Securities and Exchange Commission Historical Society
Oral History Project
Interview with Donald Hayes
Conducted on February 14, 2011, by James Stocker

JS: This is James Stocker. I'm talking today with Donald Hayes. We're really happy to have you here.

DH: Thank you, James. It's a pleasure to have you here in sunny California.

JS: First of all, why don't you tell me a little bit about your early life? Where were you born and where did you grow up?

DH: I was born in Wayne, Pennsylvania in 1929, December 10, 1929, just a couple of months after the big crash. My father worked for Beech-Nut Packing Company as a salesman for a number of years. There were cutbacks. We had to pack up and move the family back to his hometown in Crafton, just outside of Pittsburgh, Pennsylvania. I grew up in Crafton, went to grade school there, also high school.

In the course of my high school days, of course, there was talk about what career do you want to pursue. I had two uncles who were in the accounting field, were very successful at it. I was pretty good at math. We put two and two together and decided I should go to Duquesne University, take business administration, and major in accounting. That's how I started in accounting.

JS: Were you ever tempted by any other career paths?

DH: In high school I was fascinated by sports, where I participated in baseball, tennis, and hockey. I quickly figured out I could go nowhere in those other than have some fun. I was also fascinated by astronomy. So I thought about that. But again, I thought about - you work all night, you don't make much money, and concluded accounting sounds much better. So I chose that course.

JS: Did you join the Air Force before or after college?

DH: I joined it after. When I went to Duquesne University, they had the ROTC program. I joined that and took four years of ROTC Air Force training. The Korean War started mid-point through my college days. However, being in ROTC, I was able to continue on and graduate, and then became a second lieutenant in the United States Air Force from 1952 to 1954; had some interesting experiences there.

JS: Did your duties there involve accounting at all?

DH: Yes, they did. I was eventually stationed at an Air Force depot in Topeka, Kansas, that handled the Air Force supplies for that part of the country. They had cost accounting systems, inventory control systems, and things like that. The controller there said, "You're the man to deal with this." I got into those kinds of systems. I was there when the Air Force put its inventory records in dollars.

Prior to that, the government had inventory records in terms of quantity, but no dollar value attached to it. I went to a training course the Air Force put on, on how to put all this data on IBM punch cards, price it out, and come up with the dollar value of the inventory at the depot. None of us knew what it was going to be. We had guesses what it might be, it turned out to be $85 million or something like that, which back then, of course, was real money. I had a good experience there. But after the two-year period there, I wanted to get back and give public accounting a try.

JS: Understandably. Did you already have a job before you finished your time in the Air Force?

DH: No. Right at the end of my Air Force days I started to send out resumes to the large accounting firms in Pittsburgh. I would say five of the Big Eight. By the time I got back to Pittsburgh, I had responses from four of the firms that said, "Yes, come in and talk to us." I did that and selected Arthur Young & Company as the firm I wanted to join.

JS: So Arthur Young was your first job then, after the Air Force?

DH: Yes, it was.

JS: That's great. That was in 1954?

DH: That was in ’54.

JS: Then you worked there for two years before you took the CPA examination?

DH: Yes. In Pennsylvania, you were required to have two years’ experience to take the CPA exam. I did that and had the good fortune to pass the exam on the first try. Back then in Pennsylvania, under their CPA rules, you had to pass the entire exam in one try or start all over again. Other states would permit you to pass a part and then later take other parts. Pennsylvania required you to pass the whole thing. I breathed a very deep sigh of relief when I found out I’d passed the whole thing.

JS: I can imagine. What were you doing during those years in Pennsylvania? What was the work of a junior auditor like?

DH: You start from the bottom, of course. You start with very detailed work, which some junior auditors say is kind of boring. But that’s where you have to start to learn the ropes. On a typical audit, we would start with what we called interim work. Sometime during the year, for example, August, September, October, and at that point in time, we would audit the internal control system and also do a limited amount of work on what had transpired for, let’s say, the eight months up to that date. The purpose of doing interim work was to ascertain whether the internal control system was functioning properly and also to take the work load off the end of the year.

After going through that phase, we'd come back at the end of the year, December, January, February, and complete the audit. The year-end work would be to go down the balance sheet accounts, starting with cash, reconcile bank accounts, count petty cash, receivable, confirm them, check collectables, evaluate based on agings, inventory - observe the counting of inventory. Usually December 31st required you to miss your New Year's Eve party and go to some cold place in Pennsylvania or elsewhere to test-count inventories. Also, we had to take into account obsolescence to make sure inventories were at lower of cost to market.

Deferrals and prepaids: make sure the matching process is being properly followed and that items that should be expensed were not being deferred, for example, advertising. We called it "fixed assets" back then, but it's property, plant and equipment today. The major items purchased by the company would be vouched. We would look at the invoices and other backups, and make sure that nothing was being capitalized as property, plant and equipment other than an asset that would be usable over the period of a number of years.

On the other side of the balance sheet, at the end of the year we'd audit accounts payable, make sure they were all on the books, look at invoices that came in after the end of the year, like in January, to make sure none of those related to December items. And if they were, we'd make sure they got recorded. Accruals of all sorts, like vacation pay, warranties, pension costs, taxes: we would look at the makeup of those accounts and determine that the accrual on the books was proper.

Long-term debt: if the company had some, we'd confirm that with the trustee. Also check the loan indentures behind the long-term debt to make sure that, if there were dividend restrictions, we knew what they were. They would be disclosed in the financial statements. Contingent liabilities, which were usually footnote matters, were handled by getting legal letters from law firms, and also reading the corporate minutes to make sure that there were no legal actions referred to there.

JS: At this time, all of this was done on paper, right? You didn't have the advantage of personal computers?

DH: No personal computers. This was all on-work papers. We would have a really big stack.

JS: Did you have a secretary that would help you out with all this stuff, this paperwork? Or were you the secretary?

DH: As a junior, you do everything from get coffee to do the more basic stuff including cart around the work papers. When you're there as a senior, then you have some juniors working for you who can get the coffee, and help prepare and keep the work papers.

The only account I didn't mention, capital stock, of course you audit that to make sure that any dividends paid were authorized in the minutes. The income statement, we'd look at and investigate unusual trends. We would look into general and administrative expense, because you never know what's going to be charged in there. We would review income taxes to make sure they were properly calculated.

For large engagements, there would be other Arthur Young offices involved, so we'd have information flowing in from the other offices to put together with the local statements in consolidation. For some clients, we would actually make up the statements ourselves, because the client relied on us to do that. For most of them, however, they made up their own statements and then we would tie our information into the client's statement. We would participate in the preparation of the annual report, which looked like this one on Chevron [holding up 2009 Chevron annual statement] I have in my hand here, except not as thick. Go to the printer with them, make sure everything proofread properly.

JS: How long was the typical annual statement at this time?

DH: I would say it was probably no more than fifteen or twenty pages.

