



FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD



Memorandum

August 2008 Joint Meeting

To: Board Members, David Bean, Wendy Payne
From: Ken Schermann (GASB), Ross Simms (FASAB)
c: GASB staff, FASAB staff, meeting observers
Date: August 8, 2008
Re: GAAP Hierarchy

Accompanying this memo are two papers pertaining to the GAAP Hierarchy project that is being jointly addressed by the GASB and the FASAB. The GASB has had the benefit of several Board discussions leading to this month's consideration of a ballot draft. For the GASB, this issue was initially included in a project to codify, into the GASB's authoritative literature, accounting and financial reporting guidance that is currently contained in the AICPA Statements on Auditing Standards (SAS). The GAAP Hierarchy piece of the project was separated from the other issues into its own project so that the two Boards could benefit from a joint effort.

GASB's approach has been to lift the hierarchy from the SAS's, generally "as is," making only a few modifications to the "other accounting literature" references so that it more closely reflects the current standards-setting environment. No changes have been made to the contents of levels *a* through *d* of the hierarchy. As explained in the Basis for Conclusions in the ballot draft, if the GASB decides it is appropriate to reexamine the existing levels of the hierarchy to consider elevating certain sources (Implementation Guides or Concepts Statements, for example), or combining categories to provide for fewer levels, it would do so as a separate future initiative.

For the FASAB, this will be the Board's initial meeting on the GAAP Hierarchy topic. The FASAB plans to discuss some preliminary issues that may need to be addressed in developing a GAAP Hierarchy standard for federal reporting entities. One issue for consideration is the appropriate source of GAAP for preparing financial statements. Currently, some federal reporting entities follow FASAB accounting and reporting principles (FASAB GAAP) while others follow the Financial Accounting Standards Board accounting and reporting principles (FASB GAAP).

To facilitate the discussion, the FASAB will review a working draft standard based largely on the work of the GASB. The working draft standard also presents two possible options for addressing the source of GAAP issue.

TAB E-1

GASB BALLOT DRAFT

THE HIERARCHY OF GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES

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Governmental Accounting Standards Series

EXPOSURE DRAFT

Proposed Statement of the Governmental Accounting Standards Board

The Hierarchy of Generally Accepted Accounting Principles

This Exposure Draft of a proposed Statement of Governmental Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
Project No. 33-1

Comment Deadline: October 30, 2008



Governmental Accounting Standards Board
of the Financial Accounting Foundation

1
2 **THE HIERARCHY OF GENERALLY ACCEPTED ACCOUNTING**
3 **PRINCIPLES**

4 **Request for Written Comments**

5 **Deadline for submitting written comments:** October 30, 2008

6 **Requirements for written comments.** Any individual or organization that wants to
7 provide written comments should provide those comments **by October 30, 2008**. Written
8 comments should be addressed to the Director of Research and Technical Activities,
9 Project No. 33-1, and emailed to director@gasb.org or mailed to the address below.

10 **OTHER INFORMATION**

11 **Public files.** Written comments will become part of the Board's public file and will be
12 available for inspection at the Board's offices. Copies of those materials may be obtained
13 for a specified charge.

14 **Orders.** Any individual or organization may obtain one copy of this Exposure Draft on
15 request without charge until October 30, 2008, by writing or phoning the GASB. For
16 information on prices for additional copies and copies requested after October 30, 2008,
17 please contact the Order Department at the address shown below. The Exposure Draft
18 may be downloaded from the GASB's website at www.gasb.org.

19
20 Governmental Accounting Standards Board
21 401 Merritt 7
22 PO Box 5116
23 Norwalk, CT 06856-5116

24 Telephone Orders: 1-800-748-0659

25
26 *Please ask for our Product Code No. GEXX.*

27
28 GASB publications also may be ordered at www.gasb.org.

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36 further that each copy bears the following credit line: "Copyright © 2008 by
37 Governmental Accounting Standards Board. All rights reserved. Used by permission."

1 **Notice to Recipients**
2 **of This Exposure Draft**
3

4 The Governmental Accounting Standards Board (GASB) is responsible for
5 developing standards of state and local governmental accounting and financial reporting
6 that will (1) result in useful information for users of financial reports and (2) guide and
7 educate the public, including issuers, auditors, and users of those financial reports.

8 The due process procedures that we follow before issuing our standards are
9 designed to encourage broad public participation in the standards-setting process. As part
10 of that due process, we are issuing this Exposure Draft setting forth a proposed Statement
11 that would incorporate into the GASB’s authoritative literature the hierarchy of generally
12 accepted accounting principles that currently resides in the American Institute of
13 Certified Public Accountants’ professional auditing literature. We invite your comments
14 on all matters in this proposed Statement. Because this proposed Statement may be
15 modified before it is released as a final Statement, it is important that you comment on
16 any aspects with which you agree as well as any with which you disagree. To facilitate
17 the analysis of comment letters, it would be helpful if you explain the *reasons* for your
18 views, including alternatives that you believe the GASB should consider.

