

## ED-600 Questions 10 – Do you support the focus in ED-600 on component performance materiality?

### **Question 10:**

Do you support the focus in ED-600 on component performance materiality, including the additional application material that has been included on aggregation risk and factors to consider in determining component performance materiality?

### **Q10 – Agree**

#### **1. Monitoring Group**

##### **IAIS**

The IAIS supports the approach to component materiality, including that there is a definition of aggregation risk and that component materiality is determined by the group engagement team.

#### **5. Accounting Firms**

##### **CG**

We agree with the focus in ED-600 on component performance materiality. The Application Material provides helpful support to the standard. We would welcome this subject being addressed in the Implementation Guidance.

##### **CR**

We support the focus in ED-600 on component performance materiality, including the additional application material included on aggregation risk and factors to consider in determining component performance materiality. We are supportive of a principles-based approach to component materiality.

##### **ETY**

Yes, we do.

#### **6. Public Sector Organizations**

##### **AGSA**

Yes, the component performance materiality will reduce the aggregation risk to an acceptable level.

##### **GAO**

The focus on component performance materiality will be helpful for the group auditor in addressing aggregation risk. The added application material provides useful guidance to apply the requirements and is clearer than the existing application material. It would be helpful to adjust the application guidance section to clearly discuss when component auditors are used, so group auditors can clearly identify the applicable application material.

##### **PAS**

Yes, we support the focus in ED-600 on component performance materiality.

## 7. Member Bodies and Other Professional Organizations

### BICA

We support the focus on component performance materiality and the additional application material.

### CPAA

Yes, we are supportive of the approach to component performance materiality and related application material in the ED. The removal of the term “significant component” creates the potential for risks relevant to those previously defined significant components to be overlooked or not properly understood, as the risk assessment is likely to be more centralised, at least until the components are identified and component auditors are engaged.

### CPAI

We consider this to be appropriate. Further guidance on this area in time would be welcome.

### ECA

Yes

### INCP

Yes, we agree that the components use an amount of performance materiality less than the group's performance materiality to address aggregate risk.

### TFAC

Yes

## 8. Academics

### HUNTER

Yes, the added focus on component performance materiality gives auditors a guidance on implementing performance materiality threshold.

## Q10 – Agree with comments

### 1. Monitoring Group

#### BCBS

The Committee supports ED-600's emphasis on component performance materiality under the risk-based approach. In ED-600, the group engagement team determines the component materiality to be used in the planning and performing on the disaggregated financial information of the components. In this regard, a definition of aggregation risk has been included and it has been clarified that the component materiality is determined by the group engagement team to reduce the aggregation risk.

The Committee welcomes the application material on aggregation risk. We appreciate the list of factors that the group engagement team may take into account when defining component materiality. In this regard, we would recommend that regarding:

ED-600 paragraph A75: the group engagement team could also take into account the implications of different currencies in use across the group and how they may affect the aggregation or disaggregation of materiality – in particular where rates are volatile.

ED-600 paragraph 29(a): adding new application material that the group engagement team may also find it helpful to understand and consider the implications of any materiality (both qualitative / quantitative) applied by a “local” auditor when auditing a subsidiary, regardless of whether that subsidiary audit represents a component (it could be that local materiality highlights issues that may be relevant to consider at the level of the group audit).

ED-600 paragraph A77: the group engagement team may also consider any regulatory requirements at the component level (both qualitative and quantitative) that can have an impact in defining the thresholds above which misstatements identified in component financial information are clearly trivial to the group financial statements.

## IFIAR

We support the direction of the new component performance materiality definition in paragraph 9 (e) of ED-600, which is to set component performance materiality to an appropriately low level to reduce aggregation risk. Additional qualitative considerations are necessary to assist auditors in determining component performance materiality while considering aggregation risk. Examples of such considerations include but should not be limited to the, potential effect on loan provisions, debt covenants, contractual arrangements, implication for fraud/illegal acts, existence of statutory or regulatory reporting requirements, etc.

Paragraph A 73 indicates that a different component performance materiality may be established for each component where audit procedures are performed. This should be developed further as a requirement which should clearly state that consideration should be given to the need for a separate component materiality to be determined for each component based on the specific characteristics and facts (A 75).

## IOSCO

In addition, 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.”

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.”

While we appreciate the definition, we believe the broader concept that “aggregation risk increases as the number of components increases at which audit procedures are performed separately, either by component auditors or other members of the engagement team”, as discussed in Explanatory Memorandum paragraph 80, should be explicit in the standard or application material. This will further strengthen the auditor’s consideration of aggregation risk in a group audit. Furthermore, to the extent that audit procedures are not

performed at certain components, 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.

It would be useful 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 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, the Paper is too broad and subjective which could make it challenging for auditors to consistently and appropriately establish component performance materiality.

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”.

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 Paper to address component performance materiality and its effect on the materiality of the group audit.

In addition, with regard to the “stand back” requirement included in paragraph 49-51 (and as also mentioned in paragraph 97 of 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 under the section “Preliminary Risk Assessment Process of the Component”, 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 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.

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.

## 2. Investors and Analysts

### CRUF

We support the ED introducing factors the group engagement team may take into account in setting component performance materiality, but would like more detailed explanation and background as to why component overall materiality was eliminated from ISA 600. Regarding this point, some users expressed concern that it will increase the risk of undetected material misstatement at components, particularly those which were previously categorised as financially significant components

## 3. Regulators and Audit Oversight Authorities

### CEAOB

#### Materiality

ED 600 provides little guidance for determining component materiality (paragraphs 29 and A73 to A77), which may lead to wide variation in practice regarding the determination of component materiality. We urge the IAASB to provide further explanations and illustrations on the determination of component materiality (e.g. minimum or maximum positions / ranges, etc.) and add extensive descriptions and/or give practical examples of aggregations risks. Without further guidance consistent application of ED 600 will be difficult to achieve.

