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The Wheat Study on Establishment of Accounting Principles (1971–72): A historical study

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ABSTRACT

The 1972 report of the Wheat Study on Establishment of Accounting Principles became the blueprint for the Financial Accounting Standards Board (FASB), which began its official operations on July 1, 1973, succeeding the Accounting Principles Board. The FASB was the world's first independent, full-time standard-setting board which was not organized within the accounting profession. This paper is an attempt to understand the crisis in standard setting that led up to the appointment of the Wheat Study, as well as the main elements in the Study's process of examining the milieu of the APB, securing views from a wide range of interested parties, and fashioning its report, including the roles played by the different members of the study group.

1. Introduction

The aim of this paper is to come to understand the circumstances which led to the establishment in 1972 of the Financial Accounting Standards Board (FASB), which was the world's first independent, full-time accounting standard setter. The paper examines the run-up to the appointment by the American Institute of Certified Public Accountants (AICPA) of the Wheat Study on Establishment of Accounting Principles in 1971 and the study group's conduct of its inquiry and the development of the recommendations in its report, Establishing Financial Accounting Standards (1972).[1] This paper is

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[1] The report is accessible online at http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156777828.

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based on published and unpublished materials and an interview with the lone surviving member of the study group.

The paper unfolds by discussing the sequence of controversial and widely criticized pronouncements issued by the Accounting Principles Board (APB) from 1967 to 1970, followed by the AICPA's decision to deal with this "crisis of confidence" by appointing two study groups: one to look into a better way of establishing accounting principles, and another study group to propound a set of objectives of financial statements. The remainder of the paper examines the selection of the members of the first of these two study groups, the organization of its work, the results of its public hearing, the development of the recommendations in its report, and, finally, the swift acceptance and implementation of the recommendations by the AICPA.

2. The crisis over the establishment of accounting principles that led to the appointment of the Wheat Study

Under pressure from the Securities and Exchange Commission (SEC) to make the difficult decisions to rid GAAP of alternative practices (Zeff, 2007a, pp. 14–21), the part-time APB, which was a senior technical committee of the AICPA, had its busiest and most contentious period from 1967 to 1970. During that span, it barely approved Opinion 11 on income tax allocation by the required two-thirds majority, 12 to 6, which was followed by an omnibus Opinion and then by Opinion 13, making Opinion 9, on reporting the results of operations, applicable to commercial banks. Opinion 14, with four dissents, was issued in March 1969, which declared that none of the proceeds from the issuance of convertible debt securities should be accounted for as attributable to the conversion feature, which overturned a provision in Opinion 10. Then, in the highly criticized Opinion 15, the board at some length and in considerable detail, with three dissenting members, prescribed how to calculate primary and fully diluted earnings per share, with a 30-page appendix of "computational guidelines," and to define "residual securities," a term introduced in Opinion 9. Two leading practitioners criticized Opinion 15 for being a "cookbook" of detailed rules, and a leading accounting academic also chimed in about the amount of detail in the Opinion (Hicks, 1969, p. 60; Tietjen, 1970, p. 10; Paton, 1971, p. 42). Another accounting academic, also editor of an accounting newsletter aimed at financial analysts, criticized Opinion 15 as being "a completely arbitrary pronouncement" (Seidler, 1972, p. 90).

The 1960s were a significant decade for mergers and acquisitions, many of which gave rise to conglomerate and multinational corporations, when company executives began to view the level and trend of their reported earnings as a strategic weapon in their arsenal either to engineer takeovers or to defend against them. Also in the 1960s, the rise of "opinion shopping" by companies pitted accounting firms against one another, as companies sought a lower audit fee and a more conciliatory attitude on the part of the firm toward their interpretation of permissible accounting principles. Moreover, criticism of the accounting profession was on the rise in the wake of a number of financial scandals where pointed questions were being raised about the performance of the auditors (Zeff, 2003, p. 196; Lyons, 1966).

The decade culminated in the APB's lengthy and anguished deliberations amid mounting and incessant pressures from industry and government on the subject of accounting for business combinations and goodwill. As board members heard from constituents (and as the partner members of the board heard from their clients), the board, in a series of backtracking moves, maneuvered from an initial position to drop the "pooling of interests" method altogether to, finally at the eleventh hour, allowing the method to survive if a merger were to satisfy a dozen tightly constrained attributes. The board's twists and turns were widely reported in the nation's press. The Financial Executives Institute (FEI), the influential organization of preparers, mounted a national press campaign to lobby against the dropping of pooling of interests. In the end, the APB's vote on Opinion 16 on business combinations was by the required two-thirds majority, 12 to 6. In the vortex of outside pressures, including from the SEC, the board agreed that both Opinions 16 and 17 – on business combinations and intangible assets – had to pass, or both would fail, thus inviting the SEC to issue rules to fill the vacuum. One APB member, George R. Catlett of Arthur Andersen & Co., who firmly opposed the pooling of interests method, saw that six dissenters had already registered their votes. His seventh dissent would doom

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Opinion 16. Therefore, biting hard, he assented to the Opinion so that both pronouncements would pass. Opinion 17 on intangible assets, also contentious, passed by a one-vote margin, 13 to 5. None of the board members were satisfied with the compromises required to approve the two Opinions, both of which were issued in August 1970 (Zeff, 1972, pp. 212–216; Chatov, 1975, chaps. 13 and 14; Seligman, 2003, pp. 419–430). Leonard Spacek, the managing partner of Arthur Andersen & Co., said, "There is no question in my mind that Opinions 16 and 17 create unjustifiable harm and damage and that they do not properly state the facts [of acquisitions and mergers]" (1970, p. 69).

On the 12 substantive, single-issue Opinions which the APB issued from 1962 to 1970, there was a total of 35 dissents. Eleven of them related to the same issue, the investment credit in Opinions 2 and 4, issued in early 1960s. Twenty-four of the dissents were cast in the five major Opinions discussed above (11, 14, 15, 16, and 17), which were issued between 1967 and 1970 (Zeff, 1984, p. 463). The contentiousness of these recent pronouncements by the APB was clearly evident in this gauge of discord within the board.

Tempers in several of the Big Eight accounting firms, which were rising since the issuance of Opinion 11 on tax allocation in December 1967, reached fever pitch after Opinions 16 and 17 came out. In 1969, Robert M. Trueblood, a senior partner in Touche Ross & Co., a former APB member and former Institute president, complained that, because of the APB's lack of a basic philosophy of accounting, it had lost its effectiveness, and he proposed that it be restructured as a full-time body (1969, pp. 6–7). Academics were critical, too. In August 1970, the American Accounting Association (AAA) created a special committee (known as Committee 42) "to study the feasibility and desirability of a commission to inquire into the formulation of accounting principles" (The Role of the American Accounting Association..., 1971, p. 609). On January 8, 1971, the committee, chaired by David Solomons, submitted its report in which it unanimously recommended the creation of such a commission. The AAA's executive committee decided unanimously in February 1971 to endorse the committee's report. The AICPA's leadership, for its part, was furious that the AAA, an association run by academics, should tread on the Institute's turf, for it was an Institute committee and then board that, since 1939, had been issuing opinions on what constitutes GAAP. The leadership made its annoyance known in unmistakable terms to the then AAA president, James Don Edwards (Edwards, 2010, pp. 188–189).

The tide changed profoundly within a two-week period in November 1970. The senior partners of three of the Big Eight firms – Arthur Young & Company, Touche Ross & Co., and Arthur Andersen & Co. – wrote letters of great concern to the AICPA leadership. Ralph E. Kent of Arthur Young and Robert Trueblood of Touche Ross both referred to the charge given to the AAA committee and recommended that the Institute sponsor a re-examination of, or a commission to look into, how accounting principles should be established. Kent and Trueblood were past presidents of the Institute, and Trueblood had served on the APB. They focused in particular on APB Opinions 16 and 17, but their concerns were broader and, for Trueblood, went back several years. Trueblood referred to "the long, difficult, and embarrassing history" of the two Opinions. Kent referred to "the long drawn out battle to issue" them, "including shifting positions and threats of legal action" as well as "the not-infrequent public criticism of the Board by members of the Institute, by academicians, by analysts, by corporate executives." Trueblood said that his firm was "presently reconsidering our entire participation in the affairs of the [APB]." Harvey E. Kapnick, Jr. of Arthur Andersen, while not referring to the AAA committee, also argued that the Institute should make a number of necessary changes in the APB's organization and operations. In a letter that was longer than Trueblood's and Kent's combined, Kapnick wrote, "Most of the [APB's] pronouncements represent little more than detailed, arbitrary rules, which set forth almost no reasoning as to how and why they meet the needs of investors and other users of financial statements." He also argued that the lack of agreement on what should be the objectives of financial statements had impeded the APB's effectiveness. Ominously, Kapnick wrote, "the situation [with the APB] is rapidly deteriorating, and it may no longer be desirable for the AICPA as a whole to continue to rely upon the APB as it is presently constituted. Likewise, it may no longer be reasonable to expect AICPA members to do so." He said that his firm favored a board composed of five to seven full-time members.

John C. Biegler, the senior partner of Price Waterhouse & Co., subsequently characterized the temper of the times by the end of the 1960s, when, he said, the APB was rapidly losing its credibility as a standard setter:

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> The late '60s were turbulent times for the accounting profession and those activities closely identified with it, such as the APB. The financial press seemed to be discovering accounting and the accounting profession for the first time. It was a time of "creative" accounting practices which helped fuel the new issues and mergers boom, and it was a time of "shopping around" among accounting firms for more and more innovative applications of existing accounting techniques. At the same time the public was beginning to hear on a regular basis news of lawsuits being filed against accounting firms and to read to its dismay about some fairly spectacular business failures alleged to have had their roots, at least in part, to inadequate accounting standards in general, and inadequate financial disclosures and auditing performance in particular....
>
> Adding fuel to the fire was a constant drumbeat of heavy criticism of the profession and of the work of the APB from highly vocal sources within the profession itself (1983, p. 4).

One concern that motivated Robert Trueblood and perhaps also some other critics of the APB was the recent Continental Vending decision,[2] where the federal Court of Appeals for the Second Circuit ruled that the auditor's judgment about what constitutes GAAP does not in itself imply that the financial statements "present fairly." This meant to Trueblood that the standing of GAAP was on the decline.[3]

Within the same two-week period – from November 11 to 24, 1970 – the APB's five-member committee on board operations, headed by APB Chairman Philip L. Defliese, of the Big Eight firm of Lybrand, Ross Bros. & Montgomery, submitted its report on the APB's operations in a letter to the Institute's board of directors.[4] While expressing satisfaction with the APB's structure and operations, the committee conceded that "its reputation with the general public is probably at a low point at present," due to the board's handling of Opinions 16 and 17. It added, "Notwithstanding its confidence in the viability of its present structure, the APB believes that the time may be ripe for an independent, objective investigation of the entire question of the establishing of accounting principles."[5] Because all of the Big Eight firms were represented on the APB, this meant that all or most of the big firms were in support of such an inquiry. The report recommended a full-time chairman, greater technical support and research capability, and retention of the two-thirds vote.

