

# **A Perspective on the New Deal and Financial Reporting: Andrew Barr and the Securities and Exchange Commission, 1938-1972**

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An assessment of the influence of New Deal agencies on professional accounting standards in the United States requires attention to the office of the Chief Accountant of the Securities and Exchange Commission (SEC). As the principal advisor to the members of the Commission, the Chief Accountant and his staff play a formative role in federal policy for financial disclosures required of publicly held companies.

Andrew Barr served 16 years as Chief Accountant from November 1956 to January 1972. No other individual has served longer. Furthermore Barr's service in government, from 1938 through 1972, (including four years of active duty in the military during World War II), provides a unique career pattern for historians to consider as to capital market regulation and accounting disclosure over a period including the administrations of six Presidents, (Roosevelt through Nixon), and a variety of economic circumstances--namely depression through 1960s expansion.

This paper addresses Barr's role in a variety of events beginning with the McKesson & Robbins fraud (1938) through the expansion of SEC market authority in 1964 and includes the investment credit policy decision in the early 1960s. The paper is developed in six parts, the first part relates background about Barr's education and experience prior to joining the SEC staff. Part two reviews Barr's important role in the McKesson case. Part three addresses Barr's wartime and post-war roles. Part four examines the policy dispute as to the investment tax credit. Part five addresses the 1964 Securities Act and the final section of the paper assesses Barr's influence and legacy.

## **The Background**

When Andy Barr joined the staff of the office of the Chief Accountant at the Securities and Exchange Commission in 1938 he was like other young professionals who entered government then, committed to serving the country as it attempted to restore itself from a devastating depression. Barr also perceived the position to be an "opportunity" to be in on the "ground floor" at the SEC.

From that time until his retirement in 1972, his only employer would be his "fellow citizens" via the Federal Government; the last 16 years (1956-1972) he would be Chief Accountant of the SEC, arguably the most important *accounting* policy function in the USA's capital market system.

Barr attributes his career accomplishments to influences which relate to his undergraduate and graduate study at the University of Illinois, located in his hometown of Urbana, where several generations of the Barr family had lived. Barr's family had been involved in a business of making building bricks, and sold their products throughout the area.

At the University of Illinois, Barr was to study with other future leaders of the profession including Paul Grady. He also became acquainted with other Illinois graduates including John Queenan, who would become managing partner of Haskins & Sells during the 1960s, and Weldon Powell, an acknowledged leader among practitioner theorists. The Illinois program was in this way uniquely able to pay "network" dividends to Barr's career. Barr acknowledges that two accountancy faculty, Hiram T. Scovill and A.C. Littleton were major influences on his career. His U.S. Army officer commission, received at graduation, also linked him to a cadre of military science faculty and fellow officers with whom he would share overseas duty assignments during his service as a 3rd Armored Division field grade officer in Europe during World War II. After graduation Barr practiced public accounting in Chicago, and then accepted a teaching post at Yale in 1926.

In 1938 Barr left the academic post at Yale and began his SEC service. Carman Blough, the SEC's first Chief Accountant, interviewed him. By the time Barr reported for work, however, Blough had left the Commission. Thus Barr's first assignments at the SEC were directed by W.W. (Bill) Wertz who served as Chief Accountant from May 1938 until April 1947.

### **The McKesson & Robbins Investigation**

Wertz was faced with the issues of the massive McKesson & Robbins fraud, and the serious concerns presented by it about the adequacy of audit procedures and financial reports at a time when post-depression investor confidence was just beginning to be restored in the stock market. This affair represented the first major test of the Chief Accountant's office to address and resolve matters involving questionable activities which occurred under its New Deal jurisdiction. The manner by which the case was resolved would be an important element in resolving the public's concerns about the perception of a fair public capital market. The case would also serve as a precedent for relationships between the SEC and the American Institute, the representative organization of the growing CPA profession, as to matters of policy over standard setting in auditing practice.

Wertz assigned Barr to the McKesson case to work as a "Research Accountant," a modest title for a prominent role. Barr's tasks included assembling the facts and materials which would provide the basis for the Commission's investigation of the case. The challenge was formidable if only because there was no precedent for the proper process to follow in such a matter.