### CPAB

#### Materiality and aggregation risk

We support the direction of the new component performance materiality definition in paragraph 9(e) of ED-600 which indicates that it must be set to reduce aggregation risk to an appropriately low level. Additional qualitative considerations are necessary to assist auditors in determining how component performance materiality should be determined while considering aggregation risk and whether the initial performance materiality continues to be appropriate. Examples of such considerations include but should not be limited to the existence of statutory or regulatory reporting requirements, potential effect on loan provisions, debt covenants, contractual arrangements, implication for fraud/illegal acts, etc.

Paragraph A 73 indicates that a different component materiality may be established for each component where audit procedures are performed. This should be more explicit as a requirement that a separate component materiality must be determined based on the specific characteristics, facts, and nature of the accounts at each component.

### IAASA

#### Materiality

ED 600 provides little guidance for determining component materiality (paragraphs 29 and A73 to A77), which may lead to wide variation in practice regarding the determination of component materiality. We urge the IAASB to provide further explanations and illustrations on the determination of component materiality (e.g. minimum or maximum positions / ranges, etc.) and add extensive descriptions and/or give practical examples of aggregations risks. Without further guidance consistent application of ED 600 will be difficult to achieve.

## IRBA

We support the focus in ED-600 on component performance materiality.

We suggest that the IAASB should consider including in paragraph A75 additional overall factors to determine performance materiality, such as the understanding of the entity and component management competence assessments.

In addition, the IAASB may want to consider whether there is value in retaining the term “overall component materiality” from extant ISA 600.

## NASBA

NASBA appreciates the difficulty of providing more specific guidance or a methodology for the assignment of performance materiality to components. ED-600 is clear that component performance materiality should be set at an amount lower than group performance materiality to address aggregation risk. However, the IAASB may want to consider additional application material or implementation guidance in the form of an example of how an assignment might be made. Please refer to the article “Component Materiality for Group Audits” in the AICPA’s Journal of Accountancy (November 30, 2008) for one example that provided helpful guidance when it was issued.

## UKFRC

As noted in our response to Question 8, during our outreach activities, stakeholders expressed the view that the prescriptive mechanisms in extant ISA 600 exacerbate the issues surrounding the application of materiality in a group audit; the concept of component materiality is not well understood and there are many variations in practice. Accordingly, we strongly support the decision to remove the concept of component materiality and clarify the meaning of component performance materiality and aggregation risk. Aggregation risk 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. Indeed, as aggregation risk exists in all audits, we recommend including the definition of aggregation risk in ISA 320 as a conforming amendment.

We believe that to meet the requirement for the GET to communicate performance materiality to the CA, it would be beneficial to include an additional requirement for the CA to also have an understanding of group performance materiality. This will support collaboration between the GET and the CAs to determine if component performance materiality, in the context of group performance materiality, is appropriate in the circumstances. It will also assist where CAs have more in-depth knowledge of the component or the GET intends to obtain the assistance of the CA to determine the nature, timing and extent of further audit procedures to be performed on the financial information of the component.

## 4. National Auditing Standard Setters

### AUASB

The AUASB supports the focus in ED ISA 600 on component materiality, however, raises the following matters for consideration:

Paragraph 29 of ED-600 states that component materiality “shall be lower than group performance materiality”. The AUASB suggests that this is changed to “Shall not be greater than group performance

materiality". When a group has a component that represents almost 100% of the group, it may be reasonable to use the group performance materiality to audit this component.

While the AUASB supports the factors to consider in determining component performance materiality, Australian stakeholders have raised concern with the lack of guidance and examples regarding the actual calculation and allocation of performance materiality. The AUASB encourages the IAASB to provide implementation guidance and examples of performance materiality outside of the revised standard.

Paragraph A13 of ISA 320 refers to aggregation risk without a clear definition of aggregation risk within ISA 320. While the AUASB supports the definition of aggregation risk as included at paragraph 9(a) of ED ISA 600, the AUASB queries the placement of this definition. The AUASB recommends that aggregation risk is defined within ISA 320 with the special considerations of such risk being addressed in ISA 600.

## CAASB

Overall, we support the materials in ED-600 related to materiality and we support the focus on component performance materiality. However, we recommend that implementation guidance be developed on the following topics.

### Setting component performance materiality

While paragraph A75 provides some factors to consider in setting component performance materiality (CPM), there could be divergent practices among practitioners due to the professional judgment involved in setting CPM. While we recognize that firms will need to develop their own methodology for setting CPM, we believe examples of how to set CPM and how this is impacted by aggregation risk would be helpful to drive consistency. These examples should also include guidance on how to set CPM when auditing only one account balance of the component.

### Factors influencing aggregation risk

Significant judgment is applied in determining aggregation risk and "reducing aggregation risk to an appropriately low level". Based on the risk tolerances of accounting firms or based on different jurisdictions, there could be significant variation in how aggregation risk is applied. Paragraph A75 recognizes that aggregation risk increases as the number of components in the group increase. Additional factors to consider in determining aggregation risk (such as the complexity of the group entity and its lines of business, degree of groupwide controls, number of jurisdictions it operates in and the degree of financial reporting systems) could be included to support the consistent application of this concept. This information could be included with implementation guidance on how to set CPM.

## CNCC-CSOEC

We support the focus in ED-600 on component performance materiality, including the additional application material that has been included on aggregation risk and factors to consider in determining component performance materiality, i.e. materiality amount to be used in planning and performing audit procedures on the disaggregated financial information of a component for purposes of the group audit. The terms "component materiality" and "component performance materiality" are both used in extant ISA 600. Under the risk-based approach in ED-600, there is no longer a requirement for the group engagement team to identify significant components, nor is there a requirement to perform an audit of those significant components. Rather, the group engagement team now determines the appropriate approach to obtain sufficient appropriate audit evidence to address assessed risks of material misstatement of the group financial statements. With this change in approach, we believe that further guidance should be provided to

explain how to determine the component performance materiality and its interaction with the group materiality.