JS: Whereas this book that you have in your hand is…

DH: This book I have in my hand is about ninety pages. I was just curious and I counted the footnotes in the Chevron statements. It has twenty-six notes over thirty pages. That's not counting the management's discussion and analysis of twenty pages, and the information on oil and gas reserves of thirteen and the statements of six. So virtually, this entire report is financial information and footnotes. Whereas when I was first getting into auditing, I would say the financial statements and footnotes were only about one-third of the report. The other two-thirds was description of the business, pictures, and things like that.

JS: And that's a reflection of the evolution of accounting principles?

DH: Yes, it is.

JS: Or the complexity of business, also?

DH: Yes, I would say it's a combination. The complexity of business and more matters are now covered in accounting standards. Most of them involve disclosure. Then in addition to that, we had the SEC requiring increased amounts of disclosure. It's a combination of all those factors.

Probably also litigation is a factor. Back when I started, it was uncommon for an accounting firm to be sued. It was also uncommon for companies to be sued over the contents of their financial statements. Now, of course, it's become quite common. So companies are going to err on the side of over-disclosure.

JS: When do you think that started to change? When do you think was the turn?

DH: I would say the 1960s. One of the famous cases was *Continental Vending*, where the auditors were accused of participating in a fraud. That certainly worried us. There were a number of other lawsuits in the sixties. Of course, all the way back there was the *McKesson & Robbins* case in the late 1930s, which led to the requirement to observe physical inventories. I would say it was mostly the 1960s that started the trend towards greater disclosure and greater pressure for development of uniform accounting standards.

JS: So during the sixties, I guess, you started out the sixties in New York, where you went on Arthur Young's SEC and accounting research intern program?

DH: Right, right.

JS: Was that an important step in your career?

DH: Yes, it was.

JS: In what way?

DH: I'll go back a little further than that. The profession started out with the CPA being expected to know everything about taxes, auditing and everything else. Taxes became so complex that we decided we needed separate people who were fully informed on taxes; the auditors would be most informed on that subject.

In the sixties, we were getting into a situation where the SEC requirements were also becoming extremely complex. We thought we needed at least a few technical consultants who would be fully informed on the SEC requirements, and for all that matter, the Accounting Principles Board. I was selected to be one of those persons who would work with our national office people and learn from them, our lead partner in the firm, learn from them about SEC matters and new accounting principles matters.

JS: This was like your post-graduate specialization?

DH: Exactly right, exactly right. One of the things we did, for example, when our senior technical partner would have conversations with other offices on SEC problems they were having, he would put it on speaker phone. We'd sit and join them and listen to the full conversation and his advice of what was happening. Another thing we would do is we would have – and this was in New York now, we were right down near Wall Street - we would have one of our secretaries go to each of the underwriting firms and pick up their latest batch of prospectuses on new offerings.

We would see these in our intern group and review all the financial information in them and index any unusual item. So we had a card index. Again, this was before computers. We had a card index of unusual accounting items that we would notice. We gained the experience of what other firms were experiencing with the SEC, as well as our own client experience.

JS: So while you were in New York, were you advancing progressively in your career? Did you make partner?

DH: In the first year there, I became a manager right away. I'd mention also, when I was in the national office in the SEC group working for a senior partner, I wrote an article for the Arthur Young Journal, July '63, called "Disclosure in Summaries of Earnings." The summary of earnings, five-year income statement, so to speak, was always considered the most important part of the prospectus, because it showed the registrants, the company's, earnings strength.

Therefore, practice had developed over the years to have various kinds of disclosures and various kinds of pro forma presentations to make it all that the SEC wanted it to be, and all that the underwriter wanted it to be. What I did in this article was put together the different requirements for disclosing information in a summary of earnings. The guidelines were taken from both experience and from various accounting series releases, the SEC, and all carefully explained. After that brief national office experience, I was asked to be the lead SEC director in our New York office, and that was from '63 to '71.

JS: If I can mention just really quickly about this article that you wrote. At this time, was it necessary for someone who wanted to advance in their career to write articles like that and to publish? Or was it just something that you did because you were interested in it?

DH: It wasn't necessary to publish anything, particularly if you were partner engaged full time in audits. In a position like I was in, I thought it was a good idea to do it. It was something needed. I think it gave me some writing experience. The article I wrote, I made the first draft, had many good editors. I learned a lot about writing an article.

JS: I can imagine, because you also continued writing articles?

DH: Yes, I did.

JS: We'll talk about that a little bit later. You became the SEC report unit leader at the New York office?

DH: In the New York office, that's right. In that capacity, I would review all of the SEC filings of all the New York office clients, which were numerous. Mobil, RCA, American Machine and Foundry, and so forth. I would look at all of the 10Ks, the annual reports, the S-1 registrations and so forth, and offered comments on them to our engagement teams. We made sure they were fully compliant with SEC requirements.

JS: At this time, there were a lot of changes that were taking place in the American business environment. This was the beginning of the wave of mergers that the sixties is remembered for. What sort of challenges did that pose to you as an auditor?

DH: I would say almost every week we had a situation where a client was acquiring another company or merging with another company. It gave rise to the question, "Is the transaction a purchase or a pooling of interests?" At that particular time, the rules were kind of ambiguous and most transactions could be regarded as a pooling of interests.

Under the pooling concept, the assets of the target company were not written up. The good will is not amortized and so forth, and therefore companies were motivated to do common stock exchanges. Had they done only common stock deals that would probably not have been a problem. But then they started to add in preferred stock, convertible debentures, the concept of transactions being part purchase, part pooling came about, and all sorts of unusual things were happening.

JS: As an auditor, how did you feel about this? Because on one hand there were expectations from companies, but on the other hand, you knew that the lines were a little bit blurry at times.

DH: We knew the lines were blurry, we could see practice, and generally speaking, the standard is generally accepted accounting standards, not what the auditor would personally like to see.

JS: Did you feel that clients might shop around for different auditors? Did you think that was already a practice at this time?

DH: That later became a practice, yes. If they didn't get the answer they wanted from their own auditor, they might call another firm. I would mention that, as to the merger and acquisitions, this was probably when I started to become more acquainted with the SEC, because if the merger accounting was in any way questionable, we would take it down to the SEC. Initially, it was Andy Barr, chief accountant; it later became Sandy Burton, and later Clarence Sampson, to review the transaction with them and make sure that they would accept the accounting we were proposing.

JS: This was about the time of the creation of the Accounting Principles Board?

DH: Yes, the Accounting Principles Board came in the early 1960s with a long list of things they wanted to work on.

JS: From the viewpoint of a working accountant, did this seem like a positive development, or was it more worrisome?

DH: Yes, it was positive. Because we thought there was not sufficient uniformity in accounting. We thought there was not sufficient specificity in existing standards, that existing standards were outmoded, not up with the times. We thought the APB was the Great White Hope to solve all of these problems.

JS: Did you imagine, in the early 1960s, that you would one day be a member of the APB?

DH: It never occurred to me. I'd certainly worked with our senior partner, who was on the committee. I knew what the board was doing. But I was too busy doing things right in front of me to think about that.

JS: Were you already active in the AICPA at this time?

DH: At that particular point in time, no. I was active in the sense of going to technical meetings and so forth, but I was not, as I recall, on any other committee. I was on the firm's accounting committee, the firm's national accounting committee, too, which met five or six times a year, and went over accounting issues.

