CENTER FOR AUDIT QUALITY
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CAQ Alert #2007-30 – June 25, 2007

DEAR CENTER MEMBERS

Reexamining the Adoption of SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*

The adoption of Financial Accounting Standard Board (FASB) Statement No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS 158) was required for calendar year end public companies in their financial statements for the year ended December 31, 2006. The Center for Audit Quality (CAQ or the Center) is issuing this alert because it has come to our attention that some entities did not implement the transition provisions of SFAS 158 as specifically required by the standard. It is our understanding that provided the conditions noted below are met, the SEC staff does not intend to request amended filings to correct this misapplication of the standard.

Description of SFAS 158 Transition - Recognition Provisions

SFAS 158 moves retirement benefit plan funding deficits or surpluses from the footnotes onto the face of the sponsoring employer's balance sheet. The other side of the journal entry to adopt SFAS 158 is an adjustment of the ending balance of accumulated other comprehensive income (AOCI). Specifically, the transition provisions of SFAS 158 require companies to record any previously unrecognized gains or losses, prior service costs or credits and transition assets or obligations (the transition adjustment) as a direct adjustment to the ending balance of AOCI and **not** as a component of comprehensive income for the year of adoption. Refer to paragraph 16.a of SFAS 158. Therefore, companies that are adopting SFAS 158 should not include the transition adjustment in determining other comprehensive income for the year of adoption; rather they should include the transition adjustment as a direct adjustment to AOCI as of the end of the year of adoption.

Example of Accounting Treatment within AOCI

Below is an example of the *correct* and *incorrect* presentation of the transition adjustment which comes from paragraph A7 of SFAS 158. Note that the $513,000 debit to AOCI should **not** be included in the subtotals of Other Comprehensive Income or Comprehensive Income for 2006.

Correct presentation:

Company A
Statement of Changes in Stockholders' Equity
Year Ended December 31, 2006
(in thousands)

	Total	Compre-hensive Income	Retained Earnings	AOCI	Common Stock	Paid-in Capital
Balance at December 31, 2005	$612,979		$137,988	$24,991	$150,000	$300,000
Comprehensive income						
Net income for 2006	67,512	$67,512	67,512			
Other comprehensive income, net of tax						
Foreign currency translation gain	15	15				
Unrealized holding loss arising during period	(6)	(6)				
Other comprehensive income		9		9		
Comprehensive income		$67,521				
Adjustment to initially apply FASB Statement No. 158, net of tax	(513)			(513)		
Balance at December 31, 2006	$679,987		$205,500	$24,487	$150,000	$300,000

Incorrect presentation:

Company A
Statement of Changes in Stockholders' Equity
Year Ended December 31, 2006
(in thousands)

	Total	Compre-hensive Income	Retained Earnings	AOCI	Common Stock	Paid-in Capital
Balance at December 31, 2005	$612,979		$137,988	$24,991	$150,000	$300,000
Comprehensive income						
Net income for 2006	67,512	$67,512	67,512			
Other comprehensive income, net of tax						
Foreign currency translation gain	15	15				
Unrealized holding loss arising during period	(6)	(6)				
Adjustment to initially apply FASB Statement No. 158, net of tax	(513)	(513)				
Other comprehensive income		(504)		(504)		
Comprehensive income		$67,008				
Balance at December 31, 2006	$679,987		$205,500	$24,487	$150,000	$300,000

Evaluation of SFAS 158 Recognition Provisions

Based on discussions with staff members at the SEC (the Staff) regarding the transition provisions of SFAS 158, if a registrant has adopted SFAS 158 and misapplied the transition guidance of SFAS 158 relative to the determination of comprehensive income for the year of adoption, the Staff indicated that they would not object to a registrant, its audit committee and its auditor making a judgment that the misapplication of the standard is not material, even if it is determined to be quantitatively significant, as long as the components of comprehensive income and the transition adjustment are clearly disclosed in the company's financial statements.

Accordingly, it may not be necessary to amend a prior filing as long as the company has concluded that:

- The misapplication of the SFAS 158 transition guidance does not result in a material misstatement of the financial statements, and

- The original presentation is detailed enough that a user of the financial statements could determine: (a) the amount, if any, that should have been recorded in other comprehensive income for the change in the additional minimum liability for the period and (b) the transition adjustment amount that should have been recorded directly to AOCI.

However, the Staff stated that in such a situation the correction of the misapplication of the standard should be made the next time the registrant files the prior-year financial statements.

In addition, if the amount is quantitatively significant, the fact that previously reported comprehensive income for the prior year was not reported in accordance with the requirements of SFAS 158, as well as the corrected amount of comprehensive income, should be clearly disclosed in the company's next interim filing (e.g., second quarter Forms 10-Q for calendar year-end companies). A company should consider disclosing at least the following:

- Narrative discussion that characterizes the presentation of Other Comprehensive Income in the most recent Form 10-K as incorrect;

- The amount incorrectly reported as comprehensive income for the prior year and the "as reported" and "as revised" amounts of Other Comprehensive Income; and

- The company's intent to correct the Other Comprehensive Income presentation in the next Form 10-K filing.

The Staff stated that its decision to not object to such judgments about the materiality of this particular misapplication of the standard is not intended to set a precedent for other types of misapplications that may affect comprehensive income or AOCI.

In addition, the SEC staff indicated that in some cases, restatement of a previously filed Form 10-K may be necessary. Such circumstances include situations in which:

- A registrant commingled the recognition or adjustment of an additional minimum liability, which should be recognized as part of Other Comprehensive Income, with the effect of adopting SFAS 158, if the effect of adopting SFAS 158 is significant and there is not transparent disclosure of the individual components; or

- A registrant's prior presentation is incorrect (i.e., the registrant did not implement the transition provisions of SFAS 158 as specifically required by the standard), the effect of adopting SFAS 158 is quantitatively "significant", and the company does not make the adjustment to conform to the SFAS 158 transition requirements in the next Form 10-K filing nor signal its intent to do so in the next periodic filing.

Please note that registrants should consult with their SEC legal counsel as this alert does not constitute legal advice.

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