



Ernst & Young LLP
5 Times Square
New York, NY 10036

Phone: (212) 773-3000
www.ey.com

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Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

**Proposed Statement of Financial Accounting Standards,
The Hierarchy of Generally Accepted Accounting Principles
File Reference No. 1300-001**

Dear Ms. Bielstein:

We appreciate the opportunity to comment on the Proposed Statement of Financial Accounting Standards, *The Hierarchy of Generally Accepted Accounting Principles* (the Exposure Draft). We are pleased that the FASB has undertaken a number of initiatives aimed at improving the quality of accounting standards. We support issuance of the Exposure Draft as a final standard because enterprises, (and not auditors) are responsible for the selection of accounting principles that are used in financial statements that are presented in conformity with GAAP. Accordingly, the GAAP hierarchy should reside in the accounting literature.

We understand that the Board plans to reconsider the GAAP hierarchy upon completion of the codification and retrieval and the conceptual framework projects. We urge the Board to consider elevating the status of FASB Concepts Statements to authoritative literature at that time. We believe that if the Board is committed to issuing objectives-oriented standards that are to be based on a consistently applied conceptual framework, the conceptual framework must be authoritative. Our detailed comments on the Exposure Draft follow.

FASB Staff Positions and Statement 133 Implementation Issues

Paragraph A7 of the Exposure Draft states that "category (a)" principles were expanded to include "all sources of accounting principles that are issued after being (a) deliberated by the Board or its designee in a public forum, (b) exposed to the public for comment, and (c) *approved by the Board*" [emphasis added]. The process by which the FASB issues final guidance is described on the FASB's website using such terms as *approved*, *cleared* and *not objected to*. However, these terms are not defined or explained. The website indicates that certain FSPs are

approved by the Board, while others are issued if a majority of the Board *does not object* to its issuance. If the two terms are intended to have different meanings, we believe that paragraph A7 should be clarified to explain why all FSPs have been designated as “category (a)” GAAP.

We observe that the Exposure Draft classifies implementation guides published by the FASB staff, other than the implementation issues for FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (Statement 133), as “category (d)” GAAP. We recommend that the final standard explain why the implementation guidance for Statement 133 is classified as a higher level of GAAP than the implementation guidance for other standards that were subject to a similar level of due process, such as the FASB staff implementation guide for FASB Statement 140, “A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.”

Reference to Rules and Interpretive Releases of the Securities and Exchange Commission

In order to clarify the FASB’s authority to promulgate GAAP for public entities, we recommend that footnote 1 to paragraph 3(a) be expanded to explain that the SEC has the authority to prescribe accounting principles to be followed in the preparation of financial statements filed under federal securities laws. The footnote could also state that although the SEC has granted that authority to the FASB, the SEC retains the right to interpret the accounting principles established by the FASB. In addition, SEC registrants must adhere to the accounting principles established by the FASB, unless those principles are in direct conflict with rules or interpretive releases issued by the SEC.

Departures from the GAAP Hierarchy

We support the Board’s decision to prohibit an enterprise from asserting that its financial statements are presented in accordance with GAAP if its selection of accounting principles departs from the GAAP hierarchy as set forth in the Exposure Draft if that departure has a material effect on the financial statements. Although this does not represent a change to the GAAP hierarchy, it does effectively eliminate the exception under Rule 203 of the AICPA’s Code of Professional Conduct (Rule 203), which permits a departure from GAAP, when, due to unusual circumstances, the financial statements would be otherwise misleading.

Although we do not expect this change to affect our clients, we believe there may be reporting entities that have departed from GAAP pursuant to Rule 203. We believe the Board should provide transition guidance for an enterprise that will be required to adopt a different accounting policy in order to present its financial statements in conformity with GAAP.



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We recommend that the final standard require that a change in accounting principle, resulting from the elimination of Rule 203 be accounted for in accordance with paragraphs 4 through 18 of FASB Statement No. 154, *Accounting Changes and Error Corrections*.

Other Sources of Accounting Guidance Currently Residing in Auditing Literature

As part of the Board's effort to improve the quality of accounting standards and the standard setting process, we recommend that the Board carry forward into the accounting literature other sources of accounting guidance that currently reside in auditing literature. Although we have not performed an exhaustive search to identify such guidance, the subsequent events guidance in Statement on Auditing Standards No. 1, *Codification of Auditing Standards and Procedures*, is one such example.

We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

Ernst + Young LLP