

In
Focus

One Accounting Firm's Cont

The Story of Colonel Carter and his Col



In Brief

The United States' entry into World War II marked the start of the largest business undertaking in the nation's history, and accountants were needed to keep track of records and act as auditors. New taxes and regulations on manufacturing required their expertise—but public accounting firm staffs were decimated due to military enlistments and the draft. Although all CPA firms were affected to some extent and all made contributions to the war effort in one form or another, it was the predecessors of the firm now known as Deloitte that arguably supplied the most high-level talent. The firms that today comprise Deloitte—including Haskins & Sells; Touche, Niven & Co; and McLaren, Goode, West and Company—provided numerous partners to the Washington war machine. Their efforts helped ensure victory and led to innovations in accounting and auditing.

Contributions to World War II

Leagues at Deloitte's Predecessor Firms

By Dale L. Flesher, Gary John Previts, Mark E. Jobe, and Andrew D. Sharp

Japan's bombing of Pearl Harbor on December 7, 1941, marked the official involvement of the United States in World War II, but the nation had already been indirectly involved since the German invasion of Poland in 1939. The need for additional government revenues to support the war effort was tremendous: Defense expenditures for 1942 (\$22.905 billion) were nearly double federal revenues (\$12.547 billion). By 1943, revenues had jumped to \$21.947 billion, but defense expenditures were nearly triple that, at \$63.414 billion. New taxes eventually softened the deficit. By 1944, the full effect of the war-related tax changes had taken effect; tax collections doubled from the preceding

year, and although defense expenditures again increased, the rate of increase was less than the rate of change in federal revenues. Because nondefense outlays also increased in 1942 and 1943, the federal deficit for both years was nearly equal to total defense expenditures.

In the midst of all of these new taxes was a need for more accountants to account for the new money that the government spent on the war effort and to conduct audits of defense contracts. New regulatory bodies, such as the Office of Price Administration (OPA), also contributed to the need for more accountants.

Fortunately, many CPAs patriotically served their country in this time of need. Perhaps most memorable: those who

worked for the predecessor firms of today's Deloitte, including Haskins & Sells (the largest), Touche, Niven & Co, and McLaren, Goode, West & Company.

Serving the Country

With the onset of World War II, times were tough on the home front. Able-bodied young men—and some not so young—were drafted or enlisted. The following sections highlight some of the profession's major contributions to the nation during this time.

Haskins & Sells. This firm saw 408 employees leave the firm to join the war effort; most notable of these was the firm's managing partner, Arthur H. Carter. A Kansas native and a 1905 graduate of



Arthur H. Carter

West Point, he had become the managing partner of his father-in-law's firm, Haskins & Sells, in 1930 and was widely lauded for his 1933 congressional testimony that kept the auditing franchise within the accounting profession. Carter had been invited to testify before Congress because, from 1930 to 1933, he ably served as president of the NYSSCPA. Carter, a colonel during World War I, was

Haskins & Sells Reports, vol. 2, Spring 1965, pp. 14–15). Carter's responsibilities included the accounts and all fiscal services of the War Department. He held this position until his retirement from the Army in February 1946. Carter was initially given the rank of brigadier general and promoted to major general in 1943. He had been awarded the Distinguished Service Medal during World War I and had an Oak Leaf Cluster added in World War II.

Andrew Stewart, another of the firm's senior partners, who attained the rank of colonel, joined Carter in Washington in March 1941. Stewart served as the 1941/42 NYSSCPA president. He was the deputy director (i.e., assistant to Carter) in the Office of the Fiscal Director until October 1945 (Arthur B. Foye, *Haskins & Sells: Our First 25 Years*, New York: Haskins & Sells, 1970). Carter and Stewart oversaw a staff of more than 10,000 employees who issued approximately 8 million checks each month in amounts reaching as much as \$500 million per month. They also

Supply, of which one of our members is Director. The head of this Division is also Budget Officer and acts as Comptroller of the War Department.

