oil and Gas Producers Use Successful Efforts Costing

In October 1986, SEC Chief Accountant Clarence Sampson asked the Commission to seek public comment on a proposal to mandate use of the successful efforts costing method in oil and gas producers' financial-statement filings. This was the method, requiring exploration companies to expense the cost of dry holes, which the FASB had favored by a 4 to 3 vote over full costing in *SFAS No. 19* in 1977 but was undercut by the SEC (see above). Sampson argued that requiring all oil companies to use the same method would promote comparability. The smaller oil companies vigorously lobbied the SEC, directly and indirectly, not to move ahead with the proposal. They enlisted the Energy Secretary and Interior Secretary in the Reagan Administration, plus oil-state lawmakers, to support their campaign. In the end, the Commission turned down the request from the Chief Accountant by a vote of 4 to 1 (Frazier and Ingersoll, 1986; Ingersoll, 1986).

4.19 In 1988, Clarence Sampson Becomes the First Ex-SEC Chief Accountant to Join the FASB

As he was nearing mandatory retirement age at the SEC, Clarence Sampson, the Chief Accountant, accepted the FAF's invitation to become the first holder of that office to become a member of the FASB, serving for $5\frac{1}{2}$ years. In 1992, Walter Schuetze, who had been one of the original FASB members from 1973 to 1976, served as SEC Chief Accountant from 1992 to 1995 (and in 1997 became Chief Accountant of the SEC's Enforcement Division), and in 2013 James L. Kroeker, who had recently served for three years as SEC Chief Accountant, became an FASB member and the Vice Chair. Many years before, Carman Blough, the SEC's first Chief Accountant, served on the Committee on Accounting Procedure from 1939 to 1942 and on the Accounting Principles Board from 1959 to 1964. William Werntz, the SEC's second Chief Accountant, was on the Committee on Accounting Procedure from 1950 to 1959, including the final three years as its Chair. Bringing

a former Chief Accountant on the accounting standard setter may have been seen by some as a way by which the body could raise its standing in the eyes of the Commission.

4.20 The Business Roundtable Attempts to Gain Control of the FASB in 1988, and to Slow It Down in 1990

In 1988 and again in 1990, The Business Roundtable, an association of the chief executive officers of some 200 major U.S. companies, began putting pressure on the FASB to be more attentive to industry's interest in the setting of accounting standards. It communicated its concerns both to the FAF and the SEC. The Roundtable's spokesman was John S. Reed, the Chair and CEO of Citicorp, then the largest U.S. bank, who chaired the Roundtable's Accounting Principles Task Force. He argued that the Board was undertaking too many projects, and included ones that did not need to be addressed. His particular concerns were the Board's plans to undertake standards on accounting for companies' post-retirement health benefits and on their accounting for employee stock options. In September 1988, Reed proposed the formation of a Financial Accounting Standards Oversight Committee, which was intended to control the Board's agenda. It would be composed of two companies' CEOs, two Big 8 audit firms' senior partners, the FASB Chair, the AICPA President, and an SEC Commissioner. But David S. Ruder, the SEC Chair, peremptorily rejected the proposal, which he said was supposed to "have the power to overrule [the Board's] proposed agenda items, cause re-examination of existing rules, and delete unproductive projects from the agenda." Ruder said that "the Commission now actively oversees all aspects of the FASB's activities" and that it would be "unacceptable" if it were constrained in this oversight by a private body.²

In 1990, Reed again raised his concerns, and he succeeded in persuading the FAF to change the required majority for the Board to approve

²Letter dated October 24, 1988 from David S. Ruder to John S. Reed, accessible from the Securities and Exchange Commission Historical Society (<http://www.sechistorical.org/>).

standards from 4-3 to 5-2. If Reed had hoped this more stringent majority would slow down the Board's progress, its practical effect was more likely to encourage the Board members to enter into more compromises so as to gain the necessary five votes (Kirk, 1990). Reed's lobbying for corporate control of the Board was repeated in the middle 1990s by the Financial Executives Institute (FEI), which will be seen below (Berton and Ricks, 1988; Loomis, 1988; Miller *et al.*, 2016, 236–238; Van Riper, 1994, 135–143).

In 2002, the FAF trustees changed the required majority to approve standards back to 4-3.³

4.21 FASB's OPEB Standard in 1990, While Opposed by the FEI, Actually Leads to More Rational Management of a Huge Liability

As part of its years-long project on accounting for pensions, the FASB developed a standard on “employers’ accounting for postretirement benefits other than pensions,” referring primarily to health care benefits which many companies had been promising to their employees in return for services performed, without booking an expense or any obligation on their balance sheets to reflect their considerable commitments in future years. The Board decided unanimously in *SFAS No. 106*, issued in December 1990, to put this “pay-as-you-go” (cash basis) accounting on an accrual basis, requiring recognition of compensation expense and the corresponding liability (Wyatt, 1990). The U.S. General Accounting Office (today the Government Accountability Office) estimated that the total unaccrued health care liability by U.S. corporations was \$221 billion. Loomis (1988, 106) wrote, “Booking these costs will be a revolution for most companies, which up to now have not been accruing anything for retiree health benefits.” The FEI resisted, if only because the standard would have “the single most stringent effect on the financial statements in recent accounting history” (Roy, 1990, 57).

Most of early adopters chose to recognize their full health care liability in one fell swoop, probably because the market usually does

³See the FASB's news release dated April 24, 2002 (<https://www.fasb.org/news/nr042402b.shtml>).

not penalize companies for one-time, non-cash charges. General Motors Corporation stood out among the early adopters. Its after-tax charge was \$20.8 billion, which was three-quarters of its shareholders' equity of \$27 billion. Chrysler Corporation's up-front charge of \$4.7 billion exceeded its Retained Earnings balance.