SEC Commissioner James J. Needham, the first practicing CPA ever to be named to the Commission, added pressure of his own. He met in October with Leonard M. Savoie, the Institute's executive vice-president, to convey his disappointment at the APB's inability to resolve accounting problems quickly. He said that the SEC is considering the issuance of Accounting Series Releases on important accounting matters and wanted to know the APB's reaction to such a move.[6] Further, he attended a meeting of the Institute's committee on relations with the SEC and stock exchanges on November 5. Needham's comments were alluded to as one of a number of concerns about the viability of the APB in Ralph Kent's letter, discussed above. The gist of what Needham said was reported in the press: that, if accounting leaders did not take action to repair the process of establishing GAAP, the Commission would (Andrews, 1972).[7]

Institute President Marshall S. Armstrong, a partner in a middle-tier Midwestern firm, realized that he had a crisis on his hands. After consulting with the Institute's board of directors, he immediately called a Conference on Establishment of Accounting Principles to be held on January 7–8, 1971 at the Watergate Hotel in Washington, DC, inviting 35 prominent CPAs representing 21 large and middle-sized accounting firms, to discuss the Institute's future course with respect to pronouncing on accounting principles. In his letter, he posed nine searching questions to be addressed and said that the aim of the meeting was to "unite the accounting profession in reexamining how accounting principles should be established." He said that "It is envisioned that the discussion would lead, as soon as possible, to the submission of a report with recommendations to the Institute's Board of Directors," whose next meeting was set for February 25–26. One of the attachments to his letter was the charge to the AAA's Committee 42.

[2] *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969).

[3] Interview with George H. Sorter, August 13, 2014.

[4] In this paper, "chairman" is used because this is the form of noun used in all of the cited documentation.

[5] These four letters are in the author's files. Three of these four letters were referred to in a press report (Heinemann, 1972). The letter from Arthur Andersen & Co. was reproduced in AICPA Study on Establishment of Accounting Principles (1972, pp. 319–326).

[6] Minutes of meeting of the Accounting Principles Board, October 21–23, 1970 in New York City, p. 4 (in the author's files).

[7] The minutes of this committee meeting, if any were taken, have not survived.

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It is interesting that only the AICPA members who were partners in accounting firms were invited to this pivotal meeting. The Institute's leadership did not feel it was necessary to consult others than partners in firms. To the leadership, it would seem, "the profession" still meant the members in accounting firms. The dominant composition of the APB also reflected this view. Since its beginning in 1959 and until January 1, 1971, the APB's 59 members included the Institute's research director, an accountant in government, seven corporate financial executives, eight accounting academics, and one financial analyst, all of whom had to be CPAs and also members of the Institute (Zeff, 2007b).[8] The other 41 APB members were partners in accounting firms, and at all times they constituted a majority of the board's membership.

After nearly ten hours of discussion, the conference "adopted a resolution strongly urging the AICPA president to appoint two study groups, acting independently of one another, to explore ways of improving the Institute's function of establishing standards of financial reporting."[9] The first study group, it said, "should review the operations of the Accounting Principles Board, and the second should seek to refine the objectives of financial statements." It is noteworthy that the conference "emphasized that each group should include significant representation from outside the practice of public accounting" (Conference on Accounting Principles, 1971, p. 2).

Armstrong's determination to find an Institute solution was redoubled when Robert Trueblood informed him that, if the Institute did not act decisively, he was prepared to support the formation of the commission envisioned by AAA Committee 42 in its January 8th report.[10]

Armstrong thereupon submitted the conference's resolution to the Institute's board of directors, which promptly approved the setting up of the two study groups. The one on objectives, to be chaired by Robert Trueblood, is discussed in Zeff (2014). The one on establishing accounting principles, to be chaired by Francis M. Wheat, is the subject of this paper.

3. Selection of the members of the Study

For the chairman of the seven-member Study, Institute President Armstrong placed a safe bet by selecting a former SEC Commissioner. Of course, the SEC would have to endorse – or at least not be unhappy with – any new approach to establishing principles, because it had, since 1939, been deferring to the organized accounting profession when deciding on the GAAP acceptable to the Commission. Frank Wheat was a Commissioner from 1964 to 1969, a Democrat who was appointed by President Lyndon B. Johnson. He was best known for directing the SEC's major review of its disclosure policies, in 1969, known as the Wheat Report (Disclosure to Investors, 1969), thus "establishing a reputation as a reformer on financial reporting procedures" (The Man Behind CPA Study, 1972, p. 73). His report led to extensive changes in the SEC's disclosure regulations (SEC Makes Sweeping Changes in Disclosure Regulations, 1970). Wheat was a partner in the Los Angeles law firm of Gibson, Dunn & Crutcher.

Three of the other members were senior partners in major public accounting firms: John Biegler, the senior partner of Price Waterhouse & Co., New York City; Wallace E. Olson, executive partner of Alexander Grant & Company, Chicago; and Arnold I. Levine, national executive partner, management of J.K. Lasser & Co., New York City. Of the three, only Biegler had served on the APB, from 1966 to 1968. Biegler's firm "was considered by many to be the intellectual leader of the auditing profession" (Wise, 1982, p. 66). Olson was a member of the Institute's Council, and Biegler was on the Institute's board of directors and thus also a member of Council.

Because of the reputation of General Motors Corporation (GM) for the high quality of its financial reporting, it was believed to be important to have GM represented on the Study,[11] and an approach

[8] In this source, Biegler's name is miswritten as John P. Biegler. The number given by the Study for the APB's membership from 1959 to the beginning of 1972 of five chairmen plus 63 other members should read 63 members, including five chairmen (Establishing Financial Accounting Standards, 1972, p. 26).

[9] Of interest is the shift in wording from "establishing accounting principles" to "establishing standards of financial reporting," the latter suggesting a broader scope.

[10] Interview with George H. Sorter, August 13, 2014.

[11] Interview with Thomas C. Pryor, June 21, 2014.

was made to the company. Thomas A. Murphy, GM's executive vice-president and former corporate comptroller, who in recent years had become an active member of the Financial Executives Institute's (FEI's) committee on corporate reporting, asked Roger B. Smith, GM's vice president-finance, to accept a position on the study group, which he did (Flegm, 2002, p. ix). Smith therefore became the delegate of the FEI, the highly influential body of financial executives. He was an accounting graduate of the University of Michigan and had studied under Professor William A. Paton, whom he admired. Smith was later to become a severe critic of the FASB, and in 1981 he became GM's chairman and chief executive.

Thomas C. Pryor, CFA, a partner and chairman of the investment committee of the investment banking firm of White, Weld & Co., New York City, was tapped from the financial community. He was a former director of the Financial Analysts Federation (FAF) and was then serving on its financial accounting policy committee. He recalls that his selection, orchestrated by Leonard Savoie, the AICPA's executive vice-president, stemmed from his role in drafting a resolution for the FAF in 1964 that recommended against the use of "cash earnings per share" in analytical reports on companies. Such an earnings per share figure was the *bête noire* of the Institute and of the APB,[12] and the position which the directors of the FAF espoused, in approving the resolution, was much appreciated within the Institute's leadership.[13] Savoie, who was at that previous time a partner in Price Waterhouse, knew that Pryor had drafted the FAF resolution, and that led, Pryor thinks, to his appointment to the Study.[14]

Finally, David Solomons, an accounting professor and chairman of the department, The Wharton School of the University of Pennsylvania, Philadelphia, was chosen as the academic member. He had chaired the AAA's Committee 42 and was the AAA's director of research from 1968 to 1970. Solomons was an English chartered accountant and came to the United States in 1959. He became the principal draftsman of the Study's report, in contrast to the Trueblood Study Group, whose considerable full-time staff did all of the drafting (The Man Behind CPA Study, 1972, p. 74; Zeff, 2014).

It is interesting to note that only three of the seven members of the Study were practicing CPAs. When composing the study group, the Institute took seriously the advice from the conference, namely, "to include significant representation from outside the practice of public accounting."[15]

Michael A. Pinto, who was Leonard Savoie's executive assistant, was deputized to serve the Study as administrative secretary.

By the time the author began this research project, in June 2014, all but one of the Study's members, as well as Armstrong, Savoie, and Pinto, were deceased. The author interviewed Thomas Pryor by telephone to acquire some insights into the dynamic of the study group's work.

4. The charge to the Study

On March 29, 1971, the Institute conveyed its charge to the Study on Establishment of Accounting Principles, or Wheat Study as it came to be called. It said that

> The main purpose of the study is to find ways for the American Institute of Certified Public Accountants to improve its function of establishing accounting principles.... The study should examine the organization and operation of the Accounting Principles Board and determine what changes are necessary to attain better results faster. This will involve study, for example, of all the many changes that have been suggested, ranging from minor procedural suggestions to complete replacement of the part-time volunteer Board by a full-time paid Board with a court-like appeal

[12] See the criticism of the mis-use of "cash flow" and "cash earnings" in Mason (1961, pp. 38–39) and in an editorial in The Journal of Accountancy (APB Opinion on "Cash Flow," 1963). APB Opinion 3, issued in October 1963, recommended against the use of "cash earnings" and "cash flow per share" (paragraph 15). The title of Opinion 3 was The Statement of Source and Application of Funds.

[13] For an editorial in The Journal of Accountancy welcoming the resolution, see Not to Mislead the Public (1964). For the resolution, with an introduction by Pryor, see Funds Analysis... (1964).

[14] Interviews with Thomas C. Pryor, June 21 and 27, 2014.

[15] This desire to have a diverse membership of the Study seems to have had repercussions elsewhere in the Institute's organization. In 1971, for the first time, a company executive was brought onto the board of directors, whose membership was previously limited to partners in accounting firms and one academic. In 1972, a representative from the financial community was appointed to the board of directors.

mechanism. It will also involve consideration of entirely new approaches. (Establishing Financial Accounting Standards, 1972, p. 87)

Moreover: "The study should consider the division of responsibility for accounting principles between the public sector and the private sector and how they interrelate. Specifically, the acceptance and enforcement of accounting principles should be considered" (page 88). This part of the charge alluded to several issues: (1) should the establishment of accounting principles be performed by a private-sector body or by government, (2) what should be the role of the SEC in overseeing the deliberations of a private-sector body, and (3) should public accounting firms unilaterally be entitled to ignore the APB's Opinions with which they disagree, or when the firms seriously question the APB's process and probity when it develops Opinions? The latter alluded to the letter from one of the Big Eight firms in November 1970 in which the firm asserted that it may no longer be able to support the APB. As to the second of these two issues, the SEC had been very closely monitoring the work of the APB. Andrew Barr, the SEC's chief accountant since 1956, had been expecting the APB to "clear" its draft positions with his office in advance, to such an extent that Arthur R. Wyatt, who accompanied board member George R. Catlett, of Arthur Andersen & Co., to APB meetings in the 1960s, recalls that, "the Board really didn't do very much without talking to Andy Barr."[16] Catlett himself recalls, "we had to have [the SEC's] support or nothing would be enforceable."[17] In May 1972, SEC Chairman William J. Casey said in a speech, "Since the APB was established in 1959 it has issued a number of major opinions, all of which were considered by the Commission or the Chief Accountant prior to their adoption. Our accounting staff meets with the APB subcommittees to assure that principles are acceptable to the Commission" (1972, p. 8).

Further to the charge, the Institute said that the Study should "obtain the views of as many interested parties as possible" and that it should hold one or more public hearings (page 88). Elsewhere, the Institute said that the Study was expected to submit its report "next fall" (Wheat, Trueblood..., 1971, p. 10). This was understood to mean December 1, 1971, an expectation that was realistic only if the Study were to do no more than recommend relatively minor changes to the APB.

The Institute's charge to the Wheat Study was self-serving, in that it asked the Study to focus mainly on ways to "improve its function of establishing accounting principles," as if an accounting principles body wholly independent of the Institute, even one in the public sector, were not to be actively considered.

5. Organization of the Study's inquiry

John Biegler later wrote, "The Wheat Committee approached its task with a sense of urgency, and I suspect that much of that sense of urgency was derived from a strong feeling on the part of most, if not all, Committee members that perhaps they were participants in a 'last-chance' effort to find a way to keep the financial accounting standard-setting process in the private sector" (1983, p. 2).