1 **SUMMARY**

2 The objective of this proposed Statement is to incorporate the hierarchy of generally
3 accepted accounting principles (GAAP) into the Governmental Accounting Standards
4 Board’s (GASB) authoritative literature. The “GAAP hierarchy” consists of the sources
5 of accounting principles used in the preparation of financial statements of state and local
6 governmental entities that are presented in conformity with GAAP, and the framework
7 for selecting those principles.

8 The GASB is responsible for establishing GAAP. However, the current GAAP
9 hierarchy is set forth in the American Institute of Certified Public Accountants (AICPA)
10 Statement on Auditing Standards No. 69, *The Meaning of “Present Fairly in Conformity
11 With Generally Accepted Accounting Principles” in the Independent Auditor’s Report*,
12 rather than in the authoritative literature of the GASB.

13 **How the Changes in This Proposed Statement Would Improve**
14 **Financial Reporting**

15 The requirements in this proposed Statement would improve financial reporting by
16 contributing to the GASB’s efforts to codify all GAAP so that they derive from a single
17 source. The Board concluded that the GAAP hierarchy should reside in the accounting
18 literature established by the GASB and is issuing this proposed Statement to accomplish
19 that objective. The Board does not expect that this proposed Statement will result in a
20 change in current practice.

21 Unless otherwise specified, pronouncements of the GASB apply to financial reports of all
22 state and local governmental entities, including general purpose governments; public
23 benefit corporations and authorities; public employee retirement systems; and public
24 utilities, hospitals and other healthcare providers, and colleges and universities.
25 Paragraph 2 discusses the applicability of this Statement.

1 **Proposed Statement of the Governmental Accounting Standards Board**

2

3 **The Hierarchy of Generally Accepted Accounting Principles**

4 **August 29, 2008**

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1
2 **Proposed Statement of the Governmental Accounting Standards Board**

3
4 **The Hierarchy of Generally Accepted Accounting Principles**

5 **August 29, 2008**
6

7 **INTRODUCTION**

8 1. The objective of this Statement is to identify the sources of accounting principles
9 and the framework for selecting the principles used in the preparation of financial
10 statements of state and local governmental entities that are presented in conformity with
11 generally accepted accounting principles (the GAAP hierarchy).

12 **STANDARDS OF GOVERNMENTAL ACCOUNTING AND**
13 **FINANCIAL REPORTING**

14 **Scope and Applicability of This Statement**

15 2. This Statement applies to the financial statements of all state and local
16 governments that are presented in conformity with GAAP).

17 **The Hierarchy of Generally Accepted Accounting Principles**

18 3. The GAAP hierarchy governs what constitutes GAAP for all state and local
19 governmental entities. It lists the order of priority of pronouncements that a
20 governmental entity should look to for accounting and financial reporting guidance. The
21 sources of accounting principles that are generally accepted are categorized in descending
22 order of authority as follows:

- 23 a. Officially established accounting principles—GASB Statements and
24 Interpretations, as well as the American Institute of Certified Public Accountants
25 (AICPA) and the Financial Accounting Standards Board pronouncements
26 specifically made applicable to state and local governmental entities by GASB
27 Statements or Interpretations. GASB Statements and Interpretations are
28 periodically incorporated in the Codification of Governmental Accounting and
29 Financial Reporting Standards.

- 1 b. GASB Technical Bulletins and, if specifically made applicable to state and
2 local governmental entities by the AICPA and cleared¹ by the GASB, AICPA
3 Industry Audit and Accounting Guides, and AICPA Statements of Position.
- 4 c. AICPA Accounting Standards Executive Committee Practice Bulletins if
5 specifically made applicable to state and local governmental entities and cleared²
6 by the GASB, as well as consensus positions of a group of accountants organized
7 by the GASB that attempts to reach consensus positions on accounting issues
8 applicable to state and local governmental entities.³
- 9 d. Implementation guides (Q&As) published by the GASB staff, as well as
10 practices that are widely recognized and prevalent in state and local government.
- 11 4. If the accounting treatment for a transaction or event is not specified by a
12 pronouncement in category (a), a governmental entity should consider whether the
13 accounting treatment is specified by an accounting principle from a source in another
14 category. In such cases, if categories (b)–(d) contain accounting principles that specify
15 accounting treatments for a transaction or event, the governmental entity should follow
16 the accounting treatment specified by the accounting principle from the source in the
17 highest category—for example, follow category (b) treatment over category (c) treatment.
- 18 5. If the accounting treatment for a transaction or event is not specified by a
19 pronouncement or established in practice as described in categories (a)–(d), a
20 governmental entity should first consider accounting principles for similar transactions or
21 events within categories (a)–(d) and then other accounting literature. A governmental
22 entity should not follow the accounting treatment specified in accounting principles for
23 similar transactions or events in cases in which those accounting principles either prohibit
24 the application of the accounting treatment to the particular transaction or event or
25 indicate that the accounting treatment should not be applied by analogy.
- 26 6. Other accounting literature includes, for example, GASB Concepts Statements;
27 the pronouncements referred to in categories (a)–(d) of the GAAP hierarchy for
28 nongovernmental entities when not specifically made applicable to state and local
29 governmental entities either by the GASB or by the organization issuing them; FASB
30 Concepts Statements; Federal Accounting Standards Advisory Board (FASAB)

¹ Such pronouncements specifically made applicable to state and local governments are presumed to have been cleared by the GASB unless the pronouncement indicates otherwise.

