



International Federation of Accountants

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Agenda Item

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Committee: IAASB
Meeting Location: Brussels
Meeting Date: December 8-11, 2008

Audit Considerations Relating to an Entity Using a Third-Party Service Organization

Objective of Agenda Item

1. To review and approve as a final standard the proposed ISA 402 (Revised and Redrafted), “Audit Considerations Relating to an Entity Using a Third-Party Service Organization.”

Task Force

2. The members of the Task Force are:
 - Denise Esdon (Chair) – IAASB Deputy Chair
 - Susan Jones – IAASB Member
 - Kjell Larsson – IAASB member (supported by Kelly Ånerud, IAASB technical advisor)
 - Kevin O’Donovan – KPMG, Ireland
 - Jens Poll – Moore Stephens, Germany

Activities since Last IAASB Discussions

3. The significant comments received from the IAASB on the first-read draft (post-exposure) at the September 2008 meeting were considered and a revised draft of the proposed ISA was developed. This revised draft was circulated to the IAASB for comment on October 17, 2008. The Task Force held a conference call in November 2008 to consider the comments received from the IAASB on the revised draft and to finalize the wording of the final draft now being presented.

Comment Letter Received After September 2008 IAASB Meeting

4. The Task Force also considered a comment letter from a respondent (NIVRA) that, due to a technical transmission issue, was received only after the agenda papers for the September 2008 IAASB meeting had already been posted. The Task Force is of the view that the matters raised by this respondent are broadly similar to those that other respondents have raised, and have been appropriately addressed as part of the agenda papers presented for the September meeting.

Main Issues

5. The following summarizes the main issues raised at the September 2008 IAASB meeting and the task force’s preliminary views and recommendations in the light of comments received on the post September revised draft.
 - A. **APPLICABILITY OF THE ISA TO SHARED SERVICE CENTERS**
6. Paragraph 4 of the exposure draft suggested that the ISA could be adapted for shared service centers; respondents were specifically asked for their views on this matter. In revising the ISA to be discussed at the September 2008 IAASB meeting, the Task Force proposed new wording to address the situation in which a component auditor has to issue an opinion on the standalone financial statements of the component, usually a statutory entity, and needs to obtain information about the controls at a shared service center or carry out substantive procedures on financial information held at the shared service center. Some IAASB members thought that the reference to statutory audits only was too limiting. However, there was also a concern, raised by both the IAASB and the IAASB CAG, 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 that are not specifically addressed in the ISA. While there were mixed views as to whether any reference to shared service centers was necessary, it was suggested that the ISA should indicate that it would provide useful guidance.

Task Force Response

7. In the light of the above discussions, the Task Force agreed that the reference to shared service centers could be clarified. The Task Force proposes that the paragraph (now paragraph 4) read as follows:

The focus of this ISA is on a user entity’s use of the services of a third-party service organization, but an auditor may find this ISA useful in situations where a component auditor is engaged to perform an audit of the financial statements of a component who uses the shared services provided by another component, and those services are relevant to the audit of the component’s financial statements.
8. The Task Force had proposed additional wording in the post September revised draft to acknowledge the situation in which an auditor (not a component auditor) is engaged to perform an audit and the auditor’s ability to obtain sufficient appropriate audit evidence is affected by a user entity’s use of a shared service center. Those IAASB members who commented on the post September revised draft were of the view that this example was not helpful, and detracted from the point meant to be expressed. As a result, the Task Force believes it is appropriate to limit the reference to shared service center to the situation described in paragraph 7 above.

Matter for IAASB Consideration

Does the IAASB agree with the Task Force’s recommendation regarding the reference to shared service centers?

B. OTHER MATTERS RAISED BY THE CAG REPRESENTATIVES

9. One CAG Representative believed further emphasis should be placed on the fact that a Type A or Type B report is not likely to constitute sufficient appropriate audit evidence by itself.
10. Another CAG Representative thought the Appendix was difficult to translate and suggested more generic or global terms be used if the Appendix is to be retained. Please note that the language in the Appendix was taken from the U.S. Statement on Auditing Standards No. 70.¹
11. It was also suggested that further guidance be added to discuss whether a pricing service would meet the definition of a service organization, or whether a pricing service was more comparable to an expert.
12. Finally, the question of whether the requirement for the user auditor “to be satisfied as to the service auditor’s professional competence and independence” was sufficiently strong arose during the CAG meeting, in light of the fact that the auditor is required to evaluate the competence of an auditor’s external expert in ISA 620 (Revised and Redrafted).²

Task Force Response

13. With respect to Type A and Type B reports, the Task Force does not believe that it is 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. As currently drafted, 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 15) and using a Type B report as audit evidence that controls at the service organization are operating effectively (paragraph 18) state that the auditor shall perform specific additional procedures, rather than blindly accepting the presence of a Type A or Type B report as evidence. These procedures include reviewing the time period covered by the 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.
14. Further, the related application and other explanatory material explains that a Type A or Type B report may assist the user auditor in obtaining a sufficient understanding of the service organization, and states that additional procedures may need to be performed to update information in a Type A or Type B report when the description of controls is as of a date or for a period that precedes the beginning of the period under audit. With respect to operating effectiveness of controls at the service organization, the nature, timing and extent of tests of controls are to be evaluated to determine whether the Type B report provides sufficient appropriate audit evidence. Finally, appropriate caveats are given that a Type B report may provide less audit evidence the shorter the period covered by the Type B report, and that

¹ Statement on Auditing Standards (SAS) No. 70, “Service Organizations.”