The study group began its work in April and held its first meeting on May 14, the first of eight meetings for a total of 14 days, an average of one meeting per month. In addition, as stated in the Study's report, "subcommittees of the study group spent many days meeting separately with various individuals and groups. On two occasions the Study met with the SEC and its staff" (Establishing Financial Accounting Standards, 1972, p. 5). In Appendix B to its report, the Study listed scores of organizations and individuals who "assisted the Study," presumably in meetings with the subcommittees or by submitting their views in writing.[18] Three study group members observed the APB in action during the latter's meeting in New York City on July 28–30. Frank Wheat remained for almost all of the three-day meeting, while Wally Olson and Thomas Pryor attended the first day only.[19]

[16] Interview with Arthur R. Wyatt, July 14, 2011.
[17] Interview with George R. Catlett, July 15, 2011.
[18] For Frank Wheat's recitation of these many and diverse meetings, see The Wheat Commission Report (1972).
[19] Minutes of meeting, Accounting Principles Board, July 28–30, 1971, at the Institute's offices located at 1700 Broadway, New York City, p. 2 (in the author's files).

On August 3, the Study announced a public hearing to be held on November 3–4 at the AICPA's offices in midtown Manhattan, New York City. The transcript of the hearing as well as the position papers submitted by organizations and individuals were published by Arthur Andersen & Co. in volume 11 of its Cases in Public Accounting Practice (AICPA Study on Establishment of Accounting Principles, 1972). The next section of this paper will be given over to a discussion of the salient presentations at the hearing.

One supposes that the work of the study group in its first several months was mostly to canvass the views of interested parties and review the extensive literature and experience on the establishment of accounting principles, including especially the record of the APB, while at the same time securing a consensus on the questions and issues which it believed should be addressed. The data-gathering and drafting of Chapters 4 and 6 on the experience of the APB since 1959 were surely done in the early going.

None of the internal papers (correspondence among study group members, notes from their meetings, and successive drafts of sections of the report) have survived, except for a seven-page memorandum from Frank Wheat to David Solomons dated December 30, 1971, containing his notes from the study group meeting of December 11, five weeks after the public hearing which probably marked the end of the group's data- and opinion-gathering process.[20] The memorandum summarizes the areas of agreement among the members at the meeting, and in every detail reflects the essence of the recommendations in the eventual report. One therefore surmises that, from that point forward, Solomons undertook in earnest the drafting of the Study's recommendations, making the report into a coherent whole, and forwarding the draft chapters to the other study group members for editing and other modifications, prior to its submission to the Institute's board of directors on March 29, 1972.

6. The Study's public hearing

Seventeen individuals or groups, on their own behalf or representing an organization, gave oral testimony at the Study's 1½-day public hearing on November 3–4, summing to 153 pages of printed transcript (AICPA Study on Establishment of Accounting Principles, 1972).[21] In its notice of the public hearing, the Wheat Study posed five "pertinent questions" that interested parties should address (page 11):

1. What should be the scope of the task of establishing accounting principles? This was a catch-all question, asking what was meant by "accounting principles," whether it would be more accurate and useful to refer to "financial accounting and reporting standards," and should "the body with primary responsibility for formulating such standards limit itself to fundamentals, should it develop detailed standards, or should it undertake to do both?"
2. "Should the primary responsibility for establishing accounting standards reside in a governmental body or a non-governmental body?"
3. What should be the composition of a non-governmental standards board?
4. What should be the methods of operation of a non-governmental standards board?
5. What should be the accounting research support for a non-governmental standards board?

Numbers 2 through 5 had a series of sub-questions under them. A question about whether there should be an appeal procedure was included under number 4. No question was asked about whether the board's meetings should be held in public. Two implications of these questions were evident. First, the Study already seemed to prefer "standards" over "principles," and, second, the Study already seemed to have largely decided on a non-governmental board.

[20] This memorandum was given to the author by Solomons in 1995, shortly before he died on February 12.

[21] In this section, for simplicity in citing the oral testimony and written submissions contained in this volume, the full citation will not be repeated and "page" or "pages" with the corresponding number will be used.

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Interested parties submitted 40 position papers which were reproduced in the volume following the transcript of the oral testimony. The longest paper by far was that of Arthur Andersen & Co., at 81 pages. All of the other 39 submitted papers consumed a total of 306 pages. Six of the Big Eight accounting firms submitted papers. Price Waterhouse (PW) did not, one supposes, because its senior partner, John Biegler, was a member of the study group. Yet A. Carl Tietjen, one of PW's executive office partners, submitted a paper on his own behalf. Lybrand, Ross Bros. & Montgomery (LRB&M) did not contribute a paper, but Philip Defliese, its managing partner and APB chairman, did submit a paper of his own. Five of the Big Eight firms (all but PW, LRB&M, and Ernst & Ernst) gave oral testimony. Defliese gave testimony in which he stated his own views. Frank Wheat chaired the hearing and allowed it to be relatively informal, and he invited questions from the floor. Most of the presenters took between 25 and 35 minutes, but Wheat did not specify a desired time allotment. All of the study group members were in attendance, and they engaged in probing dialogue with those giving testimony, Wheat more aggressively than the others. The study group members regularly asked speakers to comment on the points made in papers submitted by others and on points made in the testimony given by others, in effect to stimulate a kind of dialogue among the presenters. The discussion below of 17 of the papers and 15 of the 17 oral presentations will proceed first with the accounting firms and second with associations and organizations, and then with a leading financial analyst. Seven accounting academics (including the author) submitted papers and two gave oral testimony. The views of the two academics who both submitted papers and gave oral testimony, as well as an academic who was serving on the APB, will be discussed at the end of this section on the public hearing. Most of the focus in this section, however, will be on the firms and organizations whose support would be so vital to acceptance of the Wheat recommendations.

6.1. Big Eight firms and partners

In its paper, Haskins & Sells (H&S) proposed setting up a foundation to oversee an Accounting Principles Commission of seven full-time members which would issue pronouncements on accounting principles, but not on applications thereof, after "intensive research, public hearings, interviews with interested parties, comments on exposure drafts, and its own deliberations" (page 268). A majority of the members should be accounting practitioners at the time of their appointment. The firm defined principles as "Fundamental, pervasive concepts that are established in relation to the objectives of financial statements" (page 267). A large part-time committee of the AICPA would be established to pronounce on the applications of the principles. It is essential, the firm said, to have a procedure for petitioning the commission for interpretations and reconsideration. From time to time, the trustees of the foundation were to appoint a task force on accounting objectives to prepare or update the objectives "in the light of changing needs for financial information" (page 270). Research would be contracted out or performed by an employed full-time staff under a director of research in the foundation (page 269). The firm estimated the additional expenditures for this new organization, over and above what was already being spent for the APB, at between $2 million and $3 million annually. The firm said it recommended that "the financial requirements of the Foundation be guaranteed by the American Institute of Certified Public Accountants, which in all probability would be the major source of financing" (page 271). In his oral testimony, H&S partner Thomas B. Hogan, to the surprise of all in attendance, said that the partners of his firm "would commit themselves to contribute $1 million during the first five years of the Foundation's existence" (page 78). Yet Hogan came in for close questioning by Frank Wheat and the other study group members, mostly about how the full-time commission would manage its interaction with the part-time applications committee.

Arthur Andersen & Co. (AA) also recommended a full-time board but in other respects was less enterprising than H&S. AA recommended that the APB be converted into a small, full-time body, with all financial support to come from the AICPA. The board's decisions would be made by a simple majority. The research program would be overhauled to fit the new APB's needs, and an appeal procedure should be looked into. Members of the board would not need to be AICPA members and need not be practicing accountants. "However," AA said, "a majority of the APB at any time should have had extensive experience in financial and accounting matters" (page 303). The firm felt strongly that "All contacts with the APB with respect to subjects under consideration should be a part of the public record, and the conclusions should relate to the public record" (page 309). This would represent a considerable expansion over the public record made available in the past by the APB. AA recommended that its new plan for the APB should be adopted by a vote of the entire AICPA membership (page 314). In oral testimony, Chairman Wheat pressed Harvey Kapnick, the firm's managing partner, about the salary level that would be required to attract full-time members from the public accounting firms. He asked, "Do you visualize any problem at all in that men in Government who have basic responsibility will note that they are being paid $36,000 or $37,000 a year [the salary of an SEC Commissioner], whereas these gentlemen in the private sector [the full-time standards board] are being paid $100,000 a year for a small slice of that responsibility? Does that give you any concern or pause at all, about the likelihood that such a structure might rather swiftly move the whole task into Government?" (page 51) Wheat was thinking that only in Government service would professionals be willing to endure a significant sacrifice in their salary.

Walter E. Hanson, the senior partner of Peat, Marwick, Mitchell & Co. (PMM), spoke on behalf of the firm. Hanson was regarded as one of the most powerful figures in the accounting profession, if only because his firm was the world's largest of the Big Eight. Hanson said that his firm recommended a 21-member, part-time standard-setting body but with a much more diverse membership: ten members from international and national accounting firms, two from regional and local accounting firms, two who were distinguished accounting professors, and seven public interest representatives (page 477). The public interest members "should be nominated by designated persons or organizations totally independent of government and the accounting and financial world" (page 478). The public interest members would not have voting power but would have the right to dissent (pages 479–480). The profession would have veto power over these choices "to reduce the possibility of capricious choices being inflicted upon the principles body" (page 472). He said, "The chairman, and perhaps a three-man planning committee, of the body could well serve full time," although he said that this was not an essential feature of his firm's proposal (page 480). Hanson said this proposal would, in his view, "be an enormous step toward broadening the consciousness of accountants and creating a socially relevant and responsive role for accounting during the remainder of the twentieth century" (pages 481–482). Joseph P. Cummings, a current APB member who served on the committee on board operations that rendered its November 1970 report to the board of directors (see above), gave testimony in place of Hanson, who had a conflicting engagement. His firm, he said, thinks that "the small, full-time, in-house board could not stay current" (page 153). Most important, he said, full-time members could not bring into their deliberations the kind of research which each present board member can produce from within his own organization (pages 153–154). Cummings said that he did not agree with the need for an appeal procedure but added that he had no objection to having an Institute task force evaluate the application of Opinions and make suggestions to the board on changing its agenda (page 156).

Ernst & Ernst's submission was a paper written by the firm's managing partner, Richard T. Baker, "Why Aren't We Solving our Problems?" which was the speech he gave at the annual meeting of the American Accounting Association on August 24, 1971.[22] It was mostly a criticism of both the APB and the SEC for attempting to establish accounting principles at the same time. At the very end of the article, he finally got round to making his recommendation: a broader-based, part-time body to establish accounting principles, and not rules. The body "should include representatives whose backgrounds are other than strictly accounting, such as economists, financial analysts, and other financial experts. This would, of course, eliminate the requirement that membership be confined to CPAs" (page 192). He recommended that "statutory authorities, such as the SEC, should not attempt to establish accounting principles on a case-by-case basis, but should concentrate their activities on making sure that reporting companies and their independent accountants follow and disclose compliance with the prescribed principles" (page 192). The firm did not give oral testimony.

[22] The article was published in the November–December 1971 issue of The Michigan CPA.

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Robert Trueblood conveyed Touche Ross & Co.'s recommendation: "that a five or seven man full-time and fully-compensated group of the best professional accountants in the country be appointed to the Accounting Principles Board" (page 175). They could be from a practicing firm, a university, or a business enterprise. The board "should be supported heavily by competent staff, with significant involvement of the financial, business, and academic communities" (page 175). He said that the "historic separation of accounting and auditing cannot be logically sustained." The "reconstituted board should, at a minimum, have surveillance over the proper content of the auditors' report. Consideration should be given to having the board define research needs, objectives, principles, and procedures in auditing" (page 175). He estimated an annual cost of between $8 million and $10 million, but, he said, "the major public accounting firms in the country today in fact spend this much, in the aggregate, in direct, contributed, and imputed costs for AICPA support and in practice research and guidance" (page 176). Touche Ross's recommendation was one of the narrowest, in terms of breadth of backgrounds of board members among the six Big Eight firms. At the public hearing, Trueblood pointed out that his firm's proposal contemplates that the board deal with objectives and principles, and that "the procedural implementations and interpretation kind of things come either or both from practicing firms or from the staff itself" (page 19). Frank Wheat questioned Trueblood closely about how a board could decide on principles and not be responsible also for how the principles were to be implemented (pages 19–21). No clear answer emerged. In response to a question from David Solomons, Trueblood clarified that, by "professional accountants," his firm did not mean necessarily CPAs (page 21). Men from other disciplines, he said, would serve on project advisory committees and other support committees (page 21).

