



Defining Issues®

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Bringing the GAAP Hierarchy into GAAP

The FASB's newest exposure draft would adopt the hierarchy of generally accepted accounting principles, now in the auditing literature, as a first step in developing a new approach to the hierarchy that could significantly affect future standard setting.¹ The proposal would make the rules governing which accounting principles take precedence directly applicable to preparers of financial statements, not just to auditors, and would be effective for fiscal periods beginning after September 15, 2005.

The GAAP Hierarchy

The exposure draft updates and carries forward the GAAP hierarchy established in the auditing literature's SAS 69, which contains four lettered categories, each corresponding to different types of accounting standards. The key difference between the FASB's proposed GAAP hierarchy and SAS 69's is that the FASB's hierarchy includes two types of accounting standards that came into being after SAS 69 was issued. In addition, the FASB's exposure draft omits the due-process characteristics of each category in the hierarchy. The table on the next page lists the types of pronouncements in each of the four categories.

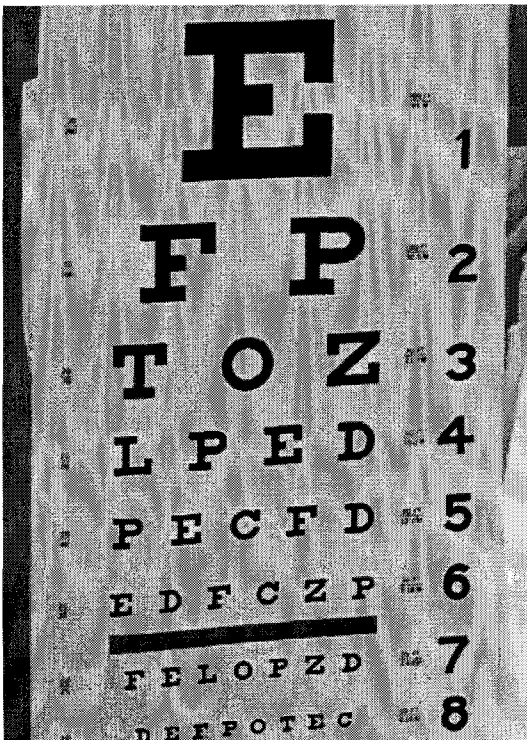
The FASB says in its Notice to readers that the exposure draft expands level A GAAP to include accounting principles issued after being subjected to the FASB's due process. However, even though some EITF consensuses have been issued after being subjected to the Board's due process, as the exposure draft acknowledges, all EITF consensuses would remain categorized as level C GAAP.

The exposure draft states that, if the literature in categories A through D does not address accounting for an event or transaction, the reporting entity should look to accounting principles for similar events or transactions and other accounting literature. The proposal gives examples of other sources of accounting literature that might be used in these situations, including FASB Concept Statements and International Financial Reporting Standards issued by the IASB.

Deviations from GAAP

The exposure draft clarifies that reporting entities may not represent that their financial statements comply with GAAP if their selection of accounting principles materially departs from the GAAP hierarchy. This differs from the language in SAS 69. The SAS says that in the

¹ FASB Exposure Draft, The Hierarchy of Generally Accepted Accounting Principles, April 28, 2005, available at www.fasb.org; AICPA Statement on Auditing Standards No. 69, The Meaning of "Presents Fairly In Accordance With GAAP," January 1992.



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absence of specifically-relevant Category A literature, if one or more items of level B, C, or D literature apply, the reporting entity “should be prepared to justify a conclusion that another treatment is generally accepted”

Potential Consequences

The exposure draft would elevate the standing within the hierarchy of FASB Staff Positions and FASB Derivatives Implementation Group Issues. Looking further ahead and more broadly, the GAAP-hierarchy exposure draft is part of a long-term program to produce a codified, objectives-oriented body of more easily researched accounting literature, supported by an authoritative conceptual framework.² The FASB intends to eventually have a GAAP hierarchy with only two levels—authoritative and nonauthoritative—and a conceptual framework elevated to authoritative status within the hierarchy. But any such changes lie down the road, to be preceded by improvements in the conceptual framework and progress on the codification-and-retrieval project.

When the GAAP hierarchy becomes part of the accounting literature, the FASB may need to articulate more clearly how it determines whether a project should be addressed by a Statement, Interpretation, Staff Position, or EITF Consensus.

Proposed GAAP Hierarchy	
Category	Relevant Accounting literature
A*	<ul style="list-style-type: none"> - AICPA Accounting Research Bulletins - Accounting Principles Board Opinions - FASB Statements and FASB Interpretations - FASB Staff Positions - FASB DIG Issues <p>FASB Concept Statements are specifically excluded from this category</p>
B	<ul style="list-style-type: none"> - AICPA Industry Audit and Accounting Guides if cleared by the FASB - AICPA Statements of Position if cleared by the FASB - FASB Technical Bulletins
C	<ul style="list-style-type: none"> - AICPA Practice Bulletins that have been cleared by the FASB - EITF consensuses
D	<ul style="list-style-type: none"> - AICPA accounting interpretations - FASB staff implementation guides - Widely recognized and prevalent practices
*For SEC registrants, Category A includes the SEC’s rules and interpretive releases	

Replacing the fourfold division of the current hierarchy with a twofold division between authoritative and nonauthoritative could have a major effect on the standard-setting process. The FASB’s program is consistent with recommendations made by the SEC staff in a paper on principles-based standard setting mandated by the Sarbanes-Oxley Act.³ The FASB publicly acknowledged its general agreement with the SEC staff’s recommendations.⁴



Comments on the exposure draft are due by June 27, 2005

Companies should not treat the descriptive and summary statements about the proposed Statement as if they represent what the FASB will ultimately adopt or as if they pertain to any company’s unique circumstances. Nor should companies treat the interpretive statements about the proposed Statement as if they represent the views of the FASB. Companies should refer to the text of the final FASB Statement when it is completed and published and should consult their accounting and legal advisors.

² FASB Response to SEC Study on the Adoption of a Principles-Based Accounting System, July 2004, available at www.fasb.org

³ SEC Staff, “Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System,” July 25, 2003, available at www.sec.gov

⁴ FASB Response to SEC Study

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