² ISA 620 (Revised and Redrafted), “Using the Work of an Auditor’s Expert.”

additional evidence may also be necessary about significant changes to the relevant controls at the service organization outside of the period covered by the Type B report.

15. With regard to the Appendix, the Task Force agreed that, since it would be difficult to retain what was intended by the descriptions in the Appendix while attempting to use jurisdictional-neutral words, the Appendix should be deleted.
16. The Task Force has considered whether further guidance surrounding pricing services should be included in this ISA. After some debate and consultation with practitioners in financial services, it was agreed that no reference should be added. This is in part because the nature of pricing services differs depending on its relationships with individual clients; for example, a large pricing service may issue a Type B report that can be used by many user auditors, but smaller pricing services might rely on direct coordination with management of an individual user entity to arrive at prices and would not necessarily meet the definition of a service organization. To conclude 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 affects the audit of the financial statements of a user entity.
17. In addition, the Task Force is of the view that sufficient deliberation has been given both by the Task Force and the IAASB to the requirement for the user auditor to be satisfied as to the service auditor's professional competence and independence from the service organization (paragraph 14). The wording in the requirement is appropriate given that the user auditor's access to the service auditor is not the same as when an auditor is using the work of an auditor's expert and has direct access to such an expert. To impose a more stringent requirement on the user auditor might lead to extreme difficulty in practice. The Task Force did conclude, however, that it was important to link in the reference to competency and independence when an other auditor is used, and has done so by linking this to the requirements and guidance in ISA 600 (Revised and Redrafted)³ (see paragraph A19).

Matter for IAASB Consideration

Does the IAASB agree with the proposals outlined above, in particular that:

- The concept of the need for the user auditor to obtain sufficient appropriate audit evidence when a Type A or Type B is clear within the proposed ISA;
- The deletion of the Appendix is appropriate;
- Further guidance on pricing services is not necessary; and
- The wording of the requirement in paragraph 14 continues to be appropriate.

³ ISA 600 (Revised and Redrafted), "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors).

C. SUBSERVICE ORGANIZATIONS

18. One IAASB member noted that, as presented at the September IAASB meeting, the application and other explanatory material surrounding the auditor's actions when a service organization used a subservice organization should be elevated to a requirement. This was in part because of the increasing use of subservice organizations and the fact that if a user auditor is not alert to whether the services of a subservice organization are included or excluded in a Type B report, the user auditor may place undue reliance on the Type B report when in fact it is necessary to perform similar procedures in the ISA in the context of a subservice organization.

Task Force Response

19. The Task Force agreed that it should be more prominent within the ISA that, if a subservice organization is used and the services of this subservice organization are not included in the Type B report received from the service organization, further work will need to be done to obtain sufficient appropriate audit evidence. As such, a proposed new requirement has been included in the post September revised ISA (see paragraph 19). The inclusion of this new conditional requirement avoids the use of the present tense in the application and other explanatory material, and states that the requirements of the ISA apply in that particular circumstance.

Matter for IAASB Consideration

Does the IAASB agree with the proposed new requirement relating to subservice organizations?

D. OTHER CHANGES TO THE ISA AS A RESULT OF COMMENTS RECEIVED

20. The Task Force reviewed all the comments received both at the IAASB September 2008 meeting, those received subsequently on the application and other explanatory material that had not been discussed at the September meeting, and those received on the post September revised draft.
21. The following substantive changes are noted in the ISA in response to those comments:
- The inclusion of new paragraph 4 to introduce the concepts of significance of the services provided by the service organization and the relevance of those services to the audit to be consistent with the objective and requirements of the ISA.
 - A requirement that the tests of controls in a Type B report should be evaluated to determine whether they provide sufficient appropriate audit evidence to support the user auditor's risk assessment has been included in paragraph 18.
 - Reference to the evaluation of the effect of fraud, non-compliance with laws and regulations, and uncorrected misstatements may have on the user auditor's conclusions and user auditor's report has been included in paragraph 20.
 - Concepts from the deleted Appendix relating to an entity's use of external bookkeeping services have been included in paragraph A5.
 - Changes have been made to paragraph A38 to ensure its consistency with proposed ISA 265.

The IAASB is asked to review all the changes to the ISA that have been proposed in Agenda Item 5-A to confirm these changes are appropriate.

Consideration of the Need to Re-Expose

22. Agenda Item 5-B shows the proposed final wording of the ISA, marked from the exposure draft. It is the view of the Task Force that the changes reflected in the proposed final wording are responsive to the comments received on exposure and do not establish new principles or substantively new requirements compared with the exposure draft. Accordingly, the Task Force believes that the changes do not warrant re-exposure.

Matter for IAASB Consideration

Does the IAASB agree that re-exposure is not necessary?

Material Presented

Agenda Item 5-A (Pages 3596 – 3619)	Revised Draft of Proposed ISA 402 (Revised and Redrafted) (Marked from September 2008 Draft)
Agenda Item 5-B (Pages 3620 – 3645)	Revised Draft of Proposed ISA 402 (Revised and Redrafted) (Marked from Exposure Draft)
Agenda Item 5-C (Pages 3646 – 3665)	Revised Draft of Proposed ISA 402 (Revised and Redrafted) (Clean)

Draft of the ISA to be Discussed at the Meeting

The Task Force proposes that **Agenda Item 5-A** (marked text from the September 2008 draft) be discussed at the meeting.

Action Requested

The IAASB is asked to consider the above issues and approve the revised draft of proposed ISA 402 (Revised and Redrafted) as a final standard.