The Budget Officer of the War Department is charged with the duty of securing the necessary funds to carry out the plans, programs, and operations of the War Department and to assure the adequacy of the financial administration of such funds. He is required to arrange for the defense and justification of such funds before the Bureau of the Budget and Congress, to allocate funds to the various Services of Supply in accordance with the program, and to prescribe the methods of record-keeping and reporting to show the use of the funds so allocated.

As Director of the Fiscal Division, he is charged with the responsibility of financial administration of contracts under which War Department funds are to be expended. This includes the duty of prescribing auditing, accounting, disbursing, cost accounting, cost analysis, and reporting procedures for all Services of Supply and for the Army Air Forces. The importance of the responsibilities placed on the Budget Officer and Director of the Fiscal Division may be indicated by stating that the total funds appropriated to the War Department in connection with the war program up to July 1, 1942, amounted to 133 billions of dollars. (Andrew Stewart, "The Importance of Accountancy in the War Program," *Wartime Accounting*, 1942, pp. 17–18)

Indeed, Carter and his assistant held important positions in the U.S. government, even as they were still affiliated with Haskins & Sells. In addition to handling the day-to-day accounting activities of the War Department, the two accountants introduced some innovations and efficiencies into government operations. One of their major innovations concerned audits of defense contracts:

Auditing manuals were prepared setting forth procedures for auditing cost-plus-fixed-fee construction and supply con-

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called back in 1941 to be the executive accountant for the U.S. Department of War. In 1940, Henry L. Stimson was again appointed to serve as Secretary of War, and he wanted to be surrounded by the best possible staff that he could possibly have. With this in mind, he remembered Carter from their experience together during Stimson's prior stint as Secretary of War (1911–1913) and invited him to serve as the head of the army's accounting division (John W. Queenan, "Arthur H. Carter: A Memorial,"

oversaw the auditing of cost-plus, fixed-fee construction, and supply contracts (Foye, 1970, p. 92). In a speech at the American Institute of Accountants (AIA) annual meeting in 1942, Stewart summarized Carter's duties as follows:

The importance of professional accounting experience in these matters has been recognized in the recent reorganization of the War Department by the concentration of responsibility for supervision of all the foregoing in the Fiscal Division, Headquarters, Services of

tracts, in which the principle of selective auditing was first enunciated for application to Government contracts. Close cooperation was established with the Comptroller General, who, under the law, was required to pass upon the legality of all expenditures, and it was arranged that he would make his examinations at the projects where the necessary information was available instead of in Washington, where all vouchers had previously been sent. These changes resulted in substantial savings in the cost of administration. (Foye 1970, p. 94)

On the surface, this may not sound that innovative, but two major points should be noted. First, the “principle of selective auditing” was used for the first time. In other words, Carter and Stewart decided to use sampling to audit defense contracts. Given the shortage of manpower, it was not possible to audit every contract, as had been done in the prewar years. According to Stewart, the decision to audit was based on the internal control system maintained by the contractor (Stewart 1942, p. 18).

Second, the Haskins & Sells partners convinced Comptroller General Lindsey C. Warren that it would be more efficient to send the auditors to where the cost documents were located, rather than having all documents sent to Washington. One of the main advantages of this fieldwork procedure was a reduction in the numbers of copies of supporting documents to be prepared. Since the founding of the General Accounting Office (GAO) in 1921, all government audits had been conducted in Washington; thus, Carter’s recommendations to conduct field audits and on selected contracts amounted to a major change in federal auditing, as did the recognition that internal controls should impact the level of auditing activity. Effective in August 1942, Warren created the War Contract Project Audit Section to carry out Carter’s recommendations (Roger R. Trask, *GAO History, 1921–1991*, 1991). Following the war, Stewart headed a Haskins & Sells staff of 14 in an engage-

ment at General Douglas MacArthur’s headquarters in Japan.

