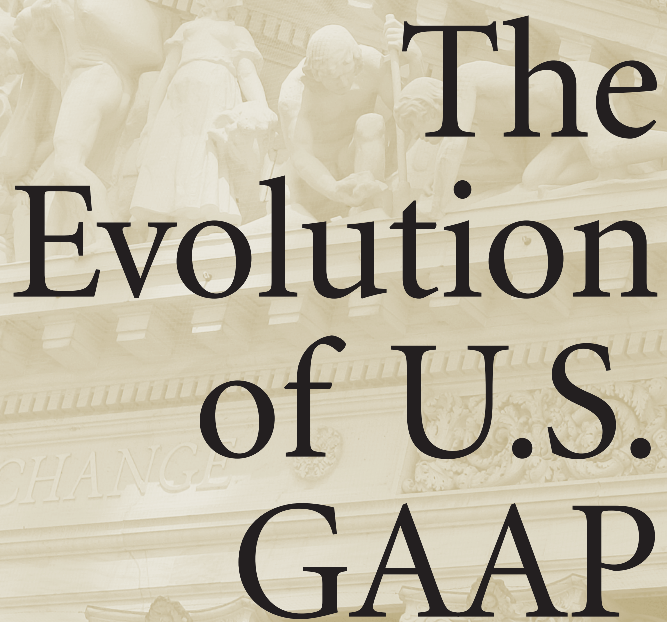
75 YEARS
In Focus

Part 1: 1930–1973

Harnessing Capital Markets and Driving Growth



The Evolution of U.S. GAAP

The Political Forces Behind Professional Standards

By Stephen A. Zeff

As we enter the fifth year of a new millennium, which is also the 75th year of publication for *The CPA Journal*, an assessment of the path of accounting standards setting over the previous 75 years should enhance our ability to deal responsibly with the challenges of the next decades. This commentary on the evolution of U.S. GAAP will be presented in two parts. The first covers the years from 1930 to 1973. The second, which will appear in the February issue, covers the years from 1973 to the present. The commentary and analysis should be interpreted in the context of several important concurrent trends in business and economics over the same time period:

- The expanding public interest in accounting standards, reflecting increased participation in the equity capital markets and improvements in the coverage of accounting by the financial media.
- The increased incidence of business combinations, creating multinational and conglomerate enterprises.
- The great volatility of equity markets and enterprise performance.
- The increased pressure placed on corporate executives for revenue and earnings performance, leading to the emergence of "managed earnings."
- The arrival of the postindustrial economy, which is oriented toward services rather than manufacturing, and the increasing importance of intangible assets, which are largely absent from company balance sheets.

In the following comments on noteworthy developments in U.S. GAAP from 1930 to 1973, the focus is deliberately on incidents that represented important changes in practice or in the way in which accounting principles and standards were set. The incidents are typically those for which interesting stories can be told about the underlying factors that led to the developments. Many of these stories involve efforts by the preparers of financial statements, or by a branch of government, to engage politically to promote their narrow interests: for example, to present a more favorable earnings picture or to promote the effectiveness of government fiscal policy. This is not to imply that U.S. accounting standards do not truly reflect the application of sound concepts, undiluted by political lobbying; many do. But because these principled standards have emerged in a natural progression from underlying concepts, their stories often are not as interesting—or as revealing about the influence that government and the broader business climate have on the accounting profession—as those standards that have been driven by politics.

1932–1933

Following the stock market crash of 1929, an American Institute of Accountants' (AIA) special committee, in correspondence with the New York Stock Exchange, recommends five "broad principles of accounting which have won fairly general acceptance" and introduces the phrase "[the financial statements] fairly present, in accordance with accepted principles of accounting consistently maintained" in the auditor's report. These five broad principles, along with a sixth, are approved by the AIA membership. The purpose is to improve accounting practice.

Comment. The AIA committee said in its recommendation, "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." This policy reflected that of Price, Waterhouse & Co., a firm with British roots, which advocated a "disclosure" approach to accounting policy choice.

1934–1935

Congress completes approval of two major Securities Acts to restore public and investor confidence in the fairness of the securities markets after the stock market crash of 1929, and creates the Securities and Exchange Commission (SEC) with authority to prescribe "the methods to be followed in the preparation of [financial] reports." The SEC becomes a strict regulator and insists on comparability, full disclosure, and transparency. In 1935, the SEC creates the Office of the Chief Accountant. The SEC insists upon historical cost accounting so that the financial statements do not contain "misleading disclosures."