Arthur Young & Company (AY) recommended the most modest changes in the APB model of any of the six Big Eight firms that submitted papers. The AICPA, the firm said, should continue to perform the principles-setting function (page 243), and the APB should continue to be part-time and, apparently, about the same size. AY said that "a preponderance of the members [of the principles body] should be CPAs in public practice" (page 245). The firm conceded that the quality of the board's pronouncements would be enhanced by "the direct participation by representatives of other disciplines," but the most feasible avenue for this participation, it said, would be as members of the body's subject-area subcommittees (pages 245–246). It would be difficult, the firm said, "to find qualified people who would be willing to serve as members of [a full-time] body. Moreover, however well qualified, the people selected would quickly lose touch with the business world, so that their pronouncements would be decreasingly realistic and hence decreasingly accepted" (page 246). AY rejected an appeal procedure. It argued that "increasing the extent of quality staff assistance" would be a "significant advance" (page 247). AY would retain the two-thirds vote to adopt an Opinion. The body, AY said, should issue only Opinions, not interpretations. The firm essentially endorsed the existing approach to establishing accounting principles. In his brief oral testimony, Ralph Kent of AY said that a full-time chairman as well as additional staff assistance would make the APB much more effective (page 106).

Philip Defliese, the APB chairman, devoted most of his 15-page paper to responding to criticisms of the operation and independence of the APB. But he did want to see some reforms. He recommended that the APB should have a broader and strengthened research program and that the board chairman should be full-time. He proposed greater diversity for a 21-member board membership, up from 18, as follows: the full-time chairman; 13 practitioners, from all of the major national firms at all times and from "the lesser national firms and the regional firms" on a rotating basis, and from a small firm; three CPAs from industry; two academics "well known for their qualifications and interest in accounting theory"; one financial analyst; and one "investment banker or practicing attorney active in securities registration work" (page 537). Most of the board members, he said, should be CPAs, but he conceded that he would really prefer to maintain the present requirement that all members be CPAs (page 538). When the board deals "with an issue that is concentrated in a particular industry or involves a specialized area requiring an expertise," Defliese would co-opt up to four specialist practitioners or industry accountants as voting members of the board (pages 537–538). He would retain the APB's mode of operation as it is. Because Defliese had not provided the study group with his written submission prior to the public hearing, he opted to read his entire paper into the record at the outset of his testimony. That left little time for questions from the study group, and nothing new was unearthed.

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PW's Carl Tietjen, in his paper, recommended that "generally accepted accounting principles," the technical rules, be dropped in favor of "broad standards" that would provide both management and independent accountants with sound guidance on "*what* they are attempting to do," not "*how* to do it" (page 202; emphasis in the original). He proposed a program composed of three interrelated elements: (1) accounting standards to be adopted officially by the AICPA; (2) a broad-based review board or council to review "apparent deviations [from the standards] and taking appropriate action where required"; and (3) a technical group, currently the APB, to provide technical guidance to support the accounting standards (pages 202–206). Tietjen's preference for "standards" aligned with that of John Biegler, the senior partner in his firm (see below). He did not give oral testimony.

None of the Big Eight firms or their partners advocated establishing accounting principles in the public (i.e., government) sector. Haskins & Sells, Arthur Andersen, and Touche Ross all favored a full-time board, while the other three firms that made submissions, as well as Philip Defliese, preferred to retain a part-time board. On other points, there was a considerable diversity of views among the firms and partners.

6.2. Other public accounting firms and partners

The letter from Main Lafrentz & Co., a middle-tier firm based in New York City, was written by LeRoy Layton, the immediate past APB chairman. He said that the contents of the letter were his views only. Appended to the letter was a speech he had given to a conference the preceding month, in which he reviewed at length the APB experience. Layton did not propose a new structure, but he said he was skeptical of the solution of a full-time, paid board which had been proposed by others (pages 485–486). In his speech, Layton said that the APB had recommended to the AICPA board of directors that it have a full-time chairman, "if the right man can be found" (page 510). This was one of the recommendations in the letter of November 1970 from the APB's committee on board operations, discussed above. He expressed skepticism of the need for a two-thirds majority rule (page 511). He said that the APB has also petitioned the board of directors "that consideration be given to a greater commitment of funds and manpower" for research (page 508). In his oral testimony, Layton said that reserving a seat for all of the Big Eight firms is indefensible, even though, as chairman, he was glad to have them and their firms' resources engaged in the work of the board (pages 135–136).

Hurdman and Cranstoun, Penney & Co., a middle-tier firm with its head office in New York City, recommended the following modifications of the APB: a full-time, paid chairman; increased research and drafting assistance; broadening of the membership of subject-area subcommittees beyond board members; abolition of permanent seats for the Big Eight firms; elimination of the two-thirds voting rule; and combining some of the work of the APB and the Committee on Auditing Procedure (page 554). It recommended the following composition of a 21-member board: 13 who are practicing public accountants and AICPA members; three members from industry; two academic members; and the remaining three members from investment banking, security analysis, economic analysis, and the legal profession (page 552). Charles B. Hellerson, one of the firm's partners, had been an APB member since 1968. The firm did not give oral testimony.

John Rapp, a partner in the New York City office of the smaller firm of Louis Sternbach & Company, wrote that his firm favored a somewhat larger board than the APB, around 25 members, which would include one or two financial executives who were not CPAs; a "good combination" of CPAs from public practice and from industrial, commercial and nonprofit organization practice; and some members from local and regional accounting firms. No academic members were suggested. All of the board's members should be volunteers, as with the APB. There should be increased staff support, partly by the firms loaning CPAs to the APB's staff for one-year terms, with the firm and the AICPA each paying half of the salary (page 255). His firm, he said, was in favor of public hearings and the two-thirds voting majority but did not favor an appeal procedure (page 256). In oral testimony, Rapp said his firm preferred "standards" over "principles" (page 34). For Opinions that had been approved by a vote of no more than 12 out of 18, he suggested that they be reviewed after two or three years to see if they had achieved a 75 or 80 percent majority (page 36).

One notes that two of the three representatives of middle-tier and small accounting firms bridled at the automatic membership of all of the Big Eight firms on the APB.

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6.3. Financial Executives Institute (FEI)

FEI submitted a policy statement, representing the consensus of the views of business executives on the operations of the APB and the establishment of "accounting principles" (quotation marks in the original). It also submitted a memorandum containing excerpts from a sampling of members' comments relating to the FEI statement. FEI recommended a private-sector standard setter of no more than 20 members, including an equal number of members from the public accounting profession and the business management community, each representing as much as 40 percent of the body's membership. The balance of the members would be drawn from "public interest groups, such as financial analysts, the academic community, government, etc." (page 449) In the aftermath of the FEI's nationwide campaign against the APB's possible dropping of pooling of interests accounting for business combinations (see above), one can understand FEI's desire for a larger representation on the standard setter from the business management community. FEI added that AICPA membership should not be required for those serving on the standard setter other than for the public accountants. On balance, FEI preferred a part-time body with full-time staff (page 450). FEI said that the body should be sponsored and funded by the financial community, that is, not under the auspices of the AICPA. It said that "those elements of business and public interests who are concerned with financial reporting...in conjunction with the public accounting profession" would contribute to the body's financial support (page 450). Adequate supporting research was seen as a necessary prerequisite for the body's actions, and the professional accounting and financial management associations, including FEI, should "commit a substantial portion of their research efforts" to complement the research undertaken by the body's own research staff (page 451). FEI favored an appeal procedure (page 450). The body should "hold public hearings and maintain a public record, issue exposure drafts, and otherwise solicit the participation of the financial community" (page 450). In oral testimony on behalf of FEI, J. O. Edwards said that the auspices under which the body would operate was "the one matter on which it was most difficult to arrive at a consensus" (page 89). There was almost an even split, he said, between the AICPA and another yet-to-be-determined body. He said, "If AICPA doesn't buy the changes, members of FEI feel that there should be this superbody or volunteer consortium" (page 89). He revealed that, in FEI's view, the AICPA would make the appointments, which was not mentioned in the policy statement. Thomas Pryor asked about whether FEI favored a two-thirds voting majority, and Edwards replied that, while the policy statement was silent on this issue, in some earlier committee discussion it was the feeling that a two-thirds majority should be required. Pryor then observed that a 40 percent representation on the body by "the issuer group" meant that it would have veto power over decisions by the body, and Edwards replied, "I guess that's right." He quickly retorted, "So would the certifying group" (page 93). Biegler, Olson, and Wheat asked Edwards whether financial executives constituting such a large percentage of the membership of the body would be objective even though they would be setting standards with which they would be required to comply. Edwards conceded that "there are certain concepts or principles that would be so overwhelming in their impact on a particular company, that the question of objectivity could be real" (page 94). But, he seemed to say, the representation of business management on the body must be balanced against the possible issue of independence. Wheat apparently expressed the view of the study group when he said, "I think it's fair to say that we're all immensely concerned with the matter of appropriate, substantial input from business interests" (page 91).

6.4. National Association of Accountants (NAA)

The NAA appointed a special six-man committee, composed of five past national presidents and the current national president, to prepare its submission. Like the public accounting firms, the NAA committee favored a non-governmental body. Further, it believed that the body should be sponsored by the AICPA and "be housed in a facility contiguous to the professional staff of the AICPA to take advantage of the library, research and other services of the Institute" (page 425). The body should be comprised of approximately 18 part-time voting members, with a full-time chairman who need not be a practicing CPA, selected by the AICPA and serving on a long-term basis for about ten years. No more than half of the members should be practicing CPAs, and no less than one-quarter should "be those who actively participate in the preparation of financial statements and from the industrial, commercial and public utility communities." The balance of the members should "be selected from colleges and universities and the financial community, including financial service organizations" (page 427). The body should be supported by a full-time staff. The committee suggested two possible names for the body, both containing "standards" and not "principles": Council on Financial Reporting Standards and Financial Reporting Standards Authority (page 428), and Frank Wheat cited these proposed names when questioning John Rapp (page 37). Wheat said that Financial Accounting and Standards Board had been suggested by at least one other person, and later in the colloquy John Biegler broached the name, Financial Accounting Standards Board (page 39). The NAA committee outlined a series of steps in developing an Opinion, which included a public hearing, and it called for empirical research to gauge the effect of the proposed Opinion (pages 429–430). The committee favored a two-thirds majority but counseled against an appeal procedure (page 430). Funding, it said, should come entirely from the AICPA as it does for the APB. I. Wayne Keller, one of the committee members, represented the NAA at the hearing. He pointed out that the chairman should be appointed more for his executive ability than for his accounting ability (page 62). The essence of the NAA's proposal was that the body should be like the APB but that there should be a full-time chairman and there should be provision for a greater diversity of membership.

