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Accounting Principles, at the American Institute of Certified Public
Accountants 84th Annual Meeting, Detroit, Michigan, October 11,
1971**

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REPORT ON THE PROGRESS OF THE
STUDY ON ESTABLISHMENT OF ACCOUNTING PRINCIPLES

by
Francis M. Wheat, Chairman
at the
American Institute of Certified Public Accountants
84th Annual Meeting

Cobo Hall
Detroit, Michigan
October 11, 1971

It is appropriate that I should follow Bob Trueblood in reporting to you on the activities of the second Study Group appointed by the Institute last spring. For we must now move from the sublime to the mundane, from theory to mechanics, if you please. Ours is an intensely practical task. It is to examine the procedures by which financial accounting standards are being developed in this country and to recommend specific changes, if we believe changes are needed.

No one in this audience needs much elaboration on the "why" of our study. Your President, Marshall Armstrong, in his charge to us at our first meeting, put it this way:

" . . . the number of suggestions on how the present mechanism for setting accounting principles could be improved almost matches the number who have discussed the matter - and, in fact, one man's meat proves to be another man's poison. The differing views are also often held with passionate intensity, which is not surprising since the issues are of such consequence to so many people."

Who are the people whom your President appointed to listen to the critics, whether cold or passionate, to give the most careful consideration to their views, to make our own independent study in the meanwhile, and to report our findings to you? You might say we are a blend of those who have made, enforced, applied, submitted to, taught and nitpicked the principles of accounting.

John Biegler, Managing Partner of Price Waterhouse, is a former member of the Accounting Principles Board. Arnold Levine and Wally Olson, of J. K. Lasser and Alexander Grant, respectively, are distinguished practicing accountants and the leaders of their firms. Wally, in addition, has special experience in the formulation and enforcement of ethical standards; he is currently Chairman of the Executive Committee of the Institute's Ethics Division. Tom Pryor is Chairman of the Investment Committee of White Weld & Co. and one of the country's leading financial analysts. Roger Smith is Vice President-Finance of General Motors, which should speak for itself. Professor David Solomons is Chairman of the Accounting Department of the Wharton School. And yours truly is a lawyer, sometimes involved with accounting questions which are central to the disclosure process in the field of securities law, and an erstwhile bureaucrat.

Nowhere could a more cooperative, intensely interested, hard-working group of men be found than my fellow Committee members. If we produce anything useful in the challenging atmosphere alluded to by President Armstrong, it will be due to their wisdom and good sense. And I might add that they bear no responsibility for my remarks today.

The work we had to do was apparent from the very beginning. It was first to listen and then to make practical judgments based on what we learned. We are still in the listening phase. It will culminate for practical purposes on November 4 when we expect to finish the public hearing announced in August. Meanwhile,

some or all of us have met for extended discussions with those groups and individuals who indicated a desire to talk to us. It is important, I think, to give you an idea of the scope of our inquiry. At the risk of boredom, let me run swiftly through our schedule of the past four months.

Of prime importance, we have met and debated the issues with representatives of many firms of practicing accountants, both large and small, and with many individual accountants.

We have met with delegations from the Financial Executives Institute and Robert Morris Associates. All of us have had conversations with individual businessmen.

We have talked with the staffs of the SEC, the Cost Accounting Standards Board, the Federal Power Commission, the Interstate Commerce Commission, the CAB, the Treasury Department, and one member of the President's Council of Economic Advisers. We have met informally with members of the SEC and hope to do so again.

We have held discussions with distinguished economists and professors of accounting throughout the country.

We have talked at length with committees of the American Bar Association and the Investment Bankers Association concerned with accounting. We have met with the Departments of Stock List of the New York and American Stock Exchanges.

We sat with Committees of the Financial Analysts Federation and the National Association of Accountants.

Finally, we have talked with the senior staff of the Institute and have all met with the Planning Committee of the Accounting Principles Board. Most of us have been with the Board when it was in session.

We are studying the ways in which accounting standards are established in other countries.

We have received many thoughtful written suggestions and expect to have more of them in advance of our public hearing.

We have collected a great deal of data, some of it not previously available, which we regarded as important to our job.

After all of this, where do we stand?

Unfortunately, but not unexpectedly I hope, we cannot yet give you our conclusions since we have not reached them. We are and will remain, open to wise counsel until our job is finished - particularly until November 4. I urge any of you who believe you can help us to do so, if possible before that time.

Of one conclusion, however, I am sufficiently sure to touch upon it very briefly.

