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

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A B S T R A C T

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based on published and unpublished materials and an interview with the lone surviving member of the study group.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