

# SPECIAL CONSIDERATIONS IN PERFORMING ASSURANCE ENGAGEMENTS ON EXTENDED EXTERNAL REPORTING

## SUPPLEMENT A: CREDIBILITY AND TRUST MODEL AND BACKGROUND AND CONTEXTUAL INFORMATION

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## INTRODUCTION

1. This Supplement contains information that all stakeholders in assurance engagements may find helpful in understanding the role of EER assurance engagements (Section I) and that practitioners may find useful as background and context to the IAASB's non-authoritative Guidance: *Special Considerations in Performing Assurance Engagements on Extended External Reporting* (hereafter "the Guidance") (Section II). The Guidance addresses areas where practitioners commonly encounter challenges in applying ISAE 3000 (Revised), *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* (hereafter referred to as "the Standard") in EER assurance engagements (G.App1), the nature of which is explained in the introduction to the Guidance.
2. Section I of this Supplement sets out a four factor model for credibility and trust in relation to EER reports. This model aims to show how external assurance may have a role as part of a wider context of factors that can support credibility, and therefore the users' trust in EER information (G.App1). It is intended to provide a framework that is useful to all stakeholders in assurance engagements.
3. Section II of this Supplement provides background and contextual information about general assurance concepts and other matters, which is relevant to the Guidance. In some cases, the explanations of general concepts in this Supplement draw comparisons between EER (G.App1) and more established forms of reporting and explains how these relate to key assurance concepts reflected in the Standard.
4. Some of the material below relates to the role of a preparer of such EER reports, rather than to the role of a practitioner. However, an appropriate understanding of the nature of the preparer's role in preparing an EER report, and how it relates to assurance concepts, is likely to assist practitioners in performing effective EER assurance engagements.
5. To aid navigation, the discussion in Section II follows the same order as the chapters set out in the Guidance. Cross references, with hyperlinks, are provided between this Supplement and the Guidance when the explanations in this Supplement may provide useful context to the concepts discussed in the Guidance.
6. An additional Supplement, Supplement B: *Illustrative Examples* includes a number of examples designed to illustrate practical aspects of the Guidance, which practitioners may also find useful in applying the Guidance.
7. The terminology used both in the Guidance and in this Supplement is consistent with that used in the Standard, when the concepts being discussed are addressed in the Standard. When necessary, other terms are identified and explained in the Guidance, which are set out in Appendix 1 to the Guidance: '*Terms Used in This Guidance*,' or in this Supplement, which are set out in Appendix 1 to this Supplement. Cross-references in this Supplement follow the same format as cross-references in the Guidance (G.22). When terms defined in the Standard or explained in an Appendix to the Guidance or this Supplement, are first used in this Supplement, they are referenced (as applicable) to the Standard or relevant Appendix.

# I FOUR KEY FACTOR MODEL FOR CREDIBILITY AND TRUST IN RELATION TO EER REPORTS

## 1. Introduction

1. This section explores the concept of credibility and trust in relation to EER reports and introduces four factors that may enhance their credibility. It aims to show how external assurance may have a role as part of a wider context of factors that can support credibility, and therefore the users' trust in EER information.
2. The section may be of relevance to assurance practitioners, preparers of EER, and users of EER.
3. Credibility is a user-perceived attribute of information that engenders in the mind of the user an attitude of trust in the information. Factors other than credibility can also affect user trust in information. For example, a strong track record of an entity delivering on its promises can increase trust, but a perception of self-interest – or conflicts of interest – by the entity can diminish trust.
4. In the context of EER reports, credibility is likely to be enhanced if there is:
  - A sound EER Framework—that is transparent and in which the user has confidence that the output of applying the EER framework (the EER report) provides a sound basis for meeting their needs.
  - Strong Governance over the Reporting Process—that satisfies the user that robust processes and controls were applied with appropriate oversight, and that the people involved were competent and not influenced by conflicts of interest.
  - Consistent Wider Information—that satisfies the user that the EER report is internally consistent and consistent with the user's wider knowledge.
  - External Professional Services and Other Reports—independent external professional services reports and other external inputs relating to the EER report to which the user has access.
5. As these factors show, external assurance is only one means of enhancing the credibility of EER reports, and its benefit is greatest when the other factors are present too.

## 2. Four Key Factors

6. The four factors identified above that may enhance the credibility of EER reports are illustrated in Figure 1 and discussed below. We refer to these as the “Four Key Factors.”

## How Credibility and Trust Are Established

### Four Key Factors

1. Sound EER framework – Essential first and foremost is the EER framework – the objectives of which are closely aligned with the user’s information needs.
2. Strong governance – Reporting processes, controls, and potentially external professional services engagements, are initiated under strong governance oversight.
3. Consistent wider information – Users perform their own evaluation of the consistency of the EER report with wider available sources of information to which they have access.
4. External professional services and other reports – Users also have access to any published reports issued under external assurance or other professional services engagements that relate to the EER report.

### Outcomes and Output

Together, transparency about these Four Key Factors enhances and engenders external user credibility and trust in the EER report (outcome).

Transparency for internal users about how the credibility of the EER report has been established – through strong governance to establish that the EER report has been produced in accordance with a sound EER framework (including in key judgment areas) – enhances and engenders internal user credibility and trust (outcome) that the EER report is a high-quality external report (output) that is fit for publication.

External transparency about these matters and publication of the EER report and of any external professional services report(s) enables external users to confirm the consistency of the EER report with wider available information.

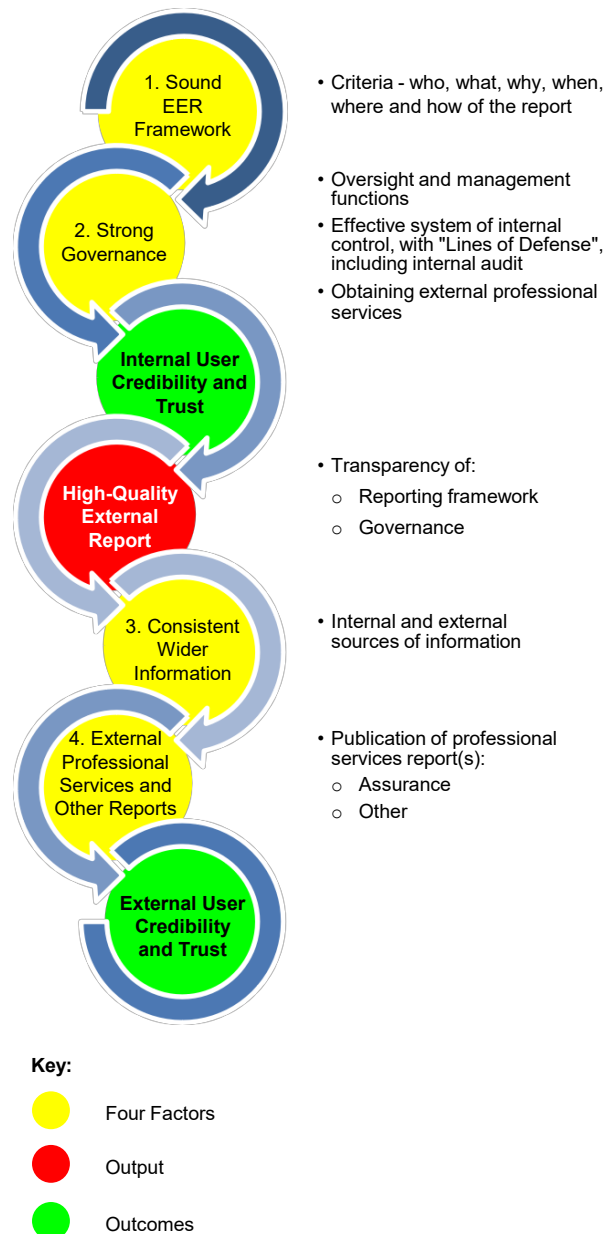


Figure 1: Overview of Credibility and Trust

**Factor 1: Sound EER Framework**

7. Management is responsible for ensuring that the external report is prepared in accordance with an applicable EER framework. The user’s perception of the credibility of an EER report can be influenced by the qualities and transparency of the EER framework used for its preparation.
8. A sound EER framework guides preparers in ensuring that the EER report is an effective communication and gives users confidence that the EER report will meet their needs. EER frameworks therefore typically address:
  - *Reporting Objectives*: intended users, scope and use (the who; the high level what, when and where; and the why of the EER report);
  - *Content Elements* to be included in the EER report (the more detailed what, when, and where of the EER report); and
  - Qualitative Characteristics of the Information, including:
    - *Depiction Methods* for the content elements (measurements, quantitative or qualitative evaluation or assessment techniques, and descriptions) (the technical aspects of the “how”); and
    - *Principles for Communicating* effectively in the EER report (the communication aspects of the “how”).
9. The table below summarizes the characteristics of the features of an EER framework that are likely to engender credible reporting, and their relationship to the characteristics of suitable criteria set out in S.A45.

Characteristics of an EER Framework that are Likely to Engender Credible Reporting	IAASB’s Characteristics of Suitable Criteria
Has an objective that reflects the users’ expectations as to the scope, intended users and intended use of the EER report	Relevance
Consistently includes and reliably depicts all relevant reportable content elements that are material to the intended users in the context of the intended purpose of the EER report	Relevance, completeness, reliability
Recognizes areas of uncertainty, ambiguity and judgment that give rise to inherently greater susceptibility to preparer bias risk and establishes adequate disclosure and neutrality principles to counter this	Neutrality, completeness
Promotes transparent (open), clear (unambiguous) and concise (readily understandable) reporting of these matters, and enables effective comparability both with other pertinent entities and over time	Relevance, reliability, understandability

10. The credibility of EER reports can also be enhanced when there is user confidence in the quality of the EER framework applied because:
  - The due process for developing the EER framework involves interaction with stakeholders to ensure that the interests of the intended users and other stakeholders are appropriately reflected;

- There is effective governance over the development of the EER framework that addresses potential conflicts of interest; and
  - The EER framework is well-known, commonly understood, and has broad stakeholder acceptance.
11. The objectives of different EER frameworks can vary significantly. The closeness of fit between the objectives of the EER framework and the user's needs is an important credibility factor. Transparency about the reporting objectives is therefore important.
  12. Where EER frameworks specify content elements and depiction methods ("criteria"), this can drive consistency in reporting but may also limit the ability of the preparer to tailor the EER report to the entity's specific circumstances. Where such tailoring is important in meeting the reporting objective, EER frameworks may specify principles-based requirements for judgments by preparers to determine relevant content elements or depiction methods.
  13. Where applicable, the need for such judgments and the potential for ambiguity in those criteria may make the EER framework inherently more susceptible to the risk of preparer bias. For example, under a principles-based requirement:
    - Identifying content elements and depiction methods can involve significant judgments about what to report and the appropriate depiction methods to use. Clear principles for determining these matters (such as a strong materiality principle and a requirement for stakeholder engagement to enable it to be applied effectively), and transparency about these matters and about the processes to implement them, can be important credibility factors for an EER report.
    - Applying depiction methods can involve addressing significant uncertainties in making estimates and qualitative evaluations or assessments and can therefore require significant judgments by preparers. EER frameworks may address such uncertainties and judgments by requiring related disclosures and by establishing a neutrality principle to be applied in making such judgments to counter the inherently greater susceptibility to preparer bias risk.
  14. The existence of a multiplicity of EER frameworks covering similar areas may lead to confusion amongst users of EER reports and may also reduce the ability of users to compare entities effectively.