We are convinced that the task of formulating financial accounting standards is of major importance to a free enterprise economy such as ours, which has matured with an ever-increasing public ownership of private business enterprise. The task

deserves more effort and commitment of resources than it has received in the past. There is no doubt that it will be done, whether well or ill. By whom it will be done depends, at least in part, on who has the ball and runs with it.

While there may have been some debate in the past about the need or desirability, from the standpoint of accountants in general, of undertaking a major effort to narrow differences in accounting, the Council of the Institute at least by 1964 had firmly established the goal of eliminating alternative financial accounting practices which are not clearly justified by differing circumstances. Intervening events, including a further large increase in the number of Americans owning stock in publicly-held corporations and the rise and fall of the conglomerate craze (hopefully in its final stage at present) have underscored the necessity of pursuing that goal with increased vigor and determination.

There is a risk that such a statement might possibly be taken as an adverse reflection upon the present Accounting Principles Board. This would be wrong.

All of you can take pride, I believe, in the sense of dedication and the high professional skills which the members of this arm of the Institute bring to the work they are doing. Their job entails substantial personal sacrifice. I need only remind you that in its first full year of operation, the Board met only two full days. During 1971, 27 full meeting days

have occurred or are scheduled, without counting the many days of work spent by subcommittees of the Board. And those who would fire heavy criticisms at the Board will find it to be a moving target. Only this spring, for example, the Board introduced the commendable innovation of public hearings on proposed opinions of a controversial nature.

Nevertheless, as the members of the Board know, we are taking the current wave of criticism very seriously indeed. Among the prime concerns which will surely be reflected in our conclusions are these:

First, we are vitally concerned with due process in the formulation of accounting standards, in its broadest sense. Among other things, there must be sensitive and appropriate mechanisms for those outside the profession, particularly business management and financial analysts, to play a significant part in the process.

Second, we are concerned with efficiency. How can the process, which has in the past been grindingly slow at times, be made more swiftly responsive to the felt needs of the public and the profession? In particular, what can be done to speed the output of necessary accounting research?

Third, we are studying the proper roles of private and public institutions in the process. What mix between the government and the private sector will preserve incentives to insure that the very best men will devote their energies to the

job? How can the specific concerns of interested public and private agencies be better coordinated before accounting principles are established?

Fourth, we are concerned with priorities. No human institution can do at once all the things that need to be done. The more important matters need to be recognized as such and should have first call on available time and manpower.

Here there is considerable room for disagreement. Some would support a concentration of effort on the evolution of a consistent body of fundamental principles. It is a consummation devoutly to be wished - but one which, as Bob has observed, has so far proved extraordinarily difficult to achieve. No one doubts its importance. However, others view the immediate need as a more pragmatic one. Let me explain their concern.

Deplore it as we may, the fact is that public investors are overwhelmingly interested in the income of business, often to the neglect of other significant financial criteria. For this reason, the incentive to manipulate income in ways that can be highly misleading is strong. The public's need for protection against potentially misleading financial information, and especially misleading earnings data, is more compellingly articulated with each passing day.

Until there is accord on fundamental principles, this need must be met with the aid of experienced judgment and

common sense. The temper of the times indicates that it will be met, either by the institutions of the accounting profession, or by government. We dare not wait, however much we might all desire full agreement at the outset on the nature of such basic concepts as business "income". I am not overly discouraged by this. The good judgment of experienced and practical men is not a bad foundation for action. You may remember the remark (slightly paraphrased) that was contained in one of Justice Potter Stewart's opinions:

"I can't define pornography and perhaps I could never succeed in intelligibly doing so. But I know it when I see it."

This brings me to the last of the pressing concerns of our study. It is, of course, the quality of the output of whatever body is charged with the primary task of formulating financial accounting standards.

How can we best insure that such standards will serve the interests of the users of financial statements?

And can such standards be expressed in a fashion that will meet the demands we have heard from the critics? In other words, can an opinion or pronouncement setting forth a standard leave no doubt as to its objective, illustrate the practices which it is aimed against, be simple and straightforward, not too long, without prolixity or complexity, yet contain no ambiguity, permit no loopholes to exist, cover the subject

matter comprehensively, and be sufficiently detailed to furnish adequate guidance to all?

That is a question we must try to answer, I suppose, if we are to discharge the duties you have laid upon us. Don't expect any miracles! We know we shall not be able to please everyone. Yet both for ourselves and for the critics, there is comfort and counsel in the remark of Horace Walpole: "Imagination", he said, "is given to man to show him what he might become, and a sense of humor to console him for what he is."

Thank you very much.