JS: By 1970, the issue of pooling had begun to come to a head to a certain extent. The SEC was starting to push the APB to issue rules governing accounting.

DH: Yes.

JS: Did you see this as a positive thing at the time? Would this have been something that would have been welcomed by Arthur Young or by you personally?

DH: Very definitely. I think all the firms wanted greater specificity in accounting standards. For one thing, in dealing with a client, if we could say to the client, "The accounting standard says this, and that's your situation," then obviously the client doesn't have much of an argument. But if we're dealing with some vague standard, and the client says, "You say it says this, I say it says this." So by having more specific standards, I think all the big firms thought we'd be better off.

JS: I can see that. I know that at some points during 1970, there was a lot of criticism of the rules that the APB did propose on the issue of pooling. Some firms began to criticize the APB's decisions, saying that they were too strict.

DH: That happened. I think you have to look at that in a context of everything the APB had done prior. For example, if you go back to the beginning, the first big thing they really handled was the investment credit. The board then proposed that the credit be deferred and amortized over the life of the property that it related to. Seemed like very sound accrual accounting.

They put out the standard to that effect. Lo and behold, the SEC, probably under pressure from elsewhere in the government, decided they cannot insist on only the deferral method of accounting, that they would accept also the flow-through, recognize immediately, method of accounting. So they undercut the board, and the board was required to rescind that requirement right off the bat.

The board then moved onto some easier things to do, like a source and application of funds statement. It had never been officially required under any accounting rules. In part that was in response to the financial analysts saying, "If you can't give us uniform accounting, at least give us good information on cash flow." So we said, "We'll give you cash flow."

Then they moved onto leases on the lessee side. Should the airline, for example, have to capitalize a lease of an aircraft? The board came up with a test called the material equity test. Many additional leases were capitalized, but an awful lot of them fell through the crack and weren't capitalized. As a matter of fact, when the board went on to deal with the lease from the lessor side - that might be the bank of finance company that owns it and is leasing it out - the board was much more liberal on letting the leases be capitalized by the lessor as a receivable, as an asset. That immediately put lease accounting out of sync. I think there was dissatisfaction with the board on the matter of leases.

Pension cost, tough problem. The pension plans became more generous. A lot of unfunded past service costs was not being recognized in the statements. The board, I think, made a very notable effort to deal with that with an extensive opinion. But it also did not put all of the unfunded liability on the balance sheet. It took the FASB to do that many years later.

In opinion nine, results of operations, many companies, prior to that, if they had a big loss they didn't want to highlight, they would treat it as a "special item." They would emphasize ordinary operating income. They would then have a "special item" below the line, in effect saying, "Stockholders, please ignore this, this was an accident, it'll never happen again."

The board thought this was an abuse and those special items should be moved up into net income and that items should not be run through surplus. That passed without too much controversy.

The next one that created a lot of controversy was that the board dealt with a very narrow subject of whether, when convertible debt is sold, whether the conversion privilege should be assigned a separate value. Let's say the convertible debt sold for $10, 000 with a privilege to convert into so many shares of common stock any time in the next ten years. The conversion privilege obviously has value, and for that reason the convertible debt would sell at a lower interest rate. The board said, "Companies should assign part of this value they received, $10,000, so much to the conversion privilege, say 150, and the rest to the debt. After you assigned the rest to the debt, that would impute the interest on the debt from say 4 percent up to say 6 percent.

Wall Street didn't like that. This was getting in the way. They objected, the board came back and took a look at that and decided, "Well, I guess we haven't figured out how to value options yet, stock options, so it probably is not reasonable to require companies to value the conversion feature of a debt." So they dropped that.

JS: When Wall Street didn't like something that the APB was considering, what did they do, who did they call?

DH: They would complain to the SEC. They would complain through the Financial Executives Institute, and obviously we as auditors would hear it directly from them. I think we felt we had to – some of the items, like the convertible debt accounting, kind of slipped through. I don't know if there was an exposure draft on it. It was slipped through without a lot of due process. Industry demanded due process. If you're going to do something, at least give us warning. Give us a chance to comment on it. In some cases, the board had to agree there wasn't enough due process involved in getting the standard out.

So that's how they made their point. I would say also in the case of leases, they wrote their congressman. The clients and investment bankers would write the congressmen and say the APB statement on leases is going to make it difficult for airlines to acquire aircraft, which we need to keep the system going. Or in the case of oil and gas, it'll make it difficult for oil companies to drill for oil wherever they want to. So that happened also.

JS: So we're in the late 1960s at this point. Were companies already talking about antitrust suits against the APB?

DH: I don't recollect that specifically, but that was probably a threat, some sort of a suit. And I think that's when the AICPA reacted and said, "Well, we need two study groups. We need a group to be headed by Bob Trueblood, an eminent CPA from Touche Ross to head up a study of the objectives of financial statements. Then we need another committee to study the establishment of standards, what kind of a board, how should accounting standards be adopted?" That to be chaired by Frank Wheat, who, I believe, was a former SEC Commissioner. So those two gentlemen undertook those two tasks to come up with two studies.

JS: So the accounting industry was supportive of these initiatives to deal with the problem?

DH: The accounting industry really started them. But I would say they started them with some urging by industry, that industry should play a bigger role. For example, at our APB meetings there was one industry member. Exposure drafts were sent out to industry. If we had committees on a particular topic, like oil and gas, it would generally be made up from auditors in the accounting profession, who we could enlist to help do the work. Industry would not be well represented. So industry thought it should have greater representation.

JS: The Wheat Committee ended up recommending the establishment of an independent board.

DH: Yes.

JS: The FASB. It seems interesting that the accounting industry would have supported an initiative that basically took the power out of its own hands.

DH: There were mixed feelings about it. First of all, the cost for the AICPA to deal with all these accounting issues, in terms of added staff, more meeting time, travel time, everything like that, was becoming larger and larger and larger as we took more on our agenda. So the AICPA would have had to pass that cost on in membership fees. Many members would say industry is presumably getting the benefit of all the work we're doing. Why shouldn't they help pay for it? The industry was receptive to the idea that if we have an independent board, they would chip in, which, of course, they did through the Financial Accounting Foundation, to help pay for the FASB.

I think the AICPA, on the one hand, would have liked to be in the business, but on the other hand, the business was becoming too expensive, too difficult. They recognized we probably needed full-time members, not just six-times-a-year member, like I eventually became.

JS: Of course this was costly not only in terms of money, but also in terms of the time of the individuals involved, right?

DH: Yes.

JS: As you would find out yourself very soon.

DH: Yes, that's right.

JS: So I want you to tell me, how did you become a member of the APB?

DH: Probably because of my background and the fact that I'd worked closely with our prior member on the board, who was retiring. I was also in New York, and the board usually met in New York.

JS: Who was the prior member on the board?

DH: The prior member on the board was Frank Weston.

JS: And you knew him?

DH: I knew him quite well. I was recommended by a number of people as someone who would largely fit into that role. I knew what the board was doing, I'd worked with Frank.

JS: Were the members elected?