The OPEB standard (as it came to be called⁴) "had done Corporate America a huge favor in pointing up the future costs of its commitment to postretirement health care" (Van Riper, 1994, 149).

By having to book their liabilities, companies became strikingly aware of just how much in retiree health care benefits they had promised their employees over the years, and, as a result, began managing this fringe benefit much more rationally. It gave force to the maxim, "you manage what you measure" (Lowenstein, 1996, 1349). It has been reported that some companies pulled back on the benefits in their retiree health care plans, and others began a major overhaul of their health care promises to their employees, both as a result of *SFAS No. 106* (Flesher *et al.*, 2019, 64–65; Mittelstaedt *et al.*, 1995; Ripston, 1992). This standard has come to be regarded as one of the Board's successes.

4.22 From 1991 Onward, Former FASB Members and Users Assess the Board's Performance

Arthur Wyatt, a former Arthur Andersen & Co. partner, served on the FASB from 1985 to 1987, when he resigned because of a frustration over the growing pressure on the Board from the preparer community (Berton and Ricks, 1988). In 1991, he assessed the Board's record as follows (Wyatt, 1991b, 211):

Overall, FASB's performance is mediocre at best. Maybe the expectations were too high and the forces asserted against its moving in the proper direction were too strong. Board decisions are too slow in evolving and too much time is devoted to issues of lesser significance. FASB issues standards that

⁴OPEB derived from "other postemployment benefits," which was a name subsequently used to refer to *SFAS No. 106*.

are too detailed. Sorely needed guidance on broad matters has been delayed to deal with trivial issues. The Board is too willing to compromise. It gets weary from the aggregative effect of intense criticism.

In 1998, Dennis Beresford, who was the FASB Chair from 1987 to 1997, wrote a valedictory article in which he gave a much rosier assessment. He said, “I was tempted to say that the Board’s singular accomplishment is that it has *survived* for a quarter century, longer than either of its predecessors” (Beresford, 1998b, 154; emphasis in the original). In regard to institutional matters, he cited seven accomplishments, of which three were the following: “The Board has been able to achieve reasonable independence and has *not* become subservient to the SEC, the business community, or the accounting profession”; the Board “has not shied away from controversy”; and “An exhaustive set of due-process operating procedures has been established and continues to evolve as needs arise” (1998, 154; emphasis in the original). Yet David Mosso, who served on the Board from 1978 to 1987 and then stayed on as Assistant Director of Research until 1996, has claimed that one of the Board’s fundamental problems is “excessive due process. The present form of due process causes delay beyond reason – it takes far too long to complete a standard-setting project” (Mosso, 2009, 33). Robert Herz, the FASB Chair from 2002 to 2010, has said, “The word *glacial* has sometimes been used by critics to describe what they perceive as an unacceptable slow pace of the FASB” (Herz, 2016, 372; emphasis in original). Moreover, the Association for Investment Management and Research (AIMR, today the CFA Institute), a major user group, wrote in 1993, “we are convinced that, if anything, the FASB is too concerned with due process and sunshine. In many cases, the system has acted to slow almost to a halt the pace at which new standards are issued. The stages seem excruciatingly slow on occasion” (AIMR, 1993, 83). SEC Chief Accountant Michael H. Sutton (1996a) echoed that view in February 1996.

Whether the Board was, or was not, “subservient” to the SEC and to the business community can be debated, but, as will be seen, the business community defeated the Board on accounting for employee

stock options in *SFAS No. 123*, and the Board backed off from issuing its preferred standard in 1995 on the advice of the SEC Chair.

Mosso (2009, 33) further argued that “the current standard-setting process is broken” and said that “A second problem is conflict of interest. Entities that issue public financial statements and have their performance judged by those statements, have far too much influence on the standard-setting process.” Was this Beresford’s subservience?

4.23 SEC Sets a Precedent by Hosting a Conference in 1991 and a Symposium in 1996 on Accounting for Market Values and Intangibles

Historically, the SEC has deferred to the standard setter to sponsor public meetings on controversial accounting principles. But in November 1991 and again in April 1996, the SEC held a conference and symposium, respectively, on market value accounting and accounting for intangibles (Miller, 1992).⁵ The former’s principal sponsor was SEC Chair Richard C. Breeden, and the latter’s was SEC Commissioner Steven M. H. Wallman, both lawyers. The views of academics, preparers, government officials, and users, among others, were explored with a view toward stimulating active consideration of reforms by the accounting standard setter. While the use of fair value for financial instruments was a persistent theme at the Board in the 1990s, the taste at the Board for exploring a fuller accounting of intangible assets was limited to getting rid of pooling of interests (see below).

4.24 Banking Community Forces the FASB in 1993 to Dilute a Standard on Requiring Mark-to-Market for Investments in Marketable Securities

In September 1990, SEC Chair Breeden began urging that standard setters require financial institutions to value their holdings of marketable securities at market value, with the unrealized gains and losses taken to reported earnings. Encouraged by Breeden’s rhetoric, the FASB began

⁵The transcript of the proceedings of the April 1996 symposium is held by the AICPA Library at the University of Mississippi.

proceeding in that direction, but it was resolutely opposed by bankers and the bank regulators. Many banks have large portfolio holdings in debt securities, and they and their regulators did not want their earnings, and capital, to be depressed by market losses or be made more volatile by the swings between gains and losses. The Treasury Secretary, Nicholas F. Brady, argued in a letter to the FASB in March 1992, “This proposal could have serious, unintended effects on the availability of credit as well as on the stability of the financial system, and I strongly urge the FASB not to adopt it at this time.”⁶ Alan Greenspan, the Chair of the Federal Reserve Board, also opposed the proposal, as did hundreds of banks. In the face of this pressure the Board felt that it had no choice but to compromise. It partitioned marketable equity and debt securities into “trading,” “available for sale,” and “held to maturity,” and the holders of the securities were to decide upon their classification. The unrealized gains and losses would be taken to income if classified as “trading,” and be lodged in shareholders’ equity if classified as “available for sale.” No gains and losses would be recognized if a debt security were classified as “held to maturity.” Reflecting this three-part classification, the Board approved *SFAS No. 115*, “Accounting for Certain Investments in Debt and Equity Securities,” which was issued in October 1993 (Berton, 1992; Johnson and Swieringa, 1996; Kirk, 1991; Schultz and Hollister, 2003; Worthy, 1992; Wyatt, 1991a).