One of the important units created in the SEC is the Division of Corporation Finance (DCF), which is charged with reviewing filings by companies to determine whether they satisfy the SEC's requirements, especially for conformity with proper accounting, full disclosure, and comparability.

Comment. The United States is the only country where the government regulator charged with securing compliance with GAAP was established and began its operations before an entity was created to determine GAAP. In most other countries, an entity to determine GAAP was established years or even decades before the government created a regulator to secure compliance with GAAP, if such a regulator exists.

The DCF reviews the financial statements in both periodic filings (on a sampling basis) and prospectuses. The DCF writes deficiency letters to companies, raising questions about certain accounting and disclosure practices. If the company cannot satisfy the DCF's concerns, the company must revise and reissue its financial statements accordingly. If the company were to fail to do so, the SEC can stop the trading of the company's securities or forbid the public offering of its securities. No securities commission anywhere in the world possesses and uses such extensive authority to regulate financial reporting as the SEC.

From its founding, the SEC rejected any deviation from historical cost accounting in the body of financial statements. This position was a reaction to a widespread practice during the 1920s (prior to federal regulation) wherein listed companies would revalue their assets upward, often based on questionable evidence of market value. The abuse of this discretion, especially in the public utility field, was alleged to have misled investors when judging the values of their shares prior to the crash of 1929. The SEC was determined not to allow a repetition of this abuse of judgment. The SEC's unyielding policy on historical cost accounting persisted until 1978, when, for the first time, it proposed a requirement that oil and gas reserves be periodically revalued, with the change taken to earnings.

1936

The AIA publishes *Examinations of Financial Statements*, which introduces the term "generally accepted accounting principles," known as GAAP.

1938

The SEC issues its first *Accounting Series Release*, which conveys its views on accounting and auditing. (The series becomes known as *Financial Reporting Releases* in 1982.)

1938–1939

The SEC, by a narrow vote, supports a reliance on the private sector to establish GAAP. Under pressure from the SEC's chief accountant, the AIA's Committee on Accounting Procedure (CAP) begins issuing Accounting Research Bulletins (ARB) to provide the SEC with "substantial authoritative support" for proper accounting practice. The CAP is composed of 18 practitioners and three accounting academics, all serving on a part-time basis, with a small research staff. Dissents are to be recorded.

Comment. The SEC has never delegated authority to establish accounting principles, or to set accounting standards, to the private sector. By law, it cannot delegate that authority. It has typically said that it looks to the private sector for leadership. The SEC can overrule the private-sector body, and its accounting staff has regularly maintained frequent contact with the CAP and its successors. (The Sarbanes-Oxley Act of 2002 finally permits the SEC to recognize a private sector account-

TIMELINE:

Generally Accepted Accounting Principles have evolved over the past 75 years alongside increased participation in the public equity market, increased pressure on business growth and performance, and expanding public interest in accounting standards.

1932

In the wake of the 1929 stock market crash, public confidence in financial reporting is further undermined by the "Match King" pyramid scheme scandal perpetuated by Swedish businessman Ivar Kreuger. [1]

ing standards setting body and establishes a public funding mechanism for it.)

1938–1939

Congress permits companies to use a new inventory method, LIFO (last in first out), for income tax purposes, but only if LIFO is also used in all corporate reports. There is immediate pressure to allow LIFO for financial reporting purposes.

Comment. This is one of the very few instances in which tax policy has influenced GAAP. Congress acted in 1938 to avoid penalizing corporate taxpayers that purchased nonferrous metals, such as copper, zinc, or antimony, whose price fluctuated widely. LIFO availability was expanded in 1939 for use by all corporate taxpayers. Under FIFO (first in, first out), they paid excessive income taxes in some years and were not able to obtain refunds in loss years, because of the time lag between purchase and sale. Because LIFO was a novel accounting method, Congress was skeptical of its validity as a measure of income; hence, it imposed the LIFO conformity rule. Companies wanted to save taxes by using LIFO, and placed great pressure on the accounting profession to also accept it for financial reporting purposes, which it did.

1939

An AIA committee recommends the wording "present fairly … in conformity with generally accepted accounting principles" in the standard form of the auditor's report.

Comment. Unlike the United Kingdom, where the "true and fair view" is stipulated in the Companies Acts as the overriding standard that financial statements must attain, "present fairly" in the United States has never been mentioned in federal legislation related to the auditor's opinion. As a practical matter, "in conformity with generally accepted accounting principles" has implied "present fairly." The term "principles" in GAAP refers to both principles and practices.

