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transactions could be classified entirely differently based upon how they follow the GAAP leasing rules.

Critics contend that while this system sets forth voluminous rules, it allows a dishonest company to follow the rules technically while simultaneously betraying their intent. Enron Corporation appears to have technically followed GAAP accounting rules while creating its numerous complex capital structures and transactions. However, it seems that the sole purpose for entering into many of these Byzantine transactions was to keep billions of dollars of debt and other obligations off its financial statements, thus hiding many liabilities from the view of the

[2](#)

The alternative system is a principles-based system. This system provides few exact rules and little implementation guidance. Instead, general principles are put forward and companies must ensure that their financial statements fairly and accurately represent these principles. Proponents argue that this type of system does not allow for Enron-type financial engineering, where complex transactions are undertaken in order to get around following specific rules-based accounting standards. Critics believe a principles-based system allows too much leeway for companies, because they generally do not have to follow specific rules, only wide-arching

-based system has allowed its companies to smooth their earnings over time and therefore mute the impact of negative events on their earnings. [3](#)

Highest level of GAAP authority (Level A)

The highest-level issuer of accounting standards has not remained constant over time, which tends to lead to some confusion. Since 1973 the Financial Accounting Standards Board (FASB) has had this role. Two FASB releases are placed within the highest level of GAAP authority:

was issued in 1971, several years before the establishment of the FASB, it still provides many of the rules for GAAP treatment of this issue.

The Other Levels

The first step of financial accounting research is usually to see if the issue is addressed by one or more of Level A authorities. If not then lower level material should be consulted to determine GAAP.

Lower Levels of GAAP (Levels B-E)

Level B

- FASB Technical Bulletins (FTB)
- AICPA Industry Audit and Accounting Guide
- AICPA Statement of Position (SOP)

Level C

- Consensus Positions of the Emerging Is()JT4tBn(0000912 0 610024 4Pece4(de)14(t)4(O)-E]T(B)13(n)

Accounting and Auditing Enforcement Release (AAER)
SEC Staff Accounting Bulletin (SAB)

Even though, according to SAS 69, these materials would fall under the lowest level of GAAP as regulatory agency pronouncements for a publicly traded company, any guidance from the SEC actually carries much greater weight than a normal Category/Level E authority.

The next article in this series will discuss sources for obtaining GAAP literature.

Endnotes

1. AICPA Professional Standards. New York: American Institute of Certified Public Accountants. 2002.

2

Fraud Issues," *Wall Street Journal*. February 12, 2002, p. C7.

3. Karleff,