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Technical Director  
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File Reference 1300-001 – GAAP Hierarchy

Dear Director:

I support the issuance of an FASB Standard on “The Hierarchy of Generally Accepted Accounting Principles.” However, I have several suggestions for your consideration in finalizing this Standard.

Given that the FASB is the body designated by the SEC and AICPA to establish accounting standards that are to be followed by SEC registrants and by auditors in evaluating financial statements represented to be in conformity with GAAP, it is logical for the Board to determine what GAAP means. Thus, moving this designation from the auditing literature to an FASB standard is quite appropriate. I am pleased to see that you have coordinated this project with the AICPA so that the Auditing Standards Board has simultaneously proposed to amend SAS 69, which would no longer apply to non-governmental entities covered by the new FASB Standard.

The Exposure Draft notes that the Board considered “elevating the ranking of FASB Concepts Statements” but decided not to do that at this time. However, paragraph A5 notes that, “Also, the Board expects to address the role of the FASB Concepts Statements in its conceptual framework project.” While it may be inappropriate for me to prejudge the outcome of the project to reconsider the conceptual framework, I believe it would be a mistake to elevate the ranking of Concepts Statements. They are, and probably will continue to be, necessarily general in scope and wording. And from my experience at the Board, I know that reasonable people can often support diametrically opposing positions by reference to the same concepts. Further, elevating the standing of Concepts Statements could well lead to perceived conflicts between specific accounting standards and the Concepts Statements. The Exposure Draft leaves the Concepts Statements in “other GAAP” below categories (a) through (d) but having “more influence” than other sources in the same grouping, and that seems like the right treatment for concepts.

If only one source of GAAP applies to a given situation, there is no practical difference among the various levels within the Hierarchy. That source must simply be followed. The only real purpose of having different levels of GAAP seems to be to make clear which rules or practices “trump” other rules or practices if more than one applies to a given situation. So, for example, if level (b) and level (d) GAAP arguably both apply to a situation, the level (b) guidance must be followed. Practitioners are used to this approach and the Exposure Draft should result in few, if any, changes in accounting as you suggest.

However, paragraph A4 notes that the Board’s longer-term objective is to reorganize the literature into two categories: authoritative and nonauthoritative. Assuming that levels (a) through (d) would all be considered authoritative, it would seem that the only way the Board can accomplish this longer-term objective is to eliminate all possible conflicts among items listed in any of those categories. That will make the codification project very formidable, but the longer-term result will be a substantial improvement in the literature. I am concerned about how the Board plans to handle so-called nonauthoritative literature in the codification project, and I suggest that you seek input on that at an early date rather than waiting until too much work has been done.

I generally agree with the ranking of the items in the proposed Hierarchy. However, there are a couple of items that may warrant reconsideration as follows.

- FASB Technical Bulletins should be elevated to level (a). They have had as much if not more due process and Board involvement than FASB Staff Positions and possibly other level (a) items.
- EITF consensus positions should also be elevated to level (a). While procedures have changed over the years, these positions have been subject to a certain amount of due process at all times. While the FASB has only recently begun explicitly reviewing and “not objecting” to their finalization, the Board has always had the right to overrule an EITF position that is objectionable. Also, from nearly the beginning of the EITF, the SEC has made it clear that EITF consensuses are mandatory GAAP for registrants.

The first sentence of paragraph 5 and footnote 3 thereto are somewhat unclear. By combining “accounting principles for similar transactions or events” and “other accounting literature” in the same sentence, you seem to put those two notions on the same level. However, in practice it is quite common for a corporate accountant or auditor to argue that a good analogy to authoritative literature outranks articles, industry practice, etc. In fact, I suspect that vice presidents of accounting and senior technical partners spend a great deal of their time trying to determine what analogies are appropriate for new or unique transactions or events. Unfortunately, this becomes very subjective and what one accountant may think is an excellent analogy often is challenged as unreasonable by another accountant (or SEC enforcement person). It seems to me that a good analogy to level (a) GAAP, for example, ought to outrank the other items listed in paragraph 5. In any event, I suggest that you give further consideration to what you believe and what you intend to require in this paragraph.

Paragraph 6 calls for the elimination of a “Rule 203 opinion.” As far as I know, there haven’t been any of these opinions issued since a very small number were issued in the first couple of years after that Rule was promulgated by the AICPA. I think your position is the correct one and it won’t have any practical effect given the dearth of 203 opinions in the last 20 years or so. However, it is important for the FASB to work with the AICPA and have Rule 203 amended accordingly. Otherwise, an auditor may be in the position of violating an important ethics ruling by the Institute when complying with GAAP. The AICPA’s proposed amendment to SAS 69 eliminates the reference to Rule 203 in that document with respect to non-governmental organizations. But that AICPA proposal does not directly amend Rule 203 so further action by the ACIPA seems needed.

Please let me know if you have any questions about my comments.

Sincerely,

Dennis R. Beresford