6.5. Financial Analysts Federation (FAF)

Dr. Frances Stone, who wrote a two-page memo on behalf of the FAF's financial accounting policy committee which she chaired, said that the board should be in the private sector but with greater explicit cooperation with the SEC. It should be full-time with a limited tenure of membership and composed of "highly qualified professional accountants," but she did not specify a desired size of the board (page 542). It should, she said, be assisted by a permanent research staff who need not be CPAs. She said the committee favored a simple majority in board votes. She added that "An appeal procedure is vital for the working of any system to alert a board to changes in the economy – national, international, sociological, as well as technological" (page 545). She used "standards" instead of "principles" in her memo. William C. Norby, the FAF's chief executive, contributed a four-page memo of "additional commentary" to convey the "attitudes of our Officers, Directors and Committee members who have discussed this important subject from time to time...." (page 546) It is not clear how the two memos related to each other. Norby said that "The FAF has consistently held the view that professional accountants should establish accounting principles" (page 546). He advanced the novel view for an interested party that "financial analysts, business management, and all other parties affected by accounting rules should participate in the discussions and take positions of advocacy...[but] they cannot be both advocates and judges or decision makers" (page 547). So they should not be represented on the board itself. He said that, while full-time service, which was recommended by Dr. Stone's committee, would lead to better continuity in the board's work and to complete independence from employer or client relationships, there were differences of views on that point within the FAF. Some believed that part-time members would be closer to real practice through their firms, that their decisions would achieve greater acceptance than decisions made by a full-time group, and that full-time members might tend to become too "academic" (page 548). Norby himself, he said, favored a full-time compensated board. He concluded by saying that he conveyed "the preponderant opinion of our organization that we are suspicious of some of the grand, sweeping reorganizations of the accounting principles setting process that have been proposed," without naming them (page 549). As can be seen from his memo, he preferred the use of "principles" instead of "standards." In oral testimony, Dr. Stone offered a view that no others had ventured during the hearing: "I would like to see the SEC a lot more directly involved with the setting of accounting principles, or guidelines, because I'd like to see them have the force of law.... Then we'd have no problem about going to the courts on this" (pages 159–160). She used a term in her testimony, "independent," which did not appear in her memo, namely, that she (or her committee) would like to see "a full-time, independent, highly professional board" (page 160). Asked by Thomas Pryor whether he favored a small board, Norby responded that, while the FAF does not have a firm position on the precise size, the board he envisioned "would probably be a smaller body" (page 165). When David Solomons said he was surprised that the FAF's board of directors would unanimously favor a full-time board, Norby clarified that a full-time board was his personal view as well as that of Dr. Stone, but the board of directors ‘‘strongly favored the voluntary board’’ (page 165). In response to a question from Roger Smith, Norby said that it would be a ‘‘virtually unanimous’’ view throughout the FAF that, because through accounting and corporate reporting, business is giving a report on its stewardship or accountability, ‘‘others should establish the measurement of that stewardship’’. Thus, business should not be represented on the body that sets the accounting standards of measurement (page 165). The FAF's view on the composition of the board differed fundamentally from FEI's preference for a 40 percent representation from the business management community.

6.6. Machinery and Allied Products Institute (MAPI)

MAPI is a national organization representing capital goods and allied industrial equipment manufacturers. Charles W. Stewart, the president, signed the five-page communication to the Wheat Study which gave the organization's views. He expressed MAPI's concern that, ‘‘if the present trend in APB Opinions were to continue, we think there may well be a further most undesirable erosion of management discretion’’ (page 358). MAPI, he said, would like any successor to the APB to be more proactive in seeking the views of top business management, i.e., chief executives (page 359). MAPI's attached memo responded only to numbers 1, 2, and 3 of the Study's five ‘‘pertinent questions’’ addressed to those who were submitting papers or testifying at the hearing. MAPI said it prefers ‘‘standards’’ over ‘‘principles’’ because principles ‘‘suggest a universality and degree of permanence which cannot exist in a human-service institution such as accounting’’ (quoting from Paton and Littleton (1940)) (page 360). The development of standards, MAPI said, ‘‘is an evolutionary process and accounting standards must change as the nature of business may change; they are not, and must not be regarded as, immutable laws that are fixed and unchanging’’ (page 360). MAPI said that the standard-setting body should be charged with developing fundamental standards, and in general should not be expected to set detailed standards, meaning prescribed procedures, so as to retain flexibility in the application of the standards (page 360). MAPI said that the responsibility for establishing accounting standards should be vested in a non-governmental body, and it favored a ‘‘court of last resort,’’ that is, an appellate process, on controversial accounting questions. This process should be separated from the standard-setting function (page 361). On the composition of the standard-setting body, MAPI said only that, in general, there should be representatives on it from ‘‘the accounting profession, government, and financial executives from business’’ (page 361). MAPI recommended that the standard setter should refer projects at an early stage of study to an advisory committee composed of chief corporate executive officers, to solicit their views (page 361). MAPI's oral testimony, which consumed almost 19 pages of the transcript, was the longest of any at the hearing. The reason for this length was that four men represented MAPI at the hearing – Charles Stewart, MAPI's senior vice-president Charles Derr, and the chairmen of Clark Equipment Company and Ingersoll-Rand Company, both of whom were members of MAPI's executive committee – and three of the four wanted to present their views to the study group.[23] Walter E. Schirmer, of Clark Equipment, explained that MAPI has advocated that the APB have an industry advisory committee so that the companies could give advice to the APB before the latter's views were mostly locked into an exposure draft (page 114). Otherwise, the two chief executives mostly inveighed in their oral testimony against the need for product-line reporting. Stewart, in his oral presentation, emphasized that the APB's consultation with the industry advisory committee composed of chief executives should take place at an *early* stage in the development of a standard (page 119). He also complained that the APB focuses excessively on the investing public and credit grantors, almost to the exclusion of top corporate management (pages 119–120). Frank Wheat had difficulty understanding this point, because, he said, ‘‘management should be concerned about the interests of stockholders in accounting and financial accounting matters’’ (page 125). At the end of the study group's long colloquy with the MAPI representatives, David Solomons said, apparently exasperated, that, if he

[23] The Ingersoll-Rand chairman, William L. Wearly, submitted a paper (at pages 365–377) which was the basis of his oral testimony.

were asked "to sum up what the witnesses have said about disclosure and comparability, they would sum it up by saying they were against it; it's as simple as that" (page 130). Stewart denied this was so and replied that it only was a matter of striking the right balance (pages 130–131).

6.7. David Norr

The only person to give testimony but not make a written submission was David Norr, a financial analyst with First Manhattan Co. and an APB member since January 1971. He was the only analyst ever to serve on the board, and, as with all other APB members, he was a CPA. Norr was president of the New York Society of Security Analysts. He began his testimony with a pungent reply to FEI's recommendation, stated above, that the board should have an equal number of members from the public accounting profession and the business management community, each representing as much as 40 percent of the body's membership, with a two-thirds majority required for approval of the board's decisions:

> I think the Board should have the best brains among CPAs. An analyst need not be on the Board. Service on the APB is demanding; it's a full-time job; it is not a part-time job as some have suggested. I would strongly oppose forty percent management representation; I would strongly oppose twenty-five percent management representation; I would strongly oppose equal representation of management and accountants.
>
> The veto possibility [by management] is frightening. (page 108)

David Solomons remarked, "You draw a very striking distinction between the independence of the [CPA] practitioner and the incapacity for independence which you attribute to representatives of management. It's one of the most striking things that's been said here today" (page 111).

Norr said that he "could not object if the commission were to decide that the board should be independently financed with men severing their ties to firms" (page 111).

6.8. Academics

Robert I. Dickey, of the University of Illinois at Urbana-Champaign, and George Gibbs, of the Claremont Graduate School, near Los Angeles, submitted their written views and gave oral testimony. Both favored a private-sector board. Dickey argued that the control and support of the APB, which he assumed would continue in existence, should no longer be a monopoly of the AICPA. The AAA, FEI, and the NAA – the three other national accounting bodies – should join the Institute in sponsoring the board. This would imply a more diverse composition of the board membership, and not all needed to be CPAs (pages 385–386). He said, "There should be more high-ranking accountants with a strong background in broad business management experience on the APB" (page 385). By contrast, Gibbs argued for a nine-man, full-time board, whose members would be chosen for life tenure – which he likened to the Supreme Court (page 71). The members should all be CPAs, but the majority should be drawn from medium and small accounting firms, thus ending the domination by the larger firms. He also recommended that, in order to avoid "undue influence of the financial world," the board should not be based in New York City. He suggested San Francisco or Denver as better sites (pages 221–222). Gibbs did not propose that accounting academics serve on the board, but Dickey left that door ajar, as the AAA would be one of the sponsoring bodies.

Charles T. Horngren, of Stanford University, had been serving on the APB since 1968, and in his submission to the Study he supported the view of David Norr regarding management representation on the board. Horngren wrote, "Whatever the form, I hope that business executives do not have any larger *direct* role in setting accounting principles than they now possess. Their views should be heard fully, but there is an inherent conflict between their role as managers and the task of measuring their own performance" (page 558; emphasis in original). He rebutted the argument that the APB does not pay sufficient attention to the views of industry, adding, "The opinions of financial executives come through loud and clear – and they are given painstaking consideration. For example, *every* recent APB Opinion has been changed considerably in response to industry reactions" (page 558; emphasis in original).

6.9. General review of the opinions expressed at the public hearing

As indicated by the foregoing summary of a large sample of the views expressed in the submitted papers and at the public hearing, there was highly diverse thinking about full-time versus part-time, and whether the body should represent particular interests or should be composed of the most qualified individuals not representing any particular viewpoint. Most participants did not want an appeal procedure, and views differed on the composition of the body that sets the principles or standards, especially as regards the proportion of practicing CPAs on the body. Consequently, the study group members did not receive unambiguous signals on the direction in which their recommendations should go. But the public hearing did enable the members to parse the arguments made by a broad range of interested parties, which may have helped them shape their own thinking.

7. Development of the Study's report

The Study's report was not just a one-sided set of arguments in support of its conclusions and recommendations. Arguments and evidence were presented on both sides of the principal issues to be resolved, and the report clearly benefited from David Solomons' expertise as a researcher and draftsman. Unlike the Trueblood Report on objectives, the Wheat Report contains footnote references to a variety of source material. The longest and one of the most interesting chapters is Chapter 6, "Present arrangements for formulating financial accounting standards," which contains the best review in the literature of the 12 years of the APB, including discussions of its relations with the SEC and other government agencies. Chapter 6, together with Chapter 4, entitled "What does 'the establishment of accounting principles' mean?" which also reviewed the APB experience, totaled 39 pages, which constituted almost half of the 84-page text of the report. Hence, the report is valuable not only for presenting and explaining the Study's conclusions and recommendations but also as an excellent contribution to the literature of "standard setting"– a term which originated with this report. Commenting on the Study's historical rendering of the APB years, Leonard Savoie said in a speech in September 1972, "The report of the study group avoids saying the APB failed; instead it offers reasons why the new FASB can do the job better" (1973, p. 95).

It is worthy of note that the Study on Establishment of Accounting Principles produced a report entitled Establishing Financial Accounting Standards. Thomas Pryor recalls that it was Study member John Biegler, of Price Waterhouse, who said during an early meeting, "What we are talking about here are standards, not principles." Pryor added, "He coined that term for the Study."[24] The report states, "In the Study's judgment, the word 'standards' is more descriptive of the majority of the [APB's] pronouncements as well as the great bulk of its ongoing effort" (Establishing Financial Accounting Standards, 1972, p. 19).[25] Standards is a term that is more attuned to a consensus of informed opinion than is the term principles, which can be rooted in an axiomatic system of belief. The report said, "Financial accounting and reporting are not grounded in natural laws as are the physical sciences, but must rest on a set of conventions or standards designed to achieve what are perceived to be the desired objectives of financial accounting and reporting" (page 19). It is interesting that Biegler was an advocate of the change to "standards," because Price Waterhouse, as a firm, has historically subscribed to a more flexible approach to "establishing accounting principles." George O. May, the intellectual leader in the 1930s and 1940s of the accounting profession and of his firm, Price Waterhouse, chose to interpret "accepted principles of accounting" more as "a code of laws or rules, adopted or professed" than as "a fundamental truth" (1937, pp. 423–424). It is interesting that, in the U.K., the Institute of Chartered Accountants in England and Wales (ICAEW) set up an Accounting Standards Steering Committee in 1969/70. David Solomons, though a Briton and a member of the ICAEW, has written that this U.K. precedent was unknown to

[24] Interview with Thomas C. Pryor, June 21, 2014.