The Board was not pleased that the unrealized gains and losses under “available for sale,” which turned out to be the most popular among the classifications, were not reported in a statement of financial performance, such as the income statement. In 1997, mainly because of its unhappiness with the compromise classifications in *SFAS No. 115*, the Board attempted to issue a standard calling for the reporting of unrealized gains and losses on “available for sale” securities as part of “other comprehensive income” in a statement of performance, borrowing a notion from its conceptual framework. Yet industry successfully lobbied the Board to allow, as an option, other comprehensive income also to be reported in the Statement of Changes in Equity, which is not a

⁶Letter dated March 24, 1992, from Treasury Secretary Nicholas F. Brady to Mr. Dennis R. Beresford, Chairman, Financial Accounting Standards Board. In the author’s files.

statement of financial performance, in *SFAS No. 130*, issued in June 1997. When implemented, the great majority of companies chose this latter option.

Finally, in June 2011, the Board issued *Accounting Standards Update (ASU) No. 2011-05*, which required that the reporting of such gains and losses be in a statement of performance (Detzen, 2016).

4.25 FASB is Forced by Industry Pressure and Congress to Back Down in 1995 on Mandating the Expensing of Employee Stock Options

In 1992, the FASB set about developing a standard to require companies to expense the cost of employee stock options on the grant date, using an option pricing formula, but high tech companies strenuously objected and secured support from key members of Congress. Many high tech companies compensated most of their employees with stock options, and they feared the hit to their earnings from such a standard. The high tech industry thereupon mounted a nationwide campaign of intimidation against the FASB, including appeals to Congress and even President Clinton. Members of the House and the Senate introduced bills either instructing the SEC not to enforce any expensing standards issued by the FASB, or, by those few on the other side, to require the SEC to enforce any such Board standard. On May 3, 1994, the Senate went so far as to approve a “sense of the Senate” resolution by a vote of 88 to 9 in opposition to mandatory expensing, and then, as if in expiation, resolved by a vote of 94 to 2 “not to impair the objectivity and integrity” of the FASB. Following further pressure from Congress and from most of industry (including The Business Roundtable), the FASB, on advice received from SEC Chair Arthur Levitt not to imperil its very existence, relented.⁷ In *SFAS No. 123*, issued in October 1995, an anguished Board allowed companies the option to disclose in a note the impact of the expense on earnings (Beresford, 1996; Miller *et al.*, 1998; Mozes,

⁷In a later book, Levitt (2002, 110) wrote, “In retrospect, I was wrong. I know the FASB would have stuck to its guns had I not pushed it to surrender.” In his meeting with the Board, Levitt signified that the SEC supported the Board’s recommended accounting. Recollection furnished by Dennis R. Beresford in a communication to the author, dated April 1, 2021.

1998, 137–142; Zeff, 1997). All but two public companies, Boeing and Winn-Dixie, opted for disclosure in a note.

During the course of this high stakes drama, Warren E. Buffett (1993), the widely respected American investor, famously said:

If options aren't a form of compensation, what are they? If compensation isn't an expense, what is it? And, if expenses shouldn't go into the calculation of earnings, where in the world should they go?

4.26 SEC Chair Levitt Dictates Changes in FAF Membership in 1996 So as to Protect the FASB from Assaults from Industry

In January 1996, FEI President P. Norman Roy began pressuring the FAF trustees to restructure the FASB so that it would become more responsive to business interests. He argued in a letter to J. Michael Cook, of Deloitte & Touche, the FAF Chair, that “the FASB process is broken and in need of substantial repair” (Miller *et al.*, 1998, 186). SEC Chair Arthur Levitt was copied on the letter, and he was interested in how the trustees would respond to the FEI’s list of demands for structural change in the FASB. When he saw that the trustees did not rebuff the FEI and that the managing partners of the largest audit firms did not speak out and defend the Board, he joined the correspondence. He wrote to Cook in April 1996, saying that he wanted to be advised “of the steps that the FAF is prepared to take to assure that a majority of its Board of Trustees consists of individuals with strong public service backgrounds who are able to represent the public interest, free of conflict” (Miller *et al.*, 1998, 189). At that time, the FAF’s membership was mostly representative of the sponsoring organizations, and included eight preparers, four auditors, one user, and only three public representatives. Levitt said he wanted the FAF to add several additional public interest representatives. When the FAF trustees balked at this proposal, Levitt insisted, implying that he would use his full statutory authority, if necessary, to bring about the change in membership. The trustees finally gave in, and by the end of the 1996 two of the membership positions allotted to preparers were dropped and four public interest representatives, approved by Levitt, were named as new members of the FAF (Miller *et al.*, 1998, 186–192).