## **Factor 2: Strong Governance**

15. Strong governance includes sound governance structures that oversee a strong internal control system, including effective risk management and high-quality reporting processes. Management and, in some jurisdictions, those charged with governance (TCWG)<sup>1</sup> are responsible for establishing internal control as necessary to ensure that the information in the EER report is reliable and available on a timely basis. Management or TCWG may be required to, or may voluntarily make, an explicit assertion in the external report on their responsibility.
16. The competence and accountability of management and TCWG is therefore an important element of the strong governance that is required to enhance credibility and trust. Underpinning this is a need for preparers to behave in a way that is consistent with the spirit of the objectives of the relevant EER framework to present EER information faithfully and without bias. In some circumstances, the use of external specialists may be appropriate, and may enhance credibility further.

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<sup>1</sup> See the *Glossary of Terms* in the IAASB Handbook. For some entities in some jurisdictions, TCWG may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

17. Oversight by TCWG, who are responsible for overseeing the strategic direction of the entity and its obligations related to accountability, includes overseeing the entity's external reporting process, which may historically have been primarily focused on the financial statements. The responsibilities of TCWG may become broader as EER continues to evolve. In listed companies and other large entities, much of the work related to overseeing the entity's external reporting process is often undertaken by an audit committee. A transparent and constructive relationship between management and TCWG will enhance credibility of the external report. In executing their responsibilities, TCWG (including audit committees where they exist) may engage with intended users to obtain their perceptions of the usefulness and quality of external reporting.
18. Some entities also have as part of their governance process a separate disclosure committee that assists the Board of Directors and the audit committee in preparing the required disclosures and helps ensure that an entity's disclosure controls and procedures are properly implemented. These activities help to support the quality of external reporting.
19. A strong internal control system is founded on:
  - A control environment in which the oversight function (TCWG) and management actively support high-quality external reporting, and embed a culture in the entity that engenders effective internal control;
  - An effective information system for obtaining and processing relevant data and information of sufficient quality to support decision-making to enable the depiction of content elements;
  - Identification and assessment of risks that may threaten the quality of external reporting and the design, implementation and effective operation of appropriate responses in the form of control activities;
  - Regular overall monitoring of controls to determine that such controls are effective; and
  - Adequate information and communication, including more broadly on the business processes.
20. Many entities use internal audit for their operational audits or to assist in the audit of the external reporting process or the external report itself. Internal auditors are also exploring how their role may evolve along with the maturity of the EER processes within the entity.<sup>2</sup> Professional services providers may also be engaged to perform assurance engagements or other external professional services, reporting to TCWG, to support internal credibility and trust in the EER reporting process or in the resulting EER report.
21. Stakeholder engagement also forms an important part of governance processes, informing an entity's strategy and identification of material issues for disclosure.
22. Management routinely communicates and engages with intended users, particularly investors, in a number of ways. Visible, active engagement with users may provide an added motivation for management to achieve high-quality external reporting and may also enhance credibility.
23. Stakeholder dialogue is an important part of the process for defining an entity's strategy, identifying the most material issues to address, and disclosing them in external reports. The importance of such engagement is reflected in many EER frameworks and therefore influences the entity's EER 'materiality process'<sup>3</sup>. Entities may also include stakeholder representatives in their governance structures, such as

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<sup>2</sup> Institute of Internal Auditors (2013) in [Integrated Reporting and the Emerging Role of Internal Auditing](#).

<sup>3</sup> In the EER Guidance *Special Considerations in Performing Assurance Engagements on Extended External Reporting*, this process is referred to as 'the entity's process to identify reporting topics.'



in their non-executive board, or may have a separate expert advisory group to advise the board on such matters.

24. For external users, the credibility of external reports may increase if the different elements of the governance system (structures, processes, and people) that support the EER process are made transparent. This includes transparency about the individuals involved in the reporting process within an entity and those that govern these processes, as well as information pertinent to users' perception of those individuals' integrity and competence.

### **Factor 3: Consistent Wider Information**

25. Inconsistencies between the various sources of information about the entity and its environment available to users may impact the credibility of the EER report. EER reports also need to describe all relevant issues and be complete if they are to be consistent with other information available about the entity.
26. By ensuring the consistency of information in the EER report with other sources of information likely to be available to users of the EER report, or explaining apparent inconsistencies, preparers may enhance the credibility of the EER report.
27. Factors affecting the credibility of that wider information – such as the perceived independence and objectivity of the ultimate source of the information, the medium through which it is communicated (for example, a respected news agency), or the fact that the information was obtained in the past and was already perceived as credible - may influence whether the EER report or the wider information is determined to be most credible by users when there are inconsistencies between them.

### **Factor 4: External Professional Services and Other External Inputs**

28. Entities seek to enhance the credibility of their external reports not only through strong governance, but also through obtaining professional services or other external inputs. Credibility can come from a variety of professional services and other external inputs obtained from various types of providers (such as engineers), not just professional accountants. Such professional services may result in reports under assurance or other professional services engagements or other external inputs that are either made publicly available or restricted to internal parties involved in the engagement (SuA.I.20).
29. The type of professional service that is most appropriate in the circumstances and most relevant to users will depend on users' needs (which may be quite different between internal and external users), the nature of the external input and the maturity of the entity's EER processes.
30. The way such professional services and other external inputs may enhance the credibility of the EER report is dependent on the particular characteristics of such inputs and the personal traits of those providing them, for example:
  - Competence that is demonstrated or generally well known;
  - Objectivity and independence;
  - Professional skepticism and professional judgment;
  - Quality in the performance of the engagement;
  - Quality control, where applicable, at the engagement and firm level by the practitioner and firm that perform the engagement;
  - Professional standards applicable to the practitioner;
  - Regulatory oversight and supervision of professional services, where applicable; and

- Clarity of reporting, and transparency about the work performed.
31. Although the necessary competence may be different depending on the particular form of professional services or other external input and the complexity of the entity, in general competence likely needs to include:
    - Knowledge of the relevant EER framework;
    - Knowledge of the underlying subject matter; and
    - Knowledge of the professional standards that apply.
  32. Transparency about the competence of those performing the professional service or other external input may add to the credibility of the EER report. Particular types of engagements (for example, assurance engagements) also require the practitioner to meet independence and other relevant ethical requirements.
  33. The manner in which the outcome of the external professional services or other external input is reported can influence the degree to which the external service or input adds credibility to the EER report. Key characteristics of a communication that may add such credibility include that such communication is understandable and clearly structured, well balanced, not biased and, where applicable, comparable between reporting periods and with EER reports prepared by other entities
  34. An explicit reference to national or international standards for quality control of the practitioner's firm and for the performance of the engagement, as well as to relevant ethical requirements, may also enhance the degree to which the external input adds credibility to the EER report.
  35. Whether the credibility of information is enhanced may be affected by the users' understanding of the external professional services, including assurance. There may be a need to educate users about the nature of such services and the levels of assurance that can be obtained from them.
  36. Without experience of how to read assurance reports to understand the scope and level of assurance being provided, there is a danger of user confusion and misunderstanding, particularly given the range of services that practitioners can provide and the differing professional standards that assurance providers work to.

## II EER ASSURANCE ENGAGEMENTS – BACKGROUND AND CONTEXT

### 1. Underlying Subject Matter, Criteria and Subject Matter Information

#### Introduction

1. An EER assurance engagement (G.App1) is an assurance engagement on EER (G.App1). The subject matter information for an EER assurance engagement is EER information (G.App1). The Standard defines underlying subject matter, criteria and subject matter information for an assurance engagement.

#### Excerpts of Definitions in the Standard (S. 12.y, 12.x, 12.c)

<b>Underlying subject matter</b>	<b>Criteria</b>	<b>Subject matter information</b>
The phenomenon that is measured or evaluated by applying criteria.	The benchmarks used to measure or evaluate the underlying subject matter.	The information that results from applying the criteria to the underlying subject matter.

2. These three terms and the terms ‘measurement’ and ‘evaluation,’ which are used widely in the Standard and in the International Framework for Assurance Engagements, express fundamental concepts relating to the preparation of subject matter information that is to be subject to an assurance engagement.
3. This Part of Section II of Supplement A provides background and contextual information about these fundamental EER reporting concepts, as understood in the context of an EER assurance engagement.

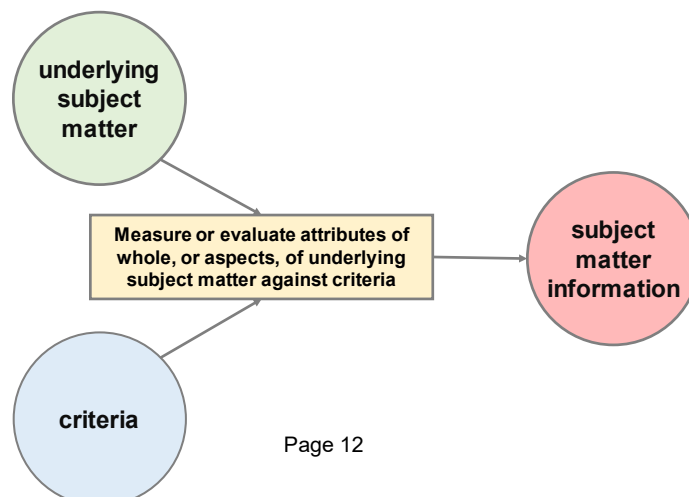
#### Understanding the Definitions

4. In the definition of ‘underlying subject matter,’ ‘phenomenon’ is used in the sense of an attribute(s) of a ‘thing(s)’ that is perceived or considered, rather than in the sense of something that is remarkable or rare. In this context, ‘attribute’ is used in the sense of a quality or feature that is regarded as a characteristic or inherent property of the thing(s) (SupA.App1). ‘Attribute’ is used rather than ‘characteristic’ because the Standard uses ‘characteristics of the underlying subject matter’ as a term that has a specialized meaning in the field of assurance, and refers to the characteristics that different underlying subject matters exhibit when measured or evaluated (S.A42).
5. In the definition of ‘criteria,’ ‘benchmark’ is used in the sense of a convention, a standard, or a set of category descriptions, which may serve as a point of reference against which an attribute(s) of a thing(s) may be compared.
6. In the definition of ‘subject matter information,’ ‘applying the criteria’ is used in the sense of comparing the attribute(s) of the thing(s) that comprise the underlying subject matter, against the applicable conventions, standards or sets of category descriptions required by the criteria.
7. In the context of an EER assurance engagement, terms (in which “EER” may be replaced by words or phrases such as “Sustainability,” “Integrated,” “Non-financial,” “Annual,” “Environmental, Social and Governance” or “Strategic”) commonly used to describe matters such as those addressed in SupA.II.1-5 include the following:
  - The entity’s [EER] report (‘subject matter information’).

- Measurement or estimation ('measurement'), assessment or appraisal ('evaluation').
  - The entity's economic, environmental, social or governance state, condition, prospects, performance or impact ('underlying subject matter').
  - [EER] Framework or Standards or an entity's [EER] reporting policies ('criteria').
  - Metrics or measurement protocols ('benchmarks' for measurement).
  - The entity's economic, environmental, social or governance resources, claims and relationships, and the entity's actions or activities, and other events and conditions, that cause such states, conditions or prospects to change (performance) or that cause other entities' states, conditions or prospects to change (impact) ([EER] phenomena).
8. The concept of an assurance engagement is essentially a generalization of the concept of a financial statement audit. In a financial statement audit, equivalent terms to those described in SupA.II.7 may include:
- The entity's financial statements ('subject matter information').
  - Measurement, valuation and estimation ('measurement') or disclosure about the nature of measurement uncertainty ('evaluation').
  - The reporting entity's financial position and performance ('underlying subject matter').
  - Financial reporting standards and accounting policies ('criteria').
  - Measurement, recognition, presentation and disclosure bases ('benchmarks').
  - Elements of the financial statements: the reporting entity's economic resources and claims against the reporting entity (i.e. assets, liabilities and equity) and the effects of transactions and other events and conditions that change those resources and claims (i.e. income and expenses) (the economic 'phenomena').

