

IAASB CAG REFERENCE PAPER

IAASB CAG Agenda (September 2007)

Agenda Item M.1

Service Organizations – Cover Memorandum – September 2007 IAASB Agenda Item 10

Service Organizations – ISAE 3402

Objectives of Agenda Item

1. To review the “first read” draft ISAE 3402, “Assurance on a Service Organization’s Controls,” and provide guidance on a number of issues identified by the task force.

Task Force Composition

2. The task force comprises
 - George Tucker, Chair, former IAASB Technical Advisor, Ernst & Young, USA, and Member ISA 402 task force
 - Romek Lubaczewski, PwC, Poland
 - Calum Thomson, Deloitte, UK
 - Karsten tom Dieck, KPMG, Germany
 - Rick Wood, Grant Thornton, Canada
 - Denise Esdon, Deputy Chair, IAASB, Ernst & Young Global, UK, and Chair ISA 402 task force
 - Correspondence member: Claire Grayston, AUASB, Australia

Background

3. This project, although separate from the project to revise proposed ISA 402 (Revised and Redrafted), “Audit Considerations Relating to an Entity Using a Third Party Service Organization,” is closely linked to that project. Proposed ISA 402 (Revised and Redrafted) addresses the considerations of user auditors, i.e., auditors who audit the financial statements of an entity that uses a service organization. ISAE 3402 provides guidance to service auditors, i.e., auditors who issue assurance reports on controls at a service organization that could be relevant to the audits of user entities’ financial statements.
4. At its March 2006 (Hong Kong) meeting, the IAASB approved the project proposal to develop ISAE 3402. An issues paper was discussed at the IAASB’s September 2006 (Montréal) meeting, and a further issues paper (including a preliminary draft Introduction and Requirements sections for ISAE 3402) were discussed at the April 2007 (Sydney) meeting. Since that time, the ISAE 3402 task force has held two physical meetings and a number of conference calls.

Matters Agreed at Prior Meetings

5. Based on agreement reached at previous IAASB discussions of this topic, the task force has prepared the attached draft of ISAE 3402 which:

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- (a) Complements proposed ISA 402 (Revised and Redrafted), in that reports prepared in accordance with ISAE 3402 are capable of providing appropriate evidence under proposed ISA 402 (Revised and Redrafted).
- (b) Defines a service organization as an organization (or segment of an organization) that provides services to user entities that are part of the entities' information system relevant to financial reporting.
- (c) Is drafted in terms of "one-to-many" situations, i.e. where one service organization has many customers (user entities), and each user entity and its financial statement auditor will receive a copy of (a) the description of the system, control objectives and related controls prepared by the service organization, and (b) the service auditor's assurance report. It can be applied, however, to "one-to-one" situations.
- (d) Assumes a direct relationship between user entities and user auditors, and between service organizations and service auditors, but does not assume any direct relationship between the service auditor and either user entities or user auditors. Therefore, the service auditor may not know the specific needs of user entities or user auditors.
- (e) Requires adherence to ISAE 3000, "Assurance Engagements Other than Audits or Reviews of Historical Financial Information" as well as ISAE 3402. Only ISAE 3402 is cited in the assurance report.
- (f) Like ISAE 3000, is written to address entire engagements, i.e., from engagement acceptance to reporting, which is different from ISAs which deal only with one aspect of an audit engagement.
- (g) Is written in the clarity format, follows the structure of ISAE 3000, and does not repeat material covered in the International Framework for Assurance Engagements (the Framework) or ISAE 3000 unless there is a service organization-specific perspective that needs to be addressed.
- (h) Includes key concepts, suitably adapted, from ISAs that are relevant to service organization engagements when those concepts are not adequately covered in ISAE 3000, rather than merely citing those ISAs.
- (i) Is drafted in terms of financial reporting controls but notes that it "may also be applied, adapted as necessary in the circumstances of the engagement, for engagements to report on other controls at third party organizations."
- (j) Is drafted in terms of assertion-based engagements (i.e., where the service organization's assertions about (i) the fair presentation of the description, (ii) the suitability of design, and (iii) in the case of a Type B engagement, the effectiveness of controls, is included as part of the package provided to user entities). It is silent on direct reporting engagements. Therefore, while direct reporting engagements may be performed, they would not be "3402"

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engagements.

- (k) Provides generic example wording for a service organization's assertions, recognizing that exact wording cannot be prescribed because it can vary with the circumstances. The service organization's assertions are included as part of the package with the description of the system, control objectives and related controls.
- (l) Requires the wording of the assurance opinion to be expressed directly in terms of the subject matter (rather than in terms of the assertion).
- (m) Is drafted in terms of "reasonable assurance" engagements, consistent with the evidence requirements of proposed ISA 402 (Revised and Redrafted). It is silent on "limited assurance" engagements. Therefore, while limited assurance engagements may be performed, they would not be "3402" engagements.
- (n) Is drafted with a preference for Type B reports (description, design and operating effectiveness of controls), but also covers Type A reports (description and design of controls).
- (o) Is drafted in terms of Type B reports that are for a period of time and Type A reports that are "as at" a point in time (see Issues Paper also).
- (p) Requires a description of the tests of controls that the auditor performed to be included in a Type B report.
- (q) Includes an appendix with limited example control objectives to illustrate the level at which such objectives should be set.
- (r) Allows either the carve-out method or the inclusive method to be used for controls over activities performed by a subservice organization.

Issues

- 6. In addition to reviewing the draft at Agenda Item 10-A, the IAASB's input is sought on the following issues, which are discussed in Agenda Item 10-B:
 - A. The Framework and ISAE 3000
 - B. Criteria
 - C. The service auditor's report
 - D. Independence
 - E. Modified opinions
 - F. Type A reports
 - G. Disclosure of sample sizes
 - H. Complementary controls

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- I. Link with ISAE 3000 and the ISAs
- J. Scope of the engagement

Approach to Discussion

7. IAASB members and Technical Advisors are asked to forward any editorial comments they may have to the task force chair and staff prior to the meeting to allow the discussion in Madrid to focus on substantive issues arising from the draft ISAE.

Material Presented

Agenda Item 10-A First Read Draft of ISAE 3402
(Pages 2843 – 2876)

Agenda Item 10-B Issues Paper
(Pages 2877 – 2884)

Action Requested

The IAASB is asked to review the draft ISAE 3402 at Agenda Item 10-A, and provide direction to the task force on the issues raised in Agenda Item 10-B.