MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Private Companies Financial Reporting Team (Delmonico, ext. 393)
Subject:	Minutes of the December 19, 2006 Board Meeting: Materiality Considerations
Date:	January 2, 2007
cc:	FASB: Allen, Bielstein, Carney, Gabriele, Glotzer, Golden, Leisenring, MacDonald, Polley, Smith, 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: Quantification and correction of current-year misstatements associated with the carryover and reversal of prior-year misstatements.

Basis for Discussion: Board Memoranda No. 1

Length of Discussion: 11:20 a.m. to 11:55 a.m.

Attendance:

Board members present: Batavick, Crooch, Herz, Linsmeier, Seidman, Trott, Young

Staff in charge of topic: Glotzer

Other staff at Board table: Delmonico, Smith

Outside participants: None

Summary of Decisions Reached:

1. The Board affirmed that guidance should be issued for the quantification of misstatements on current-year financial statements arising from the carryover or reversal of prior-year uncorrected misstatements. The Board concluded that guidance should be issued requiring the dual method approach illustrated in the SEC Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), for purposes of evaluating materiality.

2. The Board affirmed that current standards should be modified to allow for a one-time cumulative effect adjustment for private companies and not-for-profit entities to correct misstatements resulting from the carryover or reversal of prior-year misstatements.

Objectives of Meeting:

The objectives of the meeting were to determine whether the Board should:

1. Issue a standard that requires specific methodology for quantifying misstatements for use in the evaluation of materiality.
2. Modify FASB Statement No. 154, *Accounting Changes and Error Corrections*, to allow a one-time cumulative-effect adjustment for correcting misstatements arising from the carryover or reversal of prior-year misstatements.

The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

1. Mr. Glotzer opened the meeting by stating that the objective of the meeting was to discuss whether the Board should issue guidance requiring the dual method approach of SAB 108 for quantifying misstatements arising from the carryover or reversal of prior-year uncorrected misstatements and whether the Board should issue guidance allowing a one-time cumulative-effect adjustment for correcting misstatements arising from the carryover of reversal of prior-year

misstatements for private companies. Mr. Glotzer indicated that the issues arose from inquiries received from the Big 4 accounting firms.

2. Mr. Herz asked for clarification about whether the issues would apply to not-for-profit entities. It was agreed that the issues would apply to both private companies and not-for-profit entities.

3. After a short period of deliberation, the Board adopted a view opposite to that of the staff's recommendation and decided that guidance should be issued specifying the method to be used for the quantification of misstatements on current-year financial statements arising from the carryover or reversal of prior-year uncorrected misstatements (six Board members agreed; one did not (TJL)). However, on the issue as to whether the current standards should be modified to allow for a one-time cumulative-effect adjustment for private companies and not-for-profit entities to correct misstatements resulting from the carryover or reversal of prior-year misstatements, the Board unanimously agreed with the staff's recommendation that the current standards should be modified.

4. Mr. Smith indicated that he believed there are different levels or classes of private companies, those which are relatively small and rely on their accountants to prepare financial statements and those which are larger and function, from an accounting perspective, similarly to a public company. This class of larger private companies likely has passed audit adjustments that have accumulated over time. These passed adjustments reside on these companies' balance sheets and are likely the reason why the Big 4 accounting firms brought this issue to the Board's attention.

5. Ms. Seidman commented that the Securities and Exchange Commission (SEC) frequently provides guidance for public companies and accounting firms that have to deal with cases where they are treating their public clients different from their private clients. Based on this comment, Ms. Seidman asked why the Board should consider this issue. Mr. Smith indicated that SAB 108 provides public companies with an opportunity to clean up their balance sheets for passed prior-year audit adjustments without restating prior years, while private

companies are not permitted to have the same opportunity. Issuing guidance would afford private companies the same favorable treatment as public companies.

6. In response to Mr. Glotzer's comment that some large accounting firms would require their private clients to follow the guidance set forth in SAB 108, Mr. Young questioned whether it was prudent to delegate the setting of accounting standards for private companies to accounting firms. Mr. Young expressed concern with this ad hoc approach, and conveyed the view that the Board should determine the appropriate accounting standards for private companies.

7. Mr. Trott indicated that the iron curtain approach and rollover approach discussed in SAB 108 have been debated in the auditing profession for a number of years irrespective of whether the company was public or nonpublic. This issue was recently exposed and debated by the Auditing Standards Board (ASB). The Exposure Draft issued by the ASB required the SAB 108 approach. However, the ASB decided not to take a stance because they perceive this to be an accounting issue. Mr. Trott further indicated that he perceives this to be an issue and that he is not opposed to undertaking a project with a narrow scope to evaluate previously passed audit adjustments. Mr. Trott believes this phenomenon occurs regardless of whether the company is public, private, or not-for-profit and that only by answering that question does it make sense to provide for a one time cumulative effect adjustment as illustrated in SAB 108.

8. Mr. Trott indicated that he would not support only modifying Statement 154 to allow a clean up because he believes it would be unclear why companies would be changing past treatment. Mr. Trott indicated that he strongly disagreed with the staff and expressed the need to answer the iron curtain/rollover approach question in order to allow for the change to a cumulative-effect adjustment.

9. Mr. Linsmeier expressed concern that issuing guidance for this limited circumstance, firms might then analogize the guidance to other attributes of materiality. The other Board members did not share Mr. Linsmeier's concern.

10. Mr. Herz said he received a letter expressing concern about the materiality concept and the meaning of FASB's materiality box in relation to SEC Staff Accounting Bulletin No. 99, *Materiality*. Copies of the letter had been provided to the rest of the Board prior to this meeting. Mr. Herz indicated that some clarification may be in order, but that this would appear to be a broader issue beyond the scope of this project and that the Board would need to involve the SEC if it chose to deal with the issue discussed in the letter. One other Board member agreed with Mr. Herz, stating that this issue should not be addressed in this project.

Follow-Up Items:

11. The staff will draft and expose a document for public comment. No specific date was set for the release of the draft.

General Announcements:

12. None.