On paper, Carter remained managing partner of Haskins & Sells through 1947; in actuality, Arthur B. Foye ran the firm through March 1946 and officially took over as managing partner following Carter’s retirement in 1947. Carter lived until 1965, when he died just three days short of turning 81.

Another longtime Haskins & Sells partner, George P. Auld, had served in World War I as a commander in the Supply Corps. From 1915 to 1918, he had been chief accounting officer in the Navy. He had received the Navy Cross in 1919 and in 1924 was made an Officer of the French Legion of Honor. In February 1941, Auld was asked by Secretary of the Navy James Forrestal to reenter government service and establish a division to audit contract costs under the defense procurement programs.

In this role, he organized panels of supervising auditors throughout the country. The panels relied on members of 70 different CPA firms throughout the nation to conduct periodic inspections of auditing procedures and reviews of contractors’ methods of internal control and cost determination. Auld was also a member of the Navy Price Adjustment Board. He resigned from his Navy work in September 1942 because of ill health (Foye 1970, p. 96). Auld was replaced by another noted public accountant: Paul Grady, originally with Arthur Andersen and later with Price Waterhouse & Co. The use of auditing panels for reviews of defense contracts did cause some consternation in professional circles—should CPAs audit contracts entered into by their own audit clients, or did this represent an independence issue? Some firms refused to accept such business, although the question remained undecided through the duration of the war.

After the war ended, Francis A. Cox became a Haskins & Sells partner. He had joined the firm in 1935, following his graduation from New York

University. He entered the Naval Reserve as an ensign in 1942 and became chief accountant of the Navy Price Adjustment Board in New York and Washington. He was discharged in 1946 with the rank of lieutenant commander. He stayed with Haskins & Sells until 1951 when he joined the *New York Times*, first as controller and later as chief financial officer. He died in May 1982 at the age of 68 (“Francis A. Cox, 68, A *Times* Executive,” *New York Times*, May 6, 1982, p. D27).

Another person loosely connected with Haskins & Sells, Thomas H. Sanders of Harvard University, was also active with respect to the accounting aspects of the war. Sanders, who had been a coauthor of a 1938 research project (“The Statement of Accounting Principles,” by Sanders, Hatfield, and Moore) funded by the Haskins & Sells Foundation, served during the war as chief of the cost analysis section of the War Production Board (WPB) and as a member of price adjustment boards. Sanders spoke at the AIA’s annual meeting in Chicago in 1942 (Thomas H. Sanders, “Renegotiation of Contract Prices,” *Wartime Accounting*, 1942, 1942, pp. 33–44). As discussed later, Haskins & Sells was criticized for Sanders’ participation

FOR FURTHER READING

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Andrew Stewart

on price adjustment boards, even though he was not an employee of the firm.

Yet another important contributor to the war effort was the AIA's 1941/42 president, N. Loyall McLaren. Born in 1892 and a graduate of the University of

recounted McLaren's war service began on Dec. 7, 1941:

Over the radio came the news of the Japanese attack on Pearl Harbor. After a period of shocked silence, Mr. McLaren said, "This means war. I am going into uniform." Shortly after, he was sworn in as an officer of the United States Navy with the rank of commander, and later was promoted to captain, serving as chief of the cost and audit division of the Office of Procurement and Material. He offered to resign as president of the Institute, but the executive committee rejected this offer. Mr. Wellington, the immediate past president, was named as acting chairman of the executive committee, to preside at meetings which the president might be unable to attend. (John L. Carey, *The Rise of the Accounting Profession to Responsibility and Authority, 1937-1969*, 1970)

then an overcrowded city. McLaren later organized a San Francisco branch of the board and personally selected its members (N. Loyall McLaren, *Business and Club Life in San Francisco: Recollections of a California Pioneer Scion*, 1978, p. 187). As head of the price adjustment board, McLaren took part in the renegotiation of contracts between military suppliers and the government.