### HKICPA

We support the focus in ED-600 on component performance materiality. Under the risk-based approach in ED-600, there is no requirement for the group engagement team to identify significant components and obtain audit evidence on all of the component's financial information (i.e. performing an audit of component financial information using component materiality under paragraph 26 of the extant ISA 600 is no longer required). We believe ED-600's emphasis on using the component performance materiality to plan and perform procedures on disaggregated component financial information has the potential to drive the group engagement team's focus on identified risks, rather than all of the component's financial information as in the extant ISA 600, which is set to enhance the efficiency and effectiveness of a group audit engagement.

Meanwhile, we recommend that further guidance be provided on the calculation of component performance materiality in the context of ED-600.

### IDW

To the extent that group engagement teams assign to component auditors the performance of risk assessment procedures, the identification and assessment of risks of material misstatement, the design of further audit procedures, or the performance of further audit procedures, we support the focus in the draft on "component materiality" (which the draft refers to as "component performance materiality"), including the additional application material that has been included on aggregation risk and factors to consider in determining component performance materiality. However, given the potential for confusion among members of the profession and audit regulators, we believe that the IAASB needs to change the term "component performance materiality" back to "component materiality" – recognizing that the current definition of component materiality in extant ISA 600 is equivalent to the proposed definition of component performance materiality.

More importantly, on the basis of the recommendation in our response to Question 8 to reintroduce the concept of full scope audits of the entire financial information of significant components and the concept of audits of classes of transactions, account balances and disclosures components for which there is a reasonable possibility of a significant risk, we believe that the reintroduction of the concept of and requirement for "component performance materiality" as originally defined in extant ISA 600 is also needed, since in these circumstances component auditors providing such "interoffice opinions" need to deal with the aggregation risk affecting those opinions.

We note that paragraph A74 refers to the engagement team considering "whether a component performance materiality lower than the amount communicated to the component auditor may be appropriate". Aside from our comment above that the reference being made here ought to be to "component materiality", we note that both the component materiality for the component financial information as a whole and the lower component materiality for one or more classes of transactions, account balances or disclosures need to be communicated to the component auditor. Consequently, the phrase "lower than the amount communicated to the component auditor" ought to be changed to "lower than the amount for the component financial information as a whole".

## JICPA

We support the focus on component performance materiality. We make the following comments on the definition of aggregate risk.

Aggregate risk is defined in paragraph 9(a), but the current explanation is not sufficient. With the statement “exists in all audits” in paragraph A11 in mind, more detailed explanations should be provided in order to clarify whether any of the following is meant or not.

Risks that a material misstatement cannot be detected as an audit procedure is performed based on testing some selected items in a population

Risks that a material misstatement cannot be detected for classes of transactions, account balances or disclosures where no risk of material misstatement is identified

Considering this from the perspective of the group audit, the following risk is also assumed.

Risks that a material misstatement cannot be detected regarding financial information of the component where no risk of material misstatement is identified

## KSW

The relationship between group materiality and performance materiality on component level is one of the areas where more guidance is needed, especially how performance materiality is calculated as ISA 320 is also silent on this matter.

## MIA

The AASB supports the focus in ED-600 on component performance materiality, including the additional application material that has been included on aggregation risk and factors to consider in determining component performance materiality.

However, with the elimination of the significant component concept, the AASB sees challenges in determining performance materiality of the components. There may be a need for more specific guidance or a methodology for the assignment of performance materiality to components. Although ED-600 is clear that component performance materiality should be set at an amount lower than group performance materiality to address aggregation risk, the IAASB may want to consider additional application material or implementation guidance via examples of how a determination or allocation might be made. The determination of an appropriate component performance materiality may require the involvement of the component auditor.

We believe that the application material could be improved by providing additional details and clarity surrounding component performance materiality in light of the disaggregation example in paragraph A75.

ED-600 needs greater clarity for situations involving joint ventures, associates and shared service centres to provide guidance for GETs on component materiality considerations in ED-600.

## NBA

On one hand the focus on component performance materiality and the flexibility for group audit teams to adapt this to their specific situation is helpful. On the other hand, more guidance might be useful. Some examples in or outside the Standard might help to make it concrete. Apart from the component performance materiality it is stated that there might also be a performance materiality for transaction classes etc. In our opinion this too complicated.

## NZAuASB

The NZAuASB supports the ED-600 approach to component performance materiality. The NZAuASB encourages the IAASB to consider whether some practical examples can be included in implementation guidance to help a better understanding of the concept.

## 5. Accounting Firms

### BDO

While we understand the reasons for the focus on component performance materiality in ED-600, we believe the concept of component materiality should also be included in the standard. Since reporting to the group auditor will likely refer to material misstatements, the standard should include a requirement for the group auditor to set component materiality and communicate it to the component auditor. While we acknowledge that the requirements in all other ISAs apply to a group audit and therefore group materiality and performance materiality would be determined in accordance with ISA 320, we would support a stronger link to clarify that materiality and performance materiality must be set at both the group and component levels.

We appreciate the supporting application material giving additional guidance on aggregation risk and the factors to consider in determining component performance materiality. However, we believe that the application guidance could be improved by providing more details and clarity around component performance materiality particularly around the example about disaggregation in ED-600.A75.

### BT

There could be more guidance on aggregation risk and how practically to factor it in to the determination of performance materiality.

### DTT

DTTL agrees with the approach adopted by the IAASB to keep the materiality requirements in paragraphs 29 and 30 of ED-600 and the related guidance principles based. DTTL is also supportive of the focus on determining component performance materiality at a level at which appropriately precise and meaningful procedures may be performed in order to obtain sufficient appropriate audit evidence regarding the component's financial information. DTTL does acknowledge that various stakeholders have requested additional qualitative guidance to demonstrate application of the principles, but DTTL recommends that any illustrative examples be provided as supplementary material to the proposed standard.

