

AU Section 9410

Adherence to Generally Accepted Accounting Principles: Auditing Interpretations of Section 410

[1.] Accounting Principles Recommended by Trade Associations^[1]

[.01–.03] [Withdrawn, August 1982, by Statement on Auditing Standards No. 43.]

[2.] The Impact of FASB Statement No. 2 on Auditor's Report Issued Prior to the Statement's Effective Date²

[.04–.12] [Superseded, October 1979, by Interpretation No. 3, paragraphs .13–.18.]

3. The Impact on an Auditor's Report of Accounting Guidance Prior to its Effective Date

.13 Question—What is the impact on the auditor's report when (a) the auditor is reporting on financial statements issued before the effective date of accounting guidance currently reflected in Financial Accounting Standards Board (FASB) *Accounting Standards Codification*TM (ASC) as "pending content" due to transition and open effective date information, and (b) these financial statements will have to be restated in the future because this "pending content" will require retroactive application of its provisions by prior period adjustment?

.14 Interpretation—Where the accounting guidance being followed is currently acceptable, the auditor should not qualify his opinion if a company does not adopt the accounting guidance that is currently reflected as "pending content" in FASB ASC due to transition and open effective date information. An example would include the accounting guidance originally issued on research and development costs, which is now reflected in FASB ASC 730, *Research and Development Costs*. This guidance was originally issued in October 1974, but was effective for fiscal years beginning on or after January 1, 1975. This guidance requires companies to expense certain research and development costs in the period they are incurred. Companies that had deferred research and development costs were required to restate their financial statements by prior period adjustment in the period in which this guidance became effective. Deferring research and development costs before this guidance became effective was an acceptable alternative principle under generally accepted accounting principles (GAAP), although this guidance proscribed such treatment for fiscal years beginning on or after January 1, 1975. Other reporting considerations are addressed in the following paragraphs.

.15 Section 508, Reports on Audited Financial Statements, paragraph .41 states: "Information essential for a fair presentation in conformity with generally accepted accounting principles should be set forth in the financial statements (which include related notes)." For financial statements that

^[1] [Footnote deleted.]

² Originally issued under the title "Effect on the Auditor's Opinion of FASB Statement on Research and Development Costs" (*Journal of Accountancy*, Jan. 1975, p. 74).

are prepared on the basis of accounting principles that are acceptable at the financial-statement date but that will not be acceptable in the future, the auditor should consider whether disclosure of the impending change in principle and the resulting restatement are essential data. If he decides that the matter should be disclosed and it is not, the auditor should express a qualified or adverse opinion as to conformity with GAAP, as required by section 508 paragraph .41.

.16 To evaluate the adequacy of disclosure of the prospective change in principle, the auditor should assess the potential effect on the financial statements. Using the research and development cost example given previously, the effect of the anticipated prior period adjustment to write off previously deferred research and development costs would in some instances be so material that disclosure would be essential for an understanding of the financial statements. In cases such as this, where the estimated impact is so material, disclosure can best be made by supplementing the historical financial statements with pro forma financial data that give effect to the future adjustment as if it had occurred on the date of the balance sheet. (See section 560 paragraph .05.) The pro forma data may be presented in columnar form alongside the historical statements, in the notes to the historical statements, or in separate pro forma statements presented with the historical statements.

.17 The auditor also should consider whether disclosure is needed for other effects that may result upon the required future adoption of an accounting principle. For example, the future adoption of such a principle may result in a reduction to stockholders' equity that may cause the company to be in violation of its debt covenants, which in turn may accelerate the due date for repayment of debt.

.18 Even if the auditor decides that the disclosure of the forthcoming change and its effects are adequate and, consequently, decides not to qualify his opinion, he nevertheless may decide to include an explanatory paragraph in his report if the effects of the change are expected to be unusually material. The explanatory paragraph should not be construed as a qualification of the auditor's opinion; it is intended to highlight circumstances of particular importance and to aid in interpreting the financial statements (see section 508 paragraph .19).

[Issue Date: October 1979; Revised: December 1992; Revised: June 1993;
Revised: February 1997; Revised: June 2009.]