² See footnote 1.

³ As of the date of this Statement, GASB had not organized such a group.

1 Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues
2 Papers; International Public Sector Accounting Standards of the International Public
3 Sector Accounting Standards Board or International Accounting Standards of the
4 International Accounting Standards Board, or pronouncements of other professional
5 associations or regulatory agencies; Technical Information Service Inquiries and Replies
6 included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and
7 articles. The appropriateness of other accounting literature depends on its relevance to
8 particular circumstances, the specificity of the guidance, and the general recognition of
9 the issuer or author as an authority. For example, GASB Concepts Statements would
10 normally be more influential than other sources in this category.

11 **EFFECTIVE DATE AND TRANSITION**

12 7. The requirements in this Statement are effective upon its issuance. Accounting
13 changes adopted to conform to the provisions of this Statement should be applied
14 retroactively by restating financial statements, if practical, for all prior periods presented.
15 If restatement is not practical, the cumulative effect of applying this Statement, if any,
16 should be reported as a restatement of beginning net assets, fund balances, or fund equity,
17 as appropriate, for the earliest period restated. In the period this Statement is first applied,
18 the financial statements should disclose the nature of any restatement and its effect. Also,
19 the reason for not restating prior periods presented should be explained.

1

2 **Appendix A**

3 **BACKGROUND**

4 8. Representatives of the AICPA have requested that the U.S. accounting standards-
5 setters consider adopting certain guidance for accounting and financial reporting issues
6 that now resides only in the AICPA’s professional auditing literature. In response to this
7 request, a project was added to the GASB’s research agenda in late 2007. After
8 conducting research on the subject matter to identify relevant issues, the project was
9 added to the GASB’s current technical agenda in April 2008. The GAAP hierarchy
10 applicable to governments was originally intended to be within the scope of that broader
11 project. A separate project was established in July 2008 to assist the Board in its efforts
12 to work with FASAB on GAAP hierarchy-related issues.

1

2 **Appendix B**

3 **BASIS FOR CONCLUSIONS**

4 9. This appendix summarizes factors considered significant by the Board members
5 in reaching the conclusions in this Statement. It includes discussion of alternatives
6 considered and the Board’s reasons for accepting some and rejecting others. Individual
7 Board members may have given greater weight to some factors than to others.

8 10. At the beginning of its deliberations leading to this Statement, the Board
9 evaluated two approaches. One approach considered was to adopt the GAAP hierarchy
10 essentially as it currently exists in the AICPA’s auditing literature. The other approach
11 considered was to reexamine the hierarchy levels to assess whether the standards-setting
12 process and the governmental financial reporting environment have sufficiently evolved
13 since the establishment of the hierarchy to warrant reconsideration or reconfiguration of
14 certain aspects of the structure. The Board recognized that taking the first approach
15 would not significantly affect practice but the latter approach, involving redeliberation,
16 *could* have resulted in changes in practice. The Board concluded that the transition from
17 the audit literature to the accounting and financial reporting standards should be as
18 undistruptive as possible; therefore, the first approach was taken.

19 11. The Board believes that incorporation of the GAAP hierarchy into the GASB’s
20 authoritative literature would more clearly convey that financial statement preparers are
21 responsible for selecting the appropriate sources of the principles to be used when preparing
22 financial statements that are presented in conformity with GAAP. The structure presented
23 in this Statement generally carries forward the hierarchy included in Appendix C,
24 *Background Information on Governmental Accounting Standards*, in Volume I of the
25 *GASB’s Original Pronouncements*. The Board believes that relocating the hierarchy
26 generally “as is” would have the least effect on current practice. If the Board decides it is
27 appropriate to reexamine the existing levels of the hierarchy to consider elevating certain
28 sources (Implementation Guides or Concepts Statements, for example), or combining
29 categories to provide for fewer levels, it would do so as a separate future initiative.

1 **Appendix C**

2 **CODIFICATION INSTRUCTIONS**

3 12. The section that follows updates the June 30, 2008, *Codification of Governmental*
4 *Accounting and Financial Reporting Standards* for the effects of this Statement. Only the
5 paragraph number of the Statement is listed if the paragraph will be cited in full in the
6 Codification.

7 * * *

8 [Create new section as follows:]

9 **THE HIERARCHY OF GENERALLY ACCEPTED SECTION 1000**

10 **ACCOUNTING PRINCIPLES**

11 Source: GASB Statement XX

12 .101–.104 [GASB Statement XX, ¶3–¶6, including footnotes 1 and 2; omit footnote 3.]