### Understanding How Underlying Subject Matter and Criteria Give Rise to Subject Matter Information

9. Each EER assurance engagement has an underlying subject matter, which comprises the attribute(s) of the EER 'thing(s)' of interest in the context of the purpose and intended use of the subject matter information. Attributes of the underlying subject matter that are of interest are measured or evaluated against the criteria. The resulting EER information is the subject matter information of such an engagement.



## Understanding How Attributes of Underlying Subject Matter are Measured or Evaluated

### *Nature of underlying subject matter and its disaggregation*

10. The underlying subject matter of an EER assurance engagement may be diverse in nature. Criteria are applied to underlying subject matter either at the level of the underlying subject matter as a whole, or at a level(s) of disaggregation, depending on the level at which information about the underlying subject matter assists decision-making by the intended users. For example, criteria may be applied at the level of an overall reporting topic (Societal impact) or at the level of groups of subject matter elements (such as employees or intellectual assets or greenhouse gas emissions).
11. Determining whether underlying subject matter is appropriate in the context of an EER assurance engagement (see G.Ch3) involves considering whether it is identifiable and capable of reasonably consistent measurement or evaluation. These factors need to be considered at the level of disaggregation at which measurement or evaluation is to be made.
12. An underlying subject matter may or may not be capable of disaggregation. If it is, the disaggregated parts (aspects) may consist of one or more diverse types, and there may be one or more units of any such type. A unit(s) of a type of disaggregated part of the underlying subject matter is referred to hereafter as a 'subject matter element(s)' (SupA.App1).

### *Attributes of underlying subject matter*

13. Criteria are applied to attributes of the underlying subject matter that are of interest, at the relevant level(s) of disaggregation. An attribute of the underlying subject matter may be, for example, its color, value, size, or (in the case of a group of things) the number of its members. A specific subject matter element(s) may exhibit an attribute in different ways (e.g., its color may be red, yellow, blue, etc.).

#### **EXAMPLE**

An apple may be described as red or green or brown, which are different ways ('hues') that an attribute called 'color' can be exhibited by an item. In some cases, an attribute may itself have another attribute. For example, an item may exhibit a particular 'color,' which itself may exhibit an attribute known as a 'tint,' a 'shade' or a 'tone.'

14. An attribute is a characteristic or property of an underlying subject matter such as:
  - *Where, when, or how* it is deployed or occurs.
  - *What* its nature is, *what* its relations to other subject matter elements are, or (if the attribute is quantifiable) *how many* of the subject matter element(s) there are *or how much* of the attribute it exhibits.
  - *How* it can cause a change, *how* it can be changed by a cause or *what* the effect on it is, of a cause of change.

**Nature of Criteria**

15. Criteria establish the basis of preparation of the EER report and therefore determine its content. They may be reporting requirements taken from an EER framework or reporting policies that the entity has itself developed. Criteria specify both:
  - a) The identification of the nature and scope of the underlying subject matter, about which information is to be presented in the EER report; and
  - b) The types of information about the identified reporting topics (G.App1) that are to be presented in the EER report, and the way that information is to be determined and presented.
  
16. Criteria specify how to measure quantifiable attributes or how to evaluate qualitative attributes (i.e. attributes that are not quantifiable), of the underlying subject matter, such that the resulting EER information meets the information needs of the intended users. The following examples illustrate criteria for measurement or evaluation in the context of EER reporting and, by way of comparison, in the context of financial reporting.

EXAMPLE	<u>EER example</u>			
	<i>Underlying subject matter</i>	<i>Subject matter elements</i> <b>Attributes</b>	<i>Criteria</i>	<i>Resulting subject matter information</i>
	Environmental, social and governance matters about Entity X. ↓ Social or human matters ↓ Staff diversity	Entity X's employees.  <b>The gender of those employees.</b>	Requirement to report the number of employees of Entity X at a specific point in time, split by gender.	Gender A: 500 employees Gender B: 510 employees Gender C: 15 employees etc.
	<p><b>Note:</b> <i>In order to be suitable, the criteria in this example may need to be more specific, for example by providing descriptions of the gender categories and the term "employee." Details of how to measure the underlying subject matter by means of a formula may be necessary. In this example, details specifying whether contractors are employees, or how to treat part-time employees, may be needed.</i></p>			

Financial reporting example:

<i>Underlying subject matter</i>	<i>Subject matter elements</i>	<i>Criteria</i>	<i>Resulting subject matter information</i>
	<b>Attributes</b>		
Financial condition, performance and cash flows of Entity X.	Economic resources (for example assets) and claims on those resources (for example liabilities), and transactions, other events and conditions (for example income, expenses or equity).  <b>The monetary value of such assets, liabilities, income, expense or equity.</b>	The measurement bases and related disclosures set out in IFRS, <sup>4</sup> and the entity's accounting policies as disclosed in the financial statements.	The accounting values in the primary financial statements and the related disclosures in the notes.

17. Criteria used in a particular EER assurance engagement are referred to in the Standard as the 'applicable criteria.' In practice, the applicable criteria for an EER assurance engagement may be selected from one or more EER frameworks, which may be supplemented with entity-developed criteria (G.App1) where an EER framework lacks the necessary detail or is not sufficiently comprehensive to comprise suitable criteria on its own (see G.Ch4), or may be solely entity-developed.
18. EER frameworks are often less prescriptive about the reporting topics (G.App1) to be included in an EER report or methods to measure or evaluate its underlying subject matter element, as compared to financial reporting frameworks, and are therefore often less precise about the determination of these matters. In financial reporting, criteria are typically well established, and include both requirements of the applicable financial reporting framework standards and accounting policies specific to the entity. Given the diverse nature of the underlying subject matter in EER, there may be considerable opportunity for management bias in determining the reporting topics and the methods used to measure or evaluate the underlying subject matter.
19. Underlying subject matter may be presented in the subject matter information by measuring or evaluating its attribute(s) and presenting the outcome of such measurement (i.e. a measure(s)) or evaluation (i.e. a category description(s)) in the EER report, together with information about how the measurement or evaluation was made. Depending on its nature and the nature of the criteria applied,

<sup>4</sup> International Financial Reporting Standards

underlying subject matter may be presented principally in quantified terms or principally in qualitative (narrative or descriptive) terms. In either case, the principal presentation may be accompanied by related disclosures.

20. Appropriate underlying subject matter is identifiable and can therefore be distinguished from other underlying subject matter, and may comprise subject matter element(s). As in financial reporting, a subject matter element(s) may be measured or evaluated individually or collectively (for similar items) at different levels of disaggregation of the underlying subject matter information. Such a level is referred to as the 'unit of account' in financial reporting. The appropriate level may depend on what is relevant to the information needs of the intended users. A simple non-EER example is used here to illustrate this.

**EXAMPLE**

An apple is an individual item, distinct from other types of fruits. It has several different parts (such as 'pips'; 'flesh'; 'skin'; and 'stalk') each of which may have several different attributes (such as their color). It may also be a part of 'a fruit basket' that contains other types of fruits that have different attributes.

If such a fruit bowl were an underlying subject matter of interest to intended users of a report about it, then depending on those users' information needs the fruit bowl may be measured or evaluated to provide information about the fruit at the level of the bowl of fruit as a whole, at the level of the individual fruits in it or at the level of the parts of the individual fruits.

Depending on the nature of the benchmarks for such measurement or evaluation, doing so may result in a description of the apple (including its color, or its different types of parts and the numbers of each type), or of the fruit bowl and the numbers of each type of fruit it contains, to be included in such a report.

21. Another way of thinking about criteria is that they embody the questions that need to be addressed when evaluating or measuring a subject matter element(s).



**EXAMPLE**

If the subject matter element(s) was a machine in a factory, some questions that might underpin the criteria and, in parentheses, the type of resulting subject matter information, include:

- a) When was the machine built? (description of time)
- b) Where is the machine? (description of location)
- c) What color is it? (description of an attribute)
- d) What is the maximum number of widgets it can produce in an hour? (description of a capability to act so as to cause change)
- e) What is the actual number of widgets produced in the last year? (description of performance or outcome of an action that caused change)
- f) What is its accounting value at a point in time? (a quantity or measure)
- g) What has been the change in value over the last year? (description of the outcome of a change in an attribute of the machine – its state or condition)
- h) How did the change in value happen? (description of the cause of a change)
- i) Why have the directors decided to sell the machine? (description of management intent behind an action to cause a change)

**EXAMPLE**

If the subject matter element was a river next to a company's factory that the company has access to. Questions that might underpin the criteria include:

- a) Where is the river? (description of location)
- b) How much water flows through the river? (description of a condition of the river)
- c) How polluted is the river in terms of the chemical composition of the water? (a measure of the river's condition at a point in time)
- d) How has the water quality changed over a period of time? (description of a change in the river's condition over a period of time)
- e) What is the impact of the factory on the water quality of the river? (description of the factory's activities and its cause of change in condition of the river)

**Nature of Evaluation and Measurement**

22. Evaluation involves comparing the particular way in which a subject matter element(s) exhibits a qualitative attribute(s), with descriptions of possible ways in which the attribute can be exhibited. Those descriptions (which may be referred to as benchmarks) are identified by the criteria. Such a comparison yields a categorization (or classification) of the subject matter element(s), by reference to those descriptions. Such a categorization provides information about the attribute(s) of the subject matter element(s) evaluated or measured, which could be answers to questions about the subject matter element(s) of types such as those referred to in the examples in SupA.II.21.

23. The benchmarks for evaluation are such descriptions of the categories. They may be expressed in words or may be labelled using letters, numbers, nouns, adjectives or adverbs. Some benchmarks for qualitative attributes have no natural ordering (e.g., red, blue, yellow), whilst others may have some degree of natural ordering (e.g., small, medium, large).
24. Measurement is a special case of evaluation that describes evaluation of an attribute(s) in quantified terms. In that case, the benchmarks used are standardized quantities or measures. When making a measurement, the measuring instrument may be physical (a meter) or a defined process. In either case, the instrument must be aligned with the standardized measure (a process known as calibration).
25. There are different types of standardized measures. What they have in common is a specified point of reference, which has a defined relationship to a unit of measurement that is sufficiently precise for its purpose. For physical attributes, like length and time, the point of reference is usually a reference example of an item that exhibits the attribute that the measure relates to that is available for comparison and calibration (e.g. a meter of length is defined as the distance travelled by light in a vacuum, in a specified fraction of a second of time).
26. In the case of another type of attribute to be measured, it may not be directly observable or directly measurable. This is often the case, for example, for attributes of human, social, economic and intellectual resources (e.g. intelligence is a quality that cannot be observed or measured directly, and economic value is not always observable or measurable directly).
27. In such cases, a generally accepted measurement model is needed, which may be used to establish the benchmarks or to measure the attribute as exhibited by a particular subject matter element(s). Such a model is generally based on a well-defined concept that defines observable indicators of the attribute, standards for the measurement or evaluation of such indicators, and a mathematical or logical process that generates repeatable measures when applied.

**EXAMPLE**

Intelligence tests are designed to obtain measures or indicators of the quality 'intelligence.' Standard measures of intelligence are defined by sufficiently precise estimates of the distribution of measures of individual intelligence across a relevant population. These estimates are inferred from the results (scores) of a defined intelligence test (measuring instrument) taken by a sufficiently large sample of members of the population.