The Commission's Accounting Series Release No. 4 (1938), had recognized the propriety of individual members of the accounting profession determining their own sources of "substantial authoritative support" for financial reporting while at the same time retaining for the SEC the power of oversight. While federal law clearly empowers the SEC to establish accounting and financial reporting practices for publicly held companies, what was at issue in the McKesson case was what role the Commission should take in establishing auditing *procedures*. Given that independent public accountants, licensed by States, were recognized under the provisions of the Securities law as the persons competent to perform audits, the question was "*Should the SEC set auditing procedures to insure that public companies' reports were properly presented?*"

The challenge which Wertz and Barr faced was how to establish, for the record, a basis for understanding the state of the art of audit procedure and practice. Wertz decided to obtain testimony from prominent individual auditing practitioners and experts. While individual accountants had testified from time to time in Congress on legislative matters, such testimony was not common when involving investigative procedures of New Deal regulatory agencies. The proper limits for a regulatory agency in such an inquiry of a profession was a matter involving the need for diplomacy. Professionals were likely to be reluctant to respond if the hearings were a stage or a drum-head tribunal carried out in a summary fashion. Wertz succeeded at this effort, arranging for the appearance of professionals at the public hearings held during early 1939. Barr played a key role by preparing the questions to be asked of the witnesses.

In addition to top accounting firm partners, witnesses included a representative of the Controller's Institute (now the Financial Executives Institute) and a consulting engineer experienced in providing appraisals. The witness list read like a "Who's Who" of the early 20th century accounting profession representing a variety of practice firms to include (in the order of testimony):

Peat, Marwick, Mitchell & Co. (Samuel J. Broad)  
 Scovell, Wellington & Co. (Charles O. Wellington)  
 Touche, Niven & Co. (Victor H. Stempf)  
 Haskins & Sells (William H. Bell)  
 Lybrand, Ross Brothers & Montgomery (Norman J. Lenhart)  
 Mathieson, Aitken & Co. (John K. Mathieson)  
 Webster, Horne & Blanchard (Henry A. Horne)  
 Barrow, Wade, Guthrie & Co. (Charles B. Couchman)  
 University of Illinois (Hiram T. Scovill)  
 Klein, Hinds & Finke (Joseph J. Klein)  
 Ernst & Ernst (George D. Bailey)  
 Arthur Andersen & Co. (Charles W. Jones) [10].

Notably, Price Waterhouse was excluded from the list because of its involvement as the auditor of record for McKesson-Robbins.

## Outcome

The McKesson episode and related testimony provided an opportunity for the special committee on auditing procedure of the American Institute to respond to SEC concerns by establishing extended auditing procedures, such as requiring the confirmation of receivables and the observation of inventory. By the time the SEC report on the McKesson case had been completed, the practice community had already acted satisfactorily to address the concerns by establishing the extended procedures and forming a standing Committee on Auditing Procedure, chaired by Sam Broad of Peat Marwick Mitchell.

## World War II and Post War Events

Barr's professional accounting career in government was interrupted when World War II broke out. He reported for duty as a field grade staff intelligence officer, (assistant G-2), in the 3rd Armored Division. Barr was assigned to intelligence because his commanding officer knew of Barr's work on the McKesson & Robbins case and thought that it was appropriate experience to qualify Barr as an intelligence officer. He was discharged from active duty in 1946 and returned to the Commission to serve with Bill Werntz once again. When Werntz resigned, Earle King was named Chief Accountant. Barr now was assigned new duties at the SEC, as chief accountant of the Division of Corporation Finance, where the active review of registrant filings is a principal responsibility.

In conversations with Barr over the years, the authors have been impressed with the breadth of experience that Andy's years in government provided him. One can assume that, had he chosen to leave government service, he would have readily increased his compensation many times over. Yet he never admitted to being tempted to leave government service, despite the many difficult and challenging issues he addressed. In some ways, Barr, a lifelong bachelor, had acquired by virtue of his position an adopted extended family, consisting of his government associates, his University of Illinois classmates, and those who shared his interest in military history.

## Controversy and Conflict

During Earle King's term as Chief Accountant, the American Institute's Committee on Accounting Procedure (CAP) issued Accounting Research Bulletin No. 32 (December 1947). This bulletin, which was in the form of an "authoritative" statement recognized by the SEC, expressed the position that the "current" or normal operating profit concept of income determination was to be viewed as the preferred approach to income statement construction.