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TAB E-2

FASAB BRIEFING MATERIALS

For

THE HIERARCHY OF GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES

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August 6, 2008

Memorandum

To: Members of the Board

From: Ross Simms, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: **The Hierarchy of Generally Accepted Accounting Principles – Tab E¹**

MEETING OBJECTIVES

Staff is in the process of developing a standard on the hierarchy of generally accepted accounting principles (GAAP) for federal reporting entities based largely on the work of the Governmental Accounting Standards Board (GASB). The purpose of the meeting will be to discuss preliminary views and determine any issues that may need to be addressed in developing the standard for federal reporting entities. Based on the discussion, staff plans to provide a proposed standard at the October 2008 meeting.

BRIEFING MATERIAL

The briefing material includes the following attachment:

Attachment I Working Draft Statement entitled, *The Hierarchy of Generally Accepted Accounting Principles*.

¹ The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

BACKGROUND

Representatives of the American Institute of Certified Public Accountants (AICPA) requested that the U.S. accounting standards-setters consider adopting certain guidance for accounting and financial reporting issues that now reside only in the professional auditing literature. Currently, topics such as the “GAAP hierarchy” for federal and state and local governmental entities² reside in professional auditing literature. The GAAP hierarchy consists of the sources of accounting principles used in the preparation of financial statements presented in conformity with GAAP and the framework for selecting those principles. The GAAP hierarchy for federal reporting entities is set forth in AICPA Statement on Auditing Standards (SAS) No. 91, *Federal GAAP Hierarchy*. Incorporating the GAAP hierarchy in FASAB literature would assist federal reporting entities in determining the accounting principles to use in preparing financial statements in conformity with GAAP.

In response to the AICPA request, the GASB developed an exposure draft (ED) that incorporates the GAAP hierarchy into their authoritative literature. The GASB noted that the hierarchy should be directed to state and local governmental entities preparing financial statements in conformity with GAAP.

ISSUES

- I. What are members’ views on addressing the appropriate source of GAAP issue in a GAAP hierarchy standard?

Currently, some federal reporting entities are following FASAB accounting and reporting principles (FASAB GAAP) to prepare financial statements in conformity with GAAP while others are following commercial accounting and reporting principles (FASB GAAP). As members may recall, at the February 2008 meeting, the Board tentatively decided that no entities will be required to convert to full FASAB GAAP at this time. The Board is also comfortable with including two sources of GAAP in the consolidated financial statements except where it affects intragovernmental eliminations. The Board requested that staff meet with the sponsor workgroup to determine which line items are significant in the FASB vs. FASAB intragovernmental reconciliation and develop an exposure draft that proposes a note disclosure for those significant reconciling items only. That issue will be addressed in a future project.

² In May 2008, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. The statement applies to financial statements of nongovernmental entities that are presented in conformity with GAAP.

Addressing the use of commercial accounting and reporting principles in the GAAP hierarchy standard would serve four purposes:

- a. To proactively address entity concerns that moving the hierarchy of generally accepted accounting principles into the accounting literature without addressing the use of FASB GAAP will result in a sudden and dramatic change in practice;
- b. To ensure that general purpose financial reports issued by federal entities are meeting the objectives of its primary users;
- c. To respond to the AICPA's recommendation that FASAB clarify its policy with regard to entities that have been following FASB standards; and,
- d. To address compilation issues that are occurring during the consolidation of the financial report of the U.S. Government as a result of federal entities applying commercial accounting and reporting principles.

Attachment 1 provides a working draft Statement that carries forward the GAAP hierarchy presented in SAS 91 with some modifications. The modifications are indicated by strikethroughs (deleted text) and underlines (added text). The Statement includes two options for standards regarding the appropriate source of GAAP.

Option A permits entities following FASB GAAP to continue to do so and the FASAB can provide additional guidance to those entities through technical bulletins. Technical bulletins provide for both due process (more limited in scope and within a tighter minimum time frame than provided for Statements and Interpretations) and review by FASAB members. They provide guidance for applying FASAB statements and interpretations and for resolving accounting issues not directly addressed by them.³ The technical bulletins could provide guidance where FASAB GAAP requires information that is not addressed by FASB GAAP, such as budgetary accounting, cost accounting, and management's discussion and analysis.

Option B involves considering the information needs of users in determining whether to follow commercial accounting and reporting principles. This option provides factors to consider in making the determination and notes that when entities following FASB GAAP report information to be included in general purpose financial reports of a larger federal reporting entity (including the government-wide financial statements) any applicable standards issued by the FASAB that call for additional disclosure or supplemental information should be applied.

The working draft also includes proposed language for legislative and judicial branch entities. The options and proposed language are presented to facilitate discussion and members may express their preferences. Staff plans to use the feedback from the discussion to prepare a proposal for Board consideration at the October 2008 meeting.

³ FASAB Technical Bulletin 2000-1 discusses the procedures for technical bulletins.