Accounting values are measured in currency units, but currency units may be used to measure different concepts of value. The benchmarks used for accounting value measurements that are not directly observable may be values that can be observed in historical outcomes of similar items, in defined circumstances that correspond with the accounting value concept being used (the measurement basis). Those benchmarks may be used to calibrate a defined measurement model (method) that uses data and assumptions about defined indicators of the accounting value (valuation attributes) and a defined process (method) to make measurements of the defined accounting value.

28. In practice, all measurement instruments, whether physical or a defined process, have an inherent limit of precision in their ability to discriminate differences in measures. The limit of precision is

established by the smallest quantitative difference that can be discriminated using the instrument. For example, on a meter or ruler the smallest measurement that can be discriminated is determined by the closeness of the hatch marks. When the measurement instrument is a process, the degree of precision will be affected by inherent limitations in available data and knowledge to make measurements, which requires the use of assumptions.

## 2. Professional Judgment and Professional Skepticism

### Introduction

29. The nature of professional judgment and professional skepticism is addressed in the Guidance (G.Ch2). The exercise of professional judgment is required in applying all of the requirements of the International Standards issued by the IAASB<sup>5</sup>, including the Standard. Professional skepticism and professional judgment are closely linked with each other, and their effective exercise depends on the practitioner having the competence necessary to perform the engagement.
30. In an assurance engagement, information obtained in complying with the requirements is evidence as it is used by the practitioner in reaching the practitioner's conclusion (S.12.i). All decisions made in applying the requirements of the Standard are "about courses of action that are appropriate in the circumstances of the engagement" (S.12.t) and are informed by the evidence obtained by the practitioner. Professional judgment is exercised in making those informed decisions.
31. Professional skepticism is exercised throughout the engagement, in performing procedures and in making decisions. It is an attitude (of mind), and the definition in the Standard highlights three aspects of that attitude: a questioning mind; being alert to conditions which may indicate possible misstatement; and a critical evaluation of evidence (S.12.u).
32. This Part of Section II of Supplement A provides further background and contextual information about how the fundamental concepts of professional judgment and professional skepticism relate to decision-making by the practitioner throughout the engagement, the practitioner's ability to exercise them, and factors that may affect their effective exercise.

### How Professional Judgment and Professional Skepticism Relate to Practitioner Decision-Making

33. Areas of decision-making in the conduct of an assurance engagement, where professional judgment is necessary include decisions about:
  - Materiality and engagement risk.
  - The nature, timing and extent of procedures to be performed to meet the requirements of the Standard.
  - Whether sufficient appropriate evidence has been obtained and in the case of a limited assurance engagement whether a meaningful level of assurance has been obtained.
  - Whether the objectives of the Standard have been met.
  - Whether the applicable criteria have been properly applied to the underlying subject matter.
  - Whether the applicable criteria that have been selected or developed are suitable in the circumstances of the engagement.
  - The appropriate conclusions to draw based on the evidence obtained, including in forming the assurance conclusion and in drawing the conclusions that support it.
34. In performing procedures to comply with the requirements of the Standard, the practitioner makes decisions that ultimately support the assurance conclusion. Making such decisions involves making

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<sup>5</sup> IAASB Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements 2018 Edition Volume 1, Preface paragraph 17

choices about courses of action or conclusions that can be drawn. For example, the practitioner may have to decide if a risk of material misstatement exists or if an assertion about a class of transactions or balance is misstated or if a control operated effectively. These decisions are supported by the application of professional judgment and professional skepticism in determining the courses of action that are appropriate in the circumstances of the engagement, whether in making the acceptance decision or during the performance of the engagement, and either directly to support a decision about whether or not an assertion implicit in the subject matter information is corroborated or contradicted, or, indirectly, in relation to another matter that supports the assurance conclusion, for example, in relation to the assessment of risk or materiality.

35. Other procedures may involve decisions that are less directly related to the assurance conclusion. For example, those procedures that involve making decisions about aspects of engagement quality, such as the competence of those who are to perform the engagement or the sufficiency or effectiveness of direction, supervision and review procedures.

### **The Practitioner's Ability to Exercise Professional Judgment and Professional Skepticism**

36. Assurance skills and techniques include the exercise of professional judgment and professional skepticism. Competence in exercising them, as for all assurance skills and techniques, is developed through extensive training and practical application (S.31.b).
37. Practical experience is a particularly important element in acquiring such skills, including through the good example of engagement partners and more experienced engagement team members providing appropriate direction, supervision and review. Those involved in the engagement with responsibility for complying with the requirements of the Standard in planning or performing the engagement need time to develop their competence in exercising professional judgment and professional skepticism and in applying other assurance skills that support their effective exercise, to a level appropriate to their role in the engagement (G.Ch2).
38. The ability of a practitioner to apply professional skepticism is supported by skills such as:
- Being willing to consider other points of view to challenge their own;
  - Acting with the courage to challenge, where necessary;
  - The ability to critically assess evidence obtained related to the decision being made;
  - The ability to suspend drawing conclusions in decision-making and follow through with inquiry and challenge until the practitioner is satisfied that the explanations and other evidence obtained support the decision being made; and
  - Evaluating all evidence, whether corroborates or contradicts the subject matter information.
39. A critical assessment involves an appropriate level of subject matter competence, in the circumstances of the engagement, and involves understanding and addressing the impediments to professional skepticism that may need to be overcome in making that decision.
40. Although the attitude of professional skepticism is a constant, the degree of competence and the actions needed to exercise it can vary, both between assurance engagements (considering the circumstances of particular engagements) and within a particular assurance engagement (depending on the nature of the decisions being made). The greater the complexity or difficulty of the engagement, the greater the skills and competence that are likely to be needed to be able to

exercise professional judgment and professional skepticism and to take the actions that are appropriate in the circumstances.

41. Independence, professional judgment and professional skepticism are inter-related. Independence includes a mindset or attitude that avoids influences that might compromise the exercise of professional judgment in forming an assurance conclusion, and that might therefore compromise that conclusion.<sup>6</sup> It also allows the practitioner to act with integrity and exercise objectivity and professional skepticism effectively in forming an assurance conclusion (S.A33).

## **Factors Affecting the Effective Exercise of Professional Skepticism and Professional Judgment**

### *Factors relating to competence*

42. The practitioner's competence and the competence of any practitioner's or preparer's experts involved in an EER assurance engagement may have implications for the effective exercise of professional judgment and professional skepticism in performing procedures, in the engagement circumstances.

#### Need for subject matter competence on EER assurance engagements

43. An EER assurance engagement may be undertaken in relation to a wide range of underlying subject matters, many of which will require specialized subject matter competence, for example, scientific or engineering skills. As a result, the practitioner may need a relatively higher level of subject matter competence or a higher proportion of practitioner's experts to have access to the subject matter competence needed to exercise professional judgment and professional skepticism effectively. This may contrast with a financial statement audit, where the assurance practitioner is trained in the underlying subject matter competence (financial accounting) of the engagement.

#### Need for a practitioner's expert to have assurance competence

44. It is not necessary for a practitioner's expert to have competence in exercising professional judgment and professional skepticism and other assurance skills to perform work to be used by a practitioner in an EER assurance engagement. Even if a practitioner's expert has the ability to apply a questioning mindset, be alert to possible error or bias in their work, and be able to critically assess evidence, doing so in their capacity as an expert may be different from applying similar assurance competence.
45. However, if such an expert is also responsible for applying a requirement(s) in the Standard, they will require some level of competence in assurance skills (including professional judgment and professional skepticism) and will, in that respect be a member of the engagement team, whose work is subject to direction, supervision and review under the oversight of the engagement partner. This is discussed further in G.Ch1 *Applying Appropriate Competence and Capabilities*.

#### Using the work of a preparer's expert

46. In the context of an EER engagement, the preparer may employ their own subject matter expert(s) to assist in the preparation of the subject matter information, giving rise to a number of risks, including that the work of such an expert may reflect management bias.

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<sup>6</sup> IAASB Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements 2018 Edition Volume 1 Glossary of Terms Independence

47. If information to be used as evidence has been prepared using the work of a responsible party's or preparer's expert, the practitioner is required to evaluate the competence, capabilities and objectivity of that expert, obtain an understanding of the work of that expert and evaluate the appropriateness of that expert's work as evidence.
48. The skills and competence needed in exercising professional judgment and professional skepticism in making such evaluations may vary depending on the circumstances of the engagement; for example, where the subject matter is complex or subject to a high degree of measurement uncertainty, a high degree of assurance competence and skills as well as an appropriate degree of competence in the subject matter are likely to be needed to be able to exercise professional judgment and professional skepticism in assessing the risks involved and in determining an appropriate course of action to address the assessed risks.

#### Assurance skills and competence of the practitioner

49. Where there is a high degree of measurement uncertainty associated with the underlying subject matter, in addition to having an appropriate degree of competence in the subject matter, the practitioner may need significant assurance skills and experience in addition to knowledge of the entity and its business to be able to consider whether there could be pressures or incentives for management to misstate the subject matter information or apply bias when measuring the subject matter, and to :
  - a) Question whether the expert has considered all the evidence expected to be available to them;
  - b) Question whether the assumptions and methods used to measure the subject matter are reasonable; and
  - c) Determine whether the nature and extent of further procedures that may be needed to understand and assess the work of that expert.
50. Practitioners without significant assurance experience may not have acquired the level of competence to apply a critical, questioning and objective mindset to all aspects of the planning or performance of the engagement, including in reviewing the work of others. For example, they may have insufficient confidence to question or challenge the judgments and assumptions of a preparer (G.App1), or of a management's or practitioner's expert, particularly where they lack the necessary level of subject matter competence.
51. To address this, assigning engagement team members with appropriate levels of competence to those areas of the engagement for which their skills are appropriate, and flexing the direction, supervision and review of their work accordingly may be an important part of engagement team members acquiring the level of competence to be able to apply a critical, questioning and objective mindset to the engagement.

#### *Factors relating to particular decision points throughout the engagement*

52. While the exercise of professional skepticism and professional judgment is needed throughout the engagement, there are specific decision points in the lifecycle of the engagement where professional skepticism and professional judgment may be particularly important. These are discussed below.

#### Acceptance or continuance decision

53. In determining whether to accept or continue an engagement, and considering whether the preconditions for assurance are met, including whether the engagement has a rational purpose (S.24.b.vi), the practitioner's consideration of whether the engagement team, collectively, has the appropriate competence and skills to perform the engagement and to enable an assurance report that is appropriate in the circumstances to be issued (S.32.a) may involve important professional judgments and require the exercise of professional skepticism.
54. Considering whether the engagement has a rational purpose, of necessity, involves being able to understand the intended users' perspective and to make judgments about what is likely to influence the decisions of those intended users.
55. Before accepting or continuing the engagement, the engagement partner exercises professional judgment to be satisfied that there is no reason to believe that relevant ethical requirements, including independence, will not be satisfied and that those persons who are to perform the engagement collectively have the appropriate competence and capabilities to do so (S.22.a-b). This may involve considering a broad range of matters, such as:
  - The reputation of the entity and its management;
  - The purpose of the engagement;
  - The intended users;
  - Whether there may be fee or time pressures and the effect those may have on the quality of the assurance engagement;
  - Whether or not there is a well-developed reporting framework;
  - The complexity of the subject matter and its measurement;
  - Whether there is sufficient knowledge, experience and ability to perform the engagement;
  - Whether and where additional expertise may be needed; and
  - Whether there are other factors that may contribute to the decision to either accept or decline the engagement.
56. The acceptance decision may also involve considerations, by the engagement partner, of whether the practitioner's firm has developed a methodology to help support the performance of an EER engagement and reinforce expectations around the exercise of good judgment.

