



Financial Accounting Standards Board

FASB Staff Position 154-a, Considering the Effects of Prior-Year Misstatements When Quantifying Misstatements in Current-Year Financial Statements

Board Meeting Handout

August 1, 2007

OVERVIEW

The purpose of this Board meeting is 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. The staff has received 13 comment letters, 12 of which were received in time to be included in the comment letter analysis. Any additional comment letters received have been distributed to Board members and staff. The significant issues raised by the respondents will be discussed at today’s meeting.

At the meeting, the staff will:

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

ISSUE 1: REMOVAL OF THE PROPOSED FSP FROM THE BOARD’S AGENDA

1. 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 have 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.

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

Staff members who support alternative (a) argue that the Board should not be addressing materiality issues. They 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. 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. These staff members further argue that materiality should be left to professional judgment without the imposition of rules.

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, the staff has learned that the SEC staff is currently seeking opinions about whether materiality guidance is needed for interim financial reporting. 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.

The staff favoring alternative (c) argue that the overall quality of financial reporting is improved by the project. 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. 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.

The staff has also 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. 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.

Does the Board want to move forward with the proposed FSP or drop it from its agenda?

If the Board decides to drop the project from its agenda, does it prefer alternative (a) or (b)?

If the Board decides to move forward with the project, the staff has identified several issues from respondents' comment letters for consideration by the Board. The following paragraphs discuss those issues and the staff's recommendations.

ISSUE 2: REFERENCES TO SAB 99

Five respondents suggested that the Board remove all references to SEC Staff Accounting Bulletin No. 99, *Materiality*, or that references be minimized. Respondents argue that SAB 99 is not part of authoritative GAAP literature. It was written by the SEC staff specifically for SEC registrants and does not apply to private entities. As a result, it may be confusing for nonpublic entities.

Staff Response

The staff recommends removing direct references to SAB 99 in the proposed FSP and instead proposes to incorporate a summarized version of SAB 99 in the proposed FSP to address materiality. The staff believes that without some framework to assess materiality, the proposed FSP lacks a foundation upon which to address the quantification of misstatements for the evaluation of materiality. Staff members who support alternative (b) of Issue 1 believe that the Board should address the quantification of misstatements in a full materiality project rather than using a summarized version of SAB 99.

Does the Board agree with the staff's recommendation to provide a summary of SAB 99 eliminating direct references to it?

ISSUE 3: INTERIM FINANCIAL STATEMENTS

Two respondents expressed concern that the proposed FSP was silent about APB Opinion No. 28, *Interim Financial Reporting*, specifically paragraph 29. One suggested that the proposed FSP specifically state that it does not affect the application of Opinion 28 while the other suggested that the proposed FSP address materiality in interim financial statements because SAB 108 did not.

Staff Response

The staff has learned that the SEC is currently studying the possibility of a project to address materiality for interim financial reporting. The staff believes that to properly address materiality for interim financial reporting along with the quantification of misstatements, it would have to be done as part of a larger materiality project or as a stand-alone project after the SEC staff issues a SAB on the topic.

Does the Board agree with the staff's recommendation to proceed without providing guidance on materiality for interim financial reporting?

ISSUE 4: INTERACTION OF SAB 108 AND THE PROPOSED FSP

One respondent commented that the proposed FSP could lead to interpretations outside the original intent of SAB 108 since the application of the proposed FSP may not be consistent with the manner in which SAB 108 has been applied to SEC registrants. The FASB staff has also received comments from the SEC staff that indicated that the SEC would support a jointly developed FSP. The SEC would rescind SAB 108 upon its completion. Two respondents commented that issuing an FSP to bring SAB 108 requirements into GAAP might become a precedent.

Staff Response

The staff believes that continuing with the proposed FSP in its current form could lead to diversity in interpretation and application because the language in the proposed FSP may be similar to, but not the same as SAB 108. The staff believes that developing an FSP for both public and private entities would eliminate the diversity in interpretation

and application because entities, both public and private, would be applying the same standard for quantifying errors. Further, the staff believes that the FASB should not be writing standards specifically for either public or private entities, but rather, should be writing standards for both. Therefore, the staff recommends modifying the proposed FSP to encompass both public and private entities.

Does the Board agree with the staff's recommendation to modify the FSP to provide guidance for all entities, public and nonpublic?

ISSUE 5: CORRECTION OF IMMATERIAL MISSTATEMENTS

Two respondents commented that the proposed FSP did not address how and when the correction of immaterial items should be presented in prior-year financial statements.

Staff Response

The staff believes that the SAB addressed this issue because of SEC filing requirements. Those filing requirements are not applicable to nonpublic entities. Statement 154 governs the correction of errors. Therefore, the staff believes that the proposed FSP does not need to address this issue.

Does the Board agree with the staff's recommendation to not provide additional guidance for the correction of immaterial errors?

ISSUE 6: TRANSITION AND THE USE OF THE CUMULATIVE-EFFECT ADJUSTMENT

One respondent recommends that the transition provisions of paragraphs 12 and 16 in the proposed FSP be amended to allow the cumulative-effect adjustment when previously identified prior-year immaterial errors were identified using both the iron curtain and rollover approaches. Another respondent stated that requiring the use of either the rollover or iron curtain approach, but not both, complicates the proposed FSP. One respondent recommended that the transition provisions be amended to allow the cumulative-effect adjustment for previously unidentified prior-year immaterial errors identified during the transition period.

Staff Response

The staff notes that in SAB 108, the SEC staff did not intend for the SAB to provide a free pass to clean up an entity's balance sheet. In order to qualify for the transition guidance, an immaterial error must have been previously identified using either the iron curtain or rollover approach, but not both. If the proposed FSP were to allow the cumulative-effect adjustment regardless of the method used in the past, it would result in continued diversity between public and nonpublic entities. Therefore, the staff recommends that no change be made to the transition guidance of paragraphs 12 or 16 in the proposed FASB staff position.

Does the Board agree with the staff's recommendation to allow the cumulative-effect adjustment only in those circumstances where the entity used either the iron curtain or rollover approach, but not both?

ISSUE 7: EFFECTIVE DATE

Five respondents recommend that the effective date for the proposed FASB staff position be delayed. Each respondent expressed concern that the current effective date would not provide sufficient time for entities and their accountants to understand its provisions and properly apply the proposed FSP.

Staff Response

The staff has considered the respondents' comments and recommends that the Board delay the effective date. Therefore, the staff recommends an effective date for financial statements beginning after December 15, 2007 with early adoption permitted.

*Does the Board agree with the staff's recommendation to extend the effective date?
If so, what effective date should be used?*