II. Are there other issues the Board would like to address?

If you have questions or need additional information, please contact me at 202-512-2512 or by email at simmsr@fasab.gov as soon as possible. I will be able to consider and respond to your request more fully in advance of the meeting.

Attachment

**ATTACHMENT 1
WORKING DRAFT STANDARD**

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Federal Accounting Standards Advisory Board

The Hierarchy of Generally Accepted Accounting Principles

Statement of Federal Financial Accounting Standards

Exposure Draft

Written comments are requested by November XX, 2008

August XX, 2008

Working Draft – Comments Are Not Requested on This Draft

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or “the Board”) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- “Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board.”
- “Mission Statement: Federal Accounting Standards Advisory Board”, Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB’s website at: www.fasab.gov.

Federal Accounting Standards Advisory Board
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www.fasab.gov

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1 August 2008

2 TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

3 The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting
4 comments on the exposure draft of a proposed Statement of Federal Financial
5 Accounting Standards entitled, *The Hierarchy of Generally Accepted Accounting*
6 *Principles*. Specific questions for your consideration appear on page 7 but you are
7 welcome to comment on any aspect of this proposal. If you do not agree with the
8 proposed approach, your response would be more helpful to the Board if you explain
9 the reasons for your position and any alternative you propose. Responses are
10 requested by November XX, 2008.

11 All comments received by the FASAB are considered public information. Those
12 comments may be posted to the FASAB's website and will be included in the project's
13 public record.

14 We have experienced delays in mail delivery due to increased screening procedures.
15 Therefore, please provide your comments in electronic form. Responses in electronic
16 form should be sent by e-mail to fasab@fasab.gov. If you are unable to provide
17 electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow
18 up by mailing your comments to:

19 Wendy M. Payne, Executive Director
20 Federal Accounting Standards Advisory Board
21 Mailstop 6K17V
22 441 G Street, NW, Suite 6814
23 Washington, DC 20548
24

25 The Board's rules of procedure provide that it may hold one or more public hearings on
26 any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice
27 of the date and location of any public hearing on this document will be published in the
28 *Federal Register* and in the FASAB's newsletter.

29

30 Tom L. Allen
31 Chairman

1 **Executive Summary**

2 **What is the Board proposing?**

3

4 This statement incorporates the hierarchy of generally accepted accounting
5 principles (GAAP) into the FASAB's authoritative literature. The "GAAP
6 hierarchy" consists of the sources of accounting principles used in the
7 preparation of financial statements of federal reporting entities that are presented
8 in conformity with GAAP and the framework for selecting those principles.

9 **How would this proposal improve federal financial reporting and contribute to**
10 **meeting the federal financial reporting objectives?**

11

12 The FASAB, as the body designated by the American Institute of Certified Public
13 Accountants (AICPA) as the source of GAAP for federal reporting entities, is
14 responsible for identifying the sources of accounting principles and providing
15 federal reporting entities with a framework for selecting the principles used in the
16 preparation of financial statements that are presented in conformity with GAAP.
17 However, the current GAAP hierarchy is set forth in the AICPA Statement on
18 Auditing Standards (SAS) No. 91, *Federal GAAP Hierarchy*, rather than in the
19 authoritative literature of the FASAB. The Board believes that the structure for
20 the selection of principles used in the *preparation* of financial statements should
21 be directed to federal reporting entities because it is the preparer of financial
22 statements that is responsible for identifying accounting principles for financial
23 statements that are presented in conformity with GAAP. Accordingly, the Board
24 concluded that the GAAP hierarchy should reside in the accounting literature
25 established by the FASAB and is issuing this Statement to accomplish that
26 objective. The Board does not expect that this Statement will result in a change
27 in current practice.

28

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1 Question for Respondents

2 The FASAB encourages you to become familiar with all proposals in the Statement
3 before responding to the questions in this section. In addition to the questions below,
4 the Board also would welcome your comments on other aspects of the proposed
5 Statement.

6 The Board believes that this proposal would improve Federal financial reporting and
7 contribute to meeting the Federal financial reporting objectives. The Board has
8 considered the perceived costs associated with this proposal. In responding, please
9 consider the expected benefits and perceived costs and communicate any concerns
10 that you may have in regard to implementing this proposal.

11 Because the proposals may be modified before a final Statement is issued, it is
12 important that you comment on proposals that you favor as well as any that you do not
13 favor. Comments that include the reasons for your views will be especially appreciated.

14 The questions in this section are available in a Word file for your use at
15 www.fasab.gov/exposure.html. Your responses should be sent by e-mail to
16 fasab@fasab.gov. If you are unable to respond electronically, please fax your
17 responses to (202) 512-7366 and follow up by mailing your responses to:

18 Wendy M. Payne, Executive Director
19 Federal Accounting Standards Advisory Board
20 Mailstop 6K17V
21 441 G Street, NW, Suite 6814
22 Washington, DC 20548

23 All responses are requested by **[November XX, 2008]**.

24 Q1. This Exposure Draft setting forth a proposed Statement that would incorporate into
25 the FASAB's authoritative literature the hierarchy of generally accepted accounting
26 principles (GAAP) that currently resides in the professional auditing literature. Do you
27 agree with the hierarchy presented in the Exposure Draft (see paragraph 9). If not,
28 please explain why.