#### Assessing risk and materiality

57. During the planning stage of an engagement, the appropriate exercise of professional skepticism is likely to be enhanced by a practitioner's knowledge and understanding of the industry and environment in which the entity operates, its business processes, supply chain, customers and other factors. With such knowledge and understanding, the practitioner will be better placed to ask questions that need to be asked.
58. For example, a practitioner, with a good knowledge of the business and sufficient subject matter competence in the criteria, may be able to assess whether the subject matter information is complete, whether there is a heightened risk of misstatement of the subject matter information due to fraud,



non-compliance with laws and regulations, lack of preparer competence or management bias. An experienced assurance practitioner has the ability to recognize what could create challenges in preparing the subject matter information and to ask the 'right' questions to obtain an understanding of where the risks may exist, the possible causes of those risks, and to design assurance procedures to address those risks.

59. The exercise of professional judgment and professional skepticism also assists in obtaining an understanding of who the users are and what is likely to influence their decisions when assessing materiality for the engagement.

#### Designing and performing evidence-gathering procedures

60. Having understood who the users of the subject matter information are, and what is likely to influence their decisions, and having assessed the risk of the subject matter information being materially misstated, the practitioner uses their judgment to consider whether the risk assessment procedures performed provide an appropriate basis for the design of further assurance procedures.
61. During the evidence-gathering stage of the assurance engagement, areas where the exercise of professional judgment and professional skepticism may be important may include, for example, assessing:
- Information that may bring into question the reliability of documents and responses to inquiries to be used as assurance evidence, or
  - Whether there are circumstances that suggest the need for additional assurance procedures, and to reduce the risks of:
    - i. Overlooking unusual circumstances;
    - ii. Using inappropriate assumptions in determining the nature, timing and extent of assurance procedures; and
    - iii. Over generalizing when drawing conclusions from assurance observations.

#### Evaluating the sufficiency and appropriateness of evidence

62. At the conclusion of the engagement the exercise of professional judgment includes consideration of the sufficiency and appropriateness of assurance evidence obtained to support the assurance conclusion. A critical self-assessment of the work done in the light of all the circumstances allows the practitioner to stand back and to reassess the subject matter information and the sufficiency and appropriateness of the evidence obtained, from the perspective of what would be likely to influence the users' decision-making, considering both evidence that supports the conclusion and evidence that may be contradictory to that conclusion.

### 3. Assertions

#### Introduction

63. The Guidance (G.Ch7) addresses how categories of assertions may be used by practitioners to consider the different types of potential misstatements that may occur in the subject matter information of an EER assurance engagement.
64. This Part of Section II of Supplement A provides further background and contextual information about the nature of assertions and their categories and how categories of assertions relate to the applicable criteria and their characteristics.

#### Nature of Assertions and Their Categories That May be Used by the Practitioner

65. Assertions are defined in certain IAASB standards as:

“Representations by [the measurer or evaluator], explicit or otherwise, that are embodied in the [subject matter information], as used by the [practitioner] to consider the different types of potential misstatements that may occur.”<sup>7</sup>
66. The proper application of the applicable criteria necessarily results in subject matter information that embodies many individual assertions, explicit or otherwise, which follow from particular requirements of the applicable criteria. The application material in IAASB standards that address certain types of underlying subject matter indicates categories into which assertions relating to subject matter information about such underlying subject matter may fall, and ways in which those categories may be expressed<sup>8</sup>.
67. For example, the applicable criteria may require that the preparer includes in the subject matter information defined measures and disclosures about defined types of elements. If so, proper application of such criteria would imply representations that the subject matter information includes each of such measures and each required disclosure about all such elements, i.e. that the related subject matter information is ‘complete’ in those various respects. Similarly, proper application of the criteria would imply representations that each measure and disclosure has been accurately measured or developed, i.e. that the related subject matter information is ‘accurate.’
68. Proper application of the criteria is likely to result in representations that many different aspects of the subject matter information are ‘complete’ in different ways (assertions that address ‘completeness’) or ‘accurate’ in different ways (assertions that address ‘accuracy’). These two types of representations are respectively referred to as categories of assertions about ‘completeness’ and ‘accuracy’ in the IAASB standards that address assertions.<sup>8</sup>

#### How Assertions Relate to Characteristics of the Applicable Criteria

69. Categories of assertions are analogous to what is sometimes known in EER frameworks as ‘guiding principles’ for, or ‘qualitative characteristics’ of, the information to be included in an EER report. Such

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<sup>7</sup> ISA 315 paragraph 4(a) and ISAE 3410 paragraph 14(b) – in December 2019, the IAASB issued ISA 315 (Revised 2019), which reflects a revised definition of assertions in paragraph 12(a), which will be addressed in finalizing the Guidance and Supplement A post consultation.

<sup>8</sup> ISA 315 (Revised) paragraph A129 and ISAE 3410 paragraph A82

principles or characteristics are often expressed in terms of characteristics of subject matter information that results from proper application of the criteria established under the framework.

70. Assertions are used by the practitioner at the level of the categories into which they fall rather than at the level of detailed assertions about aspects of the subject matter information. These categories correspond with the types of potential misstatements that may occur. For example, for an assertion that falls into the category of completeness, the corresponding type of potential misstatement is an omission. See G.261-267. If an EER framework establishes a guiding principle or qualitative characteristic of subject matter information that results from proper application of the criteria established under the framework that requires completeness, the criteria established in accordance with that principle or characteristic can be said to have the characteristic of completeness.

*How categories of assertions may be identified from the applicable criteria*

71. The categories of assertions that may be used by the practitioner in an EER assurance engagement result from such characteristics of the applicable criteria. If the criteria are suitable, they will have the five required characteristics of suitable criteria. Chapter 8 of the Guidance describes the attributes of subject matter information resulting from criteria that exhibit those characteristics (relevance, completeness, reliability, neutrality and understandability). For example, the proper application of criteria that exhibit 'completeness' gives rise to assertions about the subject matter information that are of a type that assert that the subject matter information is 'complete.' See G.264-267.
72. Applicable criteria, whether selected from an EER framework or developed by the entity itself, may also have characteristics other than the required characteristics of suitable criteria. Such characteristics may imply attributes of the resulting subject matter information of types other than those implied by the characteristics of suitable criteria. The assertions required by entity-developed criteria may be more likely to result from representations about the subject matter information required implicitly, rather than explicitly, by such criteria.
73. The practitioner may identify categories of assertions to identify potential types of misstatement at an appropriate level of disaggregation of the underlying subject matter, consistent with the requirements of the criteria (see SupA.II.10-12 and G.262).

**EXAMPLE**

Subject matter information could be about an attribute(s) of a class of subject matter elements that have similar characteristics, when it has been prepared by applying the criteria to the underlying subject matter at that level of disaggregation. For example, the subject matter information may include a measure of the average time taken to rectify multiple minor breaches of water quality regulations following their discovery.

In other cases, the subject matter information may be about an attribute(s) of an individual subject matter element. For example, the subject matter information may be about the time taken to rectify a single major breach of water quality regulations that caused a community's water supply to be cut off.

In the first case, categories of assertions may be used by the practitioner to identify potential types of misstatement in the information about the class of subject matter element(s), such as whether it is complete (the average includes information about all minor breaches). In the second case, categories of assertions may be used by the practitioner to identify potential types of misstatements about the single subject matter element, such as whether it is accurate (the time to rectify has been properly measured).

74. There may also be categories of assertions about, and therefore potential types of misstatement of, the EER report as a whole. For example, in some circumstances, even when each individual piece of subject matter information is free from material misstatement, the overall message may be misleading or biased.

## **4. Obtaining Evidence**

### **Introduction**

75. The Guidance (G.Ch8) assists the practitioner in determining how much evidence is enough, considering what evidence is needed and available, the design and performance of procedures to obtain evidence, evaluating the sufficiency and appropriateness of the evidence obtained and addressing aggregation risk in an EER assurance engagement.
76. This Part of Section II of Supplement A provides background and contextual information about the fundamental concepts of evidence and aggregation risk, in the context of an EER assurance engagement and how those and other related assurance concepts (the characteristics of persuasive evidence, the level of assurance, assurance procedures and performance materiality) relate to the practitioner considerations (G.284) and other guidance in G.Ch8.

### **Fundamental Significance of Evidence in an EER Assurance Engagement**

77. Evidence is a fundamental concept that defines the nature of an assurance engagement, one in which a practitioner aims to obtain sufficient appropriate evidence in order to express an assurance conclusion (S.12.a). The assurance conclusion is about whether the subject matter information is free from material misstatement (S.65). Evidence is the information used by the practitioner in arriving at the assurance conclusion (S.12.i). Evidence is primarily obtained from procedures performed during the course of the engagement but may include information obtained from other sources (S.A146). Ordinarily, evidence available will be persuasive rather than conclusive and is obtained to reduce engagement risk to an acceptably low, or acceptable, level (the level of assurance for the engagement) (S.12.a.i).
78. A misstatement is a difference between the subject matter information and the appropriate measurement or evaluation of the underlying subject matter in accordance with the criteria. Misstatements can be qualitative or quantitative in nature and include omissions (S.12.o). Identifying potential types of misstatements is addressed in G.Ch7 and the materiality of misstatements is addressed in G.Ch9.
79. The significance of evidence in an assurance engagement is emphasized in the preconditions for accepting an assurance engagement, which include that the practitioner establishes that:
- The underlying subject matter is appropriate, such that the subject matter information can be subjected to procedures for obtaining sufficient appropriate evidence to support an assurance conclusion (S.24.b.i, S.A40); and
  - The practitioner expects to be able to obtain the evidence needed to support the assurance conclusion (S.24.b.iv).

### **Characteristics of Persuasive Evidence**

80. The nature, timing and extent of the procedures designed to be performed determine the persuasiveness of the evidence that is available to be obtained by performing a procedure. Different underlying subject matters have different characteristics, including the degree to which subject matter information about them is qualitative or quantitative, objective or subjective, historical or prospective, and relates to a point in time or covers a period. These characteristics may also affect the persuasiveness of available evidence (S.A42).

