

**PROPOSED AUDITING STANDARD ON EVALUATING CONSISTENCY OF
FINANCIAL STATEMENTS**
Statement of Charles D. Niemeier
April 3, 2007 Open Meeting

The crux of this proposal, like the existing standard on consistency, is that, to be useful, audit reports need to be credible. Without a requirement for the auditor to evaluate and report on consistency, a report saying that financial statements are fairly presented today, even though they are based on different accounting principles or different numbers than were used in the past, risks appearing not to be credible.

Overall, I support the idea of proposing changes to our standards to reflect the fact that the risk of inconsistency in financial reporting has shifted in some respects and to align our standard on consistency with Statement 154. I think the proposal is a considerable improvement over the existing standard, because it is simpler and clearer in many respects than the existing standard.

In particular, the proposal would, more clearly I think, focus auditors on the importance of evaluating material changes to previously issued financial statements, whatever the reason for the change. There's no doubt that auditors have had to sign-off on changes to previously issued financial statements in the past. But the proposal would specifically focus auditors on ensuring that disclosures about those changes are accurate.

As you mentioned, in October 2005 we held a discussion with our Standing Advisory Group that touched on these issues. One of the things we

heard is that retroactive changes to previously issued financial statements can be confusing to analysts and other users if there is not adequate disclosure about the changes. This can present a risk to the credibility of audit reports if users get the impression that the auditor continuously signs off on an ever changing financial statement. Like the iconic Maxwell Smart from the 60s TV show “Get Smart,” successive unqualified audit reports on a retroactively changing financial picture could be understood to be asking, “Would you believe?”

Given this risk, to me, the most important thing an auditor should do in this area is evaluate whether changes are accurate as well as whether disclosures about the changes are appropriate. In particular, as some of our advisory group meeting participants noted, corrections of errors should not be disguised as changes in accounting principle or reclassifications. This proposal should go along way to addressing these problems.

Another aspect of the proposal I’d like to touch on is the requirement that auditors’ reports state when there have been changes, whether applied retrospectively or prospectively. Adding such an emphasis in the report is how the existing standard handled the inconsistent application of accounting principles. This concept is carried into the proposal and expanded to include emphasizing changes to correct errors, whether related to incorrect application of accounting principles or not.

In our Standing Advisory Group meeting, members who spoke seemed to have a pretty consistent view that our goal should be for auditors to evaluate the accuracy of a company’s disclosure about changes in the company’s financial statements as opposed to requiring detailed disclosures by auditors on the reasons for changes.

Now, I do have one area of concern about the proposal, which is that it leaves in place the language of the pre-existing Second Standard of Reporting.

The Second Standard of Reporting is the foundation of the existing auditing standard on consistency, and to me it focuses on situations where a switch from one acceptable accounting principle to another could be misleading if it wasn't adequately called out. Statement 154 significantly changed that environment, and so I'm not sure how relevant the Second Standard of Reporting is anymore. For example, I'm not sure the Second Standard of Reporting was intended to encompass changes to previously issued financial statements. The proposal clearly does encompass such changes, so my concern is whether the Second Standard of Reporting should be conformed to the new environment after Statement 154.