On the heels of this episode, Levitt was consulted by the FAF when considering the appointment of Edmund Jenkins to chair the FASB for a term beginning on July 1, 1997.⁸

4.27 FASB Overcomes Banks' Appeal to Congress in 1997 and Approves a Standard on Derivatives and Hedging

For some time, the SEC had been pressing the FASB to issue a standard on accounting for derivative instruments and hedging activities. In June 1996, the Board issued an exposure draft, and it held four days of public hearings in November. The Board was heading toward the required use of fair value for derivatives, with non-hedged gains and losses taken to earnings. The banking community did not like what it saw, and it launched one of its vaunted drives to thwart the FASB. In October 1997, Floyd Norris, the chief financial correspondent of *The New York Times*, aptly summed up the challenge:

the campaign is on to kill the F.A.S.B. The banks are furious over the new derivatives rule, which would force users of derivatives to record the market value of those instruments in their financial reports. The banks say the rule will confuse investors and scare off some companies that would benefit from using derivatives. They have lobbied hard in Congress, and both the House and Senate have held hearings to bash the F.A.S.B. on the issue. Last week, John Reed, the chairman of Citicorp, called for abolishing the F.A.S.B. and transferring its duties to the S.E.C.

Two bills were introduced in Congress to prevent the FASB from moving ahead, but they died aborning. Undaunted, a unanimous Board issued *SFAS No. 133*, "Accounting for Derivative Instruments and Hedging Activities," in June 1998. Once again, those objecting to the direction the Board was taking appealed to Congress, but this time to no avail (Beresford, 1998a).

⁸Recollection furnished by Michael H. Sutton in a communication to the author, dated April 7, 2021.

4.28 FASB's Public Hearings Evolve into Roundtable Discussions in the 1990s and Early 2000s

Until as late as 1999, the FASB usually held public hearings for major projects. For those that were highly controversial, as many as 300 or 400 people might attend. By the early 1990s, some on the Board and at least one of the FAF's sponsoring organizations had come to believe that the public hearings had become too confrontational, as Board members might pointedly question certain presenters on why they believed what they did. To overcome this problem, the Board began experimenting with roundtable discussions, which were much smaller, and the mix of those who volunteered to be presenters and those whom the Board invited to present produced more of a dialogue among preparers, auditors and users. By 2004, roundtable discussions supplanted public hearings as the usual forum for obtaining a large sampling of written and oral views on discussion papers or exposure drafts. For some projects, the Board has held multiple roundtable discussions.

4.29 U.S. Senator Prompts FASB in 2000 to Consider Changing Goodwill Accounting in SFAS No. 142

Shortly after Michael Sutton, a former Deloitte partner, became SEC Chief Accountant in June 1995, he believed that *APB Opinion No. 16*, which set forth the attributes of business combinations qualifying for pooling of interests treatment, had some major design flaws. In an August 1996 speech, he said,

Since the publication of APB 16 in 1970, continuing consideration of business combination issues has required 39 formal interpretations published by the AICPA; three FASB interpretations, and one FASB Technical Bulletin; more than 50 Emerging Issues Task Force Issues; four Accounting Series Releases published by the Commission and at least eight staff accounting bulletins.

(Sutton, 1996b)

He said that “roughly thirty percent of the [SEC's] staff time on registrant inquiries was devoted to pooling of interest accounting.” Sutton

made the case to the FASB that pooling of interests should be added to its agenda, and the Board dutifully complied (Interview with Mike Sutton, 2005, 66–67).

The Board, after extensive deliberations, issued an exposure draft in September 1999 which called for dispensing with pooling of interests accounting altogether and requiring the amortization of goodwill over no more than 20 years, down from 40 years in *APB Opinion No. 17*. Industry protested both these recommendations, and succeeded in bringing their objections to the attention of Senators and members of the House of Representatives, and a pair of hearings were held. In the Senate, during a roundtable held in June 2000 by Phil Gramm (Republican, Texas), Chair of the Banking Committee, he conceded that purchase accounting was superior to pooling of interests accounting, but he reiterated his earlier suggestion that an impairment test for goodwill should be used instead of amortization. This suggestion was made in the presence of FASB Chair Edmund Jenkins. Then, after redeliberating the goodwill proposal in its 1999 draft, and conducting further research, the Board issued a revised exposure draft in February 2001 which said that goodwill should no longer be amortized but that it should instead be tested for impairment. This latter position was reaffirmed in *SFAS No. 142*, issued in June 2001. *SFAS No. 141*, issued at the same time, did away with pooling of interests accounting (Beresford, 2001; Schneider *et al.*, 2001; Zeff, 2002, 50–51). The Board, and one supposes the SEC, were relieved that their long experience with pooling of interests accounting, covering five decades, was finally behind them. But was this at the cost of effectively allowing business to escape amortization of goodwill by an optimistic application of the impairment test?

4.30 Sarbanes-Oxley Act of 2002 Instructs the SEC to Designate an Accounting Standard Setter to Set GAAP

In the wake of the accounting and auditing issues raised in both the Enron collapse in late 2001 and the WorldCom scandal in June 2002, plus others, Congress passed the Sarbanes-Oxley Act of 2002 by the

end of July.⁹ This legislation, among other things, set up the Public Company Accounting Oversight Board, which was concerned with auditing, not accounting. Several important provisions of the Act dealt with accounting. Section 108(a) instructed the SEC to designate a private-sector accounting standard setter that meets certain requirements, including recognition of the need for its standards to reflect “the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors.” The Act also provided that the designated standard setter was to be funded by an “annual accounting support fee” levied on issuers after approval of the amount by the SEC, based on its review of the FASB’s budget. It was believed by some that the standard setter could become compromised by having to rely mainly on voluntary contributions from self-interested donors. These references in the Act were the first mention in federal legislation of an accounting standard setter.

