

Discussion Document D

Topic: Labeling financial statement columns to indicate (1) a change in accounting principle, and (2) a correction of an error, as applicable

Background:

Under Statement 154, when prior periods have been adjusted to reflect the retrospective application of a new accounting principle are each prior period's column headings in the financial statements required to be labeled "As Adjusted"?

We assume current practice related to the correction of an error will continue with columns being labeled "As Restated" unless specifically allowed by current or future SEC guidance.

Applicable Guidance

Statement 154

Paragraphs 7c and 17 (a change in accounting principle) of Statement 154 require, among other considerations, that the financial statements of each individual prior period presented be adjusted to reflect the change in accounting principle. However, Statement 154 is silent as to whether each prior period's column headings of the financial statements should be labeled "As Adjusted". Although the example in paragraph A6, which illustrates a change in accounting principle, does in fact label the prior period income statement heading "As Adjusted (Note A)," paragraph A1 indicates that the examples in the appendix do not establish additional requirements.

Additional Information

SEC Staff Training Manual, Appendix A.VII.D

Paragraph 2 indicates that the nature of an error in previously issued financial statements and the effect of its correction on income before extraordinary items, net income, and related EPS should be disclosed in the first Form 10-Q and 10-K after correction and that all columns should be labeled "restated."

Issue/Question:

View A:

FOR requiring labeling of column headings for a change in accounting principle effected by retrospective application

Although Statement 154 is silent, the SEC Staff Training Manual requires labeling the column headings of restated financial statements "As Restated." Presumably, the basis for this requirement, at least in part, is to highlight the lack of comparability with the previously reported information. In addition, Statement 154 provides an illustrative

example of the retrospective application of a change in accounting principle which includes labeling the column “As Adjusted”. There does not appear to be a conceptual difference in the lack of comparability created by a correction of an error (i.e., a restatement) and the lack of comparability created by retrospective application of a new accounting principle. Therefore, the column headings of financial statements which include a change in accounting principle affected by retrospective application should be labeled “As Adjusted”. The conceptual basis underlying this approach is equally applicable for private companies.

In addition, a recently issued CPCAF Alert addressing changes to previously issued financial statements specific to retrospective modification for the presentation of cash flows from discontinued operations expressed the SEC’s views on the need for providing column headings in that particular situation (i.e., the Staff indicated such financial statements should be marked as “revised” or “restated”).

View B:

AGAINST requiring labeling of column headings for a change in accounting principle effected by retrospective application

Considering the guidance in Statement 154 which indicates that the examples in the appendix do not establish additional requirements and Statement 154 is silent regarding labeling of column headings, such labeling **should be encouraged**, but not required, for retrospective application of a change in accounting principle. The rationale for this conclusion includes the following:

Statement 154 does not require such labeling; rather, it requires specific disclosures of such a change. Presumably the Board concluded that the consistency issues inherent in such a change are sufficiently addressed in Statement 154’s stated requirements. As such, regardless of whether the column headings are labeled “As Adjusted,” a financial statement user is provided the relevant information to understand that a change in accounting principle has occurred and its impact. In addition, auditing standards address financial statement consistency (more specifically lack thereof), and provide auditor reporting requirements in such situations.

Second, there appears to be a functional difference in the lack of comparability created by a correction of an error and the lack of comparability created by retrospective application of a change in accounting principle. In retrospective application of a change in accounting principle, the previously issued financial statements were not incorrect at the time of issuance, but a change has occurred subsequent that date. In contrast, with a correction of an error, the previously issued financial statements included an error(s) at the time of issuance, and should no longer be relied upon. Labeling of each of the prior period’s columns “As Restated” emphasizes this point.

Third, Appendix B of APB 20 (APB 20 was superseded by Statement 154) also included similar “as adjusted (Note A)” language in an example illustrating the manner of

reporting a change in accounting principle retroactively by restating (which is the current equivalent of retrospective application under Statement 154) the prior periods presented. As the SEC guidance did not address labeling column headings as “As Adjusted” under APB 20, it does not appear warranted under Statement 154.

Committee Recommendation: The Committee supports View B.

SEC Staff Position: The SEC staff stated that while labeling financial statement columns “as adjusted” for a change in accounting principle is not explicitly required, it is considered a best practice to facilitate as much transparency as possible.