MINUTES

Financial Accounting Standards Board

To: Board Members

From: Delmonico ext. 393

Subject: Minutes of the August 1, 2007 Board Meeting; Proposed FSP 154-a, "Considering the Effects of Prior-Year Misstatements When Quantifying Misstatements in Current-Year Financial Statements"

Date: August 8, 2007

cc: Allen, Bielstein, Gabriele, Golden, Leisenring, MacDonald, Polley, Vernuccio, FASB Intranet

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic:	Comment Letter Analysis
Basis for Discussion:	Board Memorandum No. 2
Length of Discussion:	9:00 a.m. to 9:28 a.m.
Attendance:	
Board members present:	FASB: Herz, Batavick, Crooch, Seidman, Smith, Linsmeier and Young
Board members absent:	None
Staff in charge of topic:	Glotzer
Other staff at Board table:	Golden and Delmonico

Summary of Decisions Reached:

At the August 1, 2007 Board meeting, the Board began its redeliberations on the proposed FASB Staff Position 154-a, "Considering the Effects of Prior-Year Misstatements When Quantifying Misstatements in Current-Year Financial Statements." At that meeting, the Board decided not to issue a final FSP and removed the project from its agenda.

Objectives of Meeting:

The objectives of the meeting were for the Board to decide whether it wanted to remove the project from its agenda, continue with the project in its current form or expand the scope of the project and deliberate on the comments received from respondents.

The objectives were met.

Matters Discussed and Decisions Reached:

1. Mr. Glotzer began the meeting by commenting that the purpose of the Board meeting was to discuss the comments received on the proposed FSP 154-a, "Considering the Effects of Prior-Year Misstatements When Quantifying Misstatements in Current-Year Financial Statements," during the 45-day comment period which ended April 30, 2007. He noted that the staff received 13 comment letters, 12 of which were received in time to be included in the comment letter analysis. Any additional comment letters received were distributed to Board members and staff. He then stated that the significant issues raised by the respondents would be discussed at this meeting.

   At the meeting, Mr. Glotzer commented that the staff would:

   1. Ask the Board how it wanted to proceed with the project
   2. Present the comments received along with staff recommendations.

2. Mr. Glotzer commented that some staff members believe that the proposed FSP should either be deferred or removed from the Board's agenda, while other staff members believe that the project should continue. Staff members identified three alternatives:

   a. Remove the proposed FSP from the agenda without further consideration

b. Remove the proposed FSP from the current agenda and defer the project until materiality is addressed at the conceptual level

c. Continue with the current project.

He noted that staff members who support alternative (a) argue that the Board should not be addressing materiality issues. He continued noting that these staff members argue that the Board has already concluded, in the FASB Preliminary Views, *Conceptual Framework for Financial Reporting: Objective Characteristics of Decision-Useful Financial Reporting Information*, that materiality is not a matter for standard setters. Further, that these staff members also argue that this issue is not significant enough to warrant the additional time necessary to complete the project. They believe that passed audit adjustments are not prevalent in the private company sector. He commented that these staff members further argue that materiality should be left to professional judgment without the imposition of rules.

Mr. Glotzer then noted that the staff in favor of alternative (b) argue that addressing one aspect of materiality without providing guidance on materiality as a concept is inappropriate. Further, he commented that the staff has learned that the SEC staff is currently seeking opinions about whether materiality guidance is needed for interim financial reporting. He noted that the staff supporting alternative (b) argue that deferring the proposed FSP is appropriate pending the SEC staff's position. They also argue that since all FASB Statements contain a box that states, "The provisions of this Statement need not be applied to immaterial items," the Board should define the term.

Mr. Glotzer indicated that the staff favoring alternative (c) argue that the overall quality of financial reporting is improved by the project. He commented that they believe the use of both the iron curtain and rollover approaches will result in higher quality financial reporting. Further, these staff members, as well as those who support alternative (b), believe that materiality should be addressed in GAAP rather than having preparers rely on auditing standards for guidance. He noted they argue that because the financial statements are management's responsibility, management should be performing its own evaluation of misstatements for assessing materiality as part of the financial statement preparation process.

Mr. Glotzer also indicated that the staff has become aware through subsequent conversations with the Big 4 accounting firms that the firms are already providing certain private clients with the option of applying the guidance in SAB 108. He commented that these staff members note that SAB 108 is nonauthoritative for private entities and contradicts the requirements of FASB Statement No. 154, *Accounting Changes and Error Corrections*. As a result, private entities that choose to adopt the guidance in SAB 108 are in violation of GAAP.

Mr. Glotzer then asked if the Board wanted to move forward with the proposed FSP or remove it from its agenda and if the Board decided to remove the project from its agenda, did it preferred alternative (a) or (b). The Board agreed to remove the project from its agenda and not issue a final FSP. (All Board members agreed).

Mr. Golden commented that not all of the staff was in agreement with Mr. Glotzer's last statement about private companies that have chosen to adopt the guidance in SAB 108 being in violation of GAAP. He commented that arguments can be made to support what companies have done and auditors have accepted those arguments. Mr. Batavick commented that he believes that there have been other instances where private companies have analogized to SEC literature and those analogizes have been accepted in practice.