Paragraph 29 of ED-600 states that component performance materiality (i.e., an amount that is lower than group performance materiality) shall be determined “when classes of transactions, account balances or disclosures in the group financial statements are disaggregated across components ...” DTTL notes that ED-600 may be enhanced to address circumstances in which the probability of aggregation risk is lower, and suggests including examples in ED-600 or other supplementary material to the proposed standard. Examples may include situations in which the group engagement team determines to test the totality of a significant account in the aggregate (e.g., as one population), or where there is only one component that is relatively significant in relation to the group (i.e., the significant account balance at the component comprises a significant portion of the total significant account of the group). DTTL believes that in such circumstances it may be appropriate for the group engagement team to establish a component performance materiality that approaches group performance materiality.

DTTL also recommends that paragraph A75 of ED-600 be amended to bifurcate the first bullet in order to focus on the importance of “relative significance” and to provide enhanced guidance with respect to this matter.

A75. Factors the group engagement team may take into account in setting component performance materiality include the following:

The extent of disaggregation of the financial information across components (e.g., as the extent of disaggregation across components increases, a lower component performance materiality generally would be appropriate to address aggregation risk).

The relative significance of the component to the group may affect the extent of disaggregation (e.g., if a single component represents a large portion of the group, there likely may be less disaggregation across components), or the relative significance of a particular class of transactions, account balance or disclosures to the group (e.g., if an account balance is tested in the aggregate, there is likely to be little to no aggregation risk) may affect the extent of disaggregation.

## EYG

Yes, with some suggested clarifications.

Paragraph 29 of ED-600 states that component materiality “shall be lower than group performance materiality”. We suggest that this is changed to “Shall not be greater than group performance materiality”. When a group has a component that represents almost 100% of the group, it would seem reasonable to use the group performance materiality to audit this component.

ED-600 paragraphs 29 and A75 introduce the term “disaggregation”. Given this term is not defined and the term “aggregation” is used elsewhere in ED-600, the concepts described in application material A75 could be difficult to understand. We agree with this application material and particularly with the concept of relative significance to the group, as the size element may have (and often has) a bearing on the materiality of misstatements to the group financial statements and therefore also a bearing on the risk of material misstatement.

We propose the IAASB considers revising the first bullet of paragraph A75 as follows: “The relative significance of the component to the group may affect aggregation risk (e.g., if a single component represents a large portion of the group, there likely may be less aggregation risk across the remaining components. While this scenario may reduce aggregation risk at the remaining components, this structure may increase the significance of misstatements in the component to the group financial statements when the component represents a large portion of the group).” We believe this wording helps better link the concept of aggregation risk with the scoping decisions made in the revised approach to scoping a group audit.

Finally, we support the new definition of aggregation risk; however, while aggregation risk is increased in a group audit, this concept applies to all audits, as indicated in paragraph A11 of ED-600. We suggest the IAASB considers including conforming and consequential amendments to other foundational standards such as ISA 320 (to align the definition of performance materiality and include aggregation risk) and in ISA 450 (to introduce the concept of aggregation risk).

## Equity investees

ED-600 does not address performance materiality and threshold for communicating misstatements for equity investees. We suggest the IAASB considers including additional guidance in the application material

or clarify how the considerations indicated in paragraphs A73-A77 apply to equity investees. While ED-600 includes the helpful clarification that equity investees are within the scope of the standard, we would welcome further guidance on acceptable audit practice for such investments. In some instances, associates' financial information can be significantly larger than the group. In practice, when determining performance materiality and threshold for identifying misstatements, we consider the group's percentage of ownership in the associate to avoid resulting in a component performance materiality that is disproportionately small for the equity investee entity. Also refer to Question 12.

## GT

We are supportive of the introduction and definition of aggregation risk into ED-600. We are of the view that this is particularly helpful when dealing with audits of the financial statements of groups where the group comprises very few components. In such circumstances, the introduction of aggregation risk allows for greater use of professional judgment in determining what would be an appropriate component performance materiality.

We note that one of the issues with extant ISA 600 was identified as being the determination of component [performance] materiality itself. We are not convinced that the proposals in ED-600 have solved this issue. We recommend that application material, or at a minimum, implementation guidance be included to provide guidance on the application of performance materiality in certain situations such as:

Determining component performance materiality when, as a result of the risk-based scoping, the group engagement team requests that audit procedures are only performed on one or a few financial statement line items at a component, where the nature, timing and extent of the procedures performed are determined by the component auditor.

Determining performance materiality, if any, when specified procedures only, as determined by the group engagement team, are performed at a component.

In relation to the increased judgment introduced by aggregation risk, a 'framework' of factors to consider in exercising that judgment. This may also reduce inconsistencies that may be experienced due to differences in the tolerance for risk across different firms.

In circumstances where audit procedures are being conducted on aggregated component financial information, the appropriate level of materiality to be used, including whether the use of group materiality remains permissible when performing analytical procedures.

We also recommend incorporating into paragraph A73 that the determination of component performance materiality takes into account both quantitative and qualitative factors; and that there may be circumstances where components within the group have been identified but for which a component performance materiality is not required.

## KPMG

We acknowledge the Board's efforts to provide greater clarity regarding the application of "component materiality" and "component performance materiality". In this context, we support the new definition of "aggregation risk", together with the application material at A75 that describes factors that may affect the setting of component performance materiality, including greater disaggregation of classes of transactions, account balances and disclosures across multiple components.

