



International Federation of Accountants

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Agenda Item 4

Committee: IAASB

Meeting Location: Montreal

Meeting Date: September 18-22, 2006

Service Organizations – ISA 402 and ISAE 3402

Objectives of Agenda Item

To assist the ISA 402 and ISAE 3402 task forces by providing overall direction for revising ISA 402 “Audit Considerations Relating to Entities Using Service Organizations,” and overall direction for developing new ISAE 3402 “Assurance on Controls at a Service Organization.”

Introduction

At its March 2006 meeting, the IAASB discussed and approved project proposals to revise ISA 402, “Audit Considerations Relating to Entities Using Service Organizations”, and to develop a new ISAE 3402, “Assurance on Controls at a Service Organization.” See agenda items 4-C and 4-D for the approved project proposals.

Task forces have been appointed for each of these projects, consisting of individuals with the skills and experience identified in the project proposals, and considering geographical location and familiarity with existing standards on this topic issued by national standard-setters. Task force members are:

ISA 402 Task Force:

- Denise Esdon, Deputy Chair, IAASB, Ernst & Young Global, UK
- Kjell Larsson, Member IAASB, Sweden, supported by Kelly Ånerud, Norway
- Susan Jones, former IAASB Technical Advisor, Grant Thornton, USA
- Kevin O' Donovan, KPMG, Ireland
- Jens Poll, Moore Stephens, Germany
- George Tucker, IAASB Technical Advisor, Ernst & Young, USA
- Staff: Don Jeffreys, former Technical Manager – CICA, Canada

ISAE 3402 Task Force:

- George Tucker, IAASB Technical Advisor, Ernst & Young, USA
- 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
- Staff: Michael Nugent, Technical Manager – IAASB, Australia

On June 7-8, 2006, the task forces held a combined meeting, followed by individual meetings of the separate task forces. At these meetings, task force members discussed:

- The scope and objectives for each of these projects;
- The existing requirements in ISAs that affect these projects;
- The need for the revised ISA 402 and new ISAE 3402 to be closely aligned;
- Current and emerging trends in the use of service organizations;
- Issues being encountered in audits of the financial statements of entities that use service organizations;
- Issues being encountered by auditors who perform engagements to report on controls at service organizations; and
- The status of related standards issued by national standard-setters.

This led to the identification of specific issues the task forces believe should be addressed at this stage of these projects.

Definitions

For the purposes of discussion at this meeting, the following terms and definitions will be used. It is expected that they will be expanded and revised as the project progresses.

- *User Organization*—the entity that uses a service organization and whose financial statements are being audited.
- *User Auditor*—the auditor who audits and reports on the financial statements of the user organization.
- *Service Organization*—the entity (or segment of an entity) that provides services to a user organization. (The Appendix to this Agenda Item describes some of the service organizations used by user organizations today.)
- *Service Auditor*—the auditor who reports on the controls of a service organization.

Issues

The task forces are bringing the following issues to the IAASB to provide overall direction for revising ISA 402 and developing new ISAE 3402:

ISA 402 – Agenda Item 4-A

1. Existing ISA Risk Assessment Requirements.
2. Types of Service Organizations to be Encompassed by ISA 402.
3. Procedures to Obtain Information and Evidence.
4. Definitions and Relationships.

ISAE 3402 – Agenda Item 4-B

- A. Scope of ISAE 3402.
- B. Types of Service Auditor Reports.
- C. Level of Assurance Obtained by a Service Auditor.
- D. Service Organizations that use Other Service Organizations.
- E. Anticipated Format, Extent and Structure of ISAE 3402.

Material Presented

Agenda Item 4-A
(Pages 2109 - 2116)

Issues Paper – ISA 402

Agenda Item 4-B
(Pages 2117 - 2124)

Issues Paper – ISAE 3402

Agenda Item 4-C
(Pages 2125 - 2128)

Approved project proposal – ISA 402

Agenda Item 4-D
(Pages 2129 - 2132)

Approved project proposal – ISAE 3402

Action Requested

The IAASB is asked to provide direction to the task forces on the issues raised in Agenda Items 4-A and 4-B.

Appendix

Types of Service Organizations

The AICPA Audit Guide “Service Organizations: Applying SAS 70, as Amended”, includes a number of examples of service organizations. The following text is an abridged extract from para 1-06 of that Guide.

- *Trust departments of banks and insurance companies.* The trust department of a bank or an insurance company may provide a wide range of services to user organizations such as employee benefit plans. This type of service organization could be given authority to make decisions about how a plan's assets are invested. It also may serve as custodian of the plan's assets, maintain records of each participant's account, allocate investment income to the participants based on a formula in the trust agreement, make distributions to the participants, and prepare filings for the plan,.
- *Transfer agents, custodians, and recordkeepers for investment companies.* *Transfer agents* process purchases, sales, and other shareholder activity for investment companies. *Custodians* may be responsible for the receipt, delivery, and safekeeping of the company's portfolio securities; the receipt and disbursement of cash resulting from transactions in these securities; and the maintenance of records of the securities held for the investment company. The custodian also may perform other services for the investment company, such as collecting dividend and interest income and distributing that income to the investment company. *Recordkeepers* maintain the financial accounting records of the investment company based on information provided by the transfer agent and the custodian of the investment company's investments.
- *Insurers that maintain the accounting for ceded reinsurance.* Reinsurance is the assumption by one insurer (the assuming company) of all or part of the risk originally undertaken by another insurer (the ceding company). Generally, the ceding company retains responsibility for claims processing and is reimbursed by the assuming company for claims paid.
- *Mortgage servicers or depository institutions that service loans for others.* Investor organizations may purchase mortgage loans or participation interests in such loans from thrifts, banks, or mortgage companies. These loans become assets of the investor organizations, and the sellers continue to service the loans. Mortgage servicing activities generally include collecting mortgage payments from borrowers, conducting collection and foreclosure activities, maintaining escrow accounts for the payment of property taxes and insurance, paying taxing authorities and insurance companies as payments become due, remitting monies to investors (user organizations), and reporting data concerning the mortgage to user organizations.
- *Application service providers (ASPs).* Application service providers generally provide packaged software applications and a technology environment that enables customers to process financial and operational transactions. An ASP may specialize in providing a particular software package solution to its users, may provide services similar to traditional mainframe data center service bureaus, may perform business processes for user organizations that they traditionally had performed themselves, or some combination of these services.

- *Internet service providers (ISPs) and Web hosting service providers.* Internet service providers enable user organizations to connect to the Internet. Web hosting service providers generally develop, maintain, and operate Web sites for user organizations. If the user organization is using the Internet or Web site to process transactions, the user organization's information system may be affected by certain controls maintained by the ISP or Web hosting service provider, such as controls over the completeness and accuracy of the recording of transactions and controls over access to the system.
- *Regional transmission organizations (RTOs).* Independent system operators may be responsible for the operation of a centrally dispatched electric system or wholesale electric market, and for initiating, recording, billing, settling, and reporting transactions as well as collecting and remitting cash from participants based on the transmission tariff or other governing rules.

Examples of service organizations whose activities are not necessarily as clearly linked with the financial statements of their customers (the user organizations) as those above, include organizations that provide services such as:

- Human resource management;
- Research and development activities;
- Physical security;
- Library services;
- Waste disposal;
- Transport, logistics and supply chain management; and
- Maintenance of assets, such as motor vehicles, buildings and gardens.

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