1 **Introduction**

2 **Purpose**

3

- 4 1. The objective of this Statement is to identify the sources of accounting
5 principles and the framework for selecting the principles used in the
6 preparation of financial statements of federal reporting entities that are
7 presented in conformity with generally accepted accounting principles (the
8 GAAP hierarchy).

9 **Materiality**

10

- 11 2. The provisions of this Statement need not be applied to immaterial items.
12 The determination of whether an item is material depends on the degree to
13 which omitting or misstating information about the item makes it probable
14 that the judgment of a reasonable person relying on the information would
15 have been changed or influenced by the omission or the misstatement.

16 **Effective Date**

17

- 18 3. The requirements in this standard are effective upon its issuance.

1 **Proposed Standard**

2 **Scope**

3

- 4 4. This Statement applies to the financial statements of all federal reporting
5 entities that are presented in conformity with generally accepted accounting
6 principles (GAAP).

7 **The Hierarchy of Generally Accepted Accounting Principles**

8

- 9 5. The hierarchy of generally accepted accounting principles, hereafter
10 referred to as the GAAP Hierarchy, governs what constitutes GAAP for
11 federal reporting entities. It lists the priority sequence of pronouncements
12 that a federal reporting entity should look to for accounting and financial
13 reporting guidance. The sources of accounting principles that are generally
14 accepted are categorized in descending order of authority as follows:

15 *[Some modifications have been made to the language presented in SAS 91.*
16 *They are indicated by strikethroughs (deleted text) and underlines (added text).]*

- 17 a. Category (a), officially established accounting principles, consists of
18 FASAB Statements of Federal Financial Accounting Standards
19 (Statements) and Interpretations, as well as AICPA and Financial
20 Accounting Standards Board (FASB) pronouncements specifically made
21 applicable to federal reporting entities by FASAB Statements or
22 Interpretations. FASAB Statements and Interpretations will be periodically
23 incorporated in a publication by the FASAB.
- 24 b. Category (b) consists of FASAB Technical Bulletins and, if specifically
25 made applicable to federal reporting entities by the AICPA and cleared by
26 the FASAB, AICPA Industry Audit and Accounting Guides and AICPA
27 Statements of Position.¹

¹ ~~The auditor should assume that s~~Such pronouncements specifically made applicable to federal
governmental reporting entities are presumed to have been cleared by the FASAB, unless the
pronouncement indicates otherwise.

- 1 c. Category (c) consists of AICPA Accounting Standards Executive
2 Committee (AcSEC) Practice Bulletins if specifically made applicable to
3 federal reporting entities and cleared by the FASAB, as well as Technical
4 Releases of the Accounting and Auditing Policy Committee of the FASAB.
- 5 d. Category (d) includes implementation guides published by the FASAB
6 staff, as well as practices that are widely recognized and prevalent in the
7 federal government.
- 8 ~~6. In the absence of a pronouncement covered by rule 203 [ET section 203.01] or~~
9 ~~another source of established accounting principles, the auditor of financial~~
10 ~~statements of a federal governmental entity may consider other accounting~~
11 ~~literature, depending on its relevance in the circumstances.~~
- 12 7. If the accounting treatment for a transaction or event is not specified by a
13 pronouncement in category (a), a federal reporting entity should consider
14 whether the accounting treatment is specified by an accounting principle from a
15 source in another category. In such cases, if categories (b)–(d) contain
16 accounting principles that specify accounting treatments for a transaction or
17 event, the federal reporting entity should follow the accounting treatment
18 specified by the accounting principle from the source in the highest category—
19 for example, follow category (b) treatment over category (c) treatment.
- 20 8. If the accounting treatment for a transaction or event is not specified by a
21 pronouncement or established in practice as described in categories (a)–(d), a
22 federal reporting entity should first consider accounting principles for similar
23 transactions or events within categories (a)–(d) and then other accounting
24 literature. A federal reporting entity should not follow the accounting treatment
25 specified in accounting principles for similar transactions or events in cases in
26 which those accounting principles either prohibit the application of the
27 accounting treatment to the particular transaction or event or indicate that the
28 accounting treatment should not be applied by analogy.
- 29 9. Other accounting literature includes, for example, FASAB Concepts
30 Statements; the pronouncements referred to in categories (a) through (d) of
31 paragraph 5 when not specifically made applicable to federal reporting entities
32 by the FASAB; FASB Concepts Statements; GASB Statements,
33 Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues
34 Papers; International Public Sector Accounting Standards of the International
35 Public Sector Accounting Standards Board, (IPSASB), or International
36 Accounting Standards of the International Accounting Standards Committee
37 Board (IASB); pronouncements of other professional associations or regulatory
38 agencies; Technical Information Service Inquiries and Replies included in
39 AICPA Technical Practice Aids; and accounting textbooks, handbooks, and

1 articles. The appropriateness of other accounting literature depends on its
2 relevance to particular circumstances, the specificity of the guidance, and the
3 general recognition of the issuer or author as an authority. For example,
4 FASAB Concepts Statements would normally be more influential than other
5 sources in this category.