The FASB hoped that the SEC would move swiftly to designate it as the standard setter, so that the FAF could gain access to the funds from the annual support fee. But SEC Chair Harvey L. Pitt insisted on a *quid pro quo*: a greater SEC hand in setting the FASB’s agenda, SEC access to confidential Board papers, and SEC influence in the selection of FAF trustees and Board members.¹⁰ FASB Chair Herz resisted this attempt at asserting greater control over the Board, as did two Commissioners, who believed that the Board should retain its autonomy and independence. It was not until Pitt left the Commission in mid-February 2003, having announced his resignation under fire the previous November, and was succeeded as Chair by William H. Donaldson, that progress was made toward the designation (Burns, 2003; Herz, 2016, 53–54; Labaton, 2002).

⁹Even before approval of the Act, the FASB drew attention to two bills introduced in Congress in March 2002 that, if passed, would have hamstrung the Board (FASB News Release, 2002).

¹⁰SEC Chair Pitt had already involved himself in the selection of the FASB Chair. Robert Herz has revealed that, in early 2002, Pitt and SEC Chief Accountant Robert K. Herdman asked him to consider becoming the FASB Chair, which, in the end, he did (Herz, 2016, 42).

In April 2003, the SEC announced the designation of the FASB in *Release 33-8221*, saying that “the FASB will continue its role as the preeminent accounting standard setter in the private sector.”¹¹ Yet one of Pitt’s demands was retained, albeit less intrusive than he likely had in mind. In the release, the Commission made it clear that it planned to monitor closely the selection of candidates for appointment to the FAF and the FASB:

The FAF and FASB should give the Commission timely notice of, and discuss with the Commission, the FAF’s intention to appoint a new member of the FAF or FASB. While the FAF makes the final determinations regarding the selection of FASB and FAF members, we believe that to fulfill our statutory responsibilities we should provide the FAF with our views and that the FAF should consider those views in making its final selection. The Commission, FAF, and FASB share the belief that the qualifications and appropriateness of each member of the FAF and the FASB are critical if the FASB is to continue to be a premier private-sector standards-setting body. (footnote omitted)

Section 108(d) of the Act called upon the Commission to “conduct a study on the adoption by the United States financial reporting system of a principles-based accounting system.” The study was to include an examination of “the length of time required for change from a rules-based to a principles-based accounting and financial system” and of the feasibility of implementing such a system. In early 2002, both SEC Chair Pitt and Chief Accountant Robert K. Herdman had spoken in favor of a move by the FASB from rules-based to principles-based accounting standards (e.g., Herdman, 2002; Pitt, 2002), following testimony given by IASB Chair David Tweedie to the Senate Banking Committee on February 14, chaired by Paul S. Sarbanes (Democrat, Maryland), in which Tweedie vaunted the merits of his board’s principles-based approach

¹¹For the SEC release, entitled “Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter,” see https://www.sec.gov/rules/policy/33-8221.htm#P59_9943.

(Camfferman and Zeff, 2015, 73).¹² In July 2003, the SEC published its staff study which recommended that accounting standards should be developed using a principles-based approach, having the following characteristics (SEC press release, 2003):

- Be based on an improved and consistently applied conceptual framework;
- Clearly state the accounting *objective* of the standard;
- Provide sufficient detail and structure so that the standard can be operationalized and applied on a consistent basis;
- Minimize the use of exceptions from the standard;
- Avoid use of percentage tests (“bright-lines”) that allow financial engineers to achieve technical compliance with the standard while evading the intent of the standard. (emphasis in the original)

Yet the FASB’s subsequent standards did not seem to be much influenced by this exhortation (Benston *et al.*, 2006).

Section 401(b) of the Act instructed the SEC to issue rules to require that companies reporting “pro forma financial information” (i.e., non-GAAP reporting) reconcile their non-GAAP figures with the corresponding GAAP figures. In January 2003, the SEC issued *Release 34-47226*, “Conditions for Use of Non-GAAP Financial Measures,” which required this reconciliation under the new *Regulation G*.

Section 401(c) of the Act, inspired by Enron’s faulty reporting of special purpose entities (SPEs), instructed the SEC to submit a report on the reporting of off-balance sheet transactions. In June 2005, the SEC published a staff report on off-balance sheet arrangements and SPEs, coauthored by the Office of the Chief Accountant, the Office of Economic Analysis, and the Division of Corporation Finance (*Report and Recommendations*, 2005). Among the staff’s recommendations were that the FASB move away from rules-based standards, “which can provide a roadmap to avoidance of the accounting objectives inherent

¹²For the view of an FASB member on principles-based standard setting, see Schipper (2003).

in the standards”; that the Board reexamine lease accounting and its consolidation policy (including the treatment of SPEs); that it explore the feasibility of reporting all financial instruments at fair value; and that it develop a disclosure framework to enhance the transparency in the notes to the financial statements. The FASB eventually issued standards dealing with consolidations, SPEs, and lease accounting, and on fair valuing more financial instruments.

Enron and its cousin scandals took a toll on the reputation of U.S. GAAP. *The Economist* wrote in January 2002, “The Enron scandal shows that America can no longer take the pre-eminence of its accounting for granted” (The Real Scandal, 2002). In May 2002, it added, “the body of accounting rules in America has become both too detailed and too easy to circumvent” (Badly in Need of Repair, 2002).