McLaren was the elected leader of the accounting profession during the early months of the war, and he led by example. His presidential address at the AIA's annual meeting in 1942 included the following:

The part which must be taken by our profession is crystal clear—individually and collectively we must demonstrate that in war, as in peace, we are eager and fully prepared to do all that our country has the right to expect of us (Carey 1970, p. 46).

On the other hand, McLaren stated that he "was unquestionably the worst president of the American Institute they ever had. Because I did practically nothing" (McLaren 1978, p. 200). McLaren continued to remain a visible leader even after he was no longer the Institute's president. The National Association of Cost Accountants (NACA) invited him to speak at its annual meeting in 1943 on the topic of renegotiation of war contract prices. He was also a keynote speaker at the AIA's annual meeting in St. Louis in 1944, where he discussed the Surplus Property Act of 1944.

Near the end of the war, McLaren continued his public service as treasurer of the United Nations Conference Committee in San Francisco and later, during the summer of 1945, was accounting advisor to the United States Delegation with the Allied Commission on Reparations (the Yalta Agreement) in Moscow. Dividing the spoils of war among the various nations required an unimpeachable accounting system, and it was McLaren's job to create both the accounting and auditing systems. As part of that assignment,

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California at Berkeley (interestingly, he wrote the lyrics to the school's fight song), he was the son of Norman McLaren, who had started a CPA firm in San Francisco in 1895 that evolved into McLaren, Goode, West & Company, which was merged into Haskins & Sells in 1952. Before the merger, McLaren, Goode, West & Company was the oldest and largest firm on the West Coast. N. Loyall McLaren, like his father before him, served as president of the California Society of CPAs (1928). John Lansing Carey, the longtime executive secretary of the AIA,

In January 1942, while still president of the AIA, McLaren went on active duty as a commander in the Naval Reserve; he was quickly ordered to Washington to serve with the Cost Inspection Service. In early May 1942, the Price Administration Act was passed, and McLaren was named as chairman of the New York Division of the Navy price adjustment board. It was McLaren who recommended that the price adjustment board be moved out of Washington, D.C., because it was too difficult to get contractors to attend meetings in what was

he valued artworks and similar portable assets “liberated” by the Allied forces (McLaren 1978, pp. 214–217). He published an article in the October 1945 issue of the *Journal of Accountancy* about his work with the Allied Commission (N. Loyall McLaren, “Accounting for Reparations,” pp. 256–258).

At the end of the war, he retired from the Navy with the rank of commodore and was eventually promoted to rear admiral in the Naval Reserve in 1956. In 1947, McLaren was asked to conduct a survey of the Internal Revenue Bureau. In 1961, the University of California awarded him an honorary doctorate; additional honorary doctorates followed from the University of San Francisco (1963) and Whittier College (1972). Because of his accounting skills and his willingness employ them for the good of mankind, McLaren had many friends throughout the country, including former Presidents Herbert Hoover and Dwight Eisenhower (Foye, 1970, pp. 108–109). Even Prince Philip of Great Britain was an acquaintance.

Touche, Niven & Co. The Touche side of the firm also had its contributors to the war effort, including a future managing partner, Lieutenant Colonel John W. McEachren. In 1929, after one year’s experience as a cost accountant at a large Detroit pharmaceutical company, McEachren had approached the firm’s auditor, George Bailey, to discuss an error in the federal tax accrual. Bailey was impressed with McEachren and quickly hired him for Ernst & Ernst. Years later, a merger would form Touche, Niven, Bailey & Smart.

With the commencement of the war, McEachren was commissioned in April 1942 in the Office of the Fiscal Director of the Army. Despite the ongoing war, McEachren maintained his professional activities; he was one of the main speakers at the AIA’s 1942 annual meeting in Chicago (“Determination of Contract Costs by the War Department,” *Wartime Accounting*, 1942, pp. 20–22).