6

7 **Application of Commercial Accounting and Reporting Principles**

8 *[For options on the guidance for this section see Option A, on page 10, and Option B,*
9 *on page 11.]*

10

11 **Option A**

10. Financial statements prepared in accordance with accounting standards published by the FASB also may be regarded as in accordance with GAAP for those federal entities that have in the past issued such financial statements. The FASAB will provide additional guidance for instances where such statements are to be included in the financial statements of a larger federal reporting entity (including Treasury's consolidated financial statements) that prepares financial statements in accordance with FASAB standards.

1 **Option B**

10. Some federal entities, including government corporations listed in the Government Corporation Control Act and certain others, such as the United States Postal Service, continue to publish financial reports pursuant to the commercial accounting and reporting principles issued by the FASB. Some entities also may be required to prepare statements pursuant to standards set by a regulatory agency (e.g., the Federal Energy Regulatory Commission (FERC)). For the separately issued (stand-alone) general purpose financial reports of such entities, the application of commercial accounting and reporting principles may more appropriately meet user needs.
11. Unique user needs can arise from various sources that include, but are not limited to, investors, SEC filers, bondholders, and customers. Entities may determine that the application of commercial accounting and reporting principles more appropriately meets these unique user needs. This determination should involve a number of considerations. Examples of factors to consider include but are not limited to:
 - a. the entity has been delegated the financial and operational authority to carry on a business in a manner similar to private business enterprises;
 - b. it sells goods and/or services to individuals outside of the government reporting entity as its principal activity;
 - c. it is intended to, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity
12. When financial information of entities that prepare separately issued (stand-alone) general purpose financial reports through the application of commercial accounting and reporting principles is included in general purpose financial reports of a larger federal reporting entity (the consolidated financial report of the U.S. Government), any applicable standards issued by the FASAB that call for additional disclosure or supplemental information should be applied.
13. Once a particular accounting and reporting model has been applied, it should be consistently followed from year to year in order to maintain consistency and comparability.

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1 **Application to Legislative and Judicial Branches**

2 *[paragraph to be numbered accordingly]*

3 The accounting standards in FASAB statements are intended for the general purpose
4 financial reports of federal reporting entities. Although FASAB's sponsors do not set
5 accounting standards for the legislative or judicial branches, the Board believes
6 FASAB standards would be appropriate for them.

7 **Effective Date**

8 *[paragraph to be numbered accordingly]*

9 These standards are effective upon issuance.

10

The provisions of this Statement need not be applied to immaterial items.

1 Appendix A: Basis for Conclusions

2 This appendix discusses some factors considered significant by Board members in
3 reaching the conclusions in this Statement. It includes the reasons for accepting certain
4 approaches and rejecting others. Individual members gave greater weight to some
5 factors than to others. The standards enunciated in this Statement—not the material in
6 this appendix—should govern the accounting for specific transactions, events, or
7 conditions.

8 Project History

9

10 A1. Representatives of the American Institute of Certified Public
11 Accountants (AICPA) requested that the U.S. accounting standards-
12 setters consider adopting certain guidance for accounting and
13 financial reporting issues that now reside only in the professional
14 auditing literature. In July 2008, the FASAB joined the Governmental
15 Accounting Standards Board in responding to this request.

16 A2. The Board believes that incorporation of the GAAP hierarchy into the
17 FASAB's authoritative literature would more clearly convey that
18 financial statement preparers are responsible for selecting the
19 sources of the principles to be used in the preparation of financial
20 statements that are presented in conformity with GAAP. The
21 structure presented in this Statement generally carries forward the
22 hierarchy as set forth in SAS 91.

23 Application of Commercial Accounting and Reporting Principles

24 A3. Since October 1999, the AICPA has recognized FASAB as the
25 standards-setting body for federal governmental entities; therefore,
26 the pronouncements resulting from the FASAB process represent
27 GAAP for the entire federal government (FASAB GAAP).
28 Nevertheless, some federal entities follow GAAP for
29 nongovernmental entities promulgated by the private sector Financial
30 Accounting Standards Board (FASB GAAP). For example, federal
31 government corporations, the U.S. Postal Service, certain component
32 entities of the Department of Treasury, and some smaller entities in
33 the executive and legislative branches have historically applied FASB
34 GAAP and continue to do so.