Mr. Batavick stated that he did not believe the Board should move forward with the project at this time. He recommended removing the current project from the Board's agenda, but believes that materiality should be addressed in a broader project. Mr. Batavick commented that it is appropriate for the Board to provide guidance on materiality since each FASB Statement includes a statement that states "The provisions of this Statement need not be applied to immaterial items." He does not believe that a broader materiality project would constitute a major project, but when compared to the Board's current agenda and priorities, he believes this issue is less significant. He also commented that by holding off on a broader materiality project, the Board would be able to take advantage of any information gathered by SEC staff in its materiality projects. Further, Mr. Batavick believes that past adjustments are not prevalent in the private company sector, and as a result, immediate guidance is not needed. Therefore, Mr.

Batavick commented that he supported alternative (b), remove the proposed FSP from the current agenda and defer the project until materiality is addressed at the conceptual level.

Mr. Smith commented that he disagreed with those staff members who support alternative (a) because he believes this to be an issue the FASB should address. He commented that the FASB has included a materiality box at the end of each Statement and therefore should provide preparers with guidance. Mr. Smith also believes that a materiality project would not require a great deal of the Board's resources to complete. Mr. Smith further commented that he disagreed with the statement that past adjustments are not prevalent in the private company sector based on his prior experience in auditing private companies. Mr. Smith noted that the Board took on this project because it believed that the project would improve financial reporting and that private companies should have the option to apply the same accounting treatment as public companies for correcting prior-year immaterial errors that have become material to the current-year financial statements. He noted that since the auditing profession has already allowed private companies to adopt the provisions of SAB 108 that there was nothing for the Board to do at this time. As a result, Mr. Smith commented that he supported alternative (b) over alternative (c). Further, Mr. Smith noted that materiality would likely be addressed by the SEC Improvements Committee and that the Board might be able to learn from the Committee's research. Mr. Smith believes that it would be better to comprehensively address materiality and develop a conceptual approach rather than addressing it in the narrow scope of this project.

Mr. Crooch commented that he does not believe materiality is an accounting standard-setting issue. He noted that the Board had come to this tentative conclusion in the preliminary views document for the conceptual framework project. As a result, Mr. Crooch stated that he supported alterative (a).

Ms. Seidman commented that she had always been uncomfortable with issuing the proposed FSP because it was based on SEC guidance. She noted that concerns have been raised over how this guidance should be applied in practice. She continued commenting that she believed that the Treasury and SEC committees would likely investigate materiality issues. Ms. Seidman therefore believes that it would be inappropriate for the Board to move forward with the proposed FSP since the underlying approach to materiality, at least for public companies, will likely be reconsidered by these committees. Ms. Seidman then commented that she was unsure what role, if any, accounting standard setting should play in developing the concept of materiality. She indicated that she would like to see the results of the two committees' studies and to have a dialogue to determine who, if anyone, should be clarifying the definition of materiality before the Board decides to address this issue. If it is determined that the Board should play a role in defining the concept of materiality, Ms. Seidman indicated that she would then be open to adding a project to the Board's agenda. Therefore, Ms. Seidman commented that she supported alternative (a), removing the project from the Board's agenda.

Mr. Young indicated that he believes there to be two different notions of materiality, one that has to do with the preparer/auditor relationship and one that has to do with the preparer/investor relationship. Mr. Young commented that he was not convinced that standard setting should be addressing prepare/auditor materiality. However, Mr. Young does believe that preparer/investor materiality should be addressed since he believes it to be a core part of relevance. He also cited the Board's materiality box at the end of each Statement as another reason the Board should provide guidance on this issue. He believes that this box speaks directly to the preparer/investor relationship. Mr. Young also commented that he believes the Board currently does not have a good definition of materiality and that the Board should be the standard setter for this matter and not the SEC. He also stated that there should be no difference between public and private entities on this issue. Mr. Young indicated that he was in favor of the Board taking on a project to address materiality as a broader concept, but does not believe that addressing materiality in this project is the correct approach. Mr. Young indicated that he therefore supported alternative (b).

Mr. Linsmeier commented that he did not see the distinction between alternative (a) and alternative (b). He noted that the Board would still have to decide when and how it wanted to add a project to its agenda to address this issue. Mr. Linsmeier commented that this project focuses on a narrow aspect of materiality and primarily addresses the method for quantifying materiality in one isolated circumstance. Mr. Linsmeier believes that if the Board were to address materiality, it should be addressed in a broader project and not in the narrow scope of this project. As a result, Mr. Linsmeier indicated that he supported alternative (a).

Mr. Herz believes that the Board should not move forward with the project at this time. He commented that the Board should monitor the Treasury and SEC committees for developments. Mr. Herz said that although the Board was not called on to decide whether materiality was an issue the Board should address, Mr. Herz believes that the Board should address it. He also believes that if the Board were to provide guidance on materiality, it should be provided at a conceptual level. He noted, however, that it would not be appropriate for the Board to currently undertake a materiality project given the studies undertaken by the Treasury Department and the SEC. Mr. Herz therefore supports alternative (a).

Mr. Linsmeier commented that he believes that there are two places where the Board has an opportunity to address materiality, in the conceptual framework as a constraint or in another project. Ms. Seidman commented that addressing materiality in the conceptual framework would depend on whether the framework was made authoritative. Mr. Linsmeier noted that at one time the Board had a materiality project on its agenda but that the project had eventually been removed. He commented that he was interested in understanding the direction of that project and why the project was removed from the Board's agenda. Mr. Batavick commented that he was also interested in gaining a better understanding of the staff's thinking on materiality in the conceptual framework project.

Follow-Up Items:

None.

General Announcements:

None.