He was also the keynote speaker at the June 1943 annual meeting of the National Association of Cost Accountants (“Cost Determination Under Audited War Contracts,” *National Association of Cost Accountants Yearbook*, 1943, pp. 6–18). McEachren’s NACA speech was summarized the next day in the *New York Times*, indicating its significance to corporate America. Many of these individuals worked together on war-related projects. For example, McEachren collaborated with McLaren in devising the forms used for contract renegotiations. Although Bailey did not go into the military, he was seen as a resource on wartime accounting. He was one of the two keynote speakers at the NACA 1944 annual meeting (“Cost Phases of War Contract Termination,” *National Association of Cost Accountants Yearbook*, 1944, pp. 29–47).

Another Touche contributor was Jacob P. Friedman of the New York office; he was appointed in October 1941 to a special committee of the AIA that recommended revisions to the accounting system of post exchange service at Army installations. Charles R. Whitworth, a Touche, Niven & Co. partner in Chicago, accepted a commission as assistant supervisor of cost estimates for the U.S. Signal Corps. Another partner, Edward H. Wagner Jr. of the St. Louis office accepted a commission as lieutenant commander in the Naval Reserve in May 1942. Within one month, he was working with the supply corps in the Office of the Secretary of the Navy. Wagner published an article, “Renegotiation Reminders,” in the May 1945 issue of the *Journal of Accountancy* (pp. 352–355) that dealt with the regulations of the War Contracts Price Adjustment Board.

Not all of the firm’s wartime contributions were military: Henry E. Mendes, a partner in Touche’s New York office, was appointed chairman of the accountants’ division of the New York City 1943 Red Cross War Fund (John B. Niven, “The First Forty,” 1943, p. 3 of typescript). In that same year, Mendes served as president of the NYSSCPA; his partner,

Victor H. Stempf, was president of the AIA. Stempf had also served as NACA president early in the war and previously as NYSSCPA president. In April 1944, Stempf was appointed to the Committee on Post-War Tax Policy, under a grant of \$100,000 from the Falk Foundation, with the goal of drafting of a postwar federal tax program.

Criticism of the Profession’s War Efforts

Though many would laud these contributions to the nation’s war effort, they did not go without criticism. An article by Drew Pearson, a United Feature Syndicate columnist, was critical of the role of Haskins & Sells:

There is a lot of backstage indignation over the manner in which members of one Wall Street accounting firm, Haskins & Sells, dominate the cost accounting work of the Army and Navy. Cost accounting, under cost plus contracts, is extremely important. Furthermore, the Army and Navy are both engaged in scaling down some of these contracts through Price Adjustment Boards. The men who rule on these price adjustments can save the government billions of dollars—or on the other hand, they can permit billions in profits to industry. ...

It so happens that executives from Haskins & Sells occupy key accounting posts. It also happens that Haskins & Sells is the accounting firm which handles the work of General Motors and du Pont, two companies which have received very large government orders. ...

On the Navy’s Price Adjustment Board is George P. Auld, a member of the Haskins & Sells firm. High in the Army’s cost and supply service is Brig. Gen. Arthur H. Carter, a partner of Haskins & Sells, and son-in-law of Sells. Then in the cost accounting branch of the War Production Board is Dr. Thomas H. Sanders, professor of accounting at the Harvard Business School, who has been close to Haskins & Sells and has done some work for the Haskins & Sells Foundation. Another

member of Haskins & Sells is Lieut. Col. Andrew Stewart, now in the accounting branch of the War Department. ("The Washington Merry-Go-Round," United Feature Syndicate, Aug. 18, 1942)

The article did go on to say that Carter and Auld had patriotically served in the Army and Navy during World War I and in their present positions were careful to have the accounts of former clients supervised by other Army and Navy accountants. For example, it was noted that one such client, General Motors, had more than \$2 billion in war contracts and that even a reduction of 1% would mean a \$20 million savings to the federal government. To inflame the situation, Pearson, a famous columnist, reported that the firm was already being bitterly condemned by the SEC for the "obviously manipulated" financial statements in the Associated Gas and Electric Co. case, wherein "the

boards was a conscious decision on the part of the government. The War Department made the decision to organize a new group consisting of businessmen or retired businessmen instead of assigning pricing duties to established government agencies or bureaus (McLaren 1943, p. 29).