1940

The American Accounting Association (AAA) publishes Professors W.A. Paton and A.C. Littleton's monograph *An Introduction to Corporate Accounting Standards*, which is an eloquent defense of historical cost accounting. The monograph provides a persuasive rationale for conventional accounting practice, and copies are widely distributed to all members of the AIA. The Paton and Littleton monograph, as it came to be known, popularizes the matching principle, which places primary emphasis on the matching of costs with revenues, with assets and liabilities dependent upon the outcome of this matching.

Comment. The Paton and Littleton monograph reinforced the revenue-and-expense view in the literature and practice of accounting, by which one first determines whether a transaction gives rise to a revenue or an expense. Once this decision is made, the balance sheet is left with a residue of debit and credit balance accounts, which may or may not fit the definitions of assets or liabilities.

The monograph also embraced historical cost accounting, which was taught to thousands of accounting students in universities, where the monograph was, for more than a generation, used as one of the standard textbooks in accounting theory courses.

1940s

Throughout the decade, the CAP frequently allows the use of alternative accounting methods when there is diversity of accepted practice.

Comment. Most of the matters taken up by the CAP during the first half of the 1940s dealt with wartime accounting issues. It had difficulty narrowing the areas of difference in accounting practice because the major accounting firms represented on the committee could not agree on proper practice. First, the larger firms disagreed whether uniformity or diversity of accounting methods was appropriate. Arthur Andersen & Co. advocated fervently that all companies should follow the same accounting methods

1934–1935

Congress completes approval of two major Securities Acts to restore public and investor confidence in the securities markets after the stock market crash of 1929, and creates the Securities and Exchange Commission. Joseph Kennedy appointed as first SEC Chairman.

1935

Carman G. Blough (right) becomes the first SEC chief accountant. The SEC insists upon historical cost accounting so that the financial statements do not contain "misleading disclosures." [2]

in order to promote comparability. But such firms as Price, Waterhouse & Co. and Haskins & Sells asserted that comparability was achieved by allowing companies to adopt the accounting methods that were most suited to their business circumstances. Second, the big firms disagreed whether the CAP possessed the authority to disallow accounting methods that were widely used by listed companies.

1947

The CAP issues ARB 29, which allows FIFO, LIFO, and average costing for inventories; LIFO is accepted primarily because of its acceptability for income tax purposes.

Comment. This was the practical effect of the pressure brought by major companies in the late 1930s and early 1940s to allow LIFO as part of GAAP. In ARB 43, which in 1953 codified the previous ARBs on accounting, LIFO was again allowed as an accepted accounting method, and it still is today.

1947

The CAP issues ARB 32, which favors the current operating performance concept of the income statement, displaying unusual and extraordinary items after net income; the SEC chief accountant, favoring the all-inclusive income statement, threatens not to enforce the ARB.

Comment. This difference in view reflected the SEC's skepticism that companies could be trusted to use balanced and fair-minded judgment to distinguish between ordinary and extraordinary items in the income statement.

1947–1950

Despite pressure from some major companies, the CAP opposes use of inflation-adjusted depreciation expense except in supplementary disclosures, a view that the SEC supports. The CAP reaffirms this view in 1953. In 1947 to 1949, major companies try to persuade Congress to allow replacement cost depreciation for income tax purposes, and they hope that an ARB in support of that position would strengthen their argument. The companies are also trying to resist labor unions' claims for wage increases based on overstated profits during a period of sharp inflation.

Comment. A deeply ingrained belief in historical cost accounting facilitated the CAP's decision to reject the recording of inflation-adjusted depreciation in income statements, contrary to the lobbying by major companies. The CAP knew, moreover, that the SEC would not allow companies to use inflation-adjusted depreciation in determining income even if it had approved of the practice. It was important to CAP members to retain its credibility with the SEC.

In 1950, the CAP attempted to propose an upward revaluation of assets for companies in inflationary times, using as an analogy the accepted accounting method of revaluing assets downward (today's impairments) for companies facing severe financial and economic difficulties. But the SEC made it known that it would oppose any upward valuations, and the CAP abandoned its attempt.

1954

Congress amends the Internal Revenue Code (IRC) to allow companies to use accelerated historical cost depreciation for income tax purposes. Many companies adopt faster depreciation for taxes but continue to use straight-line depreciation for financial statements, making deferred tax accounting an important issue.

