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Tom Seidenstein - Chair
International Auditing and Assurance Standards Board
529 Fifth Avenue
New York
10017 USA

Subject: IAASB's Exposure Draft: Proposed ISA 600 (Revised), Special Considerations—Audits of Group Financial Statements

Dear Mr. Seidenstein,

1. The Limperg Institute (LI) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board (IAASB) ED on ISA600. As an academic[1] organization we share the goal of serving the public interest.
2. The Working Group Statistical Auditing is a part of the Limperg Institute. This is a group of experts on data auditing and statistical methods. On behalf of the Limperg Institute, the Group has prepared these comments.
3. The comments we provide in this letter reflect the views expressed by many, but not necessarily all, of the members of the Limperg Institute. However, the comments are not intended to include, or reflect, all of the views that might be provided by individual members on behalf of their respective organizations. Where we did not comment on certain specific matters, this should not be interpreted as either approval or disapproval by the Limperg Institute.

Overall Comments

4. The expanding global, multi-location reach of companies, together with changing business models, suggest that the audits of group financial statements will continue to be a common assurance service. As such, we support the Board's efforts to revise and enhance ISA 600, Special Considerations – Audits of Group Financial Statements (including the work of Component Auditors), as a matter of priority.
5. Additionally, we appreciate the Paper's explicit emphasis on Performance Materiality and aggregation risk.
6. Having said this, we encourage the Board to emphasize in the final standard to be more robust. We believe the definition of aggregation risk and performance materiality is too vague, inconsistent and inconclusive to drive consistent application of the standard by auditors. We believe that the definition and subsequent application by auditors need to be enhanced.

Aggregation Risk considerations

Current definitions need improvement

7. We note that paragraph 9(a) defines aggregation risk as: "Aggregation risk – The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole."
8. In fact, apart from the last three words, this is the definition of Audit Risk and we find this therefore less suitable. Audit Risk and

[1] The Limperg Institute's objectives are as follows: The Limperg Institute is a national institute that organizes a PhD program in Accounting and Auditing. The program is open for PhD-students from the Netherlands and for students from abroad as well. The Limperg Institute also supports interaction and collaboration between scientists and practitioners by organizing conferences, symposia and work groups. Limperg Institute is an independent academic institution supported by all Dutch universities. It has its home base at the VU University in Amsterdam.

Aggregation Risk are two different notions that need to be more distinctly codified. E.g. in a situation of a group audit with just two entities whereby one component has an undetected material misstatement there is a clear Audit Risk. However we would argue that the Aggregation Risk in this situation does not play any role. Therefore the current draft definition does not drive the right behavior.

9. Relatedly, paragraph A11 states that: “Aggregation risk exists in all audits of financial statements, but is particularly important to understand and address in a group audit engagement because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances or disclosures that are disaggregated across components.”
10. We believe that aggregation risk is one (of many) causes of audit risk, and that aggregation risk as such could better be defined as: the contribution to audit risk due to disaggregation of the financial statements into components, and, thereby, disaggregation of audit procedures.

Component (performance) Materiality should be adjusted for Aggregation Risk and decreased as the number of components increase

11. While we appreciate these two definitions (and our suggestions to strengthen it), we believe the broader concept that “*aggregation risk <u>increases as the number of components increases</u> at which audit procedures are performed separately, either by component auditors or other members of the engagement team*”, as discussed in your Explanatory Memorandum paragraph 80, should be explicit in the standard and application material that it is ***expected*** that the component performance materiality is adjusted for this risk to appropriately reflect this. This will further strengthen the auditor’s consideration of aggregation risk in a group audit and drive consistent behavior.
12. Furthermore, to the extent that audit procedures are not performed at certain components (e.g. components beneath the ‘clearly trivial’ threshold) the current draft fails to codify what is expected from an Aggregation Risk perspective. We strongly suggest that the standard states that the group auditor should be reminded to consider the aggregation risk that exists within these components as part of its overall assessment of aggregation risk and its ultimate determination of whether it has obtained sufficient appropriate audit evidence to support the group audit opinion.
13. In addition we would recommend for the Board to provide additional guidance in the areas above to set clear expectations and direct the work effort of both the group engagement team and the component auditor. We are of the opinion that the current draft regarding aggregation risk does not drive consistent auditors behavior and work-effort in a group audit context with multiple components whereby some components are below the ‘clearly trivial’ threshold (and as a whole are considered material).

The standard is insufficiently clear that Aggregation Risk drives the gap between component materiality and group performance materiality

14. The current draft standard fails to explain the aggregation risk rationale and how to mitigate this. We would suggest that the standard is amended to provide a sufficient gap between component materiality and group performance materiality that is sufficient to bear the aggregation risk from a group audit perspective.