DH: No, the members were appointed, one from each Big Eight accounting firm, and then probably three or four from mid-size accounting firms. Then one would be an industry rep who was connected with the Financial Executives Institute committee, another would be a financial analyst, if we could find one, and another would be an academic. Chuck Horngren, Professor Chuck Horngren, in this case, was on the board. The members from the individual Big Eight firms, it was basically one from each firm, the firms could make their pick.

JS: So this time Mr. Weston or someone came to you and asked you, "Would you like to serve on this board"?

DH: Actually, the managing partner of our firms nominated me. He said, "We'd like you to do it." I said, "Yes, I'll do it." My nomination went to the Institute, and since it came from the managing partner in our firm, the Institute, of course, wouldn't question it.

JS: Now, was the Wheat Commission already working on the report that would basically advocate the end of the APB?

DH: Well, they were at the time working on it. We weren't certain they would advocate the end of the APB and the start of a full-time board. I think we realized that was a likely course of action that could happen as we approached our agenda.

JS: But there were no worries that your service on this board would affect your career negatively in any way, right?

DH: I didn't think so at my young age. Now, someone in the firm who was older might have thought otherwise, who was handling big clients, might have thought otherwise. In my situation, I was still in the learning process. I think you're forever in the learning process in accounting.

JS: Were you already a partner at this point?

DH: I was a partner at that point.

JS: What year did you make partner?

DH: 1968. And this was ’70.

JS: So you were a junior partner?

DH: Since ’68.

JS: It’s very interesting to me that in the last year-and-a-half of its life, the APB issued ten or eleven rulings, which was nearly one-third of its total output during a life that stretched over a period of almost ten years.

DH: Right.

JS: So why so much activity if the board was on its way out?

DH: We had a chairman, Phil Defliese from Coopers & Lybrand, who was a very energetic chairman, who believed that we should do everything that we could possibly do to make it easier, perhaps, for the FASB when they took things over. There was also going to be a recognized gap, interval between when we finished and when the FASB started up. We knew the SEC would not be comfortable with nothing happening in terms of accounting standards. So Phil said basically full speed ahead, let’s do everything we can.

JS: What issues did you decide to tackle first?

DH: The sequence was, first of all, to clean up the standards we had in process, first an APB on accounting policy – disclosure of accounting policies. Disclosure of accounting policies was something that had been done on a fragmented basis in financial statements. Statements might disclose a company's inventory on the LIFO method. They might disclose it used the accelerated appreciation method and so forth. But rarely were the policies disclosed in one single footnote, so this new requirement was to disclose all those diverse policies together in one footnote, so a financial analyst or other reader could make their own evaluation of the impact of different policies.

The financial analysts would no doubt have liked to have some computation of the effect of each policy a company used against every alternative policy it might use. That would be a huge confusing mathematical table. We quickly decided that was not possible. So we required just a narrative description.

We then moved on to finish a couple of areas of deferred taxes, which I think doesn't require comment. We also had opened the investment credit, which had not been satisfactorily resolved in the past.

JS: This had also been a controversial issue.

DH: This had been a controversial issue going back to the start of the APB in 1961. The investment credit was still allowed under the tax law. Most companies were flowing it through income in the year they claimed it. Some would defer and amortize it over future years. We thought there should be a single standard.

We discussed it with the SEC. The SEC said they would support a single standard. So we came up with a single standard that said the investment credit should be deferred and amortized over the life of the related assets. That was supported by the Board by, I would say, a two-to-one margin. There were four or five dissenters.

I can still recall the meeting in which we were about to vote on that, and Phil Defliese was leading the meeting. Dick Lytle, the lead staff person for the institute, interrupted and said, “I have a phone call from Washington.” Phil said, “Well, what’s it about?” Dick said, “We understand that Senator Bentsen has just introduced an amendment to the Internal Revenue Code that would say no company shall be required to defer the investment credit if they don’t want to.” The message went on to say, “That amendment has just passed.” Phil put the issue aside and said, “Let’s go on to something else.” That was the end of that discussion. I think it was another reminder that we always had to take into account the political input, as the FASB has found out also. We were also dealing with oil and gas accounting at the time.

JS: Also a very political issue.

DH: Very political issue. We could see that one coming, and we decided that was a good issue to defer to the FASB. Marketable equity securities was also a very interesting one. Basically, many conglomerates, ITT was one example, were acquiring insurance companies at that time. The insurance companies would have large portfolios of common stock.

The common stocks would generally be carried at cost. Therefore, that put the company into position of having an instant profit by merely selling a stock. Even though the market generally might be going down, they could sell one with a low cost basis and have a gain. The gain would then go into their income statement. That additional income might enable them to have a total 10 percent income increase for the year.

In any event, there was a view that marketable equity securities needed to have some attention. We looked at different alternatives. State them all at market. Leave them at cost. If they're on market, should we amortize the appreciation slowly into income, which Chuck Horngren used to call "smoothing," or should we let appreciation flow through only when capital gains occurred, which some called a yo-yo method?

JS: Did you reach a decision?

DH: We didn't reach a final decision. The decision we reached on this issue was that it was intertwined with current value accounting. The Trueblood Committee was looking into the basis of financial reporting and presumably current value. This was just not the right time to jump into that. It would be premature. We let that one go for the FASB to take over.

Foreign currency translation, the problems that had arisen in the early seventies when the dollar was allowed to float, had somewhat alleviated. We thought that would be a good one to hold over to the FASB as well.

JS: Now this was, of course, an issue that must have been very dear to your heart, because you published an article on the subject in, I believe, the *Harvard Business Review* in 1972.

DH: Yes, ’72, when the dollar was first floated - meaning the dollar exchange rate with the Deutschmark, Swiss franc, Dutch guilders and so forth - those exchange rates were no longer pegged. Therefore, with the inflation in the U.S. at the time, those currencies were appreciating in value against the dollar.

Now, this was a situation which hadn’t happened before. We were usually dealing with other currencies, South American, particularly, depreciating against our currency. So we needed to look at that, and did. I suggested a proposal focused primarily on the U.S. company that might have an autonomous subsidiary in Germany doing business strictly in Deutschmarks, including with Deutschmark long-term debt.

Under the old standards, the traditional approach would be to translate the value of the

German assets from Deutschmarks into U.S. dollars at the rate that prevailed when the assets were acquired. That was historical cost accounting. On the liability side, the argument was that it should be translated at the current rate. So the assets would stay at cost while the liability would be marked up. There was a loss.

We stood back and looked at that result and said, "How can you have a loss when this German subsidiary that operates in Deutschmarks should make the same Deutschmarks earning they did before, and Deutschmarks are worth more in U.S. dollar returns. How can this represent a loss?" We thought more of an overall economic look should be taken. That led to the article that I wrote for the *Harvard Business Review*. The APB later decided that the accounting that followed that article would hold us over till the FASB could undertake a complete study.

JS: We were just talking about stock compensation. What was the APB doing on that at the time?

DH: Well, the accounting research committee of the AICPA had dealt with stock compensation to some extent in prior years. But since that date, a number of new types of stock plans, stock option plans, had been developed. The old standard was just inadequate to deal with the subject. The Board was attempting to come up with a standard that would cover all the new plans.

