



Committee: IAASB Consultative Advisory Group

Meeting Location: Dubai

Meeting Date: March 9 – 10, 2009

Report Back—Service Organizations – ISA 402 (Revised and Redrafted)

Objective of Agenda Item

1. The objective of this Agenda Item is to provide a brief report back on proposals of Representatives on proposed ISA 402 (Revised and Redrafted), “Audit Considerations Relating to an Entity Using a Third-Party Service Organization,” discussed at the September 4-5, 2008 CAG Meeting.

The IAASB approved the proposed ISA as a final standard at its December 8-11, 2008 meeting.

September 4 - 5, 2008 CAG Proposals

Shared Service Centers

2. With regard to shared service centers, in advance of the IAASB meeting, the Task Force had further considered wording to address the applicability of the ISA to shared service centers, including the suggestions of the CAG Representatives. The Representatives had previously commented on:
 - The specific wording that should be used in the ISA to describe to which circumstances the ISA could be described, including concerns over whether the ISA would require an auditor to adapt ISA 402 (Revised and Redrafted) in all cases when a shared service center was used; and
 - Concerns over whether the linkage with ISA 600 (Revised and Redrafted)¹ was adequately described in the ISA in the context of shared service centers.

As the decision of the IAASB on shared service centers, as noted in paragraph 4, supercedes the discussion of the CAG, the details of the discussion in the CAG on this area of the topic have not been reproduced in this paper.

3. Some IAASB members were of the view that the inclusion of a single paragraph to address a complex situation (as evidenced by the divergent views of the respondents to the exposure draft and the views of the CAG Representatives) was likely to result in more divergence in

¹ ISA 600 (Revised and Redrafted), “Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors).”

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practice and was not seen to be useful. For example, some IAASB members thought that the reference to statutory audits only was too limiting. There was also a concern, similar to the views of some CAG Representatives that any reference to the ISA's applicability to shared service centers may promote the ISA as being more useful than it actually will be in practice, since there are many other issues specific to shared service centers that are not specifically addressed in the ISA.

4. As a result of the deliberations and mixed views on the content of any reference to shared service centers, the IAASB agreed that the paragraph relating to the applicability of the ISA to shared service centers should be deleted. It was suggested that this matter could be a topic for a separate project in the future.

Report Back on Other Matters

5. Below is an extract from the draft minutes of the September 2008 CAG meeting² and an indication of how the IAASB Task Force or the IAASB responded to the Representatives' comments.

Representatives' Comments	Task Force/IAASB Response
SMALLER ENTITIES AND THE PERCEIVED EMPHASIS OF THE ISA ON THE USE OF TYPE A AND TYPE B REPORTS	
Ms. Koski-Grafer suggested that the concept of "sufficient appropriate audit evidence" needs to be introduced in relation to the user auditor's use of a Type A or Type B report. She noted that IOSCO was concerned that the ISA could imply that when a Type A or Type B report is available, no further work is necessary by the user auditor.	<p>Point taken into account.</p> <p>After some debate, the IAASB concluded it was not necessary to explicitly state that a Type A or Type B report is not likely to constitute sufficient appropriate audit evidence, as this is a matter for judgment by the auditor having applied the requirements of the ISA. Within the final ISA, the requirements relating to using a Type A or Type B report as audit evidence to support the user auditor's understanding about the design and implementation of controls at the service organization (paragraph 14) and using a Type B report as audit evidence that controls at the service organization are operating effectively (paragraph 17) state that the auditor shall perform specific additional procedures, rather than accepting solely a Type A or Type B report as audit evidence. These procedures include reviewing the time period covered by the</p>

² The minutes will be approved at the March 2009 IAASB CAG meeting.

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Representatives' Comments	Task Force/IAASB Response
	<p>reports, whether there are complementary user entity controls that must be in place for the service organization's controls to operate effectively and, in the case of a Type B report, evaluating the tests of controls described in the report to determine whether these provide sufficient appropriate audit evidence to support the user auditor's risk assessment.</p> <p><i>See paragraph 14 and 17 of Updated Agenda Item 5-C for the text of the ISA as approved by the IAASB.</i></p>
<p>Mr. Pickeur was of the view that the Appendix is hard to translate and that the terms used are not globally accepted terms.</p>	<p>Point accepted.</p> <p>The IAASB noted that a few respondents to the exposure draft had similar views. After some debate, the IAASB agreed that the Appendix should be deleted, as it would be difficult to find more generic terms and that any such terms could become obsolete in the changing environment.</p>
<p>Mr. Diomeda requested that the Task Force include a specific paragraph within the ISA to note that obtaining a Type A or Type B report in an SME context would likely lead to significant costs. He thought further guidance could be included to indicate how an auditor of an SME could fulfill the requirements of the ISA without doing a burdensome amount of work.</p>	<p>Point taken into account.</p> <p>During the CAG meeting, Ms. Esdon noted the ISA has attempted to more clearly highlight these SME issues; she stated, however, that she did not believe it was appropriate for the ISA to lessen the requirements for SME auditors. The IAASB concurred with this view.</p> <p>It was not the intent of the IAASB in revising the ISA to suggest that a Type A or Type B report was required whenever a service organization was used, recognizing, however, that extant ISA 402 dealt primarily with the auditor's use of such reports.</p> <p>From the user auditor's perspective, the fact that a Type A or Type B report is available assists the auditor in performing risk assessments. However, if a Type A or Type B report is not available, the user auditor then has to obtain information from other sources to perform the risk assessments.</p> <p>To Mr. Diomeda's point, in attempting to ensure the</p>

