**The University of Georgia**
**Terry College of Business**
**J. M. Tull School of Accounting**
**Brooks Hall 255**
**Athens, Georgia 30602-6252**

November 12, 2001

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Preface to International Financial Reporting Standards

Board Members:

The following are my comments on your exposure draft of a proposed "Preface to International Financial Reporting Standards."

Paragraph 6 – In subparagraph (a) the draft states that one of the objectives of the IASB is to develop "... a single set of high quality, understandable and enforceable global accounting standards...." (emphasis added). The use of the word "enforceable" implies that the Board itself has enforcement authority, which, of course, is not the case. While the Board no doubt desires that regulatory organizations around the world will ultimately see fit to require the application of International Financial Reporting Standards in their jurisdictions, using the word "enforceable" in the Board's standard Preface may create a misleading impression At a minimum, the wording of the Preface should be modified to make clear the status of enforceability.

Paragraph 6 – In subparagraph (c) the Board states its objective "... to bring about convergence...." I believe that this is the first time that the term "convergence" has been used by the new Board in an official document. Therefore, I suggest that it be precisely defined. Over the past 25 years or so there have been many terms used to discuss this general matter such as "harmonization" and "internationalization." It is possible that the Board's constituents do not have a common understanding of what the IASB intends and a clear explanation of this important term would help.

Paragraph 7 – In the second sentence of this paragraph, the exposure draft defines "other financial reporting" to comprise "information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions." This definition seems overly broad. Read literally, it would encompass virtually every piece of information that could conceivably assist in making economic decisions. The Board should specify some practical limitation on the scope of "other financial information," such as information that is required to be included in annual reports to shareholders.

The same quote above includes the word "efficient" to modify "economic decisions." However, in at least two other places in the exposure draft the term "economic decisions" is used without this modifier. The Board should consider whether it should be internally consistent in using terminology such as this or whether a different meaning is intended when the modifier is used. Further, I question whether "efficient" is the right word. Wouldn't something like "effective" be more appropriate if such a modifier is needed?

Paragraph 13 – The exposure draft states that "... the IASB has reconsidered..." earlier allowed alternatives. Is this factually correct? While I understand that such a study is underway, I was not aware that it has been completed, as is indicated by "has reconsidered."

Paragraph 14 – I strongly agree with the decision that no distinction should be made between the standing of rules printed in bold italic type vs. plain type. However, I think that this paragraph should be clearer in stating that companies adopting ISFRs must follow <u>all</u> of the rules regardless of type. The wording now says only that the new standards will not "make a distinction" between bold and plain type. That wording does not make it absolutely clear that all of what is included in a standard must be followed.

Paragraph 18 – This paragraph states that, "IFRS need not be applied to immaterial items." I believe this is an inadequate treatment of an important accounting notion and the Board needs to provide better guidance on materiality in order to make its future standards operational.

While materiality may be considered elsewhere in IASC literature, the principal reference seems to be in its Framework, in paragraphs 29 and 30:

> The relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. For example, the reporting of a new segment may affect the assessment of the risks and opportunities facing the enterprise irrespective of the materiality of the results achieved by the new segment in the reporting period. In other cases, both the nature and materiality are important, for example, the amounts of inventories held in each of the main categories that are appropriate to the business.
>
> Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

This language provides little or no useful guidance for companies and auditors faced with real world problems of how to determine whether a matter is material and, therefore, must be reported according to the specified standard. Unfortunately, the Staff of the Securities and Exchange Commission has “muddied the waters” on this matter through its Staff Accounting Bulleting No. 99. SAB 99 notes that qualitative considerations are as important as quantitative considerations in evaluating materiality. Competent attorneys challenging materiality judgments made by financial executives or auditors will find words in SAB 99 to define almost any conceivable situation as material.

Worse yet, a footnote to SAB 99 seems to contradict how practice in the United States has heretofore interpreted the standard materiality box in FASB Statements. I refer you to my attached letter to the FASB. Unfortunately, neither the FASB nor the SEC has taken further action to clarify the matter discussed in my letter. Should the IASB issue its Preface without further clarification you will be doing a serious disservice to all of those parties who must make decisions about whether the costs of precise application of standards must be incurred when the benefits of doing so are clearly unimportant to users of financial statements. I realize that this is a difficult matter but I also suspect that the rest of the world is far behind the United States in even thinking about materiality and it is important that the IASB give it appropriate consideration at the earliest possible date.

Thank you for the opportunity to comment and I wish you well in your efforts to improve international accounting standards.

Sincerely,

Dennis R. Beresford
Ernst & Young Executive Professor of Accounting

**The University of Georgia**
**Terry College of Business**
**J. M. Tull School of Accounting**
**Brooks Hall 255**
**Athens, Georgia 30602-6252**

September 15, 1999

Mr. Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856

Dear Ed:

Shortly after its issuance I read the SEC's Staff Accounting Bulletin 99 on Materiality with great interest. I also obtained a copy of the transcript of the FEI's August 20th "telediscussion" of the new SAB. I'm sure that there will be extensive discussion of the SAB at various conferences this fall and perhaps even some further clarification or other guidance from the SEC. But there is one issue that I feel the FASB should consider. That is footnote 28 to the SAB, which states:

> FASB Statements of Financial Accounting Standards ("Standards" or "Statements") generally provide that "(t)he provisions of this Statement need not be applied to immaterial items." This SAB is consistent with that provision of the Statements. In theory, this language is subject to the interpretation that the registrant is free intentionally to set forth immaterial items in financial statements in a manner that plainly would be contrary to GAAP if the misstatement were material. The staff believes that the FASB did not intend this result.