We understand the rationale for communication of component performance materiality rather than component materiality to the component auditor when the scope of work requested of the component auditor is of the nature of specified audit procedures. However, this approach may present challenges when a component auditor is requested to perform an audit of the component's financial information, or an audit of account balances, classes of transactions or disclosures, as the group engagement team may need to communicate component materiality in such circumstances. We recommend, therefore, that the ED also include a requirement to communicate, or consider the need to communicate, both component materiality and performance materiality in this situation.

## MAZ

Regarding the aggregation risk, the concept of aggregation risk is appropriate but the guidance as to how to assess aggregation risk is limited. We would encourage additional application guidance including examples to illustrate the concept.

Related to component performance materiality, we note that the concept of component materiality is not included in the ED. However, as noted in paragraph 44 (h), the group engagement team may request the "component auditor's overall findings, conclusions or opinion". We have concern as to the ability of the component auditor to provide a conclusion or opinion without having a materiality level to assess the potential for undiscovered audit differences in excess of known adjustments, that could aggregate an amount up to component performance materiality. We believe additional guidance on this topic would be beneficial to the component auditors.

Regarding the clearly trivial threshold (CTT), it is stated in paragraph 29 b that the CTT for the component financial information shall not exceed the CTT at group level. We believe that to manage the risk of aggregation, the CTT should be lower at component level and not equal to the group CTT as mentioned in paragraph A77.

Example: it can happen that the CTT given by the group auditor to the component auditor is so high in relation to the quantitative significance of the component that the likelihood of identifying an adjustment to report to the group auditors is near zero, thus potentially leading to less rigorous audit procedures. We have even observed CTT set above the component performance materiality.

In the post-implementation review of clarified ISA, there was a request to have more guidance on the calculation of component materiality as there many different practices observed. We believe that application guidance to calculate the performance component materiality is needed to ensure some consistency and increase audit quality.

## MAZUSA

We support the Board's intent in ED-600 to clarify how the concepts of materiality and aggregation risk apply in a group audit. We agree with the definition of aggregation risk in paragraph 9(a) of ED-600.

We support the Board's focus on component performance materiality. However, we note that the concept of component materiality is not included in the ED-600. Given the lack of a definition of component materiality, we have concern as to the ability of the component auditor to provide a conclusion or opinion, as suggested in paragraph 44(h), without having a materiality level to assess the potential for undiscovered audit differences in excess of known adjustments, that could aggregate up to or exceed component performance materiality. We believe that the concept of component materiality, which would be communicated to the component auditors, would be essential to the component auditors in determining their conclusion or

opinion. We recommend that the Board consider further guidance be provided in the materiality application material section.

## **MGN**

We do support the focus on component performance materiality. However we have concerns that the practical aspects of the proposed requirements could be challenging for some auditors particularly in circumstances where business components are disaggregated.

We would welcome additional implementation and practical guidance in the interests of consistency and to reduce or avoid circumstances where the auditor's judgement may be too broad. We would welcome specific examples provided in the application material, in this instance. While we recognise that there could be a crossover with methodology and tools, we do think that in this instance, specific guidance would be appropriate.

We would also welcome additional implementation and practical guidance to address circumstances where there are many subsidiaries, but a very homogenous group structure where there are no material balances or major risks across the entire group – these circumstances might be found in non-complex or less complex group situations and absent specific guidance, they could prove more challenging than more obviously problematic situations in more complex groups.

## **MNP**

Yes, we support the focus on component performance materiality and the additional application material. However, professional judgement will be required by audit firms to determine audit methodologies related to the calculation of component performance materiality and we believe that implementation guidance regarding the determination of component performance materiality would be helpful in ensuring consistency.

## **NEXIA**

### **HONG KONG**

#### **Component materiality**

- The ED600 (Revised) has removed the definition of “component materiality” but commented that “component performance materiality” being used as the materiality amount in planning and performing audit procedures on the disaggregated financial information of a component for purposes of the group audit.
- In the absence of a component materiality, it would be uncertain how a component auditor will report the work to a group auditor based on the performance materiality. It would be helpful to provide some guidance on the reporting by the component auditors to the group auditor.

## **PKF**

We do support the focus in ED-600 on component materiality, including the additional application material that has been included on aggregation risk and factors to consider when determining component performance materiality.

As mentioned in our response to question 6, we believe that it is important to define financial information, especially in the context of the revised definition of a component. If the group engagement team performs risk assessment procedures based on location, function, or activity, the form and content of financial information might not be easily obtainable as it might differ from the legal structure or accounts preparation

structure. In cases like these, the auditor might experience difficulty in determining component materiality and component performance materiality. This challenge might deter the group engagement team from following a truly risk-based approach.

In addition, any education material regarding the determination of both group and component materiality will be welcomed. Further, the taskforce should consider the extrapolation consequences when misstatements are identified based on component financial information based on location, function, or activity either as application guidance or via reference to the relevant requirements of ISA 530.

## PwC

Broadly yes. As with risk assessment, the determination of an appropriate component performance materiality may require the involvement of the component auditor to determine what would be an appropriate judgement by the group engagement team, taking into consideration the component auditor's in-depth knowledge of the component and potential sources of misstatement of the group financial statements at the component level. We believe the application material could also be expanded in order to consider the interaction between component performance materiality and statutory audit performance materiality, where relevant.

We note that when a component auditor is requested to perform an audit of the complete financial information of a component, some may believe it is important to audit quality and accountability at the component level for component auditors to form an audit opinion on that information. In such cases there will be a need for the group engagement team, or component auditor, to determine an overall materiality for the component financial information as a whole. This concept could be reflected in application material.

With a greater likelihood of more requests by group engagement teams for audits of one or more account balances, classes of transactions or disclosures in a component's financial information, additional questions might be anticipated in relation to methodology for determining an appropriate performance materiality to allocate to such components. This is an area where the IAASB may further benefit from outreach with academics with experience in aggregation risk in order to develop application material on the subject.

## RSM

Yes, we support the focus on component performance materiality. We believe this reinforces professional judgment and the application of a risk-based approach to group audits. The links to ISA 320 and ISA 450 are clear.

