SPECIAL CONSIDERATIONS IN PERFORMING ASSURANCE ENGAGEMENTS ON EXTENDED EXTERNAL REPORTING PERFORMANCE MATERIALITY

Introduction

1. As noted in paragraph 5 of Agenda Item 5 Non-authoritative Draft EER Assurance Guidance – Issues Paper, Chapter 9 of the draft non-authoritative EER assurance guidance: Special Considerations in Performing Assurance Engagements on Extended External Reporting (hereafter “the Guidance”) (Agenda Item 5-A) includes a placeholder for a sub-section on Performance Materiality.

2. This Agenda Item, 5-A.1, includes the material in relation to Performance Materiality and comprises:
   - The proposed additional material to be included in Chapter 9 of the Guidance (Section I);
   - The proposed related additional material to be included in Supplement A (Section II).

3. Additional terminology used in this sub-section on Performance Materiality, and to be included in Appendix 1 to the draft Guidance in Agenda Item 5-A, is included in Appendix 1 to this document.
I ADDITIONAL MATERIAL TO BE INCLUDED IN CHAPTER 9 OF THE GUIDANCE

Addressing aggregation risk in an EER assurance engagement

Nature of aggregation risk and how it arises in designing and performing procedures

1. In designing and performing procedures in an EER assurance engagement, there is a risk that the aggregate of uncorrected and undetected misstatements exceeds overall materiality or, when applicable, materiality at a disaggregated level (hereafter referred to as ‘aggregation risk’) (see SuA.xx1).

2. Aggregation risk arises because:
   
a) The subject matter information may be divided into separate pieces (disaggregated) by the practitioner, for the purpose of designing and performing assurance procedures;

b) Assurance procedures may be designed and performed:
   
i. To detect only individually material misstatements; and

ii. To obtain evidence only about misstatement of separate pieces of the subject matter information (i.e., at a disaggregated level).

3. Designing and performing procedures to detect only individually material misstatements may mean that misstatements whose significance2 is less than materiality may not be detected due to the design of the procedures.

4. Designing and performing procedures to obtain evidence only about misstatement of separate pieces of the subject matter information means that the evidence only addresses directly the significance of detected misstatements, considered individually. In order to assess whether misstatements are material, when considered in combination with each other, it is necessary to consider the aggregate significance of detected misstatements.

5. Taken together, designing and performing procedures in this way may overlook the possibility that the aggregate significance of individually immaterial misstatements, which are detected but not corrected, or of misstatements that remain undetected due to inherent limitations in the assurance procedures performed, may cause the subject matter information to be materially misstated.

Mitigating aggregation risk in designing and performing assurance procedures

6. The practitioner is required to accumulate uncorrected misstatements identified that are not clearly trivial (S.51) and to evaluate whether they are material individually or in the aggregate (S.65). Evaluating the significance of uncorrected misstatements to determine if they are material involves considering the influence of quantitative or qualitative factors on their significance and considering whether the significance of such misstatements rises to the threshold of being material, either individually or in the aggregate (SuA.II.xx1).

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1 This is to refer to the proposed additional material to be included in Supplement A
2 See IAASB Glossary
7. Performance materiality is 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.

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

9. Performance materiality is not explicitly addressed in the Standard. However, the ISAs and other ISAE’s may provide guidance in relation to the engagement process generally for practitioners undertaking an assurance engagement in accordance with the Standard (S.A22). The practitioner may therefore find it helpful to consider how those standards address materiality and performance materiality (SuA.II.xx)

10. As defined in those standards, performance materiality is a quantitative concept, which may be applied when considering misstatements. It involves designing and performing procedures to identify misstatements the significance of which rises to a quantitative threshold that is less than quantitative materiality for the subject matter information as a whole. The level (referred to as performance materiality) is set to reduce aggregation risk to an appropriately low level.

11. Using this level to perform procedures increases the likelihood that the procedures will result in the identification of misstatements that are not individually material in quantitative terms. Compared with applying the same procedures using materiality as the threshold for identification, this increases the likelihood that the procedures will identify misstatements that, when accumulated and their aggregate significance is considered, are material in the aggregate in quantitative terms.

12. Performance materiality does not address misstatements that would be material solely or principally due to qualitative factors that affect their significance. ISA 320\(^3\) notes that it is not practicable to design audit procedures to detect all misstatements that could be material solely because of their nature. However, to the extent it is possible to design procedures to increase the likelihood that misstatements that are material solely or principally because of qualitative factors, doing so may also assist the practitioner in mitigating aggregation risk.

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\(^3\) ISA 320, Materiality in Planning and Performing an Audit, paragraph 6
II ADDITIONAL MATERIAL TO BE INCLUDED IN SUPPLEMENT A

Addressing Aggregation Risk in an EER Assurance Engagement

Considering disaggregation of underlying subject matter when determining the preconditions

1. Underlying subject matter may be capable of disaggregation into aspects or parts and those aspects or parts may consist of one or more types (SuA.II.9), which may be a single unit or multiple units of that type (subject matter element(s) – SuA.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 (SuA.II.9). In addition, the preparer may decide to apply the criteria to a subgroup(s) of a similar type of subject matter elements. For example, the preparer may measure greenhouse gas emissions from each of several plants, separately.

2. 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.Ch2)) and the suitability of the criteria at the level of disaggregation required by the criteria (G.67), if applicable (SuA.II.17). In determining the suitability of the criteria, the practitioner may need 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).

3. 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

4. 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.

5. 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.

6. 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 (paragraph 65); and
f) Identification, when applicable, of material misstatements in a modified assurance conclusion in the practitioner’s report (paragraph 74(b)).

Considering performance materiality in designing and performing procedures

How the Standard addresses materiality

7. The practitioner is required to consider materiality in an EER assurance engagement (paragraph 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.

8. 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 (paragraphs A92-A100) provides such a frame of reference.

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

9. 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).

10. 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 and ISAE 3410 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 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 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.

11. 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

12. 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.

13. 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.

14. 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 paragraph 13.

15. 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.

16. 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.

17. 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.

18. 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**

19. 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.

20. 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.

21. 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.

22. 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**

23. Performance materiality is a technique for reducing "aggregation risk" when the subject matter information is disaggregated for purposes of designing and performing audit procedures.

24. 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.

25. 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.

26. 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.
### Terms used in this Supplement

<table>
<thead>
<tr>
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