(Group) Performance Materiality considerations

Definition of Group Performance Materiality needs additional context regarding aggregation risk

15. In 9(m) group performance materiality is defined. We find it difficult to explain the role of the threshold function that <u>group</u> performance materiality has and how it relates to <u>group</u> materiality. The whole purpose of defining performance materiality from materiality is to mitigate the aggregation risk. The current draft needs more context. Within a consolidated group audit situation

where there is one population, there is no disaggregation and therefore aggregation risk does not play a role. Only when a group is disaggregated into components, aggregation risk becomes a part of audit risk and component performance materiality is to be assessed. This amount can then be treated as materiality for the financial statements of the component, disaggregated into performance materiality for an ABCOT within those financial statements. We are of the opinion that the current draft regarding Group Performance Materiality does not drive consistent auditor's behavior and work-effort.

Distinction component materiality and component performance materiality does not drive consistent auditors behavior

16. In addition we foresee inconsistent application of the standard regarding component and component performance materiality. According to item 83 on page 25 of the draft, it appears that component materiality and component performance materiality are synonyms. In that case, we strongly prefer to consistently only use of the term component materiality.

Determination of component materiality is insufficiently codified to drive consistent auditor's behavior

17. Paragraph 29 states that: "In applying ISA 320 and ISA 450 when classes of transactions, account balances or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, the group engagement team shall determine:
(a) Component performance materiality. To address aggregation risk, such amount shall be lower than group performance materiality. (Ref: Para. A73–A76)
(b) The threshold above which misstatements identified in component financial information are to be communicated to the group engagement team. Such threshold shall not exceed the amount regarded as clearly trivial to the group financial statements."
18. We believe paragraph 29 and the related application material did not go far enough to assist the auditor in determining how the group materiality under ISA 320 for the group financial statements, as a whole, is intended to flow through to the determination of component materiality. While the factors in paragraph A75 are helpful, further guidance is needed in this area which can be particularly challenging in a group audit. Currently, (i.) the Paper is too broad and subjective which could make it challenging for auditors to consistently and appropriately establish component performance materiality. Also the current draft is (ii.) too vague and inconclusive to drive consistent application of the standard by auditors. We believe that the definition and subsequent application by auditors need to be enhanced.
19. In addition, paragraph A73 states that: "the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality".
20. We find it challenging to understand how auditors will consistently assess whether the aggregation of component performance materiality exceeding group performance materiality is appropriate, as well as adequately assess whether the relationship between component performance materiality for a specific component and group overall materiality is appropriate. We believe additional guidance, including quantitative considerations, need to be included in the standard to address component performance materiality and its effect on the materiality of the group audit. As an example, we refer to a doctoral dissertation A Bayesian Audit Assurance Model (2012) by Trevor R Stewart, supervised by the chairperson of the Limperg Institute (ISBN 978-90-5335-600-5)

"Stand back" requirement needs to include an assessment of aggregation risk in order to drive consistent behavior.

21. In addition, with regard to the "stand back" requirement included in paragraph 49-51 (and as also mentioned in paragraph 97 of

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the Explanatory Memorandum), we believe the group engagement team should be required to assess whether the aggregation risk of the group audit is at an acceptable level considering all the audit evidence evaluated. Consistent with our comments above on aggregation risk we believe aggregation risk is particularly important in a group audit and warrants further attention when the group engagement team performs a “stand back” evaluation as required in paragraph 49. As a result, we believe it would be appropriate to include strengthening of the standard and additional guidance for the group engagement team to assess aggregation risk over significant classes of transactions, account balances or disclosures in the group financial statements as part of the “stand back” analysis.

22. In this regard, we encourage the Board to provide more guidance via Application Material on how the group engagement team should assess whether aggregation risk is reduced to an appropriate level. In a group audit, aggregation risk may arise both from the determination of components (for example, no audit procedures are performed at certain components because no risk of material misstatement of the group financial statements is identified individually and in the aggregate at these components), and the determination of component materiality (for example, component materiality may be too high resulting in insufficient audit procedures being performed at the component level). Both of these aspects of aggregation risk can affect the group engagement team’s evaluation of whether sufficient appropriate audit evidence is obtained with respect to the group financial statements, and should be explicitly considered by the group engagement team as part of the “stand back” analysis.

Should you wish to discuss any of our comments, please do not hesitate to contact Prof. dr. J.J.B. de Swart MBA., Chair of the Working Group Statistical Auditing.
Yours Faithfully,

Prof. dr. J.J.B. de Swart MBA.
Chair Working Group Statistical Auditing

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