JS: Were there any particular cases at this time that had come out in the news, or was it just a general issue?

DH: I don't think there were any scandals or things of that nature. I think the SEC was getting nervous that there were so many unique kinds of stock plans that were not being accounted for. Under the old standard, if you gave stock to an employee, he had an outright grant that would be charged as compensation at the fair market value of the stock. That was pretty clean cut. However, if the stock had restrictions on it, companies would discount it to a lower value for compensation purposes. The SEC was concerned that those values were unrealistically low.

Also, the old standard called for charging compensation to expense for an option if the option at date of issue was at less than the then market value. The current market value was say $10, the employee gets an option to buy it at $8; there's $2 worth of compensation. But for the more traditional option then, the qualified stock options, the employee would get the option to buy it at $10. So the then-accounting called for no compensation charge.

But as additional variations were added onto those kinds of plans, for example, to have the price of the option decrease over time, or other variations, companies continued to not record compensation. It was obvious they were giving value to employees; the board was attempting to deal with these new plans.

JS: So what did the board decide?

DH: Well, the board evaluated whether to use the fair value of the option itself as a measure of a charge to income, or whether to adopt some variation of the old standard. Some of us thought the best approach would be to require a valuation of the option itself; just like investment bankers can and do value warrants, put a value on them. Someone ought to be able to value an option. Charge compensation for that value. That idea was not too popular in industry, obviously, because it would have involved significant charges to income.

Also, we recognized the valuation of options was quite difficult. There would be a lot of non-uniformity if we were to require that. Perhaps we would be moving too fast and we should merely change the existing standard to specify that the compensation amount is to be measured when the number of shares is known and the option price is known. If the number of shares being granted was in any way adjustable up or down, then the compensation would not be measured until the final number of shares was determined. Likewise, if the option price were adjustable up or down, the compensation would not be measured 'til the later date.

So the effect of that was for certain types of plans, phantom stock plans, variable option plans, and so forth, to cause a significant compensation charge to income. That's the way we moved that one forward. I thought it was, on balance, a good opinion. But I think the better approach would have been to value the option itself, which is what the FASB did when they dealt with the subject many years later.

The topic I was the chairman of - every topic had a subcommittee and every subcommittee had a chairman to gather the information needed for the standard - was one called non-monetary transactions, which some of the members jokingly called "trade-in accounting." If you traded in your old car and paid another thousand dollars plus the trade-in, then your purchase basis of the new car would be a thousand dollars plus cost. The tax law would dictate something close to that.

That method was frowned upon as not recognizing current values of what was being exchanged. Oil companies were exchanging oil interests to serve their own strategic purposes. Even companies like meat packing companies exchanging entire meat plants to move from one line to the other. Of course, in sports teams, teams traded players.

So the basic question was, were those non-monetary exchanges of the type that we should evaluate and record the value of what was being exchanged? And, of course, the revenue question would be what if you developed a player - if you're a sport team and you developed an outstanding player - he's on your books at a basis of zero, because you deferred no cost for him. What if you trade him to some other team for a "million dollar" player? Then should you have a million dollar gain because you "sold" a player on your books at no cost, and you received a the million dollar player for him?

Well, the concern was what if someone swaps their alleged $2 million cat for one alleged $2 million dog. To make a long story short, most members were nervous about recognizing current value, since that could lead to recognizing dubious gains and values on exchanges.

So we limited the cases where value might be recognized. That would be OK, for example, when you're swapping quoted marketable securities for a building. But if you're swapping a building for a building, that would be a type of exchange where you should merely take the old asset off the books at its cost basis and bring on the new one at the same cost basis; no gain or loss.

JS: Under this ruling, who would be responsible for assessing the value?

DH: If you used value in an exchange, you would perhaps use an appraiser. But most of the swaps being dealt with here were like-kind property exchanges. So there was no need to revert to value. I would add that the Trueblood Committee was – we assumed, looking at value accounting, and so we thought we would be premature if we required value widespread for these particular transactions not knowing how the Trueblood Committee would come down on that issue.

This issue was also closely related to another standard that was under consideration for real estate transactions. There had been a number of cases, which the SEC became aware of, and issued releases, dealing with near year-end sales real estate at large gains by the seller. Sometimes those transactions in December, which added to the company's profits, would later get unwound. The buyers decided they didn't want to keep the property, they

”walked away” from it. So the seller got the property back again.

A committee was established, an industry expert committee, to deal with accounting for real estate transactions. My job as an APB member was to coordinate with them, review what they’re doing, read the proposals they came up with, and combine them into an accounting standard, which we did. One result was to prescribe various levels of down payments required in order for the seller to recognize a gain on the sale of property. This was what some accountants called a cookbook approach, specifying exact numbers.

Another curious thing happened. Some argued that the auditors should be able to make a judgment on the collectability of a receivable if you sell real estate, like we do for everything else. But our real estate experts were saying, “Well, the problem is if the buyer pays a note, a mortgage, and acquires the property, he can always walk away from the property in most states and just give it back.” So it gets unwound.

A question was, “Do you mean even if you sell a piece of real estate to General Motors, General Motors must put down a 10 percent payment for the seller to recognize a gain?” The real estate committee said, “Yes. They should be required.” It’s interesting to see what is happening to General Motors. We looked at General Motors then as the highest standard of quality of whether a receivable is collectable or not.

JS: Things do change, I guess.

DH: Things change. There were a few other items we finished. Not particularly controversial was interim reporting and whether the gain or loss from the extinguishment of debt should be recognized immediately. It should.

JS: Overall, how did your experience at the APB compare to what you expected?

DH: I would say it's a very collegial organization. We were all talking about doing the same things, trying to improve accounting. There were no sides or anything, this firm against that firm. I would say that all the members, when they got into those meetings and discussions, if they had some related involvement with some client, they would take that client hat off and look at all of these matters very objectively.

Of course, in the unusual situation where there are alternative methods, I might have a client that has method A, another B, another C, and other D, and you can't come up with a method that pleases everybody. So basically we'd select the one we thought made the most sense.

JS: So you were selected by your firm to participate on the board?

DH: Yes.

JS: Did you feel like you were a representative primarily of the firm, or that you were pretty independent?

DH: The understanding was I was a representative of the firm. I would refer issues that came up back to our firm accounting committee, which I mentioned, which I'm a member of. I would make the case for what I thought was the best approach. We'd go around the table and basically take a vote. I would say in most all cases we were in harmony.

A couple of my opinions were qualified in some respects. For example, on stock option accounting, I thought we should have used values. But overall, I voted for the standard. But generally, I was there as a representative of the firm.

JS: Do you think the firm was ever concerned about what would happen if the opinion of their member on the board got back to clients, for instance, on the questions of stock options?

DH: I would say no. I think, basically, because of diversity in accounting it would be difficult to come up with a standard that would please every company out there, every client you have. So there's going to be some client highly pleased with some standard and another kind of unpleased, and some others in between. Basically we just called the shots as we saw them.

I would make a point, for example, on foreign currency, to get better informed, I would talk to accountants at PepsiCo, or Mobil Oil, through the client team, to get their perspectives. I made sure that they were at least heard.