[25] This is the title of the Wheat Report. Henceforth, references in this section to the report will be signified by "page" or "pages" and the corresponding numbers, without repeating the full citation. It is interesting that, on the first morning of the study group's public hearing, Biegler used "Financial Accounting Standards Board" as a possible name for the new body (page 39).

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him while he was serving on the Study.[26] He does say that he played "an important part in getting the word 'principles' replaced by 'standards' in the name of the new Board."[27] He was quoted as saying, "I have thought for a long time that the word 'principles' was a slightly pretentious term in accounting" (Nolan, 1972, p. 18).

7.1. Private-sector versus public-sector board

The Study said that a "threshold question," decided early in its deliberations, was whether the standards should be formulated by a governmental or private body. Wally Olson later wrote:

> At the outset, the committee members held widely differing views, ranging from the belief that the profession alone should set accounting standards to the position that standard setting is essentially a legislative process that belongs in the province of government. In between was the view that the process should remain within the private sector but should include participation by issuers and users of financial statements (1982, p. 66).

After reciting several alleged advantages for a governmental body, without any apparent conviction, the Study turned to the disadvantages: risk of politicization, a tendency toward inflexibility, it would "sap the vitality of the accounting profession," and, perhaps most important, the scope of authority of any governmental agency would not extend to private businesses that are regulated by other agencies or are not regulated at all (pages 22–23). The Study concluded with gusto, "Until it is shown without doubt that this task must be entrusted to government, we strongly prefer to keep it where it is" (page 23). Olson explained that the cohesion around this conclusion resulted from the impressions gained in the Study's experiences during its investigative process: interviewing spokesmen for various interest groups and viewpoints, observing an APB meeting, and attending the public hearing and reading the submitted papers. The Study said that "the great majority of organizations and individuals who gave evidence before us, including the New York and American Stock Exchanges and the SEC itself," favored keeping the standard-setting activity in the private sector (page 24). As a result of these exposures, Olson wrote, "Belief was now overwhelming that the process should remain within the private sector and should not be taken over by government" (1982, p. 67). Frank Wheat liked to say that the Study members agreed that standard setting "should continue to be shouldered in the private sector, subject to appropriate review by the SEC" (Nolan, 1972, p. 22).

7.2. Full-time versus part-time board

Then the Study turned to what Pryor calls "the biggest issue," namely, should the board be part-time or full-time.[28] In its discussion in Chapter 7, the Study said it was impressed by the benefits of a part-time board: members being in touch with the problems in practice, the research support provided for members by their respective firms (as regards members who were CPA practitioners), the diversity of experience which a part-time board can attract to its membership, and, perhaps most important, the idea that a part-time board "has a representative character, at least in relation to members of the AICPA" (page 61). It then countered, "The major positive arguments for a full-time board are independence and efficiency. It is the doubts cast on the disinterestedness of a part-time board which troubles its critics most" (page 61). The Study raised the specter of the "inevitably" divided loyalties between the member's firm or company and the member's position as an impartial arbiter on the board. The Study concluded that there was no way to avoid the "appearance of nonindependence" of a part-time board "except through a full-time board" (pages 61–62). The Study buttressed its recommendation for a full-time board

[26] Solomons' view is curious, because one member of the audience at the public hearing mentioned the ICAEW's Accounting Standards Steering Committee. Chairman Wheat then responded, "We're very much interested in the work of the English Committee" (page 75). Furthermore, the ICAEW committee was cited in Robert Dickey's submission (page 404).

[27] Letter from David Solomons to the author, dated February 12, 1981. In the letter, Solomons wrote that he was much influenced by the use of "standards" in Paton and Littleton's famous 1940 monograph, An Introduction to Corporate Accounting Standards, especially on p. 4.

[28] Interview with Thomas C. Pryor, June 21, 2014.

also by arguing that part-timers would not have the large amount of time necessary, away from their full-time jobs, to deal adequately with the issues. Pryor recalls that he, Roger Smith, and Wally Olson all argued strongly for a full-time, paid board, believing that the issues that will face the board will be "sufficiently complicated" to require the dedication of full-timers.[29]

John Biegler was the "heavyweight" member of the study group because of his senior position in Price Waterhouse, his membership on the Institute's board of directors, and as a past member of the APB. It was essential to the success of any proposed recommendation in the report that he give his assent. He was perhaps the last member of the study group to come round to accepting the idea of a full-time board, and once he signed on, agreement on the other recommendations followed quite easily.[30] Reflecting some years later on his service on the Wheat Study, Biegler said it was the "single experience in my professional career that has made a far greater impression on me than any other" (quoted in Allen and McDermott, 1993, p. 182).

David Solomons later characterized the dynamic within the study group that eventually led it to decide unanimously for a full-time board:

> It may be worthwhile to record, as a footnote to history, how, as it seems to me, the Study Group came unanimously to favor a full-time Board. We certainly did not all start out from such a position, and in the early stages of our deliberations I believe there would have been a majority in favor of continuing with a part-time board, though perhaps giving it a full-time chairman and even a full-time vice-chairman. But we gradually learned a lesson from our own part-time status as a Study Group. We learned that a heavy price in lost momentum is paid by any group that can meet only for one or two days a month, with all the supervening distractions of other activities in between, and that if this was true for us, who had a single fairly well-defined task to accomplish, it was likely to be much more serious for a body like the APB, with its more complex agenda. (1972)

The independence question troubling the study group members went beyond just standard setting. Frank Wheat was quoted as saying after the report was issued, "All of us had encountered to one degree or another the alarming growth of cynicism in the attitude of intelligent people toward the financial reporting process and especially toward the role of the independent CPA" (AICPA Adopts Wheat Report on Accounting Standards Board, 1972, p. 10). Wally Olson, who succeeded Leonard Savoie as the Institute's full-time executive vice-president in July 1972 and then became its full-time president in 1974,[31] was quoted as saying, "I felt that the appearance of independence, in addition to the fact of independence, was vital. The views heard by the study group indicated very strongly that there was a great lack of confidence in the independence of the board, that members of the financial community had concluded rightly or wrongly that members of the APB were not independent of client pressures or of pressures from their own partners" (Nolan, 1972, p. 22).

7.3. The standards board

The Study favored a much smaller board than the 18 members of the APB, "[a judgment] which is shared by many who talked with us" (page 62). The members settled on a recommendation that the full-time board, to be known as the Financial Accounting Standards Board (FASB), should consist of seven members (page 70). David Solomons later said, "We thought that seven represented a reasonable compromise between compactness and diversity of composition" (1972). They would be chosen for staggered five-year terms with the possibility of renewal for a second term (page 73). The Study also said that a majority of the members (four of the seven) should be CPAs drawn from public practice, for the reason that, at the present time, "its composition should not be such as to endanger its acceptability to the profession" (page 72). The other members of the board "should be well versed in the problems of financial reporting in order to be effective," but there was nothing in the recommendation to preclude them from being CPAs as well (page 72). As candidates for membership, the Study mentioned financial executives, financial analysts, academics, economists, and lawyers, without

[29] Interview with Thomas C. Pryor, June 21, 2014.

[30] Interview with Thomas C. Pryor, June 27, 2014.

[31] In 1974 the Institute's full-time senior officer was given the title of president in place of executive vice-president.

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pretending to be exhaustive. This recommendation was a large departure from the APB, whose members had to be CPAs who also belonged to the AICPA, including several financial executives and one financial analyst as members over the years.[32] In its early years, the APB had three financial executives as members at the same time, a number which declined to one by 1971, in a body whose size increased from 18 to 21 in the early years and then declined to 18 in the later years.[33] Rather than having "public interest" representatives on the board, the Study contemplated that "it will be the obligation of all members of the Standards Board to represent the public interest" (page 72).

After weighing the arguments pro and con, which were voiced at the public hearing, the Study recommended that an affirmative vote of five of the seven FASB members – a super-majority – should be required to approve a standard (page 62). Hence, the four practicing CPAs could not themselves constitute a voting majority. The Study also decided to recommend that any dissenting opinions should be placed on the public record but not as an attachment to the standard, saying "It is not our wish to hide any dissent which may develop within the Standards Board but simply to insure that standards, when they are issued, are unequivocal" (page 74). As this recommendation was actually implemented, the dissenting opinions were attached to the standards.

The Study also recommended that "Accompanying the standard should be a full discussion of the arguments both for and against the conclusions of the Board" (page 74), which became the FASB's section in its standards labeled "basis for conclusions." The Study wrote, "The [APB's] opinions have been criticized for giving too little explanation and justification of the conclusions reached and too little discussion of the alternatives which the Board rejected. We believe this criticism is valid" (page 38).

The board should, the Study said, "to the fullest extent practicable, carry out its functions in public," and it added that, "Though the Standards Board will hold public meetings, it must also have the right to meet in executive session" (pages 74–75). The possibility of the board's holding open meetings had not been broached at the public hearing. The APB's meetings had never been open to the public. Yet the FASB began by holding all of its meetings in private, until 1977, when the Board revised its Rules of Procedure to provide that most of its meetings will be open to observers beginning in January 1978 (Procedures for Public Meetings of Standards Board, 1977). The Study added that the board should circulate exposure drafts and hold public hearings. The APB had only begun to hold public hearings in May 1971, following its experimentation in 1969 with six symposia, held in private, where the invited participants would comment on pre-exposure drafts (Zeff, 1972, p. 207). The Study further said, "A history for each of its pronouncements should be developed and made publicly available" (page 74).

The Study also recommended that any interpretations should be issued with the full authority of the board, even though the drafting of interpretations would be done by its staff "with the help, where necessary, of a small task force familiar with the topic in question" (page 75). During the APB era, an Institute staff member, J.T. Ball, developed the interpretations.

7.4. A foundation to oversee the board

Realizing that it was recommending the radical step of divesting the standard-setting body from the AICPA, the Study tried to soften the blow by giving the Institute considerable sway in selecting the entire nine-member board of trustees in a new Financial Accounting Foundation, which was to oversee, and select the members of, the standards board. The Study provided that one of the trustees would be the elected AICPA president *ex officio*.[34] Of the other eight, four would be CPAs in public practice, two would be financial executives, and one each would be a financial analyst and an accounting

[32] In April 1964, APB Chairman Alvin R. Jennings proposed in his annual report to Council that the charter of the board be changed to allow up to three board members to be non-members of the Institute, which was intended to include non-CPAs. Evidently, the proposal did not meet with the approval of Council. (Report of the Accounting Principles Board, April 1964, in the author's files.) The author is grateful to the AICPA Library, University of Mississippi, for furnishing the document.

[33] Beginning in March 1973, Allan Wear, Ford Motor Company's controller and the last remaining financial executive on the APB, missed the last three board meetings, reducing the board size to 17. He did not sign the APB's last two Opinions, 30 and 31, both issued in June 1973. The author is grateful to J.T. Ball for this recollection.

[34] Until 1973, the AICPA's elected senior official was titled president. Beginning in 1974, this elected official was titled chairman, and the full-time senior official, previously the executive vice-president, was titled president.

