



## International Federation of Accountants

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Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington D.C. 20006-2803

By email: [comments@pcaobus.org](mailto:comments@pcaobus.org)

Dear Sir/Madam,

**RE: PCAOB Rulemaking Docket Matter No. 2008-02–Proposed Auditing Standards Related to the Auditor’s Assessment of and Response to Risk**

Staff of the International Auditing and Assurance Standards Board (“IAASB”) would like to congratulate the Public Company Accounting Oversight Board (“the Board”) on achieving a significant milestone with the completion of a comprehensive revision of its risk assessment standards. This is a significant step forward in terms of the Board’s work on amending and replacing its interim standards. The proper identification and assessment of, and response to, risks by the auditor lay the foundation for a high quality audit. Accordingly, we note the importance of this task and the enormity of the efforts put in by the Board and its technical staff in developing these proposed standards.

We are encouraged by the Board’s use of the IAASB’s International Standards on Auditing (“ISAs”) in developing the proposed standards and commend the Board’s objective to eliminate unnecessary differences between the two set of standards. We believe this is an important and positive step towards increasing the comparability of audits internationally and creates a common basis on which auditors conduct audits, thereby enhancing the consistency of practice in the public interest. We believe this also sets a good example of leveraging the efforts of other audit standard-setting bodies towards timely development of high quality auditing standards.

We would also like to take this opportunity to commend the Board on its analyses in relation to the ISAs as evident in Appendix A10. Such comparison is important in facilitating and encouraging respondents’ consideration of the similarities and differences between the two sets of standards. We encourage the Board to continue to apply this practice to its future proposals.

We would like to draw the Board’s attention to certain matters noted from our review of Appendix A10. There are a few areas where the proposed requirements differ from the ISAs and, for information, we provide some additional information on the rationale behind the approach adopted in the ISAs. We do so with the hope that the Board will find these useful in providing relevant input to its continued development of the proposed standards, particularly in evaluating the basis for establishing differences between the proposed standards and the ISAs. Convergence in an area as fundamental to the audit as risk

assessment is clearly in the best interests of promoting consistency in audit quality worldwide. Later, we also note a few general matters for clarification in connection with the ISAs.

#### *Auditor's Responses to Assessed Risks versus Risks of Material Misstatement*

Proposed Auditing Standard—*The Auditor's Responses to the Risks of Materials Misstatement* (“Response standard”) requires the auditor to respond to *risks of material misstatement*. Page 4 of Appendix A10 indicates that a difference between the proposed Response standard and ISA 330 (Redrafted) *The Auditor's Responses to Assessed Risks* lies in the references in these standards to the auditor's responses to risks. The reference in the proposed Response standard to risks of material misstatement is in alignment with the Board's intention to distinguish separately, in the proposed standards, the auditor's identification of risks from the assessment of the degree of those risks. Under these standards, the auditor is then required to respond to the risks of material misstatements, taking into account, separately, the assessment of the degree of the risks in designing audit procedures.<sup>1</sup>

In contrast, ISA 330 (Redrafted) refers to the auditor's responses to *assessed risks*. By necessity, the use of assessed risks gives recognition to the integration of the different elements of the auditor's work in obtaining an understanding the entity and its environment.<sup>2</sup> In particular, it recognizes that the auditor identifies risks that are broader than strictly risks of material misstatement consequent of the auditor's work in obtaining an understanding of the entity's risk assessment process, including how the entity identifies and addresses business risks relevant to financial reporting objectives. It also recognizes that responses to risks of material misstatement inherently cannot be formulated in the absence of an understanding of the nature, magnitude and likelihood of such risks – that is, the auditor's assessment of the risks. This is particularly true in connection to formulating an overall response.

As an aside, we note that when considered together, paragraphs 56(a) and 56(d) in the proposed Assessment standard appear to be circular, as is the case with paragraphs 6 and 7 of the proposed Response standard.<sup>3</sup>

#### *Auditor's Responses to Risks at the Financial Statement Level and Assertion Level*

The proposed Response standard requires the auditor to implement overall responses to address the risks of material misstatement, and to design and perform audit procedures to address the risk of material misstatement for each relevant assertion of each significant account and disclosure. Page 5 of Appendix

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<sup>1</sup> Proposed Auditing Standard—*The Auditor's Responses to Assessed Risks* (“Assessment standard”) requires the auditor to identify the risks of material misstatement (paragraph 56(a)) and, separately, assess the possibility that the risk could result in material misstatement (paragraph 56(d)). The auditor is then required by the proposed Response standard to design and implement overall responses to address the identified risks of material misstatement (paragraph 4), and, separately, to take into account the auditor's assessment of the risks (e.g., high, medium or low) in designing audit procedures (paragraph 7(a)).