The application material on aggregation risk is much clearer than in extant ISA 600 and is consistent with the risk-based approach in ED-600. However, we believe that implementation guidance that provides examples of the risk-based response to different scenarios related to aggregation risk would be helpful.

## 6. Public Sector Organizations

### AGA

Yes, I agree that ED-600 should focus on component materiality. I encourage the IAASB to add more focus and clarity to ED-600. Specifically, ED-600 does not provide any guidance on how to calculate component materiality and states the "amount shall be lower than group performance materiality" and "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 the component performance materiality amounts may exceed group performance materiality." This creates a significant range in ED-600 compliant

component materiality possibilities. For example, one firm may use the group performance materiality as component materiality as their general methodology. A second firm may calculate materiality for components as if they were separate entities, using standard materiality methodologies (0.5-1% of total revenues, 0.5-1% of total expenses or 1-5% of net income). A third firm may determine component materiality as a percentage of group performance materiality (e.g. 50-70% of group PM). These methods vary significantly and would result in a range of component materiality. Materiality should be clear to users and this principle should also apply to component materiality. Users should be able to anticipate the level of materiality used by the auditor as this is critical in the users understanding of the financial statements and auditor's report. I encourage the IAASB to not only include the maximum component materiality amount, but to also include within the application guidance how to calculate component materiality and calculate an aggregate component materiality. This will add clarity to auditors applying ED-600 and increase understanding for the users of group financial statements, e.g. when immaterial errors are found, it will decrease the question – why didn't the auditor find that?

### AGC

Yes, we support the focus in ISA-600 (Revised) on component performance materiality including the additional application material. However, we believe that reference to the materiality at the group level should also remain. The extant ISA 600, paragraph 21 (a) includes the following “ The group engagement team shall determine the materiality for the group financial statements as a whole when establishing the overall group audit strategy”. This establishes a strong linkage with ISA 320 for materiality at the group level.

Since components are not based on legal entities or business units anymore, determining the materiality at the component level may be challenging. In some instances, a group audit could have 2 components based on location, one shared service and two activities. Since the nature of these components could be quite different, it may be challenging to develop a methodology to allocate materiality at the component level. Consistency in how to allocate the materiality will also be an issue within firms. We think the standard could include more application material in this regard.

### AGM

Yes, we agree with the emphasis on the materiality level for the component level work.

We also agree with additional application material as for the aggregation risk.

However, we believe these details are not satisfactory. We understand that the intent was to bring additional indications on this concept. Although a definition of the aggregation risk was added, we believe that the goal was not achieved.

Indeed, paragraph A11 of ED-600 specifies that it is particularly important to understand the aggregation risk and to reply in a group audit engagement, without giving more explanation on the application of this concept in keeping with the materiality level.

We believe that the understanding of these concepts and their interrelation are not that simple. In our opinion, the application material should be improved in order to give practical examples.

### AGO

We encourage the IAASB to provide implementation guidance to assist auditors in calculating the appropriate level of component materiality. As proposed, auditors must set component materiality at a level lower than materiality for the group financial statements as a whole, but component materiality may be set

such that the aggregate of component materiality exceeds group materiality. This guidance allows for a wide range of possible solutions and in and of itself, does not take into account that the risk of undetected misstatement increases as the number of components increase. As component materiality is a key consideration in establishing the overall audit strategy and addressing the risk of material misstatement in the group audit, implementation guidance would be a valuable tool in addressing the requirement of ISA 600.

## 7. Member Bodies and Other Professional Organizations

### AE

Yes, we support the focus on component performance materiality. The relationship between the group materiality and component performance materiality is one of the areas which would benefit from implementation support.

### CAANZ-ACCA

We support the focus of ED-600 on component materiality. However, we do note that since this section introduces new complex concepts, more guidance and implementation assistance will be needed to assist practitioners.

Determining component materiality appears to be complex for firms under the extant standard. Feedback we received suggests that many firms have adopted or developed a framework based on a paper by Glover et al and that, even with standardised frameworks in place, a lot of work effort on the part of the team goes into this determination. The new concepts and approach appear to be even more complex and suggest the need for of a developed framework in order to achieve consistency across firms, networks and the wider audit profession overall.

### CaICPA

Yes we support this focus and we would like to see additional application material with respect to aggregation risk. For example, there may be mathematical techniques that are appropriate and available such as the “square root of the sum of the squares” method for allocating materiality.

### CAQ

We support the Board’s intent in ED-600 to clarify how the concepts of materiality and aggregation risk apply in a group audit. We also support the Board’s inclusion of a definition of aggregation risk in paragraph 9(a) of ED-600.

We suggest that the Board consider providing examples of how the Board intends for aggregation risk to be applied to different scenarios through implementation guidance. We believe that such guidance would be helpful to practitioners and would limit diversity in practice.

### EFAA

We have some concerns.

While we support the revised approach to determining component performance materiality and the corresponding application material, we believe more guidance, perhaps in the form of a staff publication might be useful. We also believe that performance materiality for transaction classes and so on is overly complicated.

## FAR

In general, FAR supports the response submitted by the Nordic Federation of Public Accountants and FAR therefore refers to this response.

## IBRACON

Yes, we support the focus on component performance materiality and the additional application material including guidance on aggregation risk and factors to consider in determining component performance materiality. However, we believe that the application material could be improved by providing more details and clarity around component performance materiality particularly around the example about disaggregation in paragraph A75, which is not defined as aggregation risk.

In addition, ED-600 does not address performance materiality for communicating misstatements for equity investees. Thus, we would welcome further guidance on acceptable audit practice for such investments.