The transcript of the telediscussion covers this in the following words. (No doubt at least a few words have been garbled in the transcript.)

LINVINGSTON: Well let me - let me ask some more. The - what about the fact that the, you know, the - the FASB and every financial - every standard that comes out from the FASB there's this standard box at the end of the of the statement that says that this - this standard is not to be you know not meant to apply to...immaterial items. And so now - now what do we do? Are we - have we changed that? Does this - does this impact that? I mean it - right not it's not GAAP. I mean you are in compliance with GAAP if you don't apply the standards to immaterial items.

Do you - are we now we - we kind of overriding the - the exception box there?

TURNER: I think that's probably the best and hardest question would come now. The - the whole SAB and it's one that we've struggled with and as you know it's a question we went back to CCR on and - and got the letter from CCR. As I recall what's in the SAB is consistent with CCR and that is we all agreed that if people are out there intentionally moving numbers around for something like this, then it's a problem and that's where the SAB is crafted to follow the CCR language. The board, and we also had discussions with individual members of the board as we were drafting it, never intended that box to turn around and say you could use that box to make these errors for this type of purpose that – that we're focusing in on here. On the other hand, the box, a good example, as we all know we've probably got beaucoup leases out there that under FAS 13. Xerox you know we know they'd all - all capitalize...

TURNER: ...and - and yet the box clearly is intended to apply to those Xerox things and say if they're that small you don't have to capitalize them and it's immaterial, let's get on with life. And again, that's business as usual.

As noted, the text of the SAB states that the SEC staff believes that the FASB never intended a certain interpretation of the materiality box. And Lynn Turner’s statement in the telediscussion repeated that understanding along with a comment that the SEC had had discussions with individual Board members about this matter during the development of the SAB.

My concern about this matter is twofold. First, I'm still not clear how the SEC now intends that the materiality box should be interpreted. Second, I don't necessarily agree with what I think is the SEC staff's understanding of what the FASB intends when it includes the standard materiality box.

Use of the materiality box began, of course, long before I joined the Board. I am not aware of its "legislative history" although it would be interesting to see if anything can be found in the FASB's early project files that discusses this matter. During my time at the Board we never debated the intent of the box as far as I can recall. The materiality box was simply added to the text of each document as part of the production process.

Of course, the general subject of materiality was discussed on several occasions, usually in the context of providing quantitative guidelines for some accounting or disclosure item (e.g., segment disclosures) or when the Board was asked to make an explicit materiality exception. For example, in my last few years at the Board we considered specific materiality exceptions for stock option disclosures (paragraph 244 of Statement 123) and dual earnings per share presentations (paragraph 132 of Statement 128). In both of these cases the Board chose not to specify materiality exceptions but it made reference to the materiality box for guidance.

The SEC now seems to be saying that the Board couldn't possibly have meant that companies could purposely account for or disclose accounting events or transactions contrary to the letter of a Statement. I simply don't agree with that conclusion although my main concern is that the FASB shouldn't keep repeating the materiality box in each Statement unless there is a clear understanding and communication of what it means. Let me try to articulate what I think the Board intended in the materiality box.

Each accounting standard establishes generally accepted accounting principles. In short, the standard tells reporting companies and other interested parties how to "do it right." However, practicality is important in addition to theoretical purity and the FASB recognizes that the cost of applying an accounting standard shouldn't exceed its benefit.

Standards differ in their degree of specificity but many of them contain considerable detail. At the same time, most standards are introduced with a general objective that provides the overall framework for the details that follow. I would expect that companies normally would account for all transactions at least in accordance with the general objective of each standard. But they might ignore certain details if the difficulty and cost of literal application is high and the effect of non-compliance is inconsequential. For example, where the interest method of amortization is specified for a financial asset or liability the straight-line method might be used for simplicity when the effect is inconsequential.

On the other hand, even the general objective of a standard can be ignored if the overall effect is inconsequential. When we were debating other post-employment benefits, I recall one conversation where someone asked whether a large company would have to comply with Statement 106, including obtaining actuarial studies, etc., if the only plan it had was for a limited number of senior officers. I believe that the consensus answer was “of course not, that would be covered by the materiality box.” The same answer would seem to apply to a stock option plan that covers a relatively small number of shares for a few officers.

I recognize that I have used the term “inconsequential” in each of the last two paragraphs as a notion of a very small quantitative effect. Some may feel that this needs to be defined and only effects of less than a percent or two would be permissible for such a materiality exception. I feel that it is more important that the matter in question be one where a company adopts a policy for a small dollar effect item and then follows that policy consistently. For example, it wouldn’t be acceptable for a company to expense capital expenditures of less than, say, $ 5,000 for practical reasons and then capitalize a bunch of them in a year in order to meet an earnings target.

This may be an area where a number of illustrations need to be developed and discussed by the Board and staff to ensure that there is a meeting of the minds. I hope, however, that the Board will be able to find a relatively straight forward way of describing in narrative form what it intends by the materiality box. If it hasn’t done so already, I urge the Board to consider this matter formally and issue guidance before the end of 1999.

Sincerely,

Dennis R. Beresford
Ernst & Young Executive Professor of Accounting

Copy: Timothy S. Lucas
Lynn E. Turner
Jane B. Adams