JS: I guess that's important, because you need to understand how this is actually working for companies out in the real world.

DH: That's exactly right. As Ross Perot once said, "The devil is in the detail." You have to get into the details to determine facts. That's really what happened on the convertible debt issue. The board came up with a good theoretical standard that you could work out on a blackboard. But when you tried to deal with it in practice, there were too many complications to make it work.

JS: What was it like to put out the light at the APB? Did you all have an end of an era party?

DH: I think we had an end of the era party. There were mixed emotions. There were mixed emotions. We knew that it was the consensus opinion to proceed with the FASB. As I say, I had another job. I sort of visualized I might not have to work as many twelve-hour days as I did with the APB. So I think everyone thought FASB would be a move in the right direction.

The institute had to re-evaluate, well, what are we doing to do in the area of accounting standards now that we don't have the APB? That led the formation of the Accounting Standards Executive Committee. That was a committee of representatives of the Big Eight and a number of other firms, I think we had a total of about fifteen, to address accounting issues.

JS: Was this before the end of the APB?

DH: This was right after, right after it was over. This was to be a sort of a successor committee with a very uncertain prospectus as to what we ought to do. Some of us thought that perhaps we could issue interpretations of the old standards, opinions we'd already issued. But the FASB said no, those would be binding accounting standards. You can't do that. We have that job now. So we set aside interpretations and basically came up with the idea of a position paper.

A position paper would merely express our views. It would be stated not to be binding on the members of the profession to follow it. But it was good guidance, and quite often we knew the SEC would probably require it in practice. Also we would direct all of those position papers to the FASB for consideration. In many cases they would take those standards, those position papers, and adopt them almost verbatim. In other cases they would change them around a little bit.

JS: So ideally, these position papers would be issued before the FASB would make a ruling?

DH: Oh, yes. These would be fairly narrow subjects that the FASB didn't want to tackle right away. They were dealing with big issues like research and development, and of course they were going to address foreign currency, and they were going to address oil, and gas accounting, and they were going to address leases.

So the big issues, the FASB wanted to give those the highest priority. The narrow ones, they were happy, I think, to have the AcSEC, as we called it, come up with a position paper that would set a practice and a direction and get us through for a while until they could deal with it.

JS: The AcSEC started right after the APB ended in 1973; were you involved with it from the beginning?

DH: I was on the very first AcSEC for about a three-year period. So I was in there during that formation period. Another thing AcSEC did, besides the position papers, was to read all of the FASB discussion memoranda and exposure drafts and so forth, and comment on them.

I can remember the FASB proposal on leases, which would have required fairly extensive capitalization, that was discussed by our committee. I can recall because I headed a sub-committee of our AcSEC committee, to deal with the response to the FASB. We came up with a view—a majority favored capitalization of all finance leases, which meant more extensive capitalization than before.

But there was a minority that thought it shouldn't go that far. There were others who said we ought to capitalize all leases, large, small, long, short, capitalize them all. Don't try to draw a line. I went to the FASB public hearing. That's a process the FASB instituted that we at the APB basically never used - a public hearing. I went to the public hearing to present the AcSEC position on leases, and FASB basically said, "Well, what do you have to say? What's your committee's position?" I said, "We do not have a unanimous position, but half favor the capitalization of finance leases." That was ones where the present value of the rentals is at least 90 percent of the asset cost, basically the formula the FASB later adopted. I said, "That's where the majority of the AcSEC comes down, but we don't have a two-thirds majority." I mentioned what the minority view was. Basically we did that, also. We inputted into the FASB on all the material the FASB was issuing, as well as dealing with these narrow issues through position papers. That kept us very busy.

JS: About this time in your career at Arthur Young, there were also some big changes, right?

DH: Yes, in '78, I had been in the position of director of accounting for the firm for several years and in various technical posts before that. One thing that was discussed in the profession was the notion of rotating audit firms. A company might have an auditor for say, seven years and then go to a new firm.

JS: What did you think about this?

DH: That would have been horrendously costly, because the time required to bring the audit firm up to speed on a new client is very significant. It involves a lot of cost also to the client because the client has to provide a lot of new information that the prior firm already had.

So the solution to that was let's at least rotate the senior partner on each of the major engagements after some period of time, like eight years. So in the context of that, I was looking for some new challenge. We needed a partner on the west coast to handle one of our major aerospace clients out here. They suggested I could do it.

JS: Which client was that?

DH: That was Lockheed. Part of the background is I had experience with the AICPA committee on relations with the CASB - Cost Accounting Standards Board.

JS: And what was that?

DH: The CASB was a board created in the government to deal with cost accounting standards for government contractors.

JS: So this was your first exposure to defense related issues?

DH: In that committee, that was my first exposure to defense contract reimbursement kind of issues. These were standards that were not designed for the financial statements of the contractor, but designed for the cost data that the contractor provides to the federal government when it negotiates the contract, or when it has a fixed-price contract with the government or a cost-plus contract.

I had that background, so I became a natural choice to come out to Los Angeles and direct that particular engagement. In the process I directed the audit on other companies, one a major agricultural company, another a cargo airline company, another a major biotech company.

JS: Your work on the Lockheed account took you abroad, as well, right?

DH: Yes, it did. London, Saudi Arabia, they had major operations in Saudi Arabia. Spent a week there, visited the various locations. The auditor does that to make sure they have a good feel for what's happening in overseas operations.

JS: Was this your first international work?

DH: That was my first international audit work of significance. Back in Pittsburgh, in my auditing days, various clients had overseas subsidiaries and they were usually small. We usually had our foreign office do the work. I would review it. I would work on translation and issues like that. This was the first case where I had a major client with overseas operations where I had to go to observe what was going on.

JS: So shortly after you were transferred to Los Angeles, you were appointed to the U.S. delegation to the International Accounting Standards Committee?

DH: Yes.

JS: How does one come to be appointed to the IASC?

DH: First of all, the AICPA had the practice of rotating those appointments, those memberships among the firms. So basically one would serve a three-year term and then the seat would go to another firm representative. I succeeded a representative by the name of Joe Cummings, who was from Peat Marwick. Wally Olson, then-chairman of the institute, knew me from the APB days, knew I had some background on foreign currency accounting and foreign matters like that, and so asked whether I could do that for a three-year term, involved meetings about five or six times a year, generally over in London, generally two or three days.

JS: So it was less of a demand on your time than your service on the APB?

DH: Yes. Also, many of the topics we were dealing with were repeats of the subjects I had dealt with on the APB, leases and pension accounting and many items like that which were now coming up in the international arena.

JS: While you were on the APB previously, did you attend any of the big international conferences on accounting, some of which led to the creation of the IASC?

DH: The IASC was created; I think it was back around '73. Now, I don't recall. I was not in those conferences.

JS: So you weren't following those closely?

DH: I was not closely following that issue at that time, and when I was on the APB, it never came up. The IASC was just getting off the ground then.

JS: So when you accepted the offer to join the IASC, what did you expect to find there?