<sup>2</sup> ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment” requires the auditor to identify risks (paragraph 25(a)) and consider the likelihood of misstatement (paragraph 25(d)). The auditor is then required by ISA 330 (Redrafted) to design and implement overall responses to address the assessed risks of material misstatement (paragraph 5) having regard for the risk assessment performed.

<sup>3</sup> Paragraphs 56(a) and 56(d) of the proposed Assessment standard require the auditor to identify the risks of material misstatement and also to assess the possibility that the risk [of material misstatement] could result in material misstatement of the financial statements. Paragraphs 6 and 7 of the proposed Response standard requires the auditor to design and perform audit procedures the nature, timing, and extent of which are based on and address the risks of material misstatement, but, separately, to do so taking account of the auditor's assessment of the risks.

A10 indicates that unlike ISA 330 (Redrafted), the proposed Response standard does not require the auditor to match overall responses to financial statement risks and responses involving audit procedures to assertion level risks.

ISA 330 (Redrafted) suggests a matching of the form of response to whether a risk constitutes a financial statement level risk or an assertion level risk in recognition of the fact that risks at the financial statement level are, by their nature, inherently different from those at the assertion level. Such risks relate pervasively to the financial statements as a whole and they are not necessarily identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Financial statement level risks therefore do not lend themselves to procedures as a response; rather, they represent circumstances that may increase the risk of misstatement at the assertion level and, hence, influence the auditor's general approach to the audit.

#### *Other Matters*

We note that a fair amount of explanatory and other application guidance materials currently present in the respective interim standards of the Board and comparable ISAs have not been included in the proposed standards. In the context of the ISAs, the IAASB believes that such guidance is important to the consistent and proper application of the standards and, as such, is treated as integral part of the standards themselves.

In relation to Appendix A10, the precision of the statements made is important to the proper understanding of the differences between the proposed standards and equivalent ISAs. We note a few instances where the conclusions with respect to ISAs are not fully consistent with the standards themselves. For example:

- Page 1 of Appendix A10 indicated that the provisions of the Proposed Auditing Standard—*Audit Risk in the Audit of Financial Statements* are similar to the discussion of audit risk in ISA 200 (Revised and Redrafted) *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*. In contrast to the proposed standard, ISA 200 (Revised and Redrafted) contains more extensive guidance for example, with regard to the two components of audit risks—the risk of material misstatement and detection risk.
- Page 3 of Appendix A10 indicated that ISA 315 (Redrafted) does not specify a sufficiency requirement similar to that in the proposed Assessment standard with respect to the auditor's understanding of internal control over financial reporting. Whilst not positioned as requirements, paragraphs A3 and A38 of ISA 315 (Redrafted) did provide guidance in this regard.<sup>4</sup>

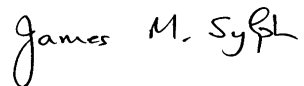
The Board appropriately used the final approved text of the 'Clarity version' of the relevant ISAs in performing its analyses. As the IAASB completed its final few clarified ISAs, it also undertook an overall review of all the approved standards for consistent use of language and necessary conforming changes. The final versions of the standards, including ISA 315 (Redrafted) and ISA 330 (Redrafted), with changes to the original text shown in mark-ups can be found on the IAASB website at <http://www.ifac.org/IAASB/Meetings/Resources/0144/Updated+Agenda>.

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<sup>4</sup> Paragraph A3 of ISA 315 (Redrafted) explains that the extent of the auditor's understanding of the entity and its environment required, including internal control, is determined by whether the auditor's understanding is sufficient to identify and assess the risks of material misstatement and thereby provide a basis for responding to the assessed risks. Paragraph A38 of ISA 315 (Redrafted) explains that an understanding of internal control will assist the auditor to identify types of potential misstatements and factors that affect the risks of material misstatement, and design the nature, timing, and extent of further audit procedures.

If you have any questions regarding the above, please do not hesitate to contact me at [jimsylph@ifac.org](mailto:jimsylph@ifac.org) or 212-286-9348, or alternatively, James Gunn, IAASB Deputy Director at [jamesgunn@ifac.org](mailto:jamesgunn@ifac.org) or 212-286-9532. As the Board progresses its work in amending and replacing its interim standards, the staff of the IAASB would be pleased to discuss any matters in connection with the ISAs that may be of assistance to the staff of the Board, as appropriate.

Yours sincerely,

A handwritten signature in black ink that reads "James M. Sylph". The signature is written in a cursive style with a large, looped initial "J".

James M. Sylph  
Executive Director, Professional Standards