81. The persuasiveness of evidence actually obtained by performing procedures may also be affected by matters such as the competence of the individuals assigned to perform them and the effectiveness of the direction, supervision and review of those individuals.
82. The characteristics of persuasive evidence are its appropriateness (relevance and reliability) and sufficiency.<sup>9</sup> The relevance and reliability of evidence relate to the quality of evidence, while the sufficiency of evidence relates to the quantity of evidence. These characteristics are not binary but are expressed in different degrees. The sufficiency of evidence relates to both the extent of the evidence obtained (e.g., from more than one source; the extent of sampling) and the strength of the relevance and reliability of the evidence.
83. The relevance of evidence relates to how closely it pertains to, assists in making, or contributes to, the decision being made in performing the procedure. It is closely related to the purpose of the procedure performed. Relevance has the characteristic of corroborating or contradicting the appropriateness of options for courses of action or conclusions that can be taken or drawn in making the decision – i.e. it is the ‘right’ evidence to consider in light of the decision to be made.
84. The reliability of evidence relates to its informational validity (sometimes referred to as representational faithfulness or authenticity), which includes its completeness, accuracy neutrality (lack of bias), and the precision with which the evidence can be obtained (sometimes referred to as its verifiability). The reliability of evidence is influenced by its nature and source and is affected by the individual circumstances under which the evidence is obtained.
85. For example, generally, evidence is more reliable when:
- It is obtained from sources external to the preparer;
  - If it is generated by the preparer, if related controls are effective;
  - Obtained directly by the practitioner rather than indirectly or by inference; and
  - It exists in documentary form.<sup>10</sup>

However, such generalizations are subject to important exceptions. For example, evidence obtained from an external source may not be reliable if the source is not knowledgeable or objective.<sup>11</sup> Obtaining evidence from different sources or evidence of a different nature may either corroborate other evidence or indicate that an individual item of evidence is not reliable.<sup>12</sup>

86. Sufficiency of evidence is a measure of the extent of the evidence obtained and the strength of its relevance and reliability. More evidence that has some relevance and some reliability, or evidence that has more relevance or more reliability, will be more persuasive in corroborating or contradicting the appropriateness of options for courses of action or conclusions that can be taken or drawn in making the decision under consideration (or the level of assurance it provides about the decision).
87. The persuasiveness of the evidence that is necessary to conclude that sufficient appropriate evidence has been obtained depends on the level of assurance that needs to be obtained in the circumstances of the engagement, and the components of engagement risk that the practitioner does

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<sup>9</sup> International Framework for Assurance Engagements, paragraph 50

<sup>10</sup> International Framework for Assurance Engagements, paragraph 63

<sup>11</sup> International Framework for Assurance Engagements, paragraph 63

<sup>12</sup> International Framework for Assurance Engagements, paragraph 64

not directly influence (those components of the risks of the subject matter information being materially misstated that exist prior to audit, i.e. inherent risk and control risk) (S.A12). The higher these components of risk are, the more persuasive the evidence that will need to be obtained to reduce engagement risk to an acceptably low, or acceptable, level in the circumstances of the engagement. However, obtaining more evidence may not compensate for the evidence having low relevance or reliability and may not therefore result in sufficient appropriate evidence (S.A148).

### **Level of Assurance to be Obtained**

88. The level of assurance to be obtained in an assurance engagement is inversely related to the acceptable, or acceptably low level, of engagement risk for the engagement – the risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated. In a reasonable assurance engagement, the practitioner aims to reduce engagement risk to an acceptably low level in the circumstances of the engagement as a basis for the practitioner’s conclusion (S.12.a.i.a). Reducing engagement risk to zero is very rarely attainable or cost beneficial and, therefore “reasonable assurance” is less than absolute assurance. This is due to factors such as the use of selective testing, the inherent limitations of internal control, the fact that much of the evidence available to the practitioner is persuasive, rather than conclusive, the use of professional judgment in gathering and evaluating evidence and, in some cases, the characteristics of the underlying subject matter when evaluated or measured against criteria (S.A14).
89. Generally, the greater the consequence to intended users of receiving an inappropriate conclusion when the subject matter is materially misstated, the greater the assurance that would be needed in order to be meaningful to them and the lower the engagement risk the practitioner would be willing to accept in carrying out their assurance procedures. In some circumstances, the intended users’ need for assurance may even be so great that a reasonable assurance engagement is needed to obtain a meaningful level of assurance.
90. As the level of assurance that the practitioner plans to obtain is not ordinarily susceptible to quantification (S.A4), determining whether the purpose of the engagement is ‘rational’ in the context of the level of assurance to be obtained may require considerable skill in the exercise of professional judgment and professional skepticism. Across the range of limited assurance engagements, what is meaningful can vary from just above assurance that is likely to enhance the intended users’ confidence about the subject matter information to a degree that is clearly more than inconsequential to just below reasonable assurance (S.A5). What is meaningful in a particular engagement represents a judgment within that range that is dependent on the particular circumstances of the engagement, including the information needs of intended users as a group, the criteria, and the underlying subject matter of the engagement.
91. The acceptably low, or acceptable, level of engagement risk may vary according to the circumstances of the engagement. The practitioner may therefore consider what is an acceptably low, or acceptable, level of engagement risk in the context of possible levels of assurance that could be obtained. Doing so may include considering the information needs of intended users as a group, the criteria, and the underlying subject matter of the engagement as well as the consequence to users of receiving an inappropriate conclusion in the circumstances of the engagement.

## Role of Procedures in Obtaining Evidence

### *Nature of a procedure and how it affects the characteristics of the evidence obtained*

92. Procedures performed in an assurance engagement vary in nature. The nature of a procedure refers both to its purpose and to its type. Purpose reflects relevance to the decision or conclusion that the practitioner is to address (SupA.II.29-30,33-35) in performing the procedure (i.e. the relevance to making the decision, of the evidence needed). The purpose also influences the reliability of the evidence needed to be obtained by the practitioner by performing the procedure. The type of a procedure refers to the manner in which the procedure is performed (to achieve its purpose). The type of procedure also influences the relevance and reliability of the evidence that is obtained by performing the procedure.

### *Purpose of a procedure and its relationship to decision making*

93. For all procedures that the practitioner performs in complying with the requirements of the Standard, the ultimate purpose is to contribute to the reduction of detection risk by enabling the practitioner to obtain evidence about conclusions that collectively support the assurance conclusion.
94. Classes of procedure that by their nature have different purposes contribute to the reduction of detection risk in different ways. Evidence obtained from performing such procedures is about conclusions that may support the assurance conclusion in a relatively more or less direct manner (SupA.II.29-30,33-35). Evidence about conclusions that support the assurance conclusion relatively less directly is often required to be responded to appropriately by designing and performing other procedures that provide evidence about conclusions that support the assurance conclusion relatively more directly.
95. For example, the practitioner is required to design and perform procedures, with the purpose of obtaining an understanding of the engagement circumstances (evidence) sufficient to provide a basis for the practitioner to design and perform other procedures (S.46L.a, S.46R.a). The practitioner is required to respond appropriately to the understanding (evidence) obtained, by designing and performing procedures, on the basis of that understanding, with the purpose of identifying and assessing the risks of material misstatement (in a reasonable assurance engagement) or of identifying areas where a material misstatement is likely to arise (in a limited assurance engagement) (S.48L.a, S.48R.a). Responding appropriately means that the design and performance of those procedures is expected to enable the practitioner to identify such risks or areas where material misstatements are likely to arise. The classes of procedures by nature described in this paragraph may be referred to collectively as risk assessment procedures.
96. The evidence obtained by performing such risk assessment procedures is also required to be responded to by procedures, which may be referred to as further procedures,<sup>13</sup> with specific purposes which may be to obtain evidence about the operating effectiveness of a control or to obtain evidence about whether a material misstatement exists. Such further procedures are required to respond appropriately to the identified and assessed risks of material misstatement or to the identified areas where a material misstatement is likely to arise. Responding appropriately means that the design (the nature, timing and extent) and performance of the further procedures is expected to enable the

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<sup>13</sup> ISAE 3410, paragraph 14(l)



practitioner to obtain sufficient appropriate evidence about whether the subject matter information is materially misstated.

97. The practitioner is also required to perform procedures, with the purpose of evaluating whether sufficient appropriate evidence has been obtained, from the performance of further procedures and other sources, about whether the subject matter information is materially misstated. Evidence obtained from the performance of the further procedures and those described in this paragraph is about conclusions that support the assurance conclusion in a relatively more direct manner (at the level of assertions or misstatements).
98. The practitioner is also required to perform procedures with many other purposes, in the conduct of an engagement. For example: procedures to consider engagement acceptance; procedures to evaluate the competence and capabilities of an expert, another practitioner, or the internal audit function, when their work is to be used as evidence; or to report in accordance with the Standard. Many of these procedures may contribute to the reduction of detection risk relatively less directly (more pervasively at the level of the engagement as a whole).

*Types of procedure and their effect on the characteristics of persuasive evidence*

99. The manner of performance of a procedure (its type) may, for example, be inspection; observation; confirmation; re-calculation; re-performance; analysis (substantive or otherwise); or inquiry. The quality of evidence obtained may vary with the type of procedure. The reliability of evidence obtained from two types of procedure with the same purpose may be very different. For example, in obtaining evidence about the implementation of a control, evidence obtained by observation may be more reliable than evidence obtained by inquiry, which is obtained indirectly or by inference.
100. Depending on the precision that is required, one type of procedure may be more appropriate than another in seeking to comply with a particular requirement of the Standard. Often evidence may be gathered to support the same purpose by performing more than one type of procedure. In this context, the Standard notes that evidence obtained by inquiry alone is not sufficient to determine whether a relevant control has been implemented or whether it is operating effectively. Professional judgment is required to make decisions about the types of procedures that are appropriate in complying with a particular requirement of the Standard.

*Types of procedures performed in a limited assurance engagement*

101. The Standard provides guidance in relation to the type of procedures to be performed in limited assurance engagements, in the context of the level of assurance to be obtained, which must be at least meaningful. The Standard notes (S.A3) that: “the emphasis placed on the nature of various procedures as a source of evidence will likely differ, depending on the engagement circumstances. For example, the practitioner may judge it to be appropriate in the circumstances of a particular limited assurance engagement to place relatively greater emphasis on inquiries of the entity’s personnel and analytical procedures, and relatively less emphasis, if any, on testing of controls and obtaining evidence from external sources than may be the case for a reasonable assurance engagement.”

**How Such Concepts Relate to Practitioner Considerations in Obtaining and Evaluating Evidence**

102. The Guidance includes considerations for the practitioner (see G.284) intended to assist practitioners in addressing challenges in obtaining and evaluating evidence in EER assurance engagements,

particularly those relating to evidence about narrative and future-oriented information. The assurance concepts underpinning each of the three steps in that process are discussed in the following paragraphs.

*Determining the evidence needed and available (G.284.A)*

103. The first stage of the thought process considers the characteristics of the evidence needed and of the available evidence. The first step is to identify and understand the nature of the decision that is to be made. This may be a decision that more directly relates to the assurance conclusion (e.g., whether an assertion about the subject matter information is materially misstated or a relevant control is operating effectively), or one that relates more indirectly to the assurance conclusion (e.g., the assessment of the risks of material misstatement or whether a practitioner's expert has the necessary competence, capabilities and objectivity for the practitioner's purposes) (see SupA.II.29-30,33-35).
104. In considering the relevance of the evidence needed, the practitioner identifies possible outcomes of the decision that has to be made and factors that may indicate which of the possible decision outcomes is appropriate. For example, when the decision to be made is whether an assertion is misstated, the possible outcomes of the decision are either that it is misstated or that it is not misstated.
105. Factors that may indicate whether it is misstated or not may depend on the nature of the assertion. For example, when the assertion is that an assumption is reasonable (accuracy), relevant factors may include past experience and other circumstances that may corroborate or contradict the reasonableness of the assumption. Factors of particular interest are those that may corroborate or contradict a possible outcome of the decision to be made and that, in doing so, would, directly or indirectly, support or undermine an unmodified assurance conclusion, because such a decision outcome would have implications for the engagement. The practitioner may then consider what reliable information (evidence) about the relevant factors is needed to make the decision.
106. The practitioner then considers whether the evidence needed to make the decision is available, and the sources from which it could be obtained. Consideration of the characteristics of the relevant factors and sources of available evidence, of the nature of the evidence available, and of the conditions under which the evidence could be obtained from the available sources, may assist the practitioner in evaluating the reliability of the available evidence.

*Designing and performing procedures to obtain sufficient appropriate evidence (G.284.B)*

107. The second stage of the thought process addresses the design and performance of procedures. It assists the practitioner in identifying the purpose of the procedure in light of the understanding of the decision developed in the first stage.
108. The thought process then moves on to consider the type of procedures that it would be feasible to perform to obtain the evidence needed. Since the type(s) of procedure performed affect the reliability of the evidence that can be obtained by performing them, the practitioner considers what types of procedure could feasibly be used to obtain available reliable evidence.
109. The practitioner also considers the level of precision and detail with which the procedure needs to be performed. This may depend on the nature of the decision to be made, the nature and complexity of the underlying subject matter, the nature of the criteria to be applied, the risk of misstatement in the

subject matter information, what is likely to affect the decisions of intended users, the nature and source of available evidence, and the level of assurance to be obtained.