4.31 FASB and IASB Pledge in 2002 to Converge Their Standards, Where Practicable

In October 2002, the FASB and the recently established International Accounting Standards Board (IASB), based in London, signed the Norwalk Agreement. SEC Chief Accountant Robert Herdman had urged the two boards to collaborate in this way. Under this accord, the two standard setters “pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.”¹³ Both boards began holding two joint meetings each year and succeeded in converging numerous of their standards during the term of the agreement (Camfferman and Zeff, 2015, 75–77; Herz, 2016, 119–134). Beginning in 2009, the G20 forum of governments and central bank governors from 19 countries and the European Union issued communiqués in which they urged the FASB and IASB to accelerate their international convergence (Camfferman and Zeff, 2015, 548–556; Herz, 2016, 154–158, 162, 204–205). The agreement formally ended in 2017, but the two

¹³For the Norwalk Agreement, see the two boards’ joint news release dated October 29, 2002 (<https://www.fasb.org/news/nr102902.shtml>).

boards have continued to meet annually in order to continue carrying out its terms.

4.32 FASB, Facing Heavy Opposition, Succeeds in Issuing an Expensing Standard on Employee Stock Options in 2004

In November 2002, the FASB proposed that it launch a project to produce, at long last, an expensing standard for employee stock options. The Board was encouraged by the progress that the IASB was making on a similar standard. Earlier in 2002, Warren Buffett persuaded his colleagues on the boards of directors of Coca-Cola Company and The Washington Post Company to expense the cost of stock options under *SFAS No. 123*. General Electric Company soon followed suit. These developments were promptly picked up in the financial press and attracted the active interest of institutional investors and shareholder groups, and a movement began to build momentum. By early 2004, more than 800 companies had opted to do the same (McConnell, 2004). All of this occurred in the national “glow” following Enron and WorldCom that accounting is important and must be done right. Yet the FASB ran up against staunch opposition from the same sources as in the early 1990s. Numerous unfriendly Congressional hearings were held, and bills were introduced to defeat the Board’s attempt to require the expensing of employee stock options.

In July 2004, the House of Representatives passed an anti-FASB bill by a vote of 312 to 111, but, fortunately for the Board, the Chair and Ranking Member of the Senate’s Banking Committee, Richard C. Shelby (Republican, Alabama) and Paul Sarbanes, respectively, supported the Board’s initiative and refused even to consider the House bill. Moreover, SEC Chair William Donaldson, Chief Accountant Donald T. Nicolaisen, and Deputy Chief Accountant Scott A. Taub “stood shoulder to shoulder” with the Board throughout the course of the stock compensation project (Herz, 2016, 109). The Board received thousands of comment letters, most of them form letters, in opposition to its March 2004 exposure draft, which called for expense recognition. Finally, in December 2004 the FASB unanimously issued *SFAS No. 123(revised 2004)*, “Share-Based Payment,” in support of mandatory expensing. The Board adopted the

same title for its standard that the IASB had used in its final standard, also in support of mandatory expensing, in February 2004 (Farber *et al.*, 2007; Herz, 2016, Chap. 3; Weil and Cummings, 2004). Convergence had occurred.

4.33 During the Financial Crisis of 2007–2009, Banks Press the FASB for Mark-to-Market Reform

In 2008–2009, in the midst of the Financial Crisis, a controversy emerged over whether the FASB’s requirements for the use of fair value accounting had contributed to the Crisis. On October 3, 2008, Congress mandated the SEC to conduct a study of mark-to-market accounting standards and their application to financial institutions. On December 30, 2008, the SEC responded by publishing a major staff study prepared by its Office of the Chief Accountant and Division of Corporation Finance (*Report and Recommendations*, 2008). Gibson Dunn (2009) synthesized the study’s findings as follows:

The report concludes that fair value accounting standards should not be suspended, but makes eight recommendations to improve their application, including additional guidance for determining fair value in inactive markets. The report finds that investors generally believe fair value accounting increases transparency and facilitates investment decision-making. The report also observes that fair value accounting did not appear to play a meaningful role in the bank failures of 2008, but rather that those failures appeared to be the result of growing probable credit losses, concerns about asset quality and eroding lender and investor confidence. (footnote omitted)

Yet, during a time of plunging stock markets and falling prices of real estate-related assets, banks and other financial institutions wanted to see a rollback, or at least a softening, of the FASB’s fair value requirements used to record writedowns of assets in disorderly markets. On March 12, 2009, a House subcommittee held a hearing on mark-to-market accounting, and invited FASB Chair Robert Herz and the SEC’s Acting

Chief Accountant, James Kroeker, to attend. The hearing was, in large measure, stage-managed by the American Bankers Association (Pulliam and McGinty, 2009). Paul E. Kanjorski (Democrat, Pennsylvania), the subcommittee Chair, set the tone for the hearing in his opening statement:

We can, however, no longer deny the reality of the procyclical nature of mark-to-market accounting. It has produced numerous unintended consequences, and it has exacerbated the ongoing economic crisis. If the regulators and standard setters do not act now to improve the standards, then the Congress will have no other option than to act itself. (*Mark-to-Market Accounting: Practices and Implications*, 2009)

A week earlier, subcommittee member Ed Perlmutter (Democrat, Colorado) had introduced legislation to call for creation of a five-member Federal Accounting Oversight Board, to be headed by the Federal Reserve Board Chair, with membership also from the Chairs of the SEC, the PCAOB, and the Federal Deposit Insurance Corporation, and the Secretary of the Treasury. It was charged to approve and oversee accounting standards for purposes of federal financial regulatory agencies. Even though Perlmutter's bill eventually died in committee, it was nonetheless a shot across the bow.

During the hearing, several subcommittee members, one after the other, demanded prompt remedial action from the FASB, within the space of just three weeks. To comply, the Board worked long hours in conditions of abridged due process to revise its guidelines on determining fair values in inactive markets and on accounting for, and presenting, impairments of debt. The Board completed them on April 9, in time to be used in first quarter reports (Herz, 2016, 246–256; Howieson, 2011; Revsine *et al.*, 2021, 8–28 to 8–31).

