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Presentation, Spring Meeting of Council, May 1, 1972

Francis M. Wheat

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Presentation by Francis M. Wheat, Chairman
Study on Establishment of Accounting Principles
Spring Meeting of Council
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Herodotus, I believe it was, reported a custom among the ancient Thurians, that whosoever should propose anything new must present himself, with a halter around his neck, to the people, so that, if his proposal be rejected, he could be promptly hanged!

With this in mind, you will understand any worried looks you might see on the faces of the members of the Study whom you invited to Boca Raton. They have an additional cause for concern, in that due to lack of time they have not seen these remarks. Fortunately, therefore, they bear no responsibility for what I have to say.

We are honored to be your guests, and we are hopeful that we can explain ourselves. To that end, I will try to keep these remarks reasonably brief so that we can respond to your questions. Apart from this, we are mindful that our work is done. The decisions to be made, and their timing, are entirely yours.

First, let me pay tribute to the members of the Study and to our superbly effective administrative aide, Mike Pinto. It was a pleasure, as well as a constant challenge, to be with these men for a year. Like the blind men, at first, each of us saw the elephant somewhat differently. But it is fair to say that each of us, on the basis of the evidence we gathered and the forceful debates we had among ourselves, changed his own thinking somewhat during the time we were at work. The fact that our conclusions were unanimous reflects less a process of compromise than it does

the powerful impact upon each of us of the data and 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 a less dramatic vein, here is what the respected dean of a major graduate school of management in my part of the country has to say:

"The profession performs a role critical to the continued success and confidence of our economy. But it is not living up to what the investing public expects of it. Those expectations must be satisfied. They reflect valid needs that must be served. Unless the accounting profession undertakes to satisfy them, the profession ultimately will be relegated to a lesser role and some other agency or body will determine the policy and perhaps even provide the machinery to satisfy them."

There is no point in extending the critical catalogue. 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. And, if the basic responsibility for standard-setting is to remain in the private sector -- as we hope it will be -- we dare not permit the delays, sometimes extending over many years, which have attended this vital function in the past.

We concluded that what must be done could only be done by a change to a full-time standards board.

Immediately, a very pertinent question arises. Can men of the necessary experience and high ability be found to serve on such a board? I am aware of the differences between the professions of law and accounting, and am therefore hesitant to react to the question based on my own experience. For I am sure that in the case of a task of comparable importance in the field of law, men of the highest competence would come forward. In light of what is at stake, I hope the accounting profession will recognize the importance of fostering arrangements by which valuable men can leave their firms for public service, with assurance that their

careers in the private practice of accounting will, if anything, be enhanced thereby, and that they could reasonably expect to be welcomed back without loss of status. Perhaps this may require some creative adjustment of the ladder which now seems to regulate advancement in private firms.

Our recommendations involve another issue of the highest importance. The comment has been made that the accounting profession must never permit outsiders to have a role in establishing financial accounting standards apart from one of commenting upon proposals designed and submitted by professional bodies. They fear that our recommendations would involve a dangerous dilution of what must be the profession's sole responsibility. We understand and sympathize with such concerns. And we hope you will note that we have carefully provided for a strong and continuing nexus between the AICPA and the new standards board.

Not only will the new foundation be organized by the AICPA, but at all times a majority of its trustees, chosen by the Board of the Institute, must be CPAs in public practice. A majority of the members of the new standards board must also be CPAs drawn from public practice. These arrangements are, we believe, realistic. The standards developed by the new board must be seen to be standards of the profession. The primacy of the profession in their development must be, and has been, assured. But a healthy degree of realism, together with a decent respect for the interests of others vitally concerned with the financial reporting process, requires that there be some sharing of the responsibility. To fail to do so, when confronted with the keen interest of groups of

growing national importance, would be to court disruptive conflict.

A third pertinent issue comes to mind. What place will there be in a new arrangement for those from medium-sized and smaller accounting firms? The experience of such firms is vitally necessary to the new board. I hope and believe it can be fully provided by representation on the board itself and through the inclusion of able leaders of the profession from smaller firms on an expanded advisory council.

Turning to the larger firms, the question can well be asked: Will the opinions of the new board command the respect of the so-called "big 8?", despite the fact that these firms are no longer granted the privilege they have each enjoyed of always having a representative on the board itself?

And what of the cost? The new arrangements will be expensive; can the funds be raised? Will they continue to be provided?

Far be it from a mere lawyer to try to answer these questions. Only you are competent to do so. But I would make one comment as a detached and sympathetic observer. Public accounting for many has become big business. Can it survive, both as big business and as a profession? It can, I believe, but only if it gives its support in full measure to the task of establishing standards of reporting in the public interest, and to the standards themselves, when adopted. In today's age, for your profession, I truly believe this is a touchstone. Members of the big 8 firms with whom I have talked also seem to sense that it is. If so, representation on the standards board need no longer be regarded

as the necessary prerequisite to insure support of a standard with which some members of a particular firm, or the firm itself, may not agree. Support and acceptance must and should spring from more laudable and fundamental considerations; in short, the preservation of the high mission of the profession.

It is just as important for big business to understand that its interests, too, are at stake. We should say to business: A new beginning has been made, with a nongovernmental structure designed to insure, insofar as is humanly possible, not only that financial reporting standards are practicable, but that the sole objective in their design will be the public interest in the most informative financial reporting.

It is a structure which will operate in the perilous area between the private pursuit of wealth and the exercise of governmental fiat. It should provide you, gentlemen of business, with every opportunity to advance your own position in comment and in testimony. But the surest way to bring it down will be to go to Congress and to lobby against a proposed, or adopted, standard as you recently allowed yourselves to do. Unless responsible businessmen warn their colleagues against this, and unless they have the courage to take swift action to counter it, should it occur, any standard-setting mechanism in the private sector is sure to be damaged, perhaps beyond repair. And it will be your loss, gentlemen of business, as well as a disaster for the profession of public accounting.

I have talked long enough. We are all anxious to respond more fully to the questions I know you have for us. Thank you for the privilege of being here.