

# Governmental Accounting Standards Series

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EXPOSURE DRAFT

## Proposed Statement of the Governmental Accounting Standards Board

### **The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments**

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

# THE HIERARCHY OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES FOR STATE AND LOCAL GOVERNMENTS

## Request for Written Comments

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

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

## OTHER INFORMATION

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

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

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<p style="text-align: center;"><b>Notice to Recipients of This Exposure Draft</b></p>
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The Governmental Accounting Standards Board (GASB) is responsible for developing standards of state and local governmental accounting and financial reporting that will (1) result in useful information for users of financial reports and (2) guide and educate the public, including issuers, auditors, and users of those financial reports.

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

## Summary

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

The GASB is responsible for establishing GAAP for state and local governments. However, the current GAAP hierarchy is set forth in the American Institute of Certified Public Accountants' (AICPA) Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*, rather than in the authoritative literature of the GASB.

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

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

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 2 discusses the applicability of this Statement.
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# **Proposed Statement of the Governmental Accounting Standards Board**

## **The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments**

**August 28, 2008**

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

## **The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments**

**August 28, 2008**

### **INTRODUCTION**

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

### **STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING**

#### **Scope and Applicability of This Statement**

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

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

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

- a. Officially established accounting principles—Governmental Accounting Standards Board (GASB) Statements and Interpretations. GASB Statements and Interpretations are periodically incorporated in the Codification of Governmental Accounting and Financial Reporting Standards.<sup>1</sup>
- b. GASB Technical Bulletins and, if specifically made applicable to state and local governmental entities by the American Institute of Certified Public Accountants (AICPA) and cleared<sup>2</sup> by the GASB, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position.

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<sup>1</sup>Category (a) standards are the subject of Rule 203, *Accounting Principles*, of the AICPA's Code of Professional Conduct and this Statement does not affect the application of that rule.

<sup>2</sup>Such pronouncements specifically made applicable to state and local governments are presumed to have been cleared by the GASB unless the pronouncement indicates otherwise.

- c. AICPA Practice Bulletins if specifically made applicable to state and local governmental entities and cleared<sup>3</sup> by the GASB, as well as consensus positions of a group of accountants organized by the GASB that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities.<sup>4</sup>
  - d. Implementation Guides (Q&As) published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local government.
4. If the accounting treatment for a transaction or other event is not specified by a pronouncement in category (a), a governmental entity should consider whether the accounting treatment is specified by an accounting principle from a source in another category. In such cases, if categories (b)–(d) contain accounting principles that specify accounting treatments for a transaction or other event, the governmental entity should follow the accounting treatment specified by the accounting principle from the source in the highest category—for example, follow category (b) treatment over category (c) treatment.
5. If the accounting treatment for a transaction or other event is not specified by a pronouncement or established in practice as described in categories (a)–(d), a governmental entity should consider accounting principles for similar transactions or other events within categories (a)–(d) and may consider other accounting literature. A governmental entity should not follow the accounting treatment specified in accounting principles for similar transactions or other events in cases in which those accounting principles either prohibit the application of the accounting treatment to the particular transaction or other event or indicate that the accounting treatment should not be applied by analogy.
6. Other accounting literature includes, for example, GASB Concepts Statements; the pronouncements referred to in categories (a)–(d) of the GAAP hierarchy for nongovernmental entities if not specifically made applicable to state and local governmental entities by the GASB; Financial Accounting Standards Board Statements, Interpretations, Technical Bulletins, Staff Positions, and Concepts Statements; Federal Accounting Standards Advisory Board (FASAB) Statements, Interpretations, Technical Bulletins, and Concepts Statements; AICPA Issues Papers; International Public Sector Accounting Standards of the International Public Sector Accounting Standards Board or International Financial Reporting Standards of the International Accounting Standards Board, or pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, GASB Concepts Statements would normally be more influential than other sources in this category.

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<sup>3</sup>See footnote 1.

<sup>4</sup>As of the date of this Statement, the GASB had not organized such a group.

## **EFFECTIVE DATE**

7. The requirements in this Statement are effective upon its issuance.

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



## **Appendix A**

### **BACKGROUND**

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

## Appendix B

### BASIS FOR CONCLUSIONS

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

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

11. The Board believes that incorporation of the GAAP hierarchy into the GASB's authoritative literature would more clearly convey that financial statement preparers are responsible for selecting the appropriate sources of the principles to be used when preparing financial statements that are presented in conformity with GAAP. The structure presented in this Statement generally carries forward the hierarchy included in Appendix C, "Background Information on Governmental Accounting Standards," in Volume I of the GASB's *Original Pronouncements*. The Board believes that relocating the hierarchy generally "as is" would have the least effect on current practice. If the Board 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.

## Appendix C

### CODIFICATION INSTRUCTIONS

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

\* \* \*

[Create new section as follows:]

#### **THE HIERARCHY OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

#### **SECTION 1000**

Source: GASB Statement XX

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