DH: I didn't know. We had—something like fifty countries were enrolled members. AICPA was a member, there's probably more now. But the board is selected from about fifteen of those countries. They're usually from the major industrial countries, like U.S., Canada, England, Germany, France, Netherlands, South Africa, Australia, Japan. Others take turns on the board: Nigeria was on when I was there. Some other countries may be on now.

But in any event, I think I knew enough about English and Canadian kind of thinking on accounting. Particularly, Canadian GAAP was very similar to the U.S. I had dealt enough with our London office on different accounting issues that came up. I knew I could talk their accounting language. I also had some dealings with our offices in France and Germany and some other countries.

JS: Did you feel like that IASC was doing useful work and that it was contributing to the development of a body of international standards?

DH: Yes, I think it was. The problem on an international basis is where we might have, in a particular accounting area, two alternatives here, working to try to get it down to one, if you look at it internationally, there's probably like six possibilities per area. So it would be unrealistic to think we could go from six down to one method. So the IASC approach was to work the six down to two or three acceptable ones, preferably no more than two, with disclosure of the alternatives used. That was a step in the right direction; at some future date the two or three could be narrowed down to one.

That's basically the approach we took. It was not looking for absolute uniformity, but basically narrowing the differences. That's the way we went about it. Basically, I think the U.S. and the Dutch and the English think the same on accounting. There were other countries that perhaps leaned a little more towards current value, appraising real estate, etc.

JS: It certainly must have been a lot to learn. There were a lot of countries involved.

DH: There were a lot more. Fortunately, all of this was done in English, so therefore there were no translators, so every representative there from Japan and every other country had to be able to speak English and did a very good job of it. We met in an old chartered accountants hall in London where you could see plaques on the wall dating back to 1900 or before and the name of Price Waterhouse and Peat Marwick. Dates all the way back; it was the history of the birth of public accounting all on the wall.

I think we made good progress. We apparently made such great progress since then that the U.S. is thinking of adopting all IASC standards. I'm not sure it'll get there, but I never dreamed it that would be happening. I knew it was a possibility.

JS: It is true we've got a globalized world today. So there may be some advantages to that. At the time while you were serving there, how were relations between the American accounting industry and the IASC?

DH: They were very good. As a matter of fact, one of the reasons I was on the Financial Accounting Standards Advisory Council for a three-year period is because I was on the IASC. So I was a pipeline between the IASC and the FASB. I knew what the FASB was doing. Generally, the IASC was lagging behind in terms of standards, so by the time the FASB had dealt with leases, the IASC had not gotten to it yet. Therefore, there was a tendency on the IASC that if the U.S. has a good standard and it's well documented, let's build on that rather than starting from scratch.

JS: So the IASC often looked to the United States and maybe to Britain, for example?

DH: Yes. They would look to one of those two. The Dutch had their own ideas, but the Dutch were also in line.

JS: The FASB wasn't worried at this time about competition from the IASC?

DH: Back in the APB and early FASB days, no, it never occurred.

JS: I did see one article about the IASC where they talked about what seemed to be a small dispute in 1979 and 1980 over whether the FASB would be allowed to send observer members to attend meetings of the IASC. I was wondering whether you remember that at all.

DH: I don't remember. That was after my day, really. That was after my day. There was some talk about it; there was also discussion about whether the U.S. representative on IASC should be someone from the APB. I think the APB thought the –

JS: FASB?

DH: Yes, the FASB. I think the FASB thought that it would compromise their processes if they were to also address issues through the IASC. So it worked out fine with myself and the other U.S. member, a member from industry. We and also Canada and some other countries sent not only someone from the auditing profession, but also someone from industry. I had an industry partner from ARCO, and then later from another large U.S. company. We put our heads together and came up with a combined auditor, business executive kind of view as to what a standard should be.

JS: While you were at the IASC, did you have any contact with Henry Benson, who was one of the originators of it?

DH: Yes. I met him at a meeting.

JS: What did you think of him?

DH: Very nice gentleman. It was sort of an interesting meeting, because it was a Arthur Young professors' roundtable meeting. We sponsored meetings between the different Arthur Young professors on different subjects once a year, perhaps. In this case it was on international accounting issues. It was over in London. I was there sitting right next to Don Kirk, the then-chairman of the FASB who was invited. Sandy Burton probably was there.

It was an open discussion about international standards and that kind of thing. Henry Benson, who had not been particularly involved in IASC in the last few years was expressing some disappointment that the U.S. had not adopted all of the IASC standards.

I whispered to Don Kirk, "I'm sure we're in conformity with every one of those standards, but I'm not sure that's necessarily true of the U.K." Don gave a response to that and Sir Henry Benson said, "Well, I guess I'm not quite up to date." To sum it up, he was a gentleman, certainly one of the leaders of the profession in England and a worldwide leader. Yes, the FASB was in the international loop of things as issues developed.

JS: They were well-informed. Were any of the standards at the IASC issued during your time there? Are there any of those you'd like to comment on?

DH: One interesting one, just to take one example, was segment reporting. The APB had looked into that, of course, the FASB came out with something, also. The SEC wanted income information broken down by segments. So the IASC had proposed something of that nature.

The U.S. position was that if we voted for that on the IASC, we were going to get it adopted here if it wasn't already adopted. The only commitment, however, was for the IASC members to use their best efforts to get it adopted within their own country. We visualized a situation, my other U.S. member and I, that if the standard on segment reporting went into effect in some country which required a breakdown of the earnings of a U.S. subsidiary, and that was public information, a foreign company, subject only to the local standard, might not have to do the same thing.

We suggested an effective date for the standard to be when the standard went into effect for all companies within the country. For some issues, like segment reporting and the disclosure of R&D, some countries had trouble with disclosures because of the concern that companies might be hurt competitively.

JS: Did you think that the capitalization of development cost should be allowed or required? What was your position?

DH: Research and development?

JS: Yes.

DH: I thought of it as expense as a matter of practicality. I think obviously companies incur R&D with the hope it'll be successful. Some is; some isn't. It's unpredictable what will and what won't be successful. Referring to the biotech companies, the biotech companies spent hundreds of millions of dollars at a time when no one was sure they would come up with anything commercially viable. Well, as it turned out, they did. If we were to Monday morning quarterback it, we could probably say they should have been capitalizing all R&D cost. But on the other hand, the usual experience with R&D is most of it's a loss but you hope to get a few winners. You don't know which ones they're going to be.

JS: What about foreign currency translation, did the IASC try to tackle that at all?

DH: They did. And they basically came up with an idea that's closer to what I proposed, except they put these currency adjustments through the equity section rather than through the income statement. But basically FASB came up with a very similar result.

JS: But it would be several years before they would actually act on it.

DH: Yes.

JS: So over the course of the 1980s, in your career at Arthur Young, you stayed in Los Angeles?

DH: Yes.

JS: At this time, you're the chairman of Arthur Young's accounting and auditing standards committee?

DH: Yes. While I was in Los Angeles, the person who had been chairman left the firm for a significant position in industry. I was on the committee. Our leaders thought I would be a good person to chair the committee meetings. I was not running the national office accounting and auditing group. I did that for a period of about three years. That would involve meetings six times a year in New York for a day or two to go over all the hot issues on accounting and auditing within the firm.

