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20 June 2005

Suzanne Bielstein
Director—Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

director@fasb.org

Re: File Reference No. 1300-001—*The Hierarchy of Generally Accepted Accounting Principles*

Dear Ms. Bielstein:

The Corporate Disclosure Policy Council (CDPC) of the CFA Institute Centre for Financial Market Integrity (Centre)¹ appreciates the opportunity to comment on the Financial Accounting Standards Board's (FASB) Proposed Statement of Financial Accounting Standards, "*The Hierarchy of Generally Accepted Accounting Principles*." One of the major objectives of the Centre and the CDPC is to foster the integrity of financial markets through their efforts to address issues affecting the quality of financial reporting and disclosure worldwide.

General Comments

We strongly agree that the FASB is the appropriate body to identify "the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental enterprises that are presented in conformity with

¹ With headquarters in Charlottesville, VA and regional offices in New York, Hong Kong and London, CFA Institute (formerly, the Association for Investment Management and Research[®]) is a non-profit professional association of 78,000 financial analysts, portfolio managers, and other investment professionals in 119 countries of which 63,000 are holders of the Chartered Financial Analyst[®] (CFA[®]) designation. The CFA Institute membership also includes 132 Member Societies and Chapters in 52 countries and territories. The CFA Centre develops, promulgates, and maintains the highest ethical standards for the investment community including the CFA Institute *Code of Ethics and Standards of Professional Conduct*. The Centre represents the views of investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education, and licensing requirements for investment professionals, and the efficiency of global financial markets.



generally accepted accounting principles (GAAP) in the United States.”² Specifically, the intent of the FASB for this Proposal is set forth in the Notice for Recipients:

1. *To carry forward the categorization of the sources of accounting principles by document type as presented in paragraph .10 of SAS 69, and not by their characteristics as presented in paragraph .05 of SAS 69;*
2. *To expand the sources of category (a) to include accounting principles that are issued after being subjected to the FASB’s due process;*
3. *To present FASB Staff Positions and FASB Statement 133 Implementation Issues, which are not addressed in SAS 69, as sources of category (a) accounting principles.*

Except for the *implicit* rejection of the allowed departures from the GAAP hierarchy permitted by the AICPA’s *Code of Professional Conduct* Rule 203 and IAS 1, *Presentation of Financial Statements*, this proposed standard, as the Board observes, “...would not result in a change in current practice.”

The Proposal states that the “Board considered making certain improvements to the GAAP hierarchy set forth in SAS 69, such as reducing the complexity of the hierarchy and elevating the ranking of FASB Concepts Statements, but decided not to make those improvements at this time...The Board expects to address the complexity of the GAAP hierarchy at the conclusion of the codification and retrieval project.” We are sensitive to the Board’s concern that such recategorizations would be premature until the potential inconsistencies among the sources in the current GAAP hierarchy are resolved. However, we believe that the Concepts Statements form a critical part of level (a) GAAP and should be elevated immediately. Indeed, we believe that this is the single most important improvement that could be made.

While we strongly support the current project to update and remove inconsistencies in the Concepts Statements, we believe that they should provide authoritative guidance in those areas where GAAP is currently lacking. Specifically, if an accounting treatment for a transaction or event is not specified by a pronouncement in level (a), or, indeed, does not exist at all in levels (a)-(d), then we believe that preparers should select an accounting method that most closely satisfies the principles in the Concepts Statements. Once the conceptual framework update project has been completed, we believe that the concepts should be required not only to guide and inform the development of new reporting standards, but should serve as a benchmark by which the quality of new standards is evaluated.

Several issues could benefit from further clarification in this Proposal. The status of SEC Staff Accounting Bulletins (SABs) is not clear. Footnote 1 to category (a) states “...in addition, the SEC staff issues Staff Accounting Bulletins that represent practices followed by the staff in administering SEC disclosure requirements.” This statement does not explicitly address whether SEC SABs are category (a) literature, although there would seem to be such a suggestion by the

² Notice for Recipients, Proposed Statement of Financial Accounting Standards, “*The Hierarchy of Generally Accepted Accounting Principles*,” FASB, 2005, Norwalk CT. p. i.

placement of the footnote. Given that the Board has decided that "...its due process is the essential characteristic of category (a) accounting principles" (paragraph A7), the lack of a clear statement as to the status of SEC SABs is likely to result in controversy, if not confusion. We believe that these pronouncements represent more than "practices followed by the staff in administering SEC *disclosure* requirements [emphasis added]." SABs also establish recognition and measurement principles followed by the Staff. SAB 101, *Revenue Recognition*, is an excellent example of this.

The proposed standard implicitly rejects departures from the GAAP Hierarchy as permitted by AICPA Code of Professional Conduct Rule 203 and IAS 1, Presentation of Financial Statements. In the Basis for Conclusions, the FASB states "...an enterprise cannot represent that its financial statements are presented in accordance with GAAP if its selection of accounting principles departs from the GAAP Hierarchy set forth in this Statement..." (paragraph 10). We strongly agree with this conclusion and believe that it should be elevated into the Standards of Financial Accounting and Reporting sections of the standard and not left in the Basis for Conclusions.

The complete sentence in paragraph A10 reads:

*Therefore, an enterprise cannot represent that its financial statements are presented in accordance with GAAP if its selection of accounting principles departs from the GAAP Hierarchy set forth in this Statement and **that departure has a material impact on the financial statements.*** [Emphasis added]

We do not believe that materiality should ever be allowed as a basis for a departure from GAAP. When an error is found in the financial statements after the fact, it may be appropriate to consider materiality when deciding whether a restatement is needed, but the use of materiality to justify a departure from GAAP should not be elevated to the status of an FASB statement.

If the FASB were to permit materiality to serve as a justification for a departure from GAAP, we believe that the FASB should require that materiality must be measured using all four of the following methods:

- (1) The effect on individual line items;
- (2) The effect on subtotals;
- (3) The effect, when combined with other departures from GAAP and misstatements, on the financial statements taken as a whole; and
- (4) The cumulative effect on the financial statements over a long period of time.

We reference SEC SAB 99, *Materiality*, which we support.

Further, if materiality were to be permitted as a justification of a departure from GAAP, there should be a requirement to disclose the intentional departure. The Board has not chosen to require such disclosure in this proposed standard.



We observe that FASB Staff Positions would be elevated to category (a) but EITF consensus positions are category (c). However, some Staff Positions provide guidance on EITF positions. We believe that this inconsistency should be resolved in the Hierarchy.

Conclusions

We support the Board's efforts in this proposal and believe that greater clarification of the authoritative position of the various reporting pronouncements will better serve both preparers and users of the financial statements. However, we believe that the problematic areas, the inconsistencies and gaps that we've identified in the proposed hierarchy are of sufficient importance to warrant the Board's reconsideration of these particular issues.

Respectfully,

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CFA Institute Centre for Financial Market
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/s/ Rebecca T. McEnally, CFA
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