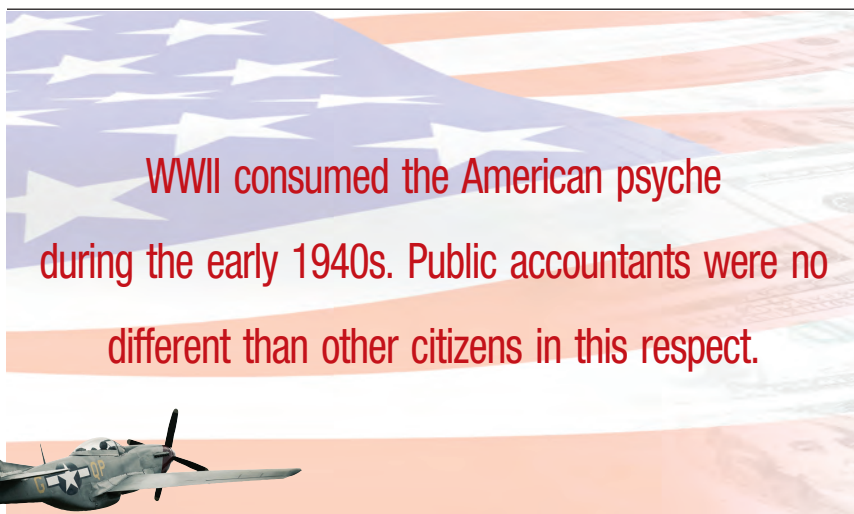
World War II was a difficult period for all CPAs, with clients experiencing new laws and regulations, new taxes, shortages of materials and manpower, and greater demands for increased productivity. The need for accounting services increased dramatically, but despite the demands on CPAs, the Deloitte predecessor firms of Haskins & Sells, Touche, Niven & Co, and McLaren, Goode, & West & Co. contributed firm manpower to the war effort.

A Lasting Impact

World War II consumed the American psyche during the early 1940s. Public

Still, CPAs maintained their professionalism and the leadership of the profession. Deloitte's predecessor firms, especially, played an important role in the war. Two managing partners, Carter and Stewart, served during the war at the level of colonel or higher, and they accounted for the largest business project in history. Lasting innovations during this time included the concept of audit sampling, conducting government audits in the field, and using the client's internal control system to determine the extent of auditing procedures.

Though Deloitte, more than any other firm, sent its leaders to serve the government and the profession, all large CPA firms were affected. For example, Arthur Andersen reported that 220 men—67% of its 1941 staff—were in the armed forces by the middle of 1943. Andersen responded by calling back retirees, reverting to a six-day workweek, and encouraging overtime (*A Vision of Grandeur*, Arthur Andersen, 1988, p. 67). Besides losing staff, Peat Marwick (predecessor of KPMG) sent one top partner, William M. Black, to serve on the War Production Board (T. A. Wise, *Peat, Marwick, Mitchell & Co.: 85 Years*, 1982, p. 41). Price Waterhouse similarly contributed men at the staff level (at least 40% of the 1941 staff) and one partner, Paul Grady (David Grayson Allen and Kathleen McDermott, *Accounting for Success: A History of Price Waterhouse in America*, 1993, p. 84).



accounting firm lacked independence." The article concluded that "members of this same firm now sit in high Army-Navy positions where they will need to exercise great independence" (Pearson 1942). The article may not have been a smoking gun, but it surely caused some readers to doubt the independence of the members of the price adjustment boards.

It should be noted that the appointment of businessmen to the price adjustment

accountants were no different than other citizens in this respect. The war, in particular, dominated the profession unlike anything else before it. Every presentation at the AIA and NACA annual meetings in 1942 and 1943 dealt with war-related aspects of accounting—from taxes, to the increased demands for accounting services by clients and the military, to demands made by price adjustment boards, to the decreased manpower to provide those ser-

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