JS: That sort of put you at the center of the action.

DH: The center of the action, right.

JS: And then you were still with Arthur Young in 1989 when it merged with Ernst & Ernst.

DH: Yes.

JS: How was that experience viewed from the Los Angeles office?

DH: I think that was a good experience viewed from any direction by both firms. Prior to the merger we ranked in size maybe four or five, that neighborhood, let's say. We both kept incurring increasing costs for manuals, instructions, training, and so forth. By being a larger firm we could get the economy of scale to work and not have to invest twice as much in training. We'd have the same training material. Rather than they inventing their training material and we inventing ours, we'd invent one combined set of training material and procedures, have one office, and so forth.

JS: Were you involved in the integration of the offices in Los Angeles?

DH: I was not the managing partner of the L.A. office at the time, nor was I involved in deciding which office we would move into. I think they may have – Ernst & Ernst may have been the same building, but I can't remember.

In any event, we basically decided to move into the Arthur Young offices, which would be expanded by another floor or two. It was not that difficult, because we were each doing the same thing; we each thought the same way; we each had clients. We were each auditing, basically, the same way; we thought the same way in accounting.

JS: So you had very similar corporate cultures?

DH: Yes, we did.

JS: And then immediately after your retirement, you joined the CASB?

DH: Yes.

JS: That institution that so many years before you had worked with?

DH: Yes.

JS: And who asked you to join the CASB? How did you become involved in that?

DH: When I was in Los Angeles, I headed up a group we called our Aerospace and Defense Industries Group, which was to promote training and services to our clients in that particular industry. I had a group of people I worked with, including someone in Washington, D.C., who was a former staff member of the CASB, who knew what was going on in Washington. He said to me, "Now that you're about to retire, why don't you take on that role, or take a shot at it?"

I knew that a number of people would be considered. I, of course, had this background, first of all, working for the committee for relations [with the CASB]. I knew the people down there, and also had the industry knowledge from my experience with Lockheed and some other defense contractors. I could present myself as someone who would not present a conflict of interest, because I was about to retire. Most of the other candidates competing for a seat were active in their firm's consulting activities with government contractors and arguably would have a conflict of interest if they were on the board, making the rules and yet working with clients.

So basically, the recommendation went that way. I was introduced to several representatives in Congress, who had committees relating to procurement matters, became acquainted with them. I talked to the man who was the head of the Federal Procurement Policy Office, got to know him. The American Institute of CPAs recommended me and three or four other CPAs. They were, of course, not going to pick out one. The OFPP head looked at my background, the lack of conflict of interest and selected me.

JS: Tell me about the issues that you dealt with while you were there.

DH: Many of the same ones we had at the APB and the FASB. Pensions was certainly a big one. They'd dealt with it before, but there were more issues coming up, how to deal with actuarial gains and losses. Mergers and acquisitions was another. If a defense contractor, that has government contracts, is acquired by another business in a purchase, and for accounting purposes its assets are stepped up to a higher cost, the price of contracts to the government goes up by virtue of this accounting adjustment. We dealt with that issue and came up with an interesting compromise, which, I think, worked.

We were beginning to look at post-retirement health benefits, which were something that had not even – I think it had just been addressed by the FASB at that time. We, of course, had previously dealt with issues of depreciation. Most of the work there really relates to allocation of overhead to government contracts. For a government contractor, all costs, including general administrative expenses, are allocable to contracts. It's a full absorption cost system. So a lot of the work relates to cost accounting formulas for allocating this cost to, first to the various units, and then to the various contracts.

JS: It's interesting that, though you spent most of your career in the private sector, you both started and ended your working life serving the public.

DH: Yes. I also looked at it that way. I was there for the last two years of President Bush and the first two or three years of President Clinton. I worked in the Old Executive Office building next door to the White House, so that was sort of a thrill.

JS: Did you move to Washington part time?

DH: Didn't have to, because this involved only six-meetings-a-year, two-day each, with a lot of work done by mail. That was before I used e-mail. I'm not sure e-mail was around in1990. But a lot of work was done by mail and phone. Comments were made during meetings. CASB also had a good staff. Not as large as the FASB staff. They got support from Defense Contract Audit Agency, also. That was a very interesting board, very diverse board, a member from industry, first from Boeing, later from Texas Instruments, myself, a representative from GSA – Government Services Administration – and the head of the Defense Contract Audit Agency. The chairman was the head of the Office of Federal Procurement Policy.

JS: Well, Mr. Hayes, are there any other issues you feel like we should talk about?

DH: I might add just two cents worth on current value accounting.

JS: Absolutely.

DH: Because this issue, I mentioned, kept coming up at the board, and still keeps coming up. I was in New York at the time the Trueblood Committee asked for views on objectives of financial statements. Someone said to me, some senior person said, "I think you're the best person to write our response to that." That was a tough job.

I had thought in terms of objectives of financial statements as to prepare them in accordance with generally accepted accounting principles. Well, what's the objective of the generally accepted accounting principles? Well, it's to prepare financial statements.

Well, this is kind of circular, so you have to step back even further and say, “Who are we preparing statements for, and why? What should be in the statements?”

It seemed to me the target audience should be investors and creditors, and not diverse sources such as labor unions, government economists, and parties like that. If those parties want financial information, they can get special reports. Investors and creditors are our target audience. Why do they need them? To make an assessment on the value of a company and its cash flows, using financial information together with any other information they obtain. In other words, financial statements are not the entire picture. They’re just part of the picture.

What should be an asset of a company? Should it be as a lot of companies say, our major asset is our employees, or it’s our R&D, or it’s our mineral reserves? Well, we don’t record those on the balance sheet. How do you measure them? They’re very subjective.

An asset shouldn’t include everything that an economist might visualize as an asset. It should be those assets that arise from business transactions. In other words, business transactions in which you acquire an asset. You have an asset to record on the books; that’s your starting point. It seems to me we should work with transaction-oriented accounting, not from appraisals.

Secondly, when you do that, the data should have some fairly high degree of reliability. It shouldn’t be pie-in-the-sky values. That led me back to concluding that historical cost accounting is probably the best way to go except in obvious cases, like a mutual fund where we know the value of all the assets and it's just a matter of using stock quotations.

But in most cases, the value of assets in a diversified company is very conjectural and it is just too difficult to come up with reliable value statements. I would anchor accounting to historical costs based on transactions.

JS: You think that's likely to be the way forward?

DH: I think it will continue to be. I keep reading about current value accounting and that some of the politicians even blame the sub-prime crisis on accountants and the accounting rules, because apparently some would require you to use a current value on collateralized mortgage obligations, even though there's no ready market for them.

I won't go quite as far as the politicians to blame the sub-prime crisis on that. But I think current value has to be looked at very cautiously. I think it's fine to have such values in footnotes, but I think the basic statements ought to reflect the more reliable data.

JS: Mr. Hayes, thank you so much. You've had a fascinating career; it was a pleasure talking with you today.

DH: Thank you, James. It's been a pleasure to recall all these events, and I hope this contributes to the library.

[End of Interview]