The issuance of ARB No. 32 led to open controversy between the CAP and the SEC. King, upon learning of the Institutes' decision to endorse the "current operating" concept, wrote to the Institute and requested that the SEC's position be published in the issue of the *Journal of Accountancy* (January 1948) in which ARB 32 was to be released. In blunt terms King stated that "...the Commission has authorized the staff to take exception to financial statements

which appear to be misleading, *even though they reflect the application of Accounting Research Bulletin No. 32*" (emphasis added, p. 25). The Commission thereby asserted its own preference for another method, the "all-inclusive" approach, to income determination.

The SEC's direct challenge to the authoritative self-regulatory role of the CAP reminded the profession where the legal authority rested in such matters--namely with the Commission. This experience foretold a similar confrontation for Barr which would occur during his term as Chief Accountant when he would have to decide upon proper practice in the matter of financial statement treatment of the investment tax credit.

Upon Earle King's departure from the SEC in November 1956, Barr was named Chief Accountant. Barr's term of service as chief accountant, which would extend to January 1972, is the longest in the 60-year history of the Commission. Barr became involved almost immediately in attempting to reconcile the difference between the American Institute's rules relating to auditor independence and those of the Commission.

His arguments were carefully set forth in a 1959 paper "The Independent Accountant and the SEC," based on his address to the Ohio State Accounting Institute, published in the *Journal of Accountancy* in October 1959 [1]. Barr stressed the difference in view about independence as between the Institute and the Commission. Professional auditors argued that independence was a "state of mind" and was not impaired "in fact" by a financial interest or consideration such as by compensation from a client in stock shares as payment for auditing services when a small company filed an initial public offering. The SEC's view, however, was that such arrangements raised doubts and potential conflicts of interest. Therefore, "in appearance", these situations were violations of independence. Thus Barr argued any financial interest should be avoided, if not prohibited, when "material" to a practice unit professional's financial position.

Such restrictions on financial relationships led to increased observation of "appearance" rules by the SEC as the basis for evaluating independence. The Commission continues to follow this "appearance rule" precedent in its policy today.

Two other important matters addressed by Barr during the economic expansion of the 1960's were the "stop order" issued in the *Atlantic Research Corporation* (ARC) case and the resolution of the accounting for the investment tax credit in corporate financial statements.

The Atlantic Research case was important because it served to illustrate how a company chose to disclose a difference of opinion about the application of generally accepted accounting principles. ARC reported a "loss" on its income statement filed with the SEC in Form 10-K (as calculated under provisions of the SEC's Regulation S-X), while for the same time period it reported "net income" under GAAP (generally accepted accounting principles) in the separate annual report financial statement that was sent to shareholders. Both statements had been subjected to audit, but two different sets of rules (S-X vs. GAAP) had been applied.

By challenging this practice, Barr initiated a process which his successors, John C. "Sandy" Burton and Clarence Sampson would follow. Eventually, as a result of this and similar concerns over such episodes of "differential disclosure,"

differences between S-X and GAAP income reporting were eliminated. By 1980 an identical "basic information package" would be disclosed in both the published annual reports and in SEC filings, (Form 10-K).

### The Investment Tax Credit Controversy

Barr's term as Chief Accountant was not one characterized by open conflict with the practicing community. However, there were controversies over particular issues. The investment tax credit (ITC) issue is an example. That issue has come to serve as a historic episode of conflict between the accounting profession and the SEC, wherein a government agency is perceived to have overruled a professional standard setting body even though the latter was acting within its domain.

During the late 1950s Barr had served as a member of the special committee of the American Institute of CPAs to establish an entity to replace the Committee on Accounting Policy (CAP). The proposed new vehicle was named the Accounting Principles Board (APB). The Board idea was controversial and had not been unanimously supported. However, the need for a process of authoritative "self" regulatory professional standard setting was widely endorsed and supported in principal by leading CPAs in public practice.

Shortly after the APB began operations, the new administration of President John Kennedy proposed, as a means of economic stimulation, to provide a 7% investment tax credit [ITC] against federal income taxes for most forms of corporate capital investment. Such a credit was, to major tax paying corporations, the economic equivalent of a cash refund, particularly since the credit could be "flowed through," that is, applied fully and immediately against taxes payable in cash.