Comment. This was an indication that Congress and the Treasury Department shared the SEC's view that deviations from historical cost accounting were to be avoided because they were difficult to monitor. Therefore, the legislation allowed accelerated historical cost depreciation, which, it was assumed, would approximate replacement cost depreciation in the early years of an asset's useful life. This was a belated attempt by Congress to meet companies' criticisms that they were being taxed on capital. This difference between depreciation for accounting and for income tax purposes is what led the CAP to discuss whether deferred tax accounting was appropriate, or indeed required, when the difference was due solely to timing.

1950s

Leonard Spacek, the managing partner of Arthur Andersen & Co., begins to criticize the CAP for allowing alternative accounting methods. This reflects a philosophical split among big accounting firms: uniformity versus flexibility.

Comment. Spacek became a frequent critic of the CAP's reluctance to reduce, or eliminate, the number of optional accounting methods.

1957

In ARB 48, the CAP allows the pooling-of-interests method for business combinations in the presence of certain "attendant circumstances."

Comment. This was one of several controversial subjects that the CAP attempted to address during the 1950s in the face of criticism for allowing optional accounting methods. The pooling-of-interests method was advocated by companies engaging in mergers and acquisitions so that they would not have to revalue (usually upward) the carrying amounts of merchandise inventories and fixed assets acquired and thus reduce the amount of current and future earnings for the combined entity. In ARB 48, the CAP established a number of criteria for distinguishing between poolings

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and purchases, but it was not long before these criteria were largely ignored and only weakly enforced by the SEC.

1958

In ARB 44 (Revised), the CAP favors deferred tax accounting when tax depreciation exceeds depreciation for financial reporting purposes.

Comment. This was a courageous bulletin on a controversial subject, yet it dealt only with the tax and financial reporting differences relating to depreciation, and it was not expressed as categorically as some would have liked. The CAP did not specify whether the deferred tax credit account was a liability or part of shareholders' equity. Shortly afterward, the SEC's chief accountant asked the CAP to clarify the balance-sheet treatment of the credit. The country's largest electric power company subsequently brought a lawsuit to enjoin the CAP from issuing the clarification, alleging that classification of the credit as a liability would cause irreparable injury to the company because of an adverse effect on its debt-equity ratio. The U.S. Supreme Court ruled that the CAP had the right to give its opinion on the matter. The CAP then announced that the deferred tax credit should be shown as a liability. This incident illustrates how far an industry critic can go when attacking the authority of the entity that establishes accounting principles.

1958–1960

Provoked by Spacek's criticisms, the Institute (known as the American Institute of Certified Public Accountants, or AICPA, from 1957 onward) appoints a special committee to review the role of research in establishing accounting principles. The committee proposes an Accounting Principles Board (APB) to succeed the CAP. The APB comes into existence in 1959 as a senior technical committee of the Institute, and by the following year its 21 members include representatives from all of the Big Eight accounting firms, as well as accounting academics, financial executives, and other accounting practitioners. Dissents are again to be recorded. The APB is charged with "narrowing the differences in accounting practice," which effectively means "stop allowing so many optional treatments."

The AICPA Council insists that all of the Big Eight firms be represented on the APB. The AICPA also creates an Accounting Research Division that is to conduct research to support the APB Opinions. Eventually, 15 Accounting Research Studies are published under the aegis of the APB.

Comment. Because of the increasing pressure from companies on members of the CAP, it became evident that company financial executives had to be brought into the process for establishing GAAP. Consequently, for the first time financial executives were appointed to the committee responsible for establishing proper accounting practice. As with the CAP, all of the members of the APB had to be CPAs. Toward the end of the APB's life, a financial analyst was appointed to the board.

It was a time when Americans were placing their faith in research. In 1957, the Soviet Sputnik had beaten the United States into space, and America responded by taking major steps to enhance the quality of education in the sciences and engineering, and also to strengthen the country's research base in all technical fields. This support carried over into other fields, including accounting. The new APB was expected to prepare and issue research studies prior to developing its Opinions, and its first research assignment was to develop a conceptual framework as the basis for its future work. Research, it was believed, was the most promising means for resolving the intractable philosophical differences between leaders of the accounting profession.