4.34 Recommendations by the SEC's Advisory Committee on Improvements to Financial Reporting in 2008

In August 2008, the SEC's Advisory Committee on Improvements to Financial Reporting rendered its final report. The committee, which

was chaired by Robert C. Pozen, chair of MFS Investment Management in Boston, was established by the SEC in June 2007 to make recommendations on how financial reporting could become less complex and more useful to investors (SEC, 2007). Among its many recommendations was that the FASB should establish a program of post-adoption review of significant new standards. In 2010, the FAF trustees launched just such a post-implementation program. The Pozen Committee (as it was called) also supported the earlier SEC staff recommendation that the FASB develop a disclosure framework, which led to an FASB discussion paper, “Disclosure Framework,” issued in 2012 (Herz, 2016, 303–317). The Pozen Committee also emphasized the importance of giving preeminence to investor perspectives in the standard-setting process (*Final Report of the Advisory Committee on Improvements to Financial Reporting*, 2008). The FASB’s lack of attentiveness to investor perspectives has continued to be an issue to the present day.¹⁴

4.35 SEC Proposes a Rule in 2008 to Require U.S. Issuers to Adopt IFRS, But It is Not Carried Forward

In August 2008, the SEC approved a proposed rule containing a roadmap to require U.S. issuers to adopt International Financial Reporting Standards (IFRS) in a series of stages culminating in 2014, but, because of growing controversy over the wisdom of this move and the onset of the Financial Crisis, the Commission never proceeded to implement the rule (Becker *et al.*, 2020; Camfferman and Zeff, 2015, 194–199, 505–517).

¹⁴See the letter dated October 26, 2020 from the Alliance of Concerned Investors to the SEC Chair and Commissioners, which alleges that the interests of investors are given insufficient attention by the FASB, especially in its agenda-setting process. The letter was re-sent to the SEC Chair and Commissioners, following the installation of Chair Gary Gensler, on April 19, 2021. The letter may be accessed at https://www.dropbox.com/s/6ccwdzvcej7sqcx/AOCI%20SEC%20Letter%2010_26_2020.pdf?dl=0.

4.36 FASB Launches Its *Accounting Standards Codification* in 2009

In June 2009, after the FASB had issued 167 *Statements of Financial Accounting Standards* and seven *Statements of Financial Accounting Concepts*, as well as *Technical Bulletins*, *Staff Positions*, and *Interpretations*, the Board unveiled its *Accounting Standards Codification*.¹⁵ The *Codification* was intended to simplify user access to the approximately 8,000 pages of GAAP through a single database, organized into some 90 topical groupings. The *Codification* also includes the relevant guidance issued by the SEC. Only the literature included in the *Codification* is authoritative GAAP, thus making the previously issued GAAP hierarchy inoperative. The FASB's future changes in GAAP have been in the form of *Accounting Standards Updates*; as few as seven and as many as 29 have been issued in the years since then.

4.37 FAF Creates Private Company Council in 2012 to Propose Standards to the FASB

In 2012, the FAF set up the Private Company Council to propose improvements in financial reporting by private companies.¹⁶ Its proposals must be endorsed by the FASB, and the Board has since approved several standards applicable to private companies.

4.38 In 2020, Congress Twice Postpones the Effective Date of the FASB's CECL Requirement for Debt Securities

In 2016, the FASB replaced the "incurred loss" model for "held to maturity" debt securities with the "current expected credit loss" (CECL) approach, which requires the holder of the securities to estimate the

¹⁵See "FASB Accounting Standards Codification," dated July 1, 2009, at https://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=900000011088.

¹⁶See "Financial Accounting Foundation Establishes New Council to Improve Standard Setting for Private Companies," dated May 23, 2012, at https://www.accountingfoundation.org/cs/ContentServer?c=FAFContent_C&cid=1176160049265&d=&pagename=Foundation%2FFAFContent_C%2FFAFNewsPage.

likely future losses over the future contractual life of the instrument. The “incurred loss” approach, which called for the losses to be recognized when probable, was criticized for recognizing the losses “too little, too late.” In 2020, Congress twice passed legislation – the CARES Act in March and the Consolidated Appropriations Act in December – each containing a provision to postpone the effective date by as much as one year of the FASB’s CECL requirement for recognizing credit losses on “held to maturity” debt securities by banking institutions (other than large SEC registrants).¹⁷ Neither the FASB nor the SEC believed that such postponements were justified. Community banks and credit unions have been vocal critics of the CECL approach because of its alleged procyclicality and adverse impact on lending capacity, and they were active in pressing members of Congress for relief. A House subcommittee held a hearing in January 2020 to reproach FASB Chair Russell G. Golden over the standard (Reosti, 2020).

This was yet another example of those objecting to an FASB recommendation, either in prospect or already issued, enlisting the support of members of Congress to thwart the Board. This practice of turning to Congress in such circumstances grew more commonplace in the 1990s.

¹⁷See “New Law Provides Option to Delay Implementing the Updated CECL Standard,” dated January 11, 2021, at <https://ssflp.com/new-law-provides-option-to-delay-implementing-the-updated-cecl-standard/>.

5

Conclusions

An attempt to draw useful conclusions from the foregoing historical evolution of U.S. regulation and the standard-setting process over a period of some 90 years is fraught with challenge. As American society has evolved over that long time span there has been fundamental change in the regulatory institutions, the professions and professional bodies, the sophistication of corporate enterprise and financial institutions, information technology, and the markets. Comparisons of regulator and standard setter behavior between the 1930s and 1940s on the one hand and the 1990s and 2000s on the other cannot be made without stating many caveats. While the Securities and Exchange Commission (SEC) has been in existence for more than 85 years, it is a very different institution today than it was only 30 or 40 years ago. Like other important institutions, it has grown and developed in the scope and complexity of its duties. On the accounting side, the Financial Accounting Standards Board (FASB) is the third in a series of three accounting standard setters since the late 1930s.