35 A4. In early 2000, FASAB recognized this practice as acceptable for
36 those entities that had been following FASB GAAP to avoid an

1 immediate and unanticipated requirement that these federal entities
2 follow federal GAAP after FASAB was recognized as the Rule 203
3 standards-setting body for the federal government. This guidance
4 was published in the January – March 2000 issue of *FASAB*
5 *News*² and was intended as a temporary measure in light of the
6 unanticipated consequences of Rule 203 recognition. The existence
7 of the issue has also been acknowledged in Statement of Federal
8 Financial Accounting Concepts (SFFAC) 2, *Entity and Display* (par.
9 78); Statement of Federal Financial Accounting Standards (SFFAS)
10 5, *Accounting for Liabilities of the Federal Government* (inside front
11 cover and Appendix A, par. 142); SFFAS 8, *Supplementary*
12 *Stewardship Reporting* (Introduction par. 40); and, SFFAS 24,
13 *Selected Standards for the Consolidated Financial Report of the*
14 *United States Government* (Appendix A, par. 20).

15

16 *[For options on additional discussions for this section see Option A, on page 15, and*
17 *Option B, on page 16.]*

² FASAB News, Jan.-March 2000, p. 2.

1 Option A: Basis for Conclusions

- A 5. The Board continues to believe that financial statements prepared in accordance with accounting standards published by the FASB also may be regarded as in accordance with GAAP for those federal entities that have in the past issued such financial statements. Such statements aid in demonstrating transparency and stewardship and the level of internal controls in place. Also, they are intended to meet the information needs of their primary users.

1 Option B: Basis for Conclusions

- A5. A project on this issue was initiated in January 2006 after the topic was considered a top priority as a result of (1) the Board's October 2004 agenda-setting session, and (2) subsequent consideration of comments on the July 2005 invitation to comment (ITC) on the four projects selected by the Board for consideration.
- A6. From January 2006 through February 2008, FASAB staff ("staff") presented various options to the Board with accompanying research and analyses. This research included preparing detailed profiles of ten federal entities that have historically followed FASB GAAP: Community Development Financial Institution, Corporation for National and Community Service, Federal Deposit Insurance Corporation, Federal Prison Industries (Unicor), Government National Mortgage Association (Ginnie Mae), Millennium Challenge Corporation, Office of Thrift Supervision, Pension Benefit Guaranty Corporation, Tennessee Valley Authority, and U.S. Mint (the Mint switched to FASAB GAAP beginning with its fiscal year 2005 financial statements).
- A7. At the February 2008 meeting, the Board tentatively decided that no entities will be required to convert to full FASAB GAAP at this time. The Board is also comfortable with including two sources of GAAP in the consolidated financial statements except where it affects intragovernmental eliminations. The Board requested that staff meet with the sponsor workgroup to determine which line items are significant in the FASB vs. FASAB intragovernmental reconciliation and develop an exposure draft that proposes a note disclosure for those significant reconciling items only. That issue will be addressed in a future project.

1 [paragraph to be numbered accordingly]

2 Including standards on the use of commercial accounting and reporting principles
3 in this proposed statement serves four purposes:

- 4 a. To proactively address entity concerns that moving the hierarchy of
5 generally accepted accounting principles into the accounting literature
6 without addressing the use of FASB GAAP will result in a sudden and
7 dramatic change in practice;
- 8 b. To ensure that general purpose financial reports issued by federal
9 entities are meeting the objectives of its primary users;
- 10 c. To respond to the AICPA's recommendation that FASAB clarify its
11 policy with regard to entities that have been following FASB
12 standards;³ and,
- 13 d. To address compilation issues that are occurring during the
14 consolidation of the financial report of the U.S. Government as a result
15 of federal entities applying commercial accounting and reporting
16 principles.
17

18 **Application to Legislative and Judicial Branches**

19 [paragraph to be numbered accordingly]

20 Neither FASAB nor any of its sponsors have legal jurisdiction over the legislative
21 and judicial branches. The legislative and judicial branches, and most entities
22 within those branches, are not currently required to prepare financial statements
23 and those that do prepare statements cannot be legally required by any of
24 FASAB's sponsors to follow FASAB GAAP or prepare a reconciliation between
25 FASAB GAAP and FASB GAAP. However, the AICPA has designated FASAB
26 as the source of GAAP for federal reporting entities. Therefore, application of
27 professional standards may lead to adoption of FASAB GAAP.

³ Letter dated July 17, 2002, from Patrick L. McNamee, Chair of the AICPA FASAB Liaison Task Force, commenting on the exposure draft of SFFAS 24, Selected Standards for the Consolidated Financial Report of the United States Government, Comment 1.

1 **Appendix B: Abbreviations**

2	AcSEC	Accounting Standards Executive Committee
3	AICPA	American Institute of Certified Public Accountants
4	FASAB	Federal Accounting Standards Advisory Board
5	FASB	Financial Accounting Standards Board
6	GAAP	Generally Accepted Accounting Principles
7	GASB	Governmental Accounting Standards Board
8	IPSASB	International Public Sector Accounting Standards Board
9	SAS	Statement on Auditing Standards

10

1 **Appendix C: Glossary**

2 **GAAP Hierarchy:** the sources of accounting principles used in the preparation of
3 financial statements of federal reporting entities that are presented in conformity with
4 generally accepted accounting principles and the framework for selecting the principles.

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