1961–1962

The APB's accounting research staff issues Accounting Research Studies 1 and 3, on basic accounting postulates and broad accounting principles. They are intended to constitute the conceptual basis for future APB Opinions that will narrow the areas of difference. The study on principles, however, advocates current value accounting for inventories and fixed assets, which, the APB asserts in a special Statement, is "too radically different from present [GAAP] for acceptance at this time." Studies 1 and 3 fail in their mission to serve as the conceptual basis for future APB Opinions.

Comment. Once again, the central question of historical cost accounting versus current value accounting was raised. The SEC chief accountant, as well as two previous chief accountants, all of whom served on the advisory panel for Studies 1 and 3, expressed their unqualified opposition to any deviation from historical cost accounting. Because of the way in which CPAs had been educated since at least the late 1930s, few knew anything about current value accounting, and they often rejected it because it went beyond their acquired expertise. In the 1960s, a number of leading accounting academics—Baxter, Edwards and Bell, Solomons, Chambers, and Sterling—wrote articles and treatises advocating one or another version of current value accounting, but their messages were not received favorably by firms, the SEC, or the APB.

1962–1963

After Congress enacts an investment tax credit in order to stimulate the purchase of equipment and machinery by companies, the APB issues Opinion 2 (in a close vote, four of the Big Eight dissent), which

1954

Congress amends the Internal Revenue Code to allow companies to use accelerated historical cost depreciation for income tax purposes. Many companies adopt faster depreciation for taxes but continue to use straight-line depreciation in their financial statements, making deferred tax accounting an important issue.

1957

In ARB 48, the CAP allows the pooling-of-interests method for business combinations in the presence of certain "attendant circumstances." The CAP established a number of criteria for distinguishing between poolings and purchases, but it was not long before these criteria were largely ignored and only weakly enforced by the SEC.

requires that the credit be subtracted from the asset cost and not be included in current earnings. Under pressure from accounting firms, industry, and the Kennedy Administration, the SEC announces it will allow either accounting method to be used by companies. The APB is similarly defeated on accounting for the credit on two subsequent occasions, in 1967 and 1971, because of intense lobbying by industry.

Comment. The SEC's decision embarrasses the APB. This was the first instance in which both government and industry opposed an ARB or an APB Opinion. The controversy and discord stirred by this episode led the financial press to pay more attention to financial reporting than ever before. In turn, this coverage made companies more aware of the APB's efforts to reduce accounting options, which companies interpreted as meaning the removal of some of their flexibility in the choice of accounting methods. To many, the disagreement over the accounting treatment of the investment tax credit, which arose on three occasions between 1962 and 1971, was the epitome of political interference in the establishment of accounting principles. In the government's view, it was a matter of providing companies with an incentive, including an accounting incentive, to stimulate the growth of the economy. The companies themselves wanted to report higher accounting earnings in times of an economic malaise.

1964

APB Opinion 5 establishes criteria for the capitalization of financing leases by lessees, but few lessees actually capitalize the cost and recognize the corresponding liability for long-term financing leases. The leasing industry had opposed a stronger set of criteria.

Comment. Leasing as an instrument for long-term financing became a growth industry in the 1950s. One of the appealing arguments made by the leasing industry was that the leasing of long-lived assets, instead of issuing bonds and buying them, would keep the asset and the corresponding liability off the lessee's balance sheet. Thus was born off–balance sheet financing. Protecting its own self-interest, the leasing industry lobbied the APB not to establish accounting principles that would make leasing less attractive to potential lessees.

1960s

The U.S. securities market begins to become even more competitive, and the decade is one of numerous multinational and conglomerate mergers. The financial press begins following accounting controversies more closely. The SEC Chairman begins criticizing the APB for not narrowing the areas of difference in accounting practice, and suggests that, if the APB does not do so, the SEC will do so itself.

Comment. Congress had authorized the SEC in 1934 to establish proper accounting practice, and in the 1960s the SEC was becoming impatient with the APB's slow progress in promoting comparability. The SEC's usual way of inciting the APB into more aggressive behavior was to threaten that it might begin establishing accounting principles itself. Leaders of the accounting profession were united in the view that this process should remain in the private sector. Of course, the SEC did issue occasional Accounting Series Releases on accounting matters, and it could exercise influence over the general direction of the APB's deliberations. The SEC was not a passive observer of the process, but it preferred that the private sector take the initiative for establishing accounting principles. Moreover, the accounting firms were willing to underwrite the substantial cost of the process through their support of the AICPA.

1966

APB issues Opinion 8, which establishes the principle that pension liabilities during the period of employee service be shown in balance sheets, but the application of the Opinion does not result in many companies reporting more pension liabilities.