110. The degree of sufficiency, relevance and reliability of the evidence needed to make the decision with the appropriate level of assurance is also considered in designing the procedure(s).
111. The practitioner considers the sufficiency of the evidence needed to be obtained, i.e. the quantity of evidence needed to be obtained, and the necessary degree of relevance and reliability that it needs. The practitioner is then able to determine the nature, timing and extent of the procedure(s) to be performed, to obtain sufficient appropriate evidence.
112. The thought process also identifies considerations that are relevant to the performance of the engagement. These may include decisions to be made about the need to exercise assurance and subject matter competence, the significance of the professional judgments and of the exercise of professional skepticism that is likely to be needed in performing the procedures. These decisions have implications for quality control at the engagement level.

*Evaluating the sufficiency and appropriateness of the evidence obtained (G.284.C)*

113. The third stage of the thought process addresses the evaluation of the evidence obtained. If the design and performance of procedures has been properly addressed, the evaluation should be able to focus primarily on differences from expectations. Such differences may relate to the results of the procedures (particularly where those results indicate that the evidence contradicts a potential outcome of a decision that would support an unmodified conclusion). Differences from expectation may also relate to new information. The assurance engagement is an iterative, systematic engagement process, which requires the practitioner to re-evaluate earlier decisions in light of new information, exercising professional skepticism, throughout the engagement.

**Addressing Aggregation Risk in an EER Assurance Engagement**

*Considering disaggregation of underlying subject matter when determining the preconditions*

114. The underlying subject matter may be capable of disaggregation into aspects or parts and those aspects or parts may consist of one or more types (SupA.II.10-12), which may be a single unit or multiple units of that type (subject matter element(s) – SupA.App1). The criteria may require the underlying subject matter to be measured or evaluated as a whole or at one or more level(s) of disaggregation (SupA.II.10-12). In addition, the preparer may decide to apply the criteria to a sub-group(s) of a similar type of subject matter elements. For example, the preparer may measure greenhouse gas emissions from each of several plants, separately.
115. It may be necessary for the practitioner to consider the appropriateness of the underlying subject matter (whether it is identifiable and capable of reasonably consistent measurement or evaluation G.Ch3)) and the suitability of the criteria at the level of disaggregation required by the criteria (G.76), if applicable (SupA.II.20). In determining the suitability of the criteria, the practitioner may need to consider whether subject matter information resulting from measurement or evaluation at a level of disaggregation assists decision-making by the intended users (an aspect of relevance).
116. Criteria applied to EER underlying subject matter at a level of disaggregation will result in subject matter information at that level. Depending on the nature of the resulting subject matter information and the presentation requirements of the criteria, that subject matter information may be presented

at the level of disaggregation at which it is measured or evaluated or may be required to be aggregated with subject matter information about similar aspects of the underlying subject matter, which have been measured or evaluated separately against the same criteria.

*Considering disaggregation of underlying subject matter in performing the engagement*

117. When the preparer applies criteria to measure or evaluate the underlying subject matter at a level of disaggregation (either because the criteria require application at such a level or because it is convenient to do so), the resulting subject matter information is about aspects or parts of the underlying subject matter, rather than about the underlying subject matter as a whole.
118. When designing and performing procedures, the practitioner may decide to perform procedures to obtain evidence about the subject matter information at the same level. However, in some cases, the practitioner may alternatively perform procedures at a lower level of disaggregation. The practitioner may also perform procedures at a higher level of aggregation, for example when subject matter information has been prepared at a level of disaggregation but then aggregated with similar information for other aspects of the underlying subject matter, the practitioner may perform procedures at the higher level of aggregation presented in the subject matter information.
119. When the subject matter information is presented at a level of disaggregation, the practitioner may perform various aspects of the engagement (S.50) at that level. These aspects may include the practitioner's:
  - a) Identification of areas where a material misstatement of the subject matter information is likely to arise (S.48L(a)) or identification and assessment of the risks of material misstatement (S.48R(a));
  - b) Design and performance of procedures (S.48L(b) or S.48R(b)), including (when applicable) using assertions to identify potential types of misstatements that may occur or addressing aggregation risk;
  - c) Accumulation of identified misstatements (S.51);
  - d) Evaluation of the sufficiency and appropriateness of the evidence obtained (S.64);
  - e) Evaluation of whether the subject matter information is free from material misstatement (S 65); and
  - f) Identification, when applicable, of material misstatements in a modified assurance conclusion in the practitioner's report (S.74.b).

**Considering Performance Materiality in Designing and Performing Procedures**

*How the Standard addresses materiality*

120. The practitioner is required to consider materiality in an EER assurance engagement (S.44). However, the practitioner is not explicitly required to determine materiality, either at the level of the subject matter information as a whole or at any level of disaggregation, or to determine performance materiality.
121. The concept of materiality is addressed in the Standard in a manner broadly equivalent to the ISAs, ISREs and other ISAEs – the concept may be discussed in the applicable criteria, in which case such

a discussion provides a frame of reference for considering materiality, or the discussion in the Standard (S.A92-A100) provides such a frame of reference.

*Other guidance that may be relevant in considering materiality in an EER assurance engagement*

122. Although ISAs and ISRE's are written for audits and reviews of historical financial statements, they and other ISAEs than the Standard may provide guidance in relation to the engagement process generally for practitioners undertaking an assurance engagement in accordance with the Standard (S.A22).
123. It may be helpful for the practitioner performing an EER assurance engagement to consider how the ISAEs other than the Standard and the ISAs address materiality and performance materiality:
- a) The concept of performance materiality is defined correspondingly in these standards:
    - i. An amount or amounts set by the practitioner at less than 'overall' materiality (for the subject matter information as a whole) or materiality at a disaggregated level
    - ii. Used by the practitioner in the identification and assessment of risks of material misstatement and in designing procedures to respond to those risks
    - iii. To reduce 'aggregation risk' to an appropriately low level – aggregation risk is the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality or materiality at a disaggregated level, as applicable.
  - b) ISA 320<sup>14</sup> and ISAE 3410<sup>15</sup> require determination of:
    - i. Overall materiality (at the level of the financial statements or GHG statement) and, when applicable, materiality at a disaggregated level (for a class of transactions, account balance or disclosure, or for particular types of emissions or disclosures);
    - ii. Performance materiality, corresponding to overall materiality or materiality at a disaggregated level.
  - c) ISA 320 indicates that overall materiality is often based a percentage of a benchmark based on the audited entity's subject matter information (amounts included in the financial statements that reflect key indicators of the entity's financial performance or condition).
  - d) ISA 600<sup>16</sup> requires determination of component materiality (an application of performance materiality to the work of a component auditor in a group audit engagement).
  - e) ISAE 3410 indicates the application of performance materiality to the work of an other practitioner (may be the same a lesser amount than performance materiality).
  - f) ISA 550<sup>17</sup> notes that tolerable misstatement is the application of the concept of performance materiality to an individual sampling procedure and that tolerable misstatement may be the same or a lower amount than performance materiality.

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<sup>14</sup> International Standard on Auditing (ISA) 320, *Materiality in Planning and Performing an Audit*

<sup>15</sup> International Standard on Assurance Engagements (ISAE) 3410, *Assurance engagements on greenhouse gas statements*

<sup>16</sup> International Standard on Auditing (ISA) 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>17</sup> International Standard on Auditing (ISA) 550, *Related Parties*

124. In considering materiality in an EER assurance engagement, the practitioner is not required to, but may, determine materiality at the level of the subject matter information as a whole or, when applicable, may determine materiality at a disaggregated level. Similarly, the practitioner is not required to, but may, determine and apply performance materiality to overall materiality or materiality at a level of disaggregation, to reduce aggregation risk to an appropriate level.

### **Considering Materiality for Identified Misstatements Individually and in Aggregate**

125. Identified misstatements may have varying degrees of significance (see IAASB Glossary), due to the influence of quantitative or qualitative factors. The practitioner is required to form a conclusion as to whether the subject matter information is free from material misstatement. This involves considering whether the significance of any identified misstatements in the subject matter information rises to the threshold of being material, either individually or in the aggregate.
126. If the practitioner were to design procedures to detect only individually material misstatements, this would overlook the fact that the aggregate significance of individually immaterial misstatements identified but not corrected may cause the subject matter information to be materially misstated. It would also overlook the possibility of undetected misstatements due to inherent limitations in the assurance procedures performed.
127. Designing procedures to detect misstatements at a lower level of significance than overall materiality or materiality at a disaggregated level (performance materiality), may mitigate the factors discussed in SupA.II.126.
128. For the purpose of designing and performing procedures, the practitioner may divide the subject matter information into pieces for various reasons. For example, they may do so because the criteria are required to be applied at different levels of disaggregation of the underlying subject matter or because the preparer has done so as a matter of convenience, or because it is appropriate to do so in the context of the practitioner's proposed testing strategy.
129. The practitioner may, for example, divide the subject matter information into pieces of information about classes of transactions or activities, account balances or resources or relationships or disclosures or about such items that exist or occur in different parts of the entity.
130. In essence, the more pieces that the practitioner divides the subject matter information into for the purpose of applying assurance procedures:
- a) The greater is the need to aggregate misstatements identified by performing the procedures (but not corrected by the preparer) and to consider not only their individual, but also their aggregate, significance and to evaluate not only whether they are individually, but also collectively, material;
  - b) The greater is the aggregation risk; and
  - c) The more allowance that should be made in designing and performing the procedures to mitigate that risk.
131. The same is true whether there is one practitioner or multiple practitioners performing an EER assurance engagement.

## **Considering the Nature of Misstatements and Factors That Affect Their Significance**

132. Aggregating misstatements means considering their aggregate significance. The EER subject matter information may relate to diverse aspects or parts of the underlying subject matter. As a result, the subject matter information may result from measuring or evaluating individual aspects or parts of the underlying subject matter, using criteria that result in measurement or evaluation outcomes that are not expressed in common measurement units or qualitative benchmarks. Even when the subject matter information relates to consistent underlying subject matter, related disclosures may not be expressed in the same measurement units or qualitative descriptions of categories that are the outcome of measurement or evaluation.
133. A misstatement is a difference between the subject matter information and the appropriate measurement or evaluation of the underlying subject matter in accordance with the criteria. A misstatement is therefore expressed in terms of the measurement units or qualitative descriptions that result from proper application of the criteria. The relative significance of misstatements expressed in different measurement units or qualitative descriptions is a matter of professional judgment. It is not a mathematical exercise. It involves considering quantitative and qualitative factors that influence the significance of the misstatement in the engagement circumstances.
134. In some EER assurance engagements, the practitioner may find it difficult, in practice, to consider either quantitative or qualitative factors for the subject matter information as a whole. For example, it may be difficult to do so when the subject matter information results from measuring or evaluating diverse aspects of the underlying subject matter using benchmarks that yield measures or evaluation outcomes that are not expressed in common benchmarks, a circumstance that is often the case for EER subject matter information.
135. In such circumstances, the practitioner may consider materiality for individual aspects of the underlying subject matter information, for which quantitative or qualitative aspects of misstatements could reasonably be expected to influence the economic decisions of users taken on the basis of the subject matter information as a whole. Based on such considerations, the practitioner may identify quantitative thresholds or qualitative conditions of misstatements of subject matter information relating to such aspects of the underlying subject matter information that would be considered material.