## ICAEW

We support the focus on component performance materiality taken in ED-600. We expect the application of the requirements in ED-600 in this area will prove challenging for group engagement teams, particularly given the change in definition of a component. The practical challenges relate more to how ISA 320 is applied in these circumstances as opposed to the requirements in ED-600 and we would encourage IAASB to consider whether these issues could be addressed through the development of worked examples or other additional resources to help support implementation.

Yes, we support the focus on component performance materiality. We anticipate that the application of the requirements in ED-600 in this area could prove challenging for group engagement teams, particularly given the change in the definition of a component and where there is a requirement of local law or regulation to perform audits at an entity level. The practical challenges relate more to how ISA 320 is applied in these circumstances than to the requirements in ED-600 and IAASB should consider whether these issues could be addressed through the development of worked examples or other guidance to support implementation.

Worked examples could also usefully help to emphasise the importance of the group engagement team using their professional judgement when determining materiality, that materiality is not solely a calculation but is determined by considering the specific circumstances of the group and user expectations.

## ICAS

We are supportive of this approach and the additional application material on aggregation risk and factors to consider in determining performance materiality. We believe that there would be benefit in implementation support being provided in relation to the relationship between group performance materiality and component performance materiality.

## ICPAS

Response: We believe the introduction section of the ED seems to provide more detailed information about aggregation risk than the standard (Explanatory Material Section 2-H Materiality - Aggregation Risk #79; ED 600 – Definitions #9a Aggregation Risk and related Application Material - A11; Application Material – paragraph A75). We believe more examples of where aggregation risk may be present and addressing qualitative considerations in addition to quantitative considerations would be helpful.

## IIA

The IIA also supports the changes to strengthen the latitude holding companies have had regarding materiality and how they decide what is and isn't important to audit in terms of business units, classes of transactions, etc. The changes take away the ability of auditors to say errors are "clearly trivial."

Yes, although more specific guidance (and perhaps examples) of aggregating risk should be discussed. For financial services firms, BCBS 239 helps with understanding how to aggregate risk information, but this generally is something all companies struggle to do correctly.

## IMCP

Yes, however, certain responsibility should be assigned to the component auditor regarding whether the materiality assigned allows the practitioner to issue an audit report. For example, the materiality assigned may seem to be excessive at the component level where the component auditor practically does not carry out audit procedures or, in contrary, the materiality might appear to be low, therefore the component may be forced to perform audit procedures in excess (over-audit).

## IPA

We support the introduction of the concept of performance materiality. However, the guidance at A73 and A74 is confusing. The last sentence of A73 states 'However, this ISA does not require a different component materiality to be established for each class of transaction, account balance or disclosure for a component' but A74 then describes when a different component performance materiality is required. The IAASB should modify the wording of A73 to better reflect the content in A74.

The IAASB should also address materiality considerations where an audit component may be required to produce separate financial statements. We aware of this is an issue for practitioners and there is diversity in practice.

While we support the approach taken to component materiality, we are aware of much confusion in practice between overall materiality, performance materiality and transaction/account-based materiality and their relationship with IASB accounting materiality. In particular, we note in determining performance materiality many auditors are using a standard "hair-cut" (say 15%) in determining performance materiality.

## ISCA

In setting component materiality, the benchmark that is used (such as group assets, revenue or profit, etc) may differ between components depending on their function or nature of activities. However, it is sometimes observed that this is not considered by GETs and a consistent benchmark is applied across all components, resulting in the component materiality set not cognizant with the risk of the component. It may be worthwhile to highlight this under A75 of the application material.

We are also of the view that the requirements in regard to aggregation risk is not sufficiently clear in the application material, in particular paragraph A11. It would be quite difficult for practitioners to understand and apply the concept in practice based on the broad principles-based guidance in the ED.

We are aware that some firms are using models such as the Maximum Aggregate Component Materiality (MACM) to perform a high-level reasonableness check. More practical guidance would be required in this area for practitioners to properly address this risk.

We suggest for the standard to include a requirement to communicate, or consider the need to communicate, component materiality when the component auditor is requested to perform:

- An audit of component financial information; or
- An audit of an account balance, significant class of transaction, or disclosure

#### KICPA

We support the focus on component performance materiality taking the risk-based approach, since the management of the total risks in audits of group financial statements is highly likely to be practically conducted in the audit procedures, related with classes of transactions, account balances and disclosures. In addition, we are also for the additional application material on what needs to be considered to support auditors make a judgment on the total risks and component performance materiality, taking into account the characteristics of the respective groups.

However, we concern that ISAs do not provide methods on how to measure materiality, thereby allowing accounting firms to apply their own materiality measurement methods, which ended up with huge differences in the amount of materiality among accounting firms, being likely to create problems in the review of audit quality. As discussed in the webinar on August 13th, it would be more useful for the Board to provide various examples to support auditors measure materiality, based on their professional judgments on a component type basis (location, function or activity) and on a business type basis (e.g., component in which revenues matter, component in which assets matter), by including the measurement method to the principle based guidance, related with the total risks and the measurement of the component performance materiality.

#### MICPA

We support the proposal. However, we believe the application material could be improved by providing additional guidance and clarity on component performance materiality in view of the disaggregation example in Paragraph A75 of the proposed ISA 600 (Revised).

With the elimination of the significant component concept, there may be challenges in determining performance materiality of the components. The determination of an appropriate component performance materiality may also require the involvement of the component auditor.

More clarification in situations involving joint ventures, associate and shared service centers are required to provide guidance for group engagement teams on component materiality considerations.

#### NRF

Yes, we support this, but we also believe that this is an area that could benefit from implementation support.

#### NYSSCPA

Component performance materiality is a useful auditing concept grounded in statistical theory. We endorse this concept as proposed, but believe it should be made clear that, although maximum levels are established by the group auditor, they must be accepted by the component auditor(s).

Allocation of materiality to assets/assertions/tests has been in use by auditors for many years in establishing the scope of their procedures; and may be used in misstatement evaluation when statistical sampling drives primary tests, and the decisions encompassing the evaluation of sufficiency of evidence.