1966, 1973, 1974, 2002

The treatment of unusual or extraordinary items had always been fraught with difficulty. In Opinion 9, on reporting the results of operations, the APB finally endorses the SEC's preferred all-inclusive income statement, although it says that extraordinary items should be reported separately. Companies had preferred to place extraordinary news that was bad in the earned surplus statement, and extraordinary news that was good in the income statement. Under APB Opinion 9, companies began rationalizing good news as ordinary and bad news as extraordinary. In 1973, APB Opinion 30 establishes a "Discontinued Operations" section of the income statement and defines extraordinary so narrowly that the classification no longer exists as a practical matter. In 1974, FASB's SFAS 4 designates gains and losses on the premature extinguishment of debt as extraordinary. In 2002, SFAS 145 rescinds SFAS 4.

Comment. This sequence of developments served to confirm the SEC's belief that companies could not be trusted to use their discretion to make balanced and fair-minded judgments on accounting treatments when given such flexibility.

1967

APB issues Opinion 11, on deferred tax accounting by the thinnest majority, which narrows the areas of difference on this contentious subject.

Comment. This was one of the APB's successes. Industry opposed this pronouncement

1957

In 1957, the Soviet Sputnik had beaten the United States into space, and America responded by taking major steps to enhance the quality of education in the sciences and engineering, and also to strengthen the country's research base in all technical fields. This support carried over into other fields, including accounting.

1959

In a development provoked by Leonard Spacek's criticisms, the APB comes into existence in 1959 as a senior technical committee of the AICPA (formerly known as the AIA).[4]

vociferously, and companies placed pressure on their audit firms to vote against it. Several days after the final vote was cast, one of the Big Eight members in the majority signified that it was changing its vote. The Opinion was already being printed, and the APB's decision had been announced. To resolve this crisis, the AICPA president called an urgent meeting of the APB members and managing partners of the Big Eight, where it was made clear that once a vote was cast at a board meeting, it was final. In the end, it was agreed that the original vote to approve the Opinion would stand. This vividly illustrates the pressures that would build on the major accounting firms when optional accounting methods were to be disallowed in an Opinion.

The process of narrowing the areas of difference was a wrenching experience within the accounting profession, because some firms, including Price Waterhouse and Haskins & Sells, opposed the Opinion because they disagreed in principle with deferred tax accounting.

1967

APB issues Statement 2, on segment reporting. Because the issue is so sensitive among companies, due to the many conglomerate mergers, the APB does not mandate that companies disclose segment revenues and profits. The Financial Executives Institute (FEI) undertakes a major research study on the subject whose purpose is to persuade the SEC not to make any hasty rules on the sensitive subject.

But in 1969, because of the APB's failure to issue an Opinion, the SEC adopts a segment reporting requirement for new issuers, and later extends it to all companies filing annual reports. In 1976, FASB, the APB's successor body, will issue a standard on the subject.

Comment. Mergers and acquisitions during the 1960s created conglomerate, or diversified, enterprises. The question arose: How well were their respective product lines performing in these new combinations? Citing competitive reasons, the companies did not wish to disclose their revenues or earnings by product line. Investors nonetheless sought out that information. Because of pressures from industry, the APB could only manage to issue a nonbinding Statement, not a binding Opinion, on the subject. The pressure on the SEC to take action itself came not from the user community, but from Congress.

In 1966, the Senate Subcommittee on Antitrust and Monopoly held a public hearing on the economic efficacy of conglomerate mergers. One of its witnesses, an economist, contended that it was difficult to evaluate their effectiveness without information about the profitability of their product lines. The subcommittee's chairman asked if the SEC would be requiring the public disclosure of such information, and the SEC chairman said that it had no such plans but that it possessed the authority to do so. Not long thereafter, reacting to pressure from the subcommittee's chairman (who was a powerful figure in Congress), the SEC chairman made it known that he wanted to see the private sector take the lead in recommending disclosures of conglomerate companies' product-line information. Statement 2, weak though it was, was the APB's response. Although FEI sponsored a major research study to provide the SEC with guidance, in the end, the SEC acted unilaterally.

1968

The SEC requires, for the first time, a Management's Discussion and Analysis of Operations (MD&A), a narrative discussion of the risks and uncertainties facing a company, including their implications for its future liquidity and solvency. In 1974, 1980, and later, the SEC expands the required disclosures to be contained in the MD&A.