## **Applying Performance Materiality**

136. Performance materiality is a technique for reducing “aggregation risk” when the subject matter information is disaggregated for purposes of designing and performing audit procedures.
137. As defined, performance materiality is a quantitative concept, which may be applied when considering misstatements at the level of the financial statements as a whole. The level is set to reduce to an appropriately low level the probability that the aggregate of identified, but uncorrected, and undetected misstatements exceeds materiality for the subject matter information as a whole.
138. Performance materiality may also be applied to a materiality level determined for subject matter information relating to a disaggregated aspect of the underlying subject matter. In that case, it is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in information relating to the disaggregated aspect of the underlying subject matter information exceeds the materiality level for that particular information.

139. The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the practitioner's understanding of the engagement circumstances, as updated during planning and performing the engagement, and the practitioner's expectations in relation to the nature and extent of misstatements in the subject matter information of the engagement, taking into account prior experience where applicable.



## **5. Concepts That Underpin Effective Communication in the Assurance Report**

### **Introduction**

140. Chapter 10 of the Guidance (see G.332 to 338) addresses the need for clear communication in the assurance report to meet the information needs of users. The purpose of an assurance engagement is to enhance the degree of confidence of the intended users about the subject matter information and the purpose of the assurance report is to communicate that conclusion and its basis effectively to the intended users. The assurance reporting requirements in the Standard allow considerable flexibility to the practitioner in reporting the required basic elements of the assurance report and additional information about the assurance engagement.
141. This Part of Section II of Supplement A provides further background and contextual information about the concept of communicating effectively in the assurance report by meeting the common information needs of intended users, the nature of assurance reporting principles that may assist practitioners in applying the reporting requirements of the Standard in a manner that achieves effective communication, and how such principles may be applied in reporting the basic elements and other assurance information in the assurance report.

### **Practitioner Reporting Requirements**

142. The Standard identifies basic elements the assurance report is to include, rather than requiring a standardized format for reporting. It recognizes the need to tailor assurance reports to the specific circumstances (S.A159). The Standard also allows the practitioner to choose a “short-form” or “long-form” style of reporting to facilitate effective communication to the intended users. “Short-form” reports ordinarily include only the basic elements. “Long-form” reports include other information and explanations that are not intended to affect the practitioner’s conclusion.
143. In addition to the basic elements, long-form reports may describe in detail the terms of the engagement, the applicable criteria being used, findings relating to particular aspects of the engagement, details of the qualifications and experience of the practitioner and others involved with the engagement, disclosure of materiality levels, and, in some cases, recommendations. The practitioner may find it helpful to consider the significance of providing such information to common information needs of the intended users (S.A160). See also G.373.e-f and G.375).

### **Communicating Effectively in the Assurance Report**

144. Interpretation challenges and expectation gaps are most likely to be minimized for the intended users, when using the assurance report, if it includes assurance information that would be useful to them in deciding whether and to what extent enhanced confidence in the subject matter information is justified, based on the outcome of the EER assurance engagement.
145. Effective communication may be most likely to be achieved by expressing the assurance conclusion and other information in the assurance report from the perspective of the common assurance information needs of the intended users as a group. Such needs may include not only the nature and basis of the assurance conclusion, and other key elements, but also the significance of these items.

### **Common Assurance Information Needs of the Intended Users**

150. In considering the common assurance information needs of users, it may be reasonable for the practitioner to assume that the intended users:

- a) Have a reasonable knowledge of the nature of assurance engagements, and a willingness to study the assurance report with reasonable diligence;
  - b) Understand that the assurance report includes only information that could reasonably be expected to influence the relevant decisions of intended users about the assurance they can take from the assurance conclusion, taken on the basis of the assurance report;
  - c) Understand any inherent limitations involved in performing the assurance engagement; and
  - d) Make reasonable decisions about the assurance that they can take from the assurance conclusion conveyed in the assurance report, on the basis of the assurance report taken as a whole.
146. Considering the assurance information needs of the intended users may not only help to address the challenges experienced by users in interpreting EER assurance reports and minimize expectation gaps, but may also assist practitioners in applying, more consistently and appropriately, the considerable flexibility in preparing and structuring assurance reports that the Standard permits.
147. The Guidance (G.339-375) includes guidance and examples to assist the practitioner in exercising professional judgment to prepare an assurance report that facilitates effective communication to the intended users and achieves the practitioner's objectives in meeting the purpose of the EER assurance engagement and of the assurance report (SupA.140), based on:
- a) Principles the practitioner may apply in seeking to meet the common assurance information needs of the intended users in preparing and structuring assurance reports (hereafter referred to as "assurance reporting principles" – see SupA.App1);
  - b) A focus on the perspective of the intended users;
  - c) Practitioner reporting requirements in the international assurance standards; and
  - d) Understanding impediments to users' understanding of the assurance report.

### **Assurance Reporting Principles**

148. The assurance report is a communication with the intended users about the assurance conclusion and its basis. The assurance information included in the assurance report may be considered to have a similar relationship to assurance conclusion and its basis, as the subject matter information has to the underlying subject matter of the engagement, and assurance reporting principles might have to the applicable criteria.
149. On this basis, the communication concepts that underpin the characteristics of suitable criteria and qualitative characteristics of useful financial information used in financial reporting frameworks may provide a basis for assurance reporting principles that could assist practitioners in meeting the common assurance information needs of the intended users, as follows (G.336):
- a) **Relevance** – Information in the assurance report is relevant if it assists decision-making by the intended users about their confidence in the subject matter information.
  - b) **Completeness** – Information in the assurance report is complete if it does not omit relevant factors that could reasonably be expected to affect decisions of the intended users about their confidence in the subject matter information made on the basis of that information. Complete

assurance reporting principles include where relevant benchmarks for presentation disclosure of information about the assurance conclusion and its basis.

- c) Reliability – Information in the assurance report is reliable if it is capable of reasonably consistent preparation including, where relevant, reasonably consistent presentation and disclosure about the assurance conclusion and its basis, when prepared in similar circumstances by different practitioners.
  - d) Neutrality – Information in the assurance report is neutral if it is free from bias as appropriate in the engagement circumstances; and
  - e) Understandability – Information in the assurance report is understandable if it can be understood by the intended users.
150. The Guidance addresses how additional information relating to the key elements of the assurance conclusion and the basis for that conclusion might be included in the assurance report to assist intended users in deciding about their confidence in the subject matter information, based on these assurance reporting principles.

#### **Considering the Assurance Reporting Principle of Relevance**

151. Key elements of the assurance conclusion itself that may be relevant may include, for example:
- a) The level of assurance obtained;
  - b) The identification of the subject matter information (and of the underlying subject matter and applicable criteria from which it is prepared);
  - c) The nature of misstatements (of the assertions required by the applicable criteria); and
  - d) How the concept of materiality was applied to misstatements.
152. Similarly, key elements of the basis for the assurance conclusion that may be relevant may include, for example:
- a) The scope of the engagement;
  - b) The identity of the intended users;
  - c) The 'rational purpose' of the assurance engagement;
  - d) The use of entity-developed criteria;
  - e) The identity and competence of the engagement partner;
  - f) The work performed and where the work effort was directed;
  - g) The use of other assurance practitioners and their identity;
  - h) The use of experts and their identity; and
  - i) Inherent limitations in the assurance that could be obtained.

#### *Understanding the intended users and their information needs*

153. Intended users are the individual(s) or organization(s), or group(s) thereof that the practitioner expects will use the assurance report. The responsible party (i.e. the party responsible for the

underlying subject matter (S.12,v) who may also be the measurer or evaluator, and the engaging party (S.A37)) can be one of the intended users, but not the only one.<sup>18</sup>

154. In some cases, there may be intended users other than those to whom the assurance report is addressed. The practitioner may not be able to identify all those who will read the assurance report, particularly where a large number of people will have access to it. In such cases, particularly where possible users have a broad range of interests in the underlying subject matter, users may be limited to major stakeholders with significant and common interests (S.A16).
155. ISAE 3410<sup>19</sup> notes that intended users and their information needs may include, for example:
- a) Investors and other stakeholders such as suppliers, customers, employees, and the broader community, whose information needs may relate to decisions to buy or sell equity in the entity; lend to, trade with, or be employed by the entity; or make representations to the entity or others, for example, politicians.
  - b) Market participants, whose information needs may relate to decisions to trade negotiable instruments (such as permits, credits or allowances) created by a trading scheme.
  - c) Regulators and policy makers in the case of a regulatory disclosure regime to monitor compliance with the disclosure regime.
  - d) Management and those charged with governance of the entity who use information for strategic and operational decisions.
156. In some cases, intended users, such as regulators, impose a requirement on, or request the appropriate party(ies) to arrange for an assurance engagement to be performed for a specific purpose. When engagements use criteria that are designed for a specific purpose, the Standard requires a statement alerting readers to this fact. In addition, the practitioner may consider it appropriate to indicate that the assurance report is intended solely for specific users (S.A18).
157. In the context of a financial statement audit, the subject matter information is prepared in accordance with a recognized framework, and the intended users of the information and the purpose for which it is prepared are identified in the framework and are well understood. In the context of an EER engagement, there may be a broad range of subject matters, and a large number of different frameworks from which to select in preparing and reporting the subject matter information. Possible users may have a broad range of interests in the underlying subject matter. In the context of an EER engagement it may, therefore, be relatively more important to identify in the assurance report who the intended users are and the purpose for which the EER report is prepared.

### **Considering the Assurance Reporting Principle of Understandability and Potential Impediments**

158. Where additional information is included in the assurance report beyond the basic elements, there is a requirement that it is clearly separated from the practitioner's conclusion and phrased in such a manner so as make it clear that it is not intended to detract from that conclusion (S.68). While long-form reports may be useful in providing explanations in more comprehensive terms, they may also

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<sup>18</sup> International Framework for Assurance Engagements, paragraph 35

<sup>19</sup> ISAE 3410, paragraph A47

reduce comparability between entities and be more difficult for intended users to understand the assurance that has been obtained.

159. ISA 700 (Revised)<sup>20</sup> notes that while there is a need for an appropriate balance between the need for consistency and comparability in auditor reporting and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant, consistency in the auditor's report promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote user's understanding and to identify unusual circumstance when they occur.<sup>21</sup> The broader range of subject matters and criteria make it relatively more important in the context of EER reporting for assurance reports to allow for comparability to assist users' understanding.
160. Even when the applicable criteria are suitable, are adequately disclosed and available to intended users, many users do not find assurance reports easily understandable, particularly information included in them that is intended to limit the reliance users should place on them.

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<sup>20</sup> International Standard on Auditing (ISA) 700, *Forming an Opinion and Reporting on Financial Statements*

<sup>21</sup> ISA 700 (Revised) paragraph 4

## Appendix 1

### Terms Used in This Supplement

Terms used	How described in the Supplement
Aggregation risk	The risk that the aggregate of uncorrected and undetected misstatements exceeds overall materiality or, when applicable, materiality at a disaggregated level
Assurance reporting principles	Principles for addressing the common information needs of the intended users in preparing and structuring assurance reports. <b>(SupA.II.147.a)</b>
Attribute	A quality or feature of the underlying subject matter that is regarded as a characteristic or inherent property of the underlying subject matter. <b>(SupA.II.4)</b>
Performance materiality	An assurance technique that may be used by practitioners to reduce “aggregation risk” in the design and performance of assurance procedures, when the subject matter information is disaggregated for purposes of designing and performing audit procedures
Standard	ISAE 3000 (Revised)
Subject matter element(s)	A unit(s) of a type of disaggregated part of the underlying subject matter. <b>(SupA.II.12)</b>

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