

Audit Alert: Disclosures Required for All Non-Public Employers Electing Delayed Adoption of FASB Statement No. 158

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)*. The main provision of Statement No. 158 requires a sponsor (this includes both for-profit and not-for-profit employers) of one or more single-employer defined benefit plans to recognize the funded status of a benefit plan (measured as the difference between plan assets at fair value and the benefit obligation) in its balance sheet. For an employer without publicly traded equity securities (a nonpublic employer) this requirement is not effective until the end of the fiscal year ending after June 15, 2007. However, a nonpublic employer is required by Statement No. 158 to disclose the following information in financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has elected the early application of the recognition provisions of Statement No. 158 in preparing those financial statements:

- A brief description of the provisions of Statement No. 158;
- The date that adoption is required; and
- The date the employer plans to adopt the recognition provisions of the Statement, if earlier.

Statement No.158 is available in full at <http://www.fasb.org/pdf/fas158.pdf>.

Guidance Proposed for Quantifying Misstatements

Financial Accounting Standards Board (FASB) Statement No. 154, *Accounting Changes and Error Corrections*, provides guidance for reporting the correction of an error in previously issued financial statements. However, Statement No. 154 does not specify the appropriate method to quantify the misstatement as a basis for evaluating materiality. On March 13, 2007, the FASB released proposed FASB Staff Position (FSP) No. FAS 154-a,

Considering the Effects of Prior-Year Misstatements When Quantifying Misstatements in Current-Year Financial Statements. This FSP describes the consideration of the effects of prior-year uncorrected misstatements when quantifying misstatements in current-year financial statements of privately held entities and not-for-profit organizations. If finalized, the FSP would extend the guidance in SEC Staff Accounting Bulletin (SAB) No. 108 that is applicable to SEC registrants to all other nongovernmental entities that are not subject to the requirements of SAB 108, thereby conforming the reporting of error corrections between SEC registrants and all other nongovernmental entities.

This proposed FSP does not address whether misstatements are material as that is a matter of professional judgment. The proposed FSP does, however, require that the assessment of materiality should be based on both quantitative and qualitative considerations. Because of the interaction of McGladrey & Pullen, LLP Page 2 Insights quantitative and qualitative considerations, misstatements of a relatively small amount could have a material effect on the current financial statements as well as financial statements of future periods.

In current practice, there is diversity amongst privately held entities and amongst not-for-profit organizations as to how to quantify the effects of prior-year misstatements in current-year financial statements. There have been two common approaches used to quantify such misstatements:

- 1861 Wiehle Avenue, Suite 125, Reston, VA 20190
Tel: 703.437.8877 • Fax: 703.437.8937
- 10502 Crestwood Drive, Manassas, VA 20109
Tel: 703-365-8877 • Fax: 703-365-8937
- Email: info@millermusmar.com • www.millermusmar.com

- The rollover approach quantifies a misstatement based on the amount of the error originating in the current-year income statement.
- The iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current year, irrespective of the misstatement's year(s) of origination.

The proposed FSP states that for purposes of evaluating the materiality of a misstatement, an entity must quantify the effect of the misstatement in its current-year balance sheet and income statement using both the rollover approach and the iron curtain approach. If a misstatement using either the rollover approach or the iron curtain approach is material to the current-year financial statements, the entity must correct its current-year financial statements. If a misstatement relating to prior-year misstatements exists after the current-year financial statements are corrected and is material to the current-year financial statements, the entity must correct the previously issued financial statements. This correction is required even if the prior-year misstatements were and continue to be immaterial to the previously issued financial statements.

If finalized, the FSP would be effective for financial statements issued for fiscal years ending after June 15, 2007. Earlier application would be permitted. To assist entities in adopting the requirements of the FSP, the FASB would allow entities to elect not to restate prior-period financial statements; assuming management properly applied its prior approach (either rollover or iron curtain), including properly evaluating all qualitative materiality considerations. In adopting the FSP, entities may report the cumulative effect of the initial application of the FSP as an adjustment to the opening balance of retained earnings. The nature and amount of each individual error being corrected in the cumulative adjustment must be disclosed. The disclosure also should include when and how each error being corrected arose and the fact that the errors had previously been considered immaterial.