Nonetheless, some inferences might be ventured. During the terms of the Committee on Accounting Procedure and the Accounting Principles Board, from 1939 to 1973, both of which were housed within the AICPA

and were composed of part-timers with a small full-time support staff, the SEC Chief Accountants may have believed that they had to monitor their deliberations and final recommendations carefully and critically in order to protect investor interests. Government regulators have often suspected that the true aims of private sector oversight bodies may not always be consonant with the public interest. From 1935 to 1972, the first four Chief Accountants were disposed, more often than not, to interpose their own beliefs about sound accounting and disclosure when overseeing the work of the standard setter. These first four Chief Accountants were career civil servants who had joined the Commission's staff between 1934 and 1938, and they were possessed by a strong sense of mission. Only two later Chief Accountants were career civil servants (Clarence Sampson and Edmund Coulson), but they had joined the Commission's staff in 1959 and 1975, respectively. And since the 1990s, the Chief Accountants have, more often than not, been recruited from major audit firms, and they remained in their post for no more than two or three years. They then entered retirement or returned to the private sector – the well-known revolving door through which most SEC Chairs and Commissioners, and many other senior staff, have also passed over the decades.

With the establishment in 1973 of the full-time, independent FASB, to be supported by a large staff, thus implementing the recommendation of a study group chaired by an ex-SEC Commissioner, the SEC was perhaps prepared to treat the new body almost as an equal. For the first time, the Commission publicly announced its support of the accounting standard setter. But the FASB arrived during the term of an activist Chief Accountant, Sandy Burton, who had studied accounting at Haverford College under Philip W. Bell, one the leading advocates of current cost accounting (Edwards and Bell, 1961).¹ During the inflationary 1970s, after the FASB had proposed the use of general price-level (GPL) accounting in supplementary disclosures, Burton countered with replacement cost accounting and thus overruled the Board. While GPL figures would have been easier to audit, Burton believed that replacement cost

¹One gauge of Burton's activism was the number of *Accounting Series Releases* which the Commission issued during his four-year term: 68, compared with 125 which had been issued previously, going back to 1937 (Sack, 2012, 151).

accounting was more relevant to company experience. Within three years, the FASB issued a standard which allowed the SEC to withdraw its release.

In another unusual case in the 1970s, the SEC overruled the FASB on accounting for oil and gas exploration costs. Yet this decision resulted from the need by the members of the Commission to hold public hearings, as called for by Congressional legislation. The Commission's members were not accountants and held no intellectual attachment to historical cost accounting. During the extensive hearings, they were persuaded by arguments that current values, not historical costs, of the oil and gas reserves were meaningful. They then rejected the FASB's advice that a historical cost solution should be adopted and decided instead to require the use of current values – contrary to more than three decades of SEC aversion to the use of current values in the body of the financial statements.

Since those two episodes, the SEC has not publicly countered the FASB on a standard-setting issue. Yet one never knows what goes on behind the scenes. In the subsequent major controversies over accounting for other postemployment benefits, marketable securities, employee stock options (twice), pooling of interests and goodwill, and CECL for debt securities, the SEC either supported the Board or did not interpose a contrary view, at least publicly. Since the rocky 1970s, the relationship between the SEC and the FASB has seemed to mature into one of genuine mutual respect and consultation.

Because of the FASB's elaborate due process, there are ample opportunities for the SEC Chief Accountant or his deputy to meet informally with FASB and staff members at periodic EITF and FASAC meetings, as well as on the sidelines during public hearings and roundtable discussions. The AICPA's annual Conference on SEC and PCAOB Developments, in Washington DC, provides another occasion for such exchanges. The line of communication between the SEC and the Board enables the two bodies to arrive at common understandings prior to announcing positions.

Two factors that may have helped shape the contemporary relationship between the SEC and the FASB are the Commission's proactive role, since 2003, in vetting the candidates for appointment to the FAF

and the FASB, as well as the SEC's funding of the Board by levying an annual accounting support fee on issuers. Both of these reforms are traceable to the Sarbanes-Oxley Act of 2002.

In former times, it was the SEC that the standard setter had to face up to over the direction it was taking in its deliberations. Since the 1990s, however, when the preparer community began regularly appealing to members of Congress to fortify its opposition to a proposed or actual Board standard, the government body which the Board has had to confront publicly has been Congress, not the SEC.

Acknowledgments

I thank Jonathan Glover for extending the invitation to write this article and for providing advice and encouragement after reading the drafts. I am also grateful to the anonymous reviewer for making excellent suggestions for improvement.

Appendix

Appendix A

A.1 SEC Chief Accountants

December 1935–May 1938	Carman G. Blough*
May 1938–April 1947	William W. Werntz*
April 1947–November 1956	Earle C. King*
November 1956–January 1972	Andrew Barr*
June 1972–September 1976	John C. (Sandy) Burton*
August 1978–December 1987	A. Clarence Sampson*
January 1988–January 1991	Edmund Coulson
January 1992–March 1995	Walter P. Schuetze*
June 1995–December 1997	Michael H. Sutton
July 1998–August 2001	Lynn E. Turner
October 2001–November 2002	Robert K. Herdman
September 2003–October 2005	Donald T. Nicolaisen*
August 2006–January 2009	Conrad W. Hewitt
August 2009–July 2012	James L. Kroeker
December 2012–September 2014	Paul A. Beswick
October 2014–July 2016	James V. Schnurr*
November 2016–May 2019	Wesley R. Bricker
July 2019–February 2021	Sagar Teotia
*Deceased	

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