The APB in considering the matter, however, favored and ultimately decided to support a view which required a "deferral" of the credit's benefit to be recognized over the life of the asset[s] acquired. This approach resulted in less immediate reduction in tax expense and less benefit to corporate income -- although the cash consequence was not impaired. The deferral vs. flow-through controversy polarized the profession, with major accounting practice firms being about equally divided. Overall the leadership of the profession preferred to establish the authority of the APB and its authoritative opinions. Support by the SEC would insure that the Board would achieve recognized authoritative status.

Barr's recommendation to the SEC Commissioners, however, was to permit either method. His reasoning is contained in "Accounting Treatment of Investment Tax Credit on Corporate Financial Statements" [1, pp. 286-89]. Barr argued that the credit "is in substance a *reduction* in income taxes" and not "a reduction in or offset against a cost chargeable...to future accounting periods." Barr reasoned that it was the *intent* of Congress to affect "immediate" benefit from such an investment tax credit, where possible. To this day Barr does not discuss the ITC matter willingly, except to point out that in the 1970's when a version of the investment tax credit was again enacted Congress specified in the legislation that either method, "deferred" or "flow through," was to be accepted for financial accounting purposes!

The investment tax credit episode demonstrated that alternatively the ultimate power of deciding an accounting controversy could be placed in the hands of Congress when the profession and the Commission disagreed. It served to emphasize the political and cultural importance of accounting and of the economic power exercised by professional standards boards and related governmental agencies.

### **The 1964 Securities Act**

During the quickening capital market environment of the early 1960s, Barr was involved in assisting the Commission in preparing for Congressional hearings which resulted in important amendments to the Securities Acts. Revising these laws, then thirty years old, was necessitated by changes in the market for publicly traded securities. Many large companies which traded on the "over-the-counter" (OTC) market "avoided" SEC disclosure filings because the OTC was not a formal stock exchange even though companies sought public capital through the informal OTC "listing". The 1964 Acts extended investor protection and the disclosure requirement process to OTC stocks and to major transportation companies and railroads, such as the Pennsylvania and the New York Central, which had previously been exempted from SEC filing because they had been subject to Interstate Commerce Commission oversight.

During these Securities Act amendment hearings, Congress also inquired if "alternative accounting" methods were accepted by the SEC and if all such practices were in accordance with GAAP? This oblique inquiry veiled a true concern, namely, "Was the SEC properly exerting its powers under the law to see that investors received information based on sound accounting practices?" During these 1964 hearings, Barr, as the Chief Accountant, affirmed that the process in place, that of professional standard setting with SEC oversight, continued to be appropriate and was sound.

### **Assessment and Perspective**

Barr was a proponent in the founding of the AGA (Association of Government Accountants/Federal Government Accounting Association) which sought to achieve federal interagency harmony. He traveled to World Congresses of Accountants, served as a vice-president of the American Accounting Association, and was a member of the governing council and committees of the American Institute of CPAs. He also was active in support of the National Association of Accountants' (now Institute of Management Accountants) and the Academy of Accounting Historians. In a sense, he was governmental accounting's ambassador to the accounting profession.

Barr's academic career, twelve years at Yale, was brief but his lifelong scholarship is evidenced in his collected papers published in 1980 by his alma mater, and by his authorship of the 3rd Armored Division's official history. He was also instrumental in publication of the collected papers of his predecessors at the SEC, William Wertz and Earle King. When Andrew Barr retired from government service in January 1972 he was seventy years of age and had achieved international recognition.

Today, persons beginning their professional accounting careers face a labyrinth of customary practices and standards, an array of institutions and professional activities all formed in earlier times. Such precedents are best considered with some perspective so as to understand and to adapt precedents to present needs. Therefore, for someone to gain an insight of "Andy" Barr's views should serve to contribute to a sense of such perspective.

Two principles appear to underlay Barr's approach to his role as an important accounting executive in the federal government during the rapid period of economic growth in the 1950s and 1960s. First, he supported a view that the corporate management had both *the right* to express their views in corporate annual reports and the *responsibility* to do so fairly. This notion was affirmed in the Atlantic Research case where Barr challenged management's report, as contained in the annual report, which departed materially from the results filed with the Commission's 10-K under Regulation S-X. Second, Barr's policies were consistent with achieving the *greatest possible cooperation* with all elements of the practicing accounting community. He was in this way someone who preferred to act as government's ambassador to the accountancy profession and by his involvement in several organizations he practiced a form of personal diplomacy.

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