We believe the Board should provide some quantitative guidance to practitioners to be able to use materiality allocations efficiently and effectively. We know that the large international auditing firms provide this guidance in their practice aids, which may involve the use of the “square root of the sum of the squares.” This method is one such application which can be easily applied through a computerized model. We understand the Board’s reluctance to depart from a principles-based model, but, in this case, we think the benefit will be helpful to many auditors. The base used in the squaring exercise would contain all components in the consolidated group including unaudited components, components for which audit procedures are applied only to certain selected accounts or assertions, and components only subject to review procedures. The practical effect of this method would be to provide for an efficient and effective allocation of materiality based on the quantitative significance of the components.

## SAICA

SAICA welcomes the guidance on materiality, including the definition of aggregation risk. This is an area that can be complex in the context of group audits. Due to the complex nature of materiality in group audits, further enhancements can be made to ED-600 to clarify some of the complexities which are discussed below.

ED-600 has removed the explicit reference to component materiality and focuses specifically on component performance materiality. SAICA’s understanding is that this has been done to emphasise the point that under the risk-based approach, in a group engagement the focus should not be on significant components, and component performance materiality is determined by the group engagement team for the purposes of performing audit procedures on disaggregated component financial information. Determining materiality in group audit engagements is distinct from the situation where the component auditor applies ISA 320, Materiality in Planning and Performing an Audit, to determine materiality for the standalone financial statements of a component and has the users of the financial statements in mind. Further guidance should be included in the application paragraphs to emphasise these two concepts. SAICA does not believe that removing “component materiality” is the correct approach to addressing this complexity and the term could be left in ISA-600 without detracting from the point being made.

Another scenario that requires further guidance in ED-600 is the situation where a component represents a significant equity investment where the group does not exercise control over the investee. The component could be larger than the group in terms of revenue, profit before tax and other applicable benchmarks and the materiality used by the component auditor could be significantly larger than the group materiality. This could have the effect that the audit procedures performed by the component auditors may not be sufficient for purposes of the group engagement. ED-600 should give guidance to the group engagement team in such scenario and the possible options that the group engagement team has to address the differences in materiality.

## SMPAG

Component performance materiality (CPM) is an important element of a risk-based audit approach. The SMPAG is of the view that the application material that has been included on aggregation risk and factors to consider in determining CPM is generally adequate.

As outlined above, there are some practitioners who believe that there is a potential issue resulting from the proposed deletion of the requirement in extant ISA 600 for an audit in respect of the financial information of a significant component. Without an appropriate replacement mechanism for the performance materiality at a significant component, they have suggested the risk of material misstatement at group level may not be

adequately addressed, particularly when the GET might lack some of the necessary information to be sufficiently familiar with the significant component's risk profile.

Nevertheless, in other cases practitioners support the revised approach and believe that it will build consistency in considerations for determining CPM, although there are calls for the Board to provide more practical examples on how CPM is calculated within a complex group structure and its co-relation with group performance materiality used by the GET that will address the group's aggregation risk during the consolidation process. This could be in the form of a separate staff publication.

## SRO AAS

Consideration should be given to developing a guide with examples on calculating the materiality of components in various circumstances, such as when only certain items of a component's financial information are audited (para 29 of Draft 600).

The correct approach is to provide an explanation of the aggregation risk of misstatements. However, corresponding amendments should be made to other fundamental standards and the aggregation risk of misstatements concept should be included in the risk-based approach (instead of including it only in the analysis of performance materiality).

## 8. Academics

### LI

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.

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."

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

While we appreciate these two definitions (and our suggestions to strengthen it), we believe the broader concept that "aggregation risk increases as the number of components increases 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.

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.

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

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

In 9(m) group performance materiality is defined. We find it difficult to explain the role of the threshold function that group performance materiality has and how it relates to group 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

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

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:

Component performance materiality. To address aggregation risk, such amount shall be lower than group performance materiality. (Ref: Para. A73–A76)

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.”

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.

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”.

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.

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

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.

## Aggregation Risk considerations

Current definitions need improvement

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.”

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 Additionally, we appreciate the Paper’s explicit emphasis on Performance Materiality and aggregation risk.

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.

## **Q10 – Disagree**

### **9. Individuals and Others**

#### **VERA**

Para. 9a) - The term «probability» in the definition of aggregation risk seems inappropriate as risks could be defined not only by terms of probability theory.

«Aggregation risk» is a new category which does not realize any specific sense and practically does not differ from the definition of audit risk. So, to my view this category should be excluded.

When components are identified the term «Group performance materiality» seems meaningless.

The category «aggregation risk» seems excessive and does not contain any special considerations in addition to audit risk (See below).

## **Q10 – No Comment**

### **3. Regulators and Audit Oversight Authorities**

#### **CSA**

No Comment

#### **MAOB**

No Comment

### **4. National Auditing Standard Setters**

#### **AICPA**

No comment

#### **ICAI**

No Comment

## 7. Member Bodies and Other Professional Organizations

### WPK

No comment.

## 8. Academics

### AFAANZ

No comment

### GRAHAM

No Comment

In 2008 the Journal of Accountancy (US) published a practice-oriented paper entitled Component Materiality for Group Audits. The approach in this paper was to allocate group materiality to major components that would be receiving auditing procedures. It was assumed that components not receiving audit procedures were of lesser value such that analytical procedures would provide sufficient evidence. While helpful in the circumstance where a few major components comprised the entity, the more difficult problem of how many components should be selected for the application of audit procedures was not addressed. However, these two approaches are not mutually exclusive, but can be applied together.

I urge the Committee to consider for inclusion in its scoping guidance at least some of the factors and structure identified in these studies for auditor consideration when faced with planning engagements where the components cannot logically be considered as a single unit.

## 9. Individuals and Others

### PITT

No Comment