

PROJECT PROPOSAL

ASSURANCE REPORT ON SERVICE ORGANIZATION'S CONTROLS

1. Subject

Development of a new ISAE 3402, "Assurance on a Service Organization's Controls."

2. Project Rationale and Objectives

(a) Issue Identification

Service organizations considerations and service auditor reports are presently addressed in ISA 402 "Audit Considerations Relating to Entities Using Service Organizations." A project proposal to revise ISA 402 is being submitted to IAASB in March 2006. That project proposal includes the revision of the section on using service auditor reports, but does not include the development of guidance on the service auditor's responsibilities for engagements to issue such reports. However, the increased use of service organizations, and the increasingly complex relationship between service organizations and entities using them, give rise to the need to develop standards and guidance on responsibilities of the service auditor whose report on the design, implementation and, where appropriate, operating effectiveness of the service organization's controls may be relied on by another auditor. Further, because an engagement to provide assurance on a service organization's controls is not an audit of historical information, the new standard on service auditor responsibilities will be an ISAE.

(b) Rationale for IAASB's Undertaking the Project

- National standard-setters, who have recently updated or developed standards on service auditor responsibilities and reporting, have requested that the IAASB consider development of such standard.
- Practitioners are dealing with the issues arising from increased use of service organizations.

(c) Objectives to Be Achieved

- To address service auditor responsibilities in performing engagements to provide assurance on service organization's controls relevant to user organizations and considerations relevant for the service auditor's reporting.

3. Outline of the Project

(a) Project Scope

The scope of this project includes the development of standards and guidance on the service auditor responsibilities in performing an engagement to provide assurance on a service organization's controls that may be relevant to a user organization's internal

controls, and the form and content of the service auditor's report. The task force will consider and recommend whether a pronouncement should be developed that provides standards and guidance on the preparation of Type A and B reports, which are referred to in ISA 402, or whether different types of report are more appropriate.

(b) List the Major Problems and Key Issues that Should Be Addressed

OBTAINING AN UNDERSTANDING OF THE SERVICE ORGANIZATION'S CONTROLS RELEVANT TO USER ORGANIZATIONS

The service auditor has to obtain an understanding of the services provided by a service organization to user organizations and of the service organization's controls that may be relevant to a user organization's internal control, and identify and assess related weaknesses. Although extant ISA 402 provides some guidance in this respect from the perspective of the user entity auditor, the increased importance of the service organization and of entity auditor/service auditor relationships gives rise to the need for additional standards and guidance to enhance existing practice and consistent application of the audit risk model.

COMMUNICATION AND REPORTING CONSIDERATIONS

ISA 402 currently describes two types of service auditor's report: the "design and implementation of the service organization's internal control" is the subject of Type A reports, and the "design, implementation and operating effectiveness of the service organization's internal control" are the subject of Type B reports. The usefulness of the reports may need to be assessed to determine whether the reports and their contents are relevant for current practice.

LEVEL OF ASSURANCE TO BE PROVIDED

In the context of evaluating the existing reports and their content, the project will also address the level of assurance to be provided by the service auditor.

(c) Cost-Benefit Considerations

A decision by the IAASB to amplify the guidance to service auditors may have cost benefit implications. The task force will consider and explore cost benefit implications in developing its recommendations to the IAASB, using a format to be developed for IAASB projects.

4. Describe the Implications for any Specific Persons or Groups

Except as described in section 6 below, the project does not have implications for any specific persons or groups.

5. Development Process, Project Timetable and Project Output

(a) Project timetable

The timetable for the project needs to be linked to the timetable for the revision of ISA 402 to ensure alignment of the two standards. ISA 402's timetable is expected to be as follows:

- Issues Paper – September 2006
- First Read of draft exposure draft – February 2007

- Exposure Draft – July 2007
- Final revised ISA – June 2008.

(b) Project output

A new ISAE drafted in accordance with the new drafting conventions under the IAASB Clarity project (as refined, if necessary, based on the present consultation thereon).

6. Resources Required

The task force should include individuals with experience in service organization issues (both as issuers and users of reports). A member of the ISA 402 revision task force should also be a member of this task force to ensure effective communication between the two projects.

At least one member needs to be an IT specialist due to the nature of the proposed ISAE.

The task force should consult the following groups at appropriate stages of the project:

- The IFAC SMP Committee;
- The IAASB CAG, due to stakeholder and regulatory interest in reporting on internal control; and
- National standard setters, due to the potential effect any international standard on service organizations may have on corresponding national standards, particularly from the perspective of convergence.

One IAASB staff member will provide staff support to the Task force. A language reviewer will be involved at appropriate stages of the project.

7. List Important Sources of Information that Address the Matter being Proposed

- AU 324, “Service Organizations,” revised January 2003, Auditing Standards Board, USA.
- AICPA Audit Guide, “Service Organizations: Applying SAS No. 70, as amended” with conforming changes as of May 1, 2004.
- CICA HB 5970: “Auditor's Report on Controls at a Service Organization,” Canada.
- Proposed ISA 402 (UK and Ireland), “Audit Considerations Relating to Entities Using Service Organizations,” June 2004.
- AUS 404, “Audit Implications Relating to Entities Using a Service Entity,” revised July 2002, Auditing and Assurance Standards Board of the Australian Accounting Research Foundation.
- PCAOB Auditing Standard 2, “An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements,” June 2004.
- Press archives.
- Academic journals archives.

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(Chair on behalf of the IAASB)