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educator. Therefore, five of the nine trustees would be CPAs in public practice. The eight trustees other than the Institute's president would have staggered, three-year terms. Most important, the Study reposed authority in the Institute's board of directors to appoint these eight trustees, including four from short lists of candidates provided by the Financial Executives Institute, the National Association of Accountants, the Financial Analysts Federation, and the American Accounting Association.[35] In this way, the Institute would retain a measure of control over the new organization, which the Study characterized as "an organizational interlock between the new Foundation and the AICPA" (page 84). When appointing FASB members, the assent of at least two-thirds, or six, of the trustees would be required. While the Institute could not itself select the members of the standards board, it could appoint, wholly on its own, the four CPA trustees who, together with the Institute president, would constitute a potential bloc of five of the six votes required to select Board members. The task would then be to recruit a sixth vote from the other four trustees. The duties of the trustees were, in addition to appointing members to the board and to a new advisory council (see below), to raise funds to support operations, and periodically to review the structure of the standard-setting organization. The trustees were to choose their own chairman (pages 69–70).

Investing the AICPA with the ultimate basic power to choose the eight other members of the trustees, after consulting with the four other professional organizations, would have been a sensitive issue within the study group. It was therefore important that Roger Smith, the financial executive, approve the grant of this authority, which he did.[36] Frank Wheat later said that "we have carefully provided for a strong and continuing nexus between the AICPA and the new standards board...." (AICPA Study on Establishment of Accounting Principles, 1972, p. 671)

7.5. An advisory council

The Study also recommended establishment of a Financial Accounting Standards Advisory Council of about 20 members "to work closely with the Standards Board in an advisory capacity" (page 75). The Study characterized the Council as the board's "permanent instrument for maintaining contact with the business and professional world.... The only qualification for membership on the Advisory Council would be a capacity to make a contribution to the work of the Standards Board" (page 75). Members would be appointed by the Foundation trustees to serve without remuneration for one-year terms, renewable indefinitely, but not normally for more than four years (page 76). The Study said that the trustees would be expected to obtain suggestions of the names of possible candidates for membership from a wide range of organizations, which could include the American Bar Association, the American Economic Association, and the Securities Industry Association in addition to the five sponsoring bodies of the Foundation. The advisory council was the Study's attempt to overcome the criticism of a full-time board, voiced by participants in the public hearing, that it would lose touch with the problems of the real world. The three main functions of the advisory council were (1) to help the FASB draw up its priorities and agenda, (2) to assist the FASB in setting up task forces when developing standards, and (3) to serve as a sounding board on proposed standards (pages 76–77). Arnold Levine was the principal source of the suggestion that the advisory council should convey its views on the board's priorities and agenda, rather than on technical matters.[37] The APB had never had an advisory body, and its subject-area subcommittees were composed mostly or entirely of board members.

The Study said nothing about whether the advisory council should meet as a group with the board.

7.6. The board's research program

On the subject of the research to be done in support of the FASB's deliberations, the Study said, "In our view, research performed by the staff of the Standards Board should be analytical, empirical, evaluative, and directed toward systematically dealing with the topics before the Board" (page 78). It

[35] The first three of these organizations are today known as Financial Executives International, the Institute of Management Accountants, and the CFA Institute, respectively.

[36] Memorandum from Francis M. Wheat to David Solomons, dated December 30, 1971, point 7 (in the author's files).

[37] Memorandum from Francis M. Wheat to David Solomons, dated December 30, 1971, point 6 (in the author's files).

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added that it did not expect that the staff "should be expected to conduct a broad, fundamental research program dealing with basic concepts on an ongoing basis, since we believe that this type of research is best left to those in the academic field" (page 78). This latter injunction occurred at a time when U.S. accounting research was in the early stages of shifting from conceptual development research to empirical, hypothesis-testing research, although David Solomons himself was the former type of researcher. Yet Solomons has advised the author in correspondence that "I did *not* write" that passage (his emphasis). Drawing a fine line, he wrote that, while the Study said that the board should avoid doing fundamental research, "it did not say that the Board should not use fundamental research in the construction of a conceptual framework. If it had said anything to discourage the board from making explicit the logical and empirical bases on which its standards were to rest, I would have written a dissenting minority report."[38]

7.7. Proposed reforms rejected by the Study

In the course of its report, the Study declined to endorse four reforms of the process of establishing accounting principles which had been proposed:

- Should there be two boards dealing, respectively, with fundamentals of financial accounting and the application or interpretation of such fundamentals?
- Should there be a separate appellate body?
- Should board opinions be officially adopted as rules of the SEC?
- Should the board be established by law as an official self-regulatory agency? (pages 63–68)

As regards the first bullet point, which was in the model proposed by Haskins & Sells during the public hearing, the Study said that dividing this responsibility "is to open up the possibility of conflict between the two bodies as to whether a particular question is one involving a basic standard, on the one hand, or its application, on the other, and also as to whether an interpretation drafted by one body is consistent with the intentions of the other" (page 64). On the second point, the Study was concerned that "this would impose serious delays on the process of improving financial accounting. . .. Those who do not like a standard promulgated by the APB have the right to press for its reconsideration. Several of the APB's opinions have revised earlier opinions in the light of changed circumstances or changed views. We endorse the continuance of that procedure" (page 65). As to the third point, again the Study was concerned by the delays such an approach would entail, but it would also mean repetition of all of the elements that went into the making of the original standard. Too, talented professionals serving on the board would feel downgraded if all of their hard work went for naught once a standard were revised or rejected by a separate authority (page 67). In regard to the fourth point, while the Study conceded that the arrangement does confer advantages, the members were concerned about its impact on the profession. The Study said, "They might affect adversely the development of that high sense of responsibility on the part of the financial reporting community which is vital to further improvement of financial accounting standards" (page 68).

7.8. The budget and funding

The Study made an estimate of the annual budget for the new organization of between $2.5 million to $3.0 million (pages 10, 78, Appendix G). It said that "These figures do not greatly exceed the present cost of operating the APB when one takes into account the approximate value of the time given by the APB members and their staffs" (page 10).

As to financing the Foundation, the Study considered various options. It suggested that assessments might be made against the five professional organizations that were to nominate the trustees: the AAA, AICPA, FAF, FEI, and NAA, either in proportion to the numbers of their members or according to the amounts of their dues income. Another possibility was "to have the AICPA levy a surcharge

[38] Letter from David Solomons to the author, dated February 12, 1981.

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on member firms as a percentage of each firm's audit fees," a cost which would be passed on to their clients (page 80). Finally, the Study contemplated a surcharge "levied by the New York and American Stock Exchanges, and possibly by other stock exchanges, on listed companies as a percentage of the value of their listed securities" (page 81). The Study recoiled from pursuing this idea because of possible legal difficulties and out of a concern that the exchanges "might regard a surcharge for this purpose as a dangerous precedent, to be followed by requests for charges for other worthy causes" (page 81). Thirty years later, a roughly similar levy on issuers to finance the Financial Accounting Foundation would be imposed by the Sarbanes–Oxley Act of 2002. In the end, the Study hesitated to make a firm recommendation on how the funds should be raised.

7.9. An overall perspective on the report

A thread running through the report was that the standard setter's constituency should be significantly broadened beyond those who attest to financial statements. The Foundation's trustees as well as the members of the standards board and its advisory council were to be drawn from a wide array of interested parties, as was the composition of the Wheat Study itself. No longer would the standard setter be dominated by the interests of partners in accounting firms, let alone by the Big Eight firms. The wider public interest in financial reporting was finally acknowledged.

8. Rendering the report

The Study submitted its report, which was unanimous, to the Institute's board of directors on March 29, 1972, the day on which it was released to the public. As the Study had begun its work in April, 1971, a span of just 12 months for completing the report represented an admirable pace for such a difficult, delicate, and wide-ranging assignment. Several thousand copies of the printed report were sent immediately to the members of AICPA Council, to members of the Institute's senior committees, and to interested organizations, government, the press, and others. Copies were placed on sale, and by early May more than 35,000 copies were sold. The chapter in the report which summarized the Study's conclusions and recommendations was mailed to every member of the Institute.[39] The report was widely covered in the press (Allan, 1972; Accounting Board Should be Supplanted..., 1972; What's Inside the Wheat Report, 1972), and it was announced in The Journal of Accountancy (The Wheat Commission report, 1972).

9. The Institute takes prompt action to approve and implement the Wheat recommendations

The Institute's leadership acted with dispatch – some would say at warp speed – to approve and begin implementing the Study's report. John Biegler, one of the three CPA members of the study group, said that both the study group and the Institute's board of directors felt a strong sense of urgency. "It was recognized," he was quoted as saying, "that there was grave danger that the morale of the APB would be seriously affected by the prospects of being lame ducks...of being put out of business. It was felt that the APB's effectiveness would be restricted and that we couldn't afford – in the public interest – to have a hiatus period" (Nolan, 1972, p. 24; ellipsis in the original). Biegler could speak as an insider in both camps, because, as mentioned above, he was also a member of the board of directors.

The Institute's leadership quickly decided that it should take the initiative to carry forward the Wheat recommendations. On April 10–11, less than two weeks after release of the Wheat Report, the Institute's board of directors held a special meeting devoted entirely to the report. The study group's members were in attendance and responded to questions from board members on the first day of the meeting.[40] On April 11, the board issued a public statement which included the following

[39] AICPA Minutes of Meeting, Board of Directors, April 28, 1972, pp. 37–38 (obtained from the AICPA Library, University of Mississippi).

[40] If minutes were kept of this meeting, they have not survived.

passage: "In strongly urging the AICPA Council [at its meeting on May 1–3] to adopt the report and to authorize its prompt implementation, the Board concurred in the judgment of the study group that an urgent need exists for 'a bold new effort to insure public confidence in the ways in which financial information is reported'" (Statement by the Board of Directors..., 1972). Anticipating Council's approval, the board of directors requested the Institute president to set up a special committee to develop the initial steps for implementing the Wheat proposals. The president, who chaired the board meeting, promptly complied, and he named Marshall Armstrong as its chairman (Olson, 1982, p. 68). Among its five members was John Biegler. The committee was to canvass reactions to the report and to determine the likely financial support for the program envisioned by the Wheat Study (AICPA Study on Establishment of Accounting Principles, 1972, p. 667).

Letters of comment on the Wheat recommendations rolled into the Institute from interested groups and individuals. It was reported in the press that the Financial Executives Institute (FEI) was unhappy that only two of the seven seats on the FASB were to be reserved for business executives. In its submission to the Study's public hearing, FEI had said that 40 percent of membership of any new standard-setting board – closer to three than two members of the seven-member board – should be reserved for business executives. Yet FEI nonetheless endorsed the "concept" embodied in the Wheat proposals (Andrews, 1972; AICPA Study on Establishment of Accounting Principles, 1972, p. 681). The same news report disclosed that SEC Commissioner Needham had recently warned industry "to consider the Wheat report carefully or be prepared to have a federal agency write accounting rules" (Andrews, 1972).

At its next regularly scheduled meeting, on April 28, the board of directors received the conclusions and recommendations of Marshall Armstrong's special committee on implementation, which apparently had been working nonstop since its appointment. The committee, he said, had canvassed twenty of the larger accounting firms and others, and had reviewed the correspondence the Institute had been receiving on the Report, and conveyed its conclusion that

> the recommendations of the study had been endorsed enthusiastically by a majority of those who communicated their views; that the support was derived from all segments of the financial community affected by the recommendations; and that the spirit of cooperation reflected in the communications created an atmosphere conducive to the establishment and maintenance of the proposed new structure.[41]

Based on the committee's survey of accounting firms and associations of firms, Armstrong said that it "was convinced that the minimum contribution which could be expected from the accounting profession would be approximately $10 million over a five-year period." The committee therefore decided not to pursue any of the funding suggestions considered by the Wheat Study and instead proposed that voluntary contributions be sought. The committee suggested that "a reasonable target date for the establishment of the Foundation would be July 1 and that the date for the formation of the Standards Board should be January 1, 1973."[42] The board of directors thereupon adopted a resolution for Council's approval to implement "as soon as possible" the Wheat recommendations in cooperation with the four other sponsoring bodies (the AAA, FAF, FEI, and NAA), which had all signified their conceptual support of the recommendations.[43]

On the first day of Council's regular spring meeting, May 1, six of the seven Wheat Study members attended (all but Thomas Pryor, who had a prior commitment), and it devoted a considerable fraction of the day, and also on May 2, to hearing views on the Wheat recommendations. Walter J. Oliphant, the Institute president and a partner in Arthur Andersen & Co., chaired the meeting. There was a lively discussion among the some 250 Council members in attendance. At the outset, Frank Wheat addressed

[41] AICPA Minutes of Meeting, Board of Directors, April 28, 1972, pp. 3–4 (obtained from the AICPA Library, University of Mississippi).

