The new auditing standard the Board is considering today, Auditing Standard No. 6, and the related amendments to the Board’s interim standards, would basically accomplish two fairly straightforward things.

First, the new standard would update the auditing literature in light of the Financial Accounting Standards Board’s adoption, in 2005, of SFAS No. 154, Accounting Changes and Error Corrections. Under new Auditing Standard No. 6, the auditor will have responsibility to evaluate whether the financial statements on which he or she is expressing an opinion are consistent with the company’s previously-issued statements. In evaluating consistency, the auditor would consider whether there are either changes in the accounting principles on which the current statements are based or material adjustments to correct misstatements in the prior financials. If these kinds of changes have occurred, and if they have a material effect on the comparability of the current statements to the prior version, the auditor will be required to explain the change in accounting principle or the correction in his or her report. A somewhat similar obligation already exists under the Board’s interim auditing standards, and Auditing Standard No. 6 will not fundamentally alter the auditor’s responsibilities. However, the new standard will benefit financial statement users by requiring the auditor to make disclosure, regardless of whether the changes in the company’s financial reporting stem from errors or from accounting principle changes. In the case of restatements, this will provide users of the auditor’s report with new information.

Second, these amendments would remove the so-called “GAAP hierarchy” from the auditing literature. For those not steeped in the jargon, the “GAAP hierarchy” is the explanation in the Board’s interim auditing standards of what types of accounting pronouncements constitute generally accepted accounting principles and of which ones take precedence over others in case of a conflict. The GAAP hierarchy is essentially about the sources of the accounting principles, not guidance on auditing. Accordingly, the FASB has proposed to include such a hierarchy as part of the accounting literature, and the deletion of the existing hierarchy from the interim auditing standards is, in effect, a conforming change in anticipation of the FASB action. The deletion of the hierarchy from the interim standards will not have any substantive effect on auditing.

In both cases, these are sensible, and necessary, changes that keep us in step with the FASB. I support the staff’s recommendations.