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	<p>requirements of the ISA are appropriate for entities of all sizes, the IAASB did, however, agree to include more guidance to note the context in which certain procedures may be performed. The ISA now states that Type A and Type B reports are only to be obtained “if available,” and related application and other explanatory material now indicates that it may not always be possible or practicable for a user auditor to obtain a Type A or Type B report. <i>See paragraphs 12 and 16, as well as paragraph A15-A18) of Updated Agenda Item 5-C for the text of the ISA as approved by the IAASB.</i></p>
<p>Mr. Ratnayake drew attention to the fact that the Type B report was more comprehensive than the Type A report, and because of that they should have been named the other way around. However he observed that as the standard has been in use for time it may not be appropriate to rename them at this stage.</p>	<p>The Task Force agreed with Mr. Ratnayake’s observation that renaming would cause confusing among those who had been using reports of service auditors for some time.</p> <p>However, in finalizing the ISA, the IAASB agreed that it would be appropriate to change the terms used in the ISA from Type A and Type B reports to type 1 and type 2 reports, to be consistent with the definitions used in U.S. SAS 70,³ which is most widely used in practice as the basis for preparing a service auditor’s report.</p>
<p>Ms. Sucher expressed difficulty with the phrase “Services provided by a service organization are relevant to the audit of a user entity’s financial statements when those services, and the controls over them, affect the user entity’s information system.” She suggested that the word “affect” might inadvertently result in widening the scope of the ISA.</p>	<p>Point accepted.</p> <p>The IAASB reverted to the original wording of this phrase to avoid confusion. The sentence now reads: “Services provided by a service organization are relevant to the audit of a user entity’s financial statements when those services, and the controls over them, are part of the user entity’s information system, including related business processes, relevant to financial reporting.”</p> <p><i>See paragraph 3 of Updated Agenda Item 5-C for the text of the ISA as approved by the IAASB.</i></p>

³ Statement on Auditing Standards (SAS) 70, “Service Organizations,” as amended.

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<p>Ms. Sucher noted that ISA 620 (Revised and Redrafted) requires the auditor to “evaluate” the competence of an auditor’s expert and questioned why the requirement was not the same in ISA 402 (Revised and Redrafted). She also reiterated the comment by IOSCO that the requirement for the user auditor “to be satisfied” as to the professional competence and independence of the service auditor should be strengthened.</p>	<p>Point not accepted.</p> <p>During the meeting, Ms. Esdon noted that the IAASB considered whether the requirement should be for the auditor to “determine” or “evaluate,” and the Task Force redeliberated this in revising the ISA, and concluded that the phrase “shall be satisfied” was appropriate. She explained that the fundamental difference is that when an auditor is using an auditor’s expert, the auditor has direct access to the expert and can perform more rigorous procedures. When a third-party service organization is used, the user auditor does not have direct contact with the service organization or the service auditor, and so to require the auditor to do something more than what is implied by the requirement “shall be satisfied” would likely result in a user auditor being unable to meet the requirement.</p> <p>The IAASB supported this view, believing that to impose a more stringent requirement on the user auditor might lead to extreme difficulty in practice.</p>
<p>Ms. Sucher noted the issues encountered to date regarding fair value and wondered whether something might be said within ISA 402 (Revised and Redrafted) about pricing services. Mr. Edwards questioned whether a pricing service would be considered a service organization or an auditor’s expert.</p>	<p>Point not accepted.</p> <p>During the meeting, Ms. Esdon noted that the Task Force had considered this point and had inquired of practitioners as to whether there are US SAS 70⁴ reports for financial institutions that deal with pricing services as subservice organizations. In some cases, pricing services are viewed as subservice organizations and there would be scope for discussing them in ISA 402 (Revised and Redrafted). However, in other cases, pricing services are merely a source of information used in preparing a valuation and would not be considered a service organization. She noted the Task Force would consider this matter further in finalizing the ISA.</p> <p>After some debate and further consultation with</p>

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	practitioners in financial services, the IAASB agreed that no reference should be added because of the view that to state in the ISA whether a pricing service is or is not a service organization would remove the important aspect of the auditor's judgment in determining how a pricing service is relevant to the audit of the financial statements of a user entity.

Material Presented – IAASB CAG REFERENCE PAPERS ONLY

Updated Agenda Item 5-C - Final wording of ISA 402 (Revised and Redrafted) as approved by the IAASB in December 2008

<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4433>