[42] AICPA Minutes of Meeting, Board of Directors, April 28, 1972, p. 4 (obtained from the AICPA Library, University of Mississippi).

[43] AICPA Minutes of Meeting, Board of Directors, April 28, 1972, p. 6 (obtained from the AICPA Library, University of Mississippi). At the subsequent Council meeting (discussed below), Institute President Walter Oliphant disclosed that both the board of directors' statement of April 11 and its proposed Council resolution of April 28 were adopted by an "almost unanimous" vote (Council Minutes, pp. 32–33). One supposes that the dissenter was board member Harry F. Reiss, Jr., who was a partner of Ernst & Ernst.

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remarks to Council in which he underscored his concern over the increasing perception of the lack of independence facing the accounting profession and therefore the need for a full-time board:

> The fact that our conclusions were unanimous reflects less a process of compromise than it does the powerful impact on each of us of the data and the opinions we sought during the course of the study.
>
> All of us have encountered, in one degree or another, the alarming growth of cynicism in the attitude of intelligent people toward the financial reporting process and especially toward the role of the independent CPA. Perhaps you read the editorial in Business Week the other day. "To outsiders," the editors said, "it sometimes seems that generally accepted accounting principles are what an accountant's biggest client wants them to be."...
>
> In such a climate, reasoned rebuttal is largely ineffective. For it is obvious to all that the pressures on the independent CPA have drastically increased. Powerful market forces have been at work; forces which have riveted the attention of the businessman on his reported earnings. I need not describe these forces to you – you are all aware of them – and they persist today in full measure despite the recent shakeout in which multitudes of investors were badly hurt.
>
> It was our conclusion that this situation holds great risks for the profession, risks that can be abated only by bold measures. The profession can no longer permit doubts to persist as to the disinterestedness of those charged with setting financial accounting standards....
>
> We concluded that what must be done could only be done by a change to a full-time standards board. (AICPA Study on Establishment of Accounting Principles, 1972, pp. 668–670)[44]

Wheat emphasized that a majority of both the trustees and the standards board must be CPAs drawn from public practice, because he was sensitive to criticism among Institute members that its influence over standard setting would be, as he said, "dangerously diluted." He also made the point that, as a result of the rising level of interest and activity by other groups in shaping accounting principles since the middle 1960s, the Institute had already begun to lose some of its power over financial reporting. He cited the major study by Professor Robert K. Mautz on line of business reporting in 1968, sponsored and published by the Financial Executives Institute's research foundation, which, he said, "the SEC took note of and found very helpful." Thus, he said, "The ball is not quite 100 per cent in the Institute's court" (Nolan, 1972, pp. 21–22).

Marshall Armstrong then addressed Council, and he read extracts from letters of support for the Wheat recommendations from the FAF, NAA, AAA, and FEI, as well as the entirety of a supporting letter from SEC Chairman Casey.[45] In his letter, Casey said that the AICPA "should conduct public hearings as soon as drafts are available of the charter, by-laws, and rule-making procedures which will govern the operations of the three new entities, as well as the method by which financial resources will be obtained" (Council Minutes, p. 44). Oliphant then said that he had persuaded Casey that the new Foundation was the more appropriate body to make this public exposure (pp. 54–55). Accordingly, on October 13, 1972, the Financial Accounting Foundation exposed its certificate of incorporation, its by-laws, and the proposed rules of procedure for the FASB for public comment, and announced a public hearing on December 15 in New York City for interested persons to give oral testimony (Financial Accounting Foundation, 1972, Preface).

Armstrong also said that his committee concluded "that there is little reason to doubt that sufficient funds will be forthcoming to establish the new entity on a very firm foundation" (p. 47), and he endorsed the board of directors' recommendation that Council take "prompt action" (p. 49). Clearly, the Institute's establishment supported Council's expeditious approval of the Wheat recommendations.

Richard Baker, the managing partner of the Big Eight firm of Ernst & Ernst, spoke to Council about his concern over the haste with which the Institute was proceeding, as well as expressing opposition

[44] Also reported in Proceedings, 1972 Spring Meeting of Council of the American Institute of Certified Public Accountants, May 1–3, 1972, Boca Raton, Florida (Martin C. Johnson Reporting Service, Inc., New York, New York), pp. 25–26. Subsequent references, and one previous reference, to these minutes are referred to as Council Minutes. These minutes were supplied by the AICPA Library, University of Mississippi. Wheat's quotation from Business Week appeared in an editorial (A Dose of Self-discipline, 1972).

[45] An extract from Casey's letter is reproduced in AICPA Study on Establishment of Accounting Principles, (1972, pp. 682–683).

to the idea of a full-time standards body. He called for public hearings to be held and urged that "a matter of such importance be taken to the full membership of the Institute" (Council Minutes, p. 56). He said that, if Council were nonetheless to take final action on the Wheat recommendations, his firm "will accept the decision of Council and support its actions with our full share of funds, cooperation and participation. And we will do this in the face of the strong reservations which most of my partners and I share about the proposal" (pp. 56–57). Ernst & Ernst, as it happens, was one of only two Big Eight firms that did not give oral testimony, or have a partner give personal testimony, at the Wheat Study's public hearing.

Baker began his case against the recommendations by saying, "The price the profession is asked to pay for this new structure is too high. The probability of its success is too low" (p. 57). He said that the merit of the APB was that its members who were partners in firms could draw on their partners for experience and wisdom derived from actual practice. "Will the new Board, cut completely free from real world ties, have any better basis for reaching acceptable conclusions?" (p. 60) He argued that "A company wishing to make its views known to the new Board has no need or reason to consult with its independent accountants," (p. 58) because the accounting firms will no longer be represented on the board. Baker concluded that "The profession will be putting its complete trust in seven unspecified people who will have no direct affiliation whatever with practice; who, so far as we can know now, will have no better research support than the APB, and who will have no legal or assured professional support" (pp. 61–62). One can understand the deep skepticism by some accounting professionals at seeing the Wheat recommendations become a reality, for the Study proposed embarking upon an uncertain course without precedent: there never had been a full-time, accounting standard setter in any country which was independent of the accounting profession. Wally Olson, who was present at the Council meeting, later wrote that Baker "denounced the profession's surrender of its existing control of the standard-setting body" (1982, p. 68).

Many speakers, pro and con, aired their views during two days of the Council meeting. The main issue was whether Council should act now or delay action until a wider consultation, including perhaps a public hearing and even a vote by Institute members, could be held – because the Wheat recommendations had been available for scrutiny for less than five weeks. The presenters included a parade of 15 past Institute presidents and former or current APB members, all but two of whom advocated immediate Council approval of the recommendations (Council Minutes, pp. 62–108, 153–176). At the end of the long session, Council voted to adopt the Wheat recommendations by "nearly unanimous consent" and authorized the board of directors to implement them as soon as possible (AICPA Study on Establishment of Accounting Principles, 1972, p. 674). The APB was to continue in operation until the FASB was fully operational (AICPA Adopts Wheat Report on Accounting Standards Board, 1972, p. 12). Although Armstrong's committee had said it expected the FASB to begin its official operations as the standard setter on January 1, 1973, this date had to be put off until July 1, 1973, because all seven board members could not be appointed and be in place by that date.[46] Accordingly, the APB ceased operation on June 30.

In early 1973, the AICPA membership voted to restate Rule 203 in its Code of Professional Ethics (Accounting Institute..., 1973) to say

> A member shall not express an opinion that financial statements are presented in conformity with generally accepted accounting principles if such statements contain any departure from an accounting principle promulgated by the body designated by Council to establish such principles....

Accordingly, at its May 1973 meeting, AICPA Council designated the FASB as the body "to establish such principles." Olson wrote, "This action, for the first time, explicitly brought compliance with accounting standards under the disciplinary machinery of the profession" (1982, p. 69).

On December 20, 1973, the SEC issued Accounting Series Release No. 150, which said that "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

[46] The seventh board member was not appointed until February, 1973.

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the body's conclusions will promote the interests of investors," effectively giving the FASB its endorsement.

10. The new structure begins to be built

Wheat Study members John Biegler and Thomas Pryor were elected as trustees of the Financial Accounting Foundation in June 1972, and Ralph Kent, who had signed one of the letters from three Big Eight firms in November 1970 protesting the APB's performance, was also elected to the trustees and promptly became their choice as president of the Foundation (Board of Directors Names Trustees..., 1972). Ironically, Kent's accounting firm, Arthur Young, was perhaps the least inclined of the Big Eight firms participating in the Study's public hearing toward making changes to the APB model.

The Foundation was incorporated promptly on June 30, 1972. It was set up as a Section 501(c)(3) tax-exempt organization under the Internal Revenue Code. Donations to such organizations are deductible as charitable contributions on the donor's federal income tax return. The five sponsoring organizations – the AAA, AICPA, FAF, FEI, and NAA – pledged their support for implementation of the study group's recommendations, and each individually agreed to use its best efforts to raise an aggregate funding of $3.5 million from their memberships during calendar 1973. In the end, they raised $3,759,000 for the period ended December 31, 1973 (Financial Accounting Foundation Report, 1974). The Big Eight firms "each pledged $200,000 a year for five years in support of the new FASB" (Olson, 1982, p. 68).

Marshall Armstrong, the Institute president for 1970–71 who had overseen the appointment of the Wheat Study's members, was named chairman of the FASB, to take effect on November 1, 1972 (Marshall S. Armstrong is FASB Chairman, 1972). The FASB held its first meeting on March 8, 1973 with all members and members-designate in attendance. Frank Wheat was named to the FASB's 28-member advisory council, which met for the first time on March 28. It was made known that the advisory council would meet with the board every three months (Financial Accounting Foundation Report, 1974, p. 3).

The FASB began with a research staff of twelve, drawing on backgrounds in public accounting, industry, government, academe and financial analysis. The new organization moved into its permanent headquarters on July 2, which was an entire floor in an executive office park in Stamford, Connecticut, within easy commuting distance of New York City (Financial Accounting Foundation Report, 1974, p. 15).

11. Conclusion

The Wheat Study's recommendations led to the establishment of the first full-time, independent accounting standard setter anywhere in the world, complemented by a sizable full-time research staff. The SEC welcomed the innovation. The Institute lost its control over the standard setter but retained considerable leverage in the appointment of the trustees of the Financial Accounting Foundation and therefore indirectly in the appointment of FASB members.

The model proposed by the Wheat Study not only changed the course of standard setting in the United States, it had an impact as well overseas. In the Dearing Report in the U.K., which led to the establishment of the Accounting Standards Board in 1990, the example of the FASB arguably played a role in the recommendations for the shape of the new board and its oversight body (The Making of Accounting Standards, 1988).[47] In 1999, the SEC chief accountant argued strongly that the part-time International Accounting Standards Committee (IASC) should be restructured along the lines of the FASB, and the IASC complied. In 2001, the IASC became the International Accounting Standards Board (Camfferman and Zeff, 2007, pp. 480–493). Thus, it can be argued that the structural balances in the Wheat Study's design for the world's first full-time, independent, private-sector standard setter proved adaptable to other times and other settings.

[47] Whittington (1989, p. 204) referred to "the obvious pedigree" of the Dearing Report stemming from the Wheat Report.

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