Comment. The economic environment and the makeup of business enterprise were becoming increasingly complex and more susceptible to unpredictable change, both domestically and internationally. The SEC concluded that investors required a narrative discussion of risks and uncertainties that could not be conveyed in the financial statements and footnotes.

1962–1964

Under pressure from accounting firms, industry, and the Kennedy Administration, the SEC overrules APB Opinion 2. This was the first instance in which both government and industry opposed an ARB or an APB Opinion. Philip Defliese (right) joins the APB in 1964. [5]

1967

APB issues Statement 2 on segment reporting. Because the issue is so sensitive among companies, due to the many conglomerate mergers, the APB does not mandate that companies disclose segment revenues and profits.

1970

The APB issues Opinions 16 and 17, on business combinations and intangibles, following intense lobbying by industry and government either for or against the pooling-of-interests accounting and the mandatory amortization of goodwill over a defined useful life. Pooling of interests is continued in specified circumstances, and the APB minimizes the negative impact on net income by amortizing intangibles over 40 years.

Comment. Coming at the end of a decade marked by a record number of mergers and acquisitions, Opinions 16 and 17 were preceded by unprecedented corporate lobbying. The FEI blanketed the nation's press with news releases critical of the APB, and lobbied Congress and the SEC as well. One branch of government advocated the elimination of pooling-of-interests accounting, if only to stem the tide of mergers and acquisitions. The Big Eight themselves were divided and were under pressure from their audit clients. A final vote, by the narrowest majority, in support of an Opinion on business combinations and goodwill was thwarted when one of the Big Eight changed its mind several weeks after the vote was taken. In order to obtain sufficient majorities on both subjects, the subjects had to be treated in two Opinions, drafted at the last minute. No one was satisfied with the high-pressure environment in which these matters were resolved.

1970

The APB issues Statement 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*. This was originally intended to be a mandatory Opinion, and was to be the successor to the APB's failed conceptual framework, Accounting Research Studies 1 and 3. By issuing an advisory Statement, the APB betrays the deep division of opinion among its members over the formulation of a conceptual framework.

Comment: Arthur Andersen & Co. held strongly the view that progress could not be made on controversial accounting issues until the APB agreed on the objectives of financial statements. The firm counted on the APB to issue an Opinion on this subject, and when it issued a nonauthoritative Statement instead, the Arthur Andersen partner serving on the APB dissented.

1970–1971

Three of the Big Eight are so critical of the intense political lobbying of the APB leading up to Opinions 16 and 17 that they announce they have lost confidence in the APB as a source of principles for sound financial reporting. Criticisms such as these prompt the AICPA to establish the Wheat Study Group, on the establishment of accounting principles, and the Trueblood Study Group, on the objectives of financial statements.

Comment. The 1970s were a decade when Corporate America and, in some cases, the government, consistently thwarted the APB's proposed Opinions. Company executives were awakening to the strategic importance of flexibility in the choice of accounting methods, especially when engineering, or defending against, company takeovers. Questions were raised whether a part-time board, such as the APB, could stand up against such pressures, because the accounting firms represented on the board had clients with vested interests in the outcome of the board's deliberations. Many observers concluded that research had not contributed to a resolution of difficult accounting questions, as few of the APB's Accounting Research Studies seemed to have an impact on the board's thinking.

1971

The APB is successfully pressured by industry not to proceed with possible Opinions on accounting for marketable securities (opposed by the insurance industry), for long-term leases (opposed by the leasing industry), and for the costs of exploration and drilling of oil and gas (opposed by the petroleum industry). The leasing industry went to members of Congress to prevent the APB from taking action.

Comment. Although the APB always held its meetings behind closed doors, it gradually opened its process to symposia and then to public hearings, so that interested parties could express their views in person rather than only by writing letters of comment on exposure drafts. All three subjects taken up in 1971 were accorded public hearings. Industry opponents continued to be vociferous. The leasing industry organized a national letter-writing campaign to more than 50 members of Congress, arguing that the APB was injuring industry's ability to raise funds for expansion and modernization. After many of the Congressional recipients pointedly inquired of the SEC why the APB would create a hardship on industry, the SEC advised the APB to postpone further action.

1971

For the third time, industry prevents the APB from requiring that the investment tax credit be amortized over the useful life of the purchased equipment and machinery instead of being taken immediately into earnings. Congress passes legislation authorizing companies to use any method of accounting for the credit.

Comment. This was the ultimate denouement for the APB, and it came in December, during the later stages of the Wheat Study Group's deliberations. This legislation continues to be valid law today, although the

1968

The SEC requires, for the first time, a Management's Discussion and Analysis of Operations (MD&A), a narrative discussion of the risks and uncertainties facing a company, including their implications for its future liquidity and solvency.

1970–1971

No-confidence votes from three of the Big Eight prompt the AICPA to establish the Wheat Study Group, led by Commissioner Francis M. Wheat (right) on the establishment of accounting principles, and the Trueblood Study Group, on the objectives of financial statements.

credit was reduced to 0% in 1986 and thus is no longer a taxation issue.

1971–1972

The Wheat Study Group, appointed in 1971 by the AICPA, recommends that an independent, full-time standards-setting body, the Financial Accounting Standards Board (FASB), which would be overseen by a Financial Accounting Foundation, should replace the part-time APB. FASB will have a large research staff, follow an elaborate due process, and have a sizable budget, financed by donations to the Foundation and the sale of publications. Dissents are to be recorded. The AICPA approves this recommendation in its entirety in 1972.

Comment. FASB began operations on July 1, 1973. It was the first full-time accounting standards-setting body in the world, and it was hoped that the members' separation from their former employers would assure their independence of mind. To project an air of independence, FASB's office was deliberately set in Connecticut, outside of New York City, where many corporate headquarters were located, and outside of Washington, where the SEC was located. FASB was endowed with a much larger full-time research staff than had been available to the APB; it eventually increased in size to more than 40. FASB was also the first accounting standards setter to be established apart from the organized accounting profession, and not everyone in the AICPA's leadership liked giving up one of its most important functions, the setting of accounting standards. Unlike the CAP and the APB, FASB members did not have to be CPAs (two of the initial seven members were not). The Financial Accounting Foundation raised all of the FASB's funding from the private sector.

1972

John C. (Sandy) Burton, an accounting professor, becomes the first SEC chief accountant who had not served on the SEC's accounting staff in the 1930s. He is not imbued with the SEC's philosophical attachment to historical cost accounting. Burton was to become an activist chief accountant during his term (1972–1976). It would not be until 1992 that the SEC again hired a chief accountant who had not come up through the SEC staff ranks. After 1992, all of the chief accountants would be from accounting firms or industry.

Comment. Burton had studied at Haverford College, where he was exposed to the teaching of Professor Philip W. Bell, who was a leading advocate of current cost accounting. Burton's background became important in the inflationary decade of the 1970s, when he preferred replacement cost accounting to FASB's preference for general price-level accounting.

Burton was an activist chief accountant and an articulate spokesman. During his term, the Commission issued 70 Accounting Series Releases (more than a third of which dealt with financial reporting), compared to 126 Releases issued during all of the period from 1937 to 1972. He said that he and FASB had a policy of mutual nonsurprise, by which each would not catch the other by surprise. Yet he surprised FASB by declaring that, while FASB should take the lead on issues of recognition and measurement, disclosure was primarily the province of the SEC. Many believed, however, that measurement and disclosure were interrelated.

1973

After the APB hastily issues Opinion 31, which requires lessees to disclose certain rental data for noncapitalized leases, the SEC, in Accounting Series Release 147, responds by requiring lessees to disclose the present value of financial leases and the impact on the lessee's earnings. This SEC initiative provides a transition toward SFAS 13 three years later, which may have been made somewhat easier to issue because lessees were already calculating and disclosing the present values of their financial lease commitments in footnotes.

Comment. This Release exemplified Burton's reliance on disclosure to deal with a sensitive accounting matter. To most company executives, disclosure is not threatening. Yet financial analysts thrive on disclosure. One of the enduring findings of the many years of capital market research in accounting is that disclosure is a substantive issue. Yet executives and accountants refer to "mere" disclosure, rather than changing the contents of the balance sheet or income statement, which in their minds are truly substantive. ❑

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1: Photo Courtesy of Dale Flesher, University of Mississippi.

2–7: Photos courtesy of The Accounting Hall of Fame at Ohio State University.

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1971–1972

The Wheat Study Group recommends that an independent, full-time standards-setting body, FASB, which would be overseen by a Financial Accounting Foundation, should replace the part-time APB. Marshall Armstrong (right) is named the first Chairman of FASB. [6]

1972

John C. (Sandy) Burton, an accounting professor, becomes the first SEC Chief Accountant who had not served on the SEC's accounting staff in the 1930s. He is not attached to historical cost accounting. [7]