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Director - Technical Application and Implementation Activities
File Reference No. 1300-001
Financial Accounting Standards Board
401 Merritt 7
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Norwalk, CT 06856-5116

Dear Mr. Smith:

BDO Seidman, LLP is pleased to offer our comments on the exposure draft, *The Hierarchy of Generally Accepted Accounting Principles*. We agree the GAAP hierarchy and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental enterprises should reside in the accounting literature, as opposed to the auditing standards. This is a proper transition since the enterprise (not its auditor) is primarily responsible for the selection of accounting standards and the issuance of financial statements in accordance with GAAP. A summary of our major comments is:

- Although the Board does not expect the proposed modifications to the GAAP hierarchy will change current practice, it appears to us the proposed Standard would effectively nullify Rule 203 of the AICPA Code of Professional Conduct. As such, transition guidance would be necessary.
- The proposed Standard should include new AICPA Industry Audit and Accounting Guides as a source of guidance in paragraph 5 for transactions or events without accounting treatment specified in categories (a) through (d) of the GAAP hierarchy.
- The use of analogy to the literature or industry practice in categories (a) through (d) should be clearly ranked compared to the other accounting guidance in paragraph 5.

We develop each of these thoughts more fully below.

Rule 203

This section of the AICPA Code of Professional Conduct indicates that if a strict or literal application of GAAP would result in misleading financial statements, an auditor's report could still express a "clean" opinion "by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement." This is essentially a substance-over-form exception and is rarely invoked. As we observed in our letter dated December 2, 2002 to the Board regarding its proposal, a *Principles-Based Approach to U.S. Standard Setting*, substance-over-form is "a rather vague idea that defies precise definition." Inevitably, such an override is an invitation to accountants to substitute their

judgment for the standard-setter's judgment. No objective benchmark exists by which an enterprise or its auditors could decide that complying with a standard would be misleading. Instead, we believe that the fairness of presentation should be debated during the development of a standard. The Board and its constituents should consider whether valid principles carried to logical extremes might create confusing or misleading results. However, once the Board makes a final decision, we are uncomfortable with empowering individual accountants to override the Board's judgment. Therefore, we agree with the conclusions the Board reached in paragraph 6 and in paragraphs 9 and 10 of Appendix A in the current exposure draft.

For those rare instances in which an enterprise has previously issued GAAP-compliant financial statements by virtue of a Rule 203 opinion, guidance is needed to assist such entities' transition to a standard GAAP basis. Although we are not aware of any public companies in this situation, it is difficult to determine how prevalent it may be among private companies. As such, the final Statement should include transition guidance to address whether the Board has a preference for retrospective application to prior periods' financial statements or a cumulative effect adjustment in the current period. Without this guidance, we understand that FASB Statement No. 154, *Accounting for Changes and Error Corrections*, would require retrospective application unless it was impracticable to determine its effects. Therefore, the final Standard should clarify the Board's intent in this regard.

New AICPA Industry Audit and Accounting Guides

Because new AICPA Industry Audit and Accounting Guides will not be cleared by the Board as category (b) GAAP, the proposed Standard should indicate the role that the new Guides will continue to play on a non-authoritative basis. We believe they should be included in the list of other accounting literature in paragraph 5 that preparers should consult in the absence of on-point literature in categories (a) through (d).

In addition, the Standard should refer to footnote 4 in SAS No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report*, which states "The auditor should assume that such pronouncements have been cleared by the FASB unless the pronouncement indicates otherwise." This would clarify the place of existing Guides, as well as AICPA Statements of Position, in the hierarchy. We note the Board retained a similar reference in FASB Statement No. 111, *Rescission of FASB Statement No. 32 and Technical Corrections* (footnote 5), and believe one would also be appropriate in the final form of this proposed Standard.

Ranking of Analogy

We agree that analogies are an appropriate way to establish accounting principles when no directly applicable guidance exists. Our primary concern with respect to the use of analogy in the exposure draft is that no guidance is proposed on the relative influence of an analogy to (1) a pronouncement or practice in levels (a) through (d) versus (2) on-point guidance in other accounting literature enumerated in paragraph 5. We believe this should be clarified.

In addition, paragraph 5 indicates if authoritative literature does not exist in categories (a) through (d) for a particular event or transaction, the preparer “shall consider” the other sources listed therein. We are unclear whether the Board intends to establish a more definitive position in the proposed Standard compared to the language in paragraph 9 of SAS No. 69, which states “it might be possible to report the event or transaction on the basis” of analogy in the appropriate circumstances. SAS No. 69 offers examples of what the appropriate circumstances would be, such as new legislation or emerging business transactions. Therefore, if the Board intends to *require* the use of analogy in certain cases, it should explain in the basis for conclusions why it is necessary to elevate the use of analogy beyond the SAS No. 69 concept, i.e., when new or novel developments arise.

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We would be pleased to discuss our comments with the Board or the FASB staff. Please direct questions to Ben Neuhausen at (312) 616-4